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- In tables, a blank cell indicates "not applicable," ellipsis points (. . .) indicate "not available," and 0 or 0.0 indicates "zero" or "negligible." Minor discrepancies between sums of constituent figures and totals are due to rounding.
- An en dash (–) between years or months (for example, 2008–09 or January–June) indicates the years or months covered, including the beginning and ending years or months; a slash or virgule (/) between years or months (for example, 2008/09) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY2009).
- "Billion" means a thousand million; "trillion" means a thousand billion.
- "Basis points" refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to ¼ of 1 percentage point).
- As used in this publication, the term "country" does not in all cases refer to a territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.
- Some of the documents cited and referenced in this report were not available to the public at the time of publication of this report. Under the current policy on public access to the IMF's archives, some of these documents will become available five years after their issuance. They may be referenced as EBS/YY/NN and SM/YY/NN, where EBS and SM indicate the series and YY indicates the year of issue. Certain other documents are to become available 10 to 20 years after their issuance, depending on the series.

Foreword

This evaluation has been concluded at a time when the global community has once again been reminded of the risks to economic growth and stability arising from potential protectionist responses to the current global economic crisis. The report addresses many controversies generated by the IMF's involvement in trade policy issues since the establishment of the World Trade Organization (WTO). After overextending its reach on trade policy advice, particularly in conditionality on its lending operations in the late 1990s, the IMF recently has retrenched to the point that it has failed to address some key trade policy issues with systemic and macroeconomic effects.

The evaluation advises a rebalancing of the IMF's treatment of trade policy issues.

On the one hand, the evaluation finds the scaling back of IMF conditionality on traditional trade polices (tariff and nontariff barriers to merchandise trade) since the streamlining initiative of 2000 to be appropriate as average tariffs in most countries had fallen to relatively low levels, IMF pressure for unilateral liberalization—especially through conditionality—created tensions with multilateral negotiations in the WTO, and conditionality often did not achieve lasting changes in trade policy.

But the evaluation also points to several areas where the Fund needs to play a larger and more considered role. For example, the Fund has been less active than it could or should have been in expressing cogent views on whether and how countries should liberalize trade in financial services (an issue underscored by the global financial crisis), on the systemic implications of the proliferation of preferential trade agreements, and on the global effects of trade policies (especially high agricultural tariffs and subsidies) of systemically important countries. And interinstitutional cooperation on trade policy issues, while found to have been broadly satisfactory with relatively minimal duplication/overlaps, has tended to be more personality-driven than systematic, resulting in gaps in institutional coverage of some issues.

The overarching message of the report is that the IMF should recommit itself to trade policy issues that have potentially significant implications for macroeconomic and systemic stability. To this end, the Fund needs to use better the limited resources it can devote to trade policy by more actively engaging in interinstitutional cooperation; concentrating and nurturing a small but critical mass of trade expertise within the institution; and improving the quality and dissemination of its views on trade policy issues. In order to ensure that the Fund's work on trade evolves with the changing global trade policy environment, the Executive Board and IMF management should periodically review macroeconomic implications of changes in the global trade system and the appropriate role for the IMF in it.

Thomas A. Bernes
Director
Independent Evaluation Office

IMF Involvement in International Trade Policy Issues

This report was prepared by an IEO team of Susan Schadler (head), Ling Hui Tan, and Seok-Hyun Yoon, with research assistance from Emily Ku and Chris Monasterski. Contributions also came from Ayesha Ali, Chonira Aturupane, Bryan Chan, John Dodsworth, Robert Gregory, Kala Krishna, Jaime de Melo, Chi Nguyen, Robert Stern, Yoichi Sugita, Mu Jeung Yang, and Iqbal Zaidi. Administrative assistance was provided by Jeanette Abellera, Arun Bhatnagar, Annette Canizares, and Erika Marquina, and editorial assistance by Esha Ray and Rachel Weaving. The report was approved by Thomas A. Bernes.

Abbreviations

ACP	African, Caribbean, and Pacific
AFR	African Department (IMF)
AFTA	ASEAN Free Trade Area
AGOA	African Growth and Opportunity Act
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of South East Asian Nations
ATC	Agreement on Textiles and Clothing
CAFTA-DR	Central America-Dominican Republic Free Trade Agreement
CAG	Committee on Agriculture (WTO)
CARICOM	Caribbean Community
CARTAC	Caribbean Regional Technical Assistance Center
CBI	Cross-Border Initiative
CBR	Committee on Balance of Payments Restrictions (WTO)
CEMAC	Central African Economic and Monetary Community
CFF	Compensatory Financing Facility (IMF)
CGATT	Committee on Liaison with the Contracting Parties of the GATT (IMF)
COMESA	Common Market for Eastern and Southern Africa
CTFS	Committee on Trade in Financial Services (WTO)
CWTO	Committee on Liaison with the World Trade Organization (IMF)
DSB	Dispute Settlement Body (WTO)
DSC	Development Support Credit (World Bank)
DTIS	Diagnostic Trade Integration Study
EAC	East African Community
ECCU	Eastern Caribbean Currency Union
ECOWAS	Economic Community of West African States
ED	Executive Director (IMF)
EFF	Extended Fund Facility (IMF)
EFTA	European Free Trade Association
EPA	Economic partnership agreement
ESAF	Enhanced Structural Adjustment Facility (IMF)
ESF	Exogenous Shocks Facility (IMF)
EU	European Union
FAD	Fiscal Affairs Department (IMF)
FAO	Food and Agriculture Organization
FDMD	First Deputy Managing Director (IMF)
FDI	Foreign direct investment
FSAP	Financial Sector Assessment Program (IMF)
GATS	General Agreement on Trade in Services (WTO)
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GFSR	*Global Financial Stability Report* (IMF)
GNP	Gross national product
GTAP	Global Trade Analysis Project
HIPC	Heavily indebted poor countries
HLWGC	High Level Working Group on Coherence

ICMR	*International Capital Markets Report* (IMF)
IDA	International Development Association (World Bank)
IF	Integrated Framework
IFC	International Finance Corporation
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee (IMF)
ISI	Import substitution industrialization
LDC	Least developed country
MCM	Monetary and Capital Markets Department (IMF)
MDRI	Multilateral Debt Reduction Initiative (IMF)
MEFP	Memorandum of Economic and Financial Policies (IMF)
MERCOSUR	Common Market of the South
MFA	Multi-Fiber Arrangement
MFN	Most-favored-nation
MONA	Monitoring of Fund Arrangements (IMF)
NAFTA	North American Free Trade Agreement
NFIDC	Net food-importing developing country
NGO	Nongovernmental organization
NTB	Nontariff barrier
OECD	Organization for Economic Cooperation and Development
OTRI	Overall Trade Restrictiveness Index (World Bank)
PDR	Policy Development and Review Department (IMF)
PRGF	Poverty Reduction and Growth Facility (IMF)
PRSP	Poverty Reduction Strategy Paper
PSE	Producer Support Estimate (OECD)
PSI	Policy Support Instrument (IMF)
PTA	Preferential trade agreement
RED	Recent economic developments (IMF)
REO	*Regional Economic Outlook* (IMF)
RES	Research Department (IMF)
SACU	Southern African Customs Union
SADC	Southern African Development Community
SBA	Stand-By Arrangement (IMF)
SIP	Selected issues paper (IMF)
SMP	Staff-Monitored Program (IMF)
SRF	Supplemental Reserve Facility (IMF)
TA	Technical assistance
T&C	Textiles and clothing
TIM	Trade Integration Mechanism (IMF)
TNC	Trade Negotiations Committee (WTO)
TPR	Trade policy review (WTO)
TRI	Trade Restrictiveness Index (IMF)
UFR	Use of Fund resources (IMF)
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
USAID	United States Agency for International Development
USBTA	(Vietnam-) United States Bilateral Trade Agreement
USTR	U.S. Trade Representative
VAT	Value-added tax
VER	Voluntary export restraint
WAEMU	West African Economic and Monetary Union
WEO	*World Economic Outlook* (IMF)
WGTDF	Working Group on Trade, Debt, and Finance (WTO)
WGTI	Working Group on Trade and Investment (WTO)
WTO	World Trade Organization

Executive Summary

Trade policy occupies an unusual and at times problematic place in the work of the IMF. Few would dispute that trade policies of IMF members have strong influences on macroeconomic stability. However, trade policies are often seen as peripheral to the IMF's core competency. This leaves scope for a range of views on the proper role for the IMF in advising on trade policy. Also, the IMF's orientation toward unilateral trade liberalization has stoked the debates on whether such liberalization is always in a country's own interests and whether preferential trade agreements are harmful. Added to these debates are charges that the IMF has pressed harder for liberalization in borrowing countries than in countries with which it has a surveillance-only relationship.

This evaluation, which examines the IMF's involvement in trade policy issues during 1996–2007, addresses five questions. What is the nature of the IMF's mandate to cover trade policy? Did the IMF work effectively with other international organizations on trade policy issues? Did the Executive Board provide clear guidance to staff on the IMF's role and approach to trade policy? How well did the IMF address trade policy issues through lending arrangements and surveillance? Was IMF advice effective?

The evaluation finds that the IMF's role in trade policy has evolved in some desirable and some less desirable ways. In its general streamlining after 2000, the IMF scaled back its involvement in traditional trade policy issues (tariff and nontariff barriers to merchandise trade), especially in the context of conditionality. This is welcome as average tariffs in most countries had fallen to relatively low levels, conditionality often did not achieve lasting changes in trade policy, and the pressure for unilateral liberalization especially through conditionality created tensions with multilateral negotiations in the World Trade Organization.

But in other respects the IMF's scaling back on trade policy advice came at the cost of constructive roles in trade issues central to financial and systemic stability. Three such gaps stand out. First, the IMF has not clearly enough defined or pursued a role vis-à-vis trade in financial services—an area where its perspective is essential. Second, fairly active interest of IMF researchers in macroeconomic and systemic effects of preferential trade agreements has not adequately filtered into bilateral and multilateral surveillance. Third, the IMF has not given due attention recently to global effects of trade policies (such as high agricultural tariffs and subsidies) in systemically important countries.

The evaluation recommends several ways to use the limited resources the IMF can devote to trade policy to fill these gaps. More active interinstitutional cooperation, backed by formal interactions, is essential. Also, however, the IMF needs a small repository for in-house expertise—a division solely devoted to trade policy—to be the locus of such cooperation and to help identify trade policy issues in which the IMF should be involved. Finally, regional and global implications of trade policy developments should be explored in depth periodically in World Economic Outlook and Regional Economic Outlook exercises. The Board should regularly review and give guidance on the IMF's role in trade policy issues.

CHAPTER

1 Introduction

1. The IMF's involvement in trade policy issues has been a source of controversy. In contrast to exchange rate, fiscal, or monetary policies, trade policy lies within the IMF's domain through at most a soft mandate. This leaves substantial scope for disagreement on whether the IMF has overstepped its proper role on trade policy or not done enough. Also, reflecting an orientation toward removing barriers to trade, the IMF's involvement in trade policy has stoked the debate on whether steps toward freer trade are always beneficial for a country or whether developmental objectives are better served by more gradual changes. Alongside this debate are charges that IMF advice has not been evenhanded and has pushed harder on developing countries (through lending arrangements) than on advanced countries to reduce protectionism. And with the increasing complexity of trade policy issues, questions have arisen about whether IMF staff have the expertise to address trade policies rigorously.

2. The evaluation asks what the role of the IMF in trade policy has been and how well it has been carried out. It examines these questions in the context of surveillance and conditionality on use of Fund resources (UFR). Trade-related technical assistance (TA), which is the subject of a soon-to-be completed evaluation by an external consultant to the Fund's Fiscal Affairs Department (FAD), is not systematically examined. The evaluation covers 1996–2007, the years since the establishment of the World Trade Organization (WTO) and during which IMF involvement in trade policy has continued to evolve. Box 1 has a brief retrospective on IMF involvement in trade policy prior to the evaluation period.

3. The definition of trade policy is somewhat arbitrary because myriad interlocking policies affect trade. Our definition is measures that directly and primarily aim to influence the quantity and/or value of a country's own or its trading partners' imports and exports of goods and services. It encompasses traditional instruments—tariffs, quotas, and export subsidies and taxes—customs administration, preferential trade agreements (PTAs) and domestic ("behind-the-border") policies that distort trade.[1] This delineation is not watertight as other policies also affect trade. Exchange rate policy, including exchange controls and multiple exchange rates, is noteworthy but is outside the scope of the evaluation (Box 2).

4. The evaluation considers five questions. What is the nature of the IMF's mandate to cover trade policy (addressed in Chapter 2)? Did the IMF work effectively with other international organizations on trade policy (Chapter 3)? Was clear guidance provided to staff on the IMF's role and approach to trade policy (Chapter 4)? How well did the IMF address trade policy issues through lending arrangements and surveillance (Chapter 5)? Was IMF advice effective (Chapter 6)? Chapter 7 offers findings and recommendations. Two annexes describe data sources for the evaluation and results of surveys of country officials and IMF staff.

[1] A PTA refers to an agreement between two or more countries to grant and/or receive more favorable trade conditions among themselves than vis-à-vis third countries. A PTA includes discriminatory preferences, be they unilateral (e.g., preference schemes) or reciprocal (e.g., free trade agreements and customs unions).

Box 1. IMF Involvement in Trade Policy: A History of Cycles

Until the mid-1970s, the IMF was involved in trade policy mainly as a record keeper. From a trade policy viewpoint, most countries fell into three groups: the 23 signatories of the General Agreement on Tariffs and Trade (GATT) undertook multilateral trade liberalization that spurred growth of world trade substantially faster than that of world GDP; most developing countries pursued an import substitution industrialization (ISI) strategy and were highly protectionist; and Soviet bloc countries operated in anything from barter systems to autarky. Yearly IMF Article VIII/XIV consultations recorded members' trade policy changes and gave some policy advice.

This rather passive role gave way to activism, mainly through conditionality in lending arrangements, in the 1970s, when shocks pummeled balance of payments positions, especially of developing countries. The difficulty of many countries in rebounding from these shocks, together with growing academic attention to harmful effects of protection, revealed the flaws of ISI strategies. Conditions on trade reform became prominent in IMF-supported adjustment programs during 1980–95, in efforts to improve supply conditions so as not to rely only on demand compression to reduce balance of payments imbalances. These policy changes were unilateral and outside of the GATT framework even as developing countries became GATT members.

By 1995, when the WTO was established, the trade policy landscape had changed massively. The GATT had 123 members (all became members of the WTO), and incentives for nonmembers to accede to the WTO were large. Five multilateral trade rounds during 1947–95 had reduced average tariff rates on manufactured imports in industrial countries from 40 percent to 3.5 percent. Though tariff reduction remained a goal of the WTO, it was also hoped that the new institution would be able to address impediments to trade in areas such as agriculture, textiles, services, intellectual property rights, and behind-the-border regulations, which had not yet been addressed or had proved thorny. But even as more trade policy issues were consolidated in one institution, the spread of preferential trade agreements meant that countries increasingly focused trade policy on these agreements. In this setting, the IMF began to curtail its role in trade policy issues at the turn of the century.

Box 2. Distinctions Between Exchange Rate Policy and Trade Policy from the IMF's Perspective

One purpose of the IMF, expressed in Article I(iii) of the Articles of Agreement, is "to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation." This responsibility implicitly reflects the view that exchange rate policy has profound implications for the expansion and balanced growth of international trade. In economic terms, therefore, exchange rate policy may share objectives and attributes of more narrowly defined trade policy. In two dimensions, this similarity can be particularly obvious. First, competitive depreciation can be considered a beggar-thy-neighbor trade policy similar to an across-the-board export subsidy plus import tariff. Second, substantial exchange rate volatility can have an adverse effect on trade volumes.

Nevertheless, there are good reasons, in the context of the IMF's mandate, to consider the IMF's role in trade policy separately from (though in tandem with) that in exchange rate policy. This is because of the fundamental distinction between exchange rate policy and more narrowly defined trade policy in the Articles of Agreement. Specifically, with respect to exchange rates, members undertake an obligation "to collaborate with the Fund and other members…to promote a stable system of exchange rates" and to "avoid manipulating exchange rates…to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members" (Article IV, Section 1). In turn, the Fund has the explicit responsibility "to exercise firm surveillance over the exchange rate policies of members" as it oversees "the compliance of each member with its obligations" (Article IV, Section 3). These provisions unambiguously place exchange rate policy and its implications for trade at the center of the Fund's mandate. In contrast, the mandate for the Fund's involvement in more narrowly defined trade policy is based on "soft" obligations, for example that each member shall "endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth" (Article IV, Section 1(i)). Thus, especially with the IEO having recently completed an evaluation of IMF advice on exchange rate policy and to help focus this evaluation on the IMF's role in the context of this softer mandate, this evaluation focuses on the IMF's role in providing advice on trade policy narrowly defined.

Chapter

2 What Is the Nature of the IMF's Mandate to Cover Trade Policy?

5. The IMF's mandate on trade policy issues is broad, but not precise.[2] The root of the mandate lies in Article I(ii) which specifies that a purpose of the IMF is

> ...to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

The generality of this statement has opened the door to controversy.

6. Within the IMF, a fairly broad interpretation of the purpose and responsibility of the IMF vis-à-vis international trade policy has evolved. Joseph Gold (Legal Counsel during 1946–79) held that, while the IMF has no regulatory authority over trade practices, its "soft" responsibility encompasses policies that encourage or ease the expansion of international trade. In surveillance, the IMF sees this responsibility as requiring attention to trade policies in both a passive mode (considering restrictive trade policies as an indication of the inappropriateness of a country's exchange rate and a vulnerability to macroeconomic shocks) and an active mode (advising on trade policies that promote growth and stability). In lending, the IMF has interpreted the call in Article I(v) to "correct maladjustments in…balance of payments without resorting to measures destructive of national or international prosperity" as justifying conditionality on trade reform as well as a continuous performance criterion prohibiting new import restrictions for balance of payments purposes.

7. Some critics see this interpretation of the Articles as too broad. They contrast the IMF's concrete purposes to promote exchange rate stability, oversee the multilateral payments system, and provide temporary balance of payments support with the vague reference to promoting international prosperity. They tend to see a role for the IMF in advising or agreeing on conditionality on trade policies only where immediate balance of payments issues are at stake. They reject the notion that the general language in the Articles gives the IMF free rein to involve itself in, and especially establish conditionality on, policies as far afield from the IMF's core expertise as trade policy.

8. With due respect for this debate, the evaluation focuses on the IMF's record of involvement in trade policy, not the legal legitimacy of its involvement. In the IEO's view, the sections of the Articles that are interpreted as giving the IMF responsibilities on trade policies to fulfill its purpose of facilitating international trade do not provide precise direction. But, they are general enough to underpin a wide spectrum of engagement.

[2] Background Document 1 briefly addresses the IMF's mandate vis-à-vis trade policy and provides some detail on critics and their points.

Chapter 3 Institutional Architecture for Trade Policy: How Well Has Cooperation Worked?

9. Interinstitutional cooperation is essential for the IMF to be effective on trade policy issues. Two aspects of the institutional landscape reinforce this point. First, since the IMF has few resources to devote to trade policy, it must look to organizations such as the World Bank and the Organization for Economic Cooperation and Development (OECD), even for the tools needed to address macroeconomic effects of trade policy. Second, the international community established the WTO as the locus of multilateral trade cooperation. The WTO, however, is primarily a negotiating forum, with limited capacity for taking views on how trade policies affect global, regional, or national macroeconomic vulnerabilities. Providing such views must fall to the IMF, which in turn must maintain coherence with the WTO's framework.

10. Some indicators point to difficulties in interinstitutional cooperation on trade policy. For IMF staff as a whole, the exception is cooperation with the World Bank. Especially in UFR work, 70–80 percent of staff that responded to an IEO survey had frequent or occasional contact with World Bank staff on trade issues. But the case studies of UFR (where most Fund-Bank cooperation on trade policy occurs) found high variance in the effectiveness of interaction—similar to that found in an earlier IEO evaluation of structural conditionality. Interaction with other institutions—the OECD (which is active on advanced country trade policy), the United Nations Conference on Trade and Development (UNCTAD), and regional development banks—was low. Vis-à-vis the WTO, over 60 percent of staff surveyed reported negligible contact. Most either had never read or were unsure if they had read a WTO trade policy review (TPR) on their country.

11. But a deeper look at the IMF's links with the WTO—the focus of the rest of this section—suggests stronger cooperation than the survey indicates.[3] Most contacts were channeled through small groups in the Fund's Policy Development and Review Department (PDR), the (now closed) Geneva Office, FAD, a (now dissolved) trade division in the Research Department (RES), and the Legal Department. Management contacts were cordial, often close, and generally productive. Several IMF research papers prepared during 2002–04 at the request of the WTO Secretariat (on topics including preference erosion, trade effects of exchange rate variability, and revenue effects of trade liberalization) were warmly received.

12. Reasonably comprehensive agreements underpin IMF-WTO cooperation. The 1996 Cooperation Agreement formalizes procedures for document exchange and representation, observership, and written submissions of each institution in the other's decision-making bodies. It also specifies conditions in which informal staff contact should occur. A 1998 Coherence Report addresses joint issues in "structural, macroeconomic, trade, financial and development aspects of economic policy making," but follow-up has been less structured. Meetings of the working group for the report, comprising senior staff from the IMF, World Bank, and WTO, petered out after 2001. IMF management did not support a staff effort in 2003 to revive them. After 2004, the Executive Board Committee on Liaison with the WTO was also inactive. Informal channels of communication have kept coherence alive, though with less ambition than initially envisaged.

13. Would formal contacts have produced better outcomes? Several issues identified in the 1998 Coherence Report as needing common approaches (such as resolving tensions between WTO reciprocal trade negotiations and IMF emphasis on unilateral liberalization, helping interested countries prepare for WTO accession, and dealing with PTAs) are ones that this evaluation raises as weaknesses in the IMF's work. Formal contacts might have helped focus the IMF on them.

14. Even though few overt problems arose, relations between the IMF and WTO were not trouble-free. Two aspects of the relationship have created actual or potential difficulties. First, while both institutions are dedicated to a common vision of a liberal global trading system, their approaches to trade

[3] Background Document 2 examines IMF-WTO cooperation. Interaction with the World Bank and (though limited) with the OECD is examined in the context of case studies only.

liberalization are fundamentally different. Second, some actual and potential tensions arise from overlaps in jurisdictions and responsibilities.

15. Tensions over differing approaches to liberalization raise important issues but have for now been dissipated by a drop in the IMF's use of trade conditionality. The WTO's approach involves reciprocal liberalization through multilateral negotiations backed by a dispute settlement mechanism. The IMF aims to support best practices—trade policies (even if not the result of reciprocal bargaining) it views as bolstering efficiency and stability. Also, the WTO provides greater leeway for its developing country members to phase in global agreements, while the IMF aims to apply economic principles uniformly across its members, albeit with muscle linked to whether a country has a lending arrangement. Tensions between the two approaches were evident in some countries' complaints that unilateral trade reforms embedded in IMF-supported programs without reciprocal concessions from trade partners or credit in future negotiations weakened their bargaining power in WTO negotiations. IMF staff pointed out that conditionality related to applied tariffs whereas WTO agreements relate to bound tariffs, and, anyway, considerations of economic efficiency drove conditionality. With the IMF retreat from trade conditionality in recent years, the issue has become moot.

16. Tensions from differing approaches of the two institutions to the use of import restrictions for balance of payments reasons have also receded. Countries using their rights under WTO rules to apply import restrictions to safeguard their financial position or ensure an adequate level of reserves are subject to review by the WTO's Committee on Balance of Payments Restrictions (CBR). The IMF is tasked with providing a statement to the CBR on the country's current and prospective balance of payments situation. In practice, most IMF statements went beyond this role, calling for early removal of the restriction as other methods of adjustment were preferable. The CBR agreed with the IMF's view in only about half the cases. One case (India, 1997), however, resulted in the United States filing a complaint with the WTO's Dispute Settlement Body (DSB) that brought to the fore tensions over how the IMF determines reserve adequacy and its role in the CBR. These tensions were not resolved but became dormant as no new cases came to the CBR during 2001–08.[4]

17. Actual or potential tensions arising from different ways the institutions view their jurisdictional boundaries are a greater concern. Inconsistency (which existed even during the GATT) in how the two institutions distinguish exchange and trade restrictions creates scope for jurisdictional conflicts. One indeed occurred in China's accession to the WTO (Box 2, Background Document 2). Even more thorny is the potential for different interpretations of the two institutions' roles in exchange rate policies. GATT Article XV provides that the IMF's determination on whether a country's exchange rate policy is consistent with the Articles of Agreement is binding. But observers note that the DSB, being independent, may not feel bound by the IMF's assessment. It is beyond the scope of this evaluation to judge the potential for conflict on this issue.

18. The low-key cooperation between the two institutions in other specialized areas seems appropriate. IMF staff participate in the Integrated Framework (a process for identifying needs for and coordinating trade-related TA) mainly by providing input on macroeconomic policies and projections. IMF participation in Aid for Trade (a WTO initiative to coordinate trade facilitation TA) has also been narrow. The Trade Integration Mechanism (TIM)—the IMF's response to pressure from developing countries for financial assistance to offset losses from trade preference erosion—was warmly endorsed by many of the evaluation team's interlocutors at the WTO, though only three countries have used the scheme since its inception in 2004.

19. The WTO Secretariat is concerned about the IMF's diminishing engagement in trade policy issues. The Secretariat views IMF conditionality on unilateral liberalization as inappropriate. But it sees an engaged IMF, assessing and publicizing the macro effects of trade policy, as crucial to the effectiveness of efforts to maintain and strengthen an open global trade system. This view reflects the Secretariat's own limited capacity for analysis, its focus on micro rather than macro aspects of trade policy, and the fact that the IMF, through surveillance and its position among global institutions, has interlocutors (finance ministries and central banks) that influence economic policies but have no direct role in WTO fora (trade negotiations and trade committees). Thus, the Secretariat at all levels regretted the recent scaling back of the IMF's capacity for work on trade policy (closure of the Geneva Office, merger of PDR's Trade Policy Division with two other divisions, and elimination of RES's trade division). They cautioned that in a "business-as-usual" world, these steps would probably not impair the global trade environment, but in a "*not*-business-as-usual" world—a clear risk at present—the implications could be serious.

[4] After the evaluation period, Ecuador notified the WTO of its decision to impose import restrictions for one year for balance of payments purposes. The IMF was invited to consult with the CBR in April 2009.

Chapter

4

The IMF's Evolving Role in Trade Policy: How Was the Process Guided?

20. Executive Board guidance on trade policy since the mid-1990s pushed staff both to broaden the range of issues they covered and to be more selective.[5] Discussing the 1994 Comprehensive Trade Paper (an IMF staff review of trade policy issues that was conducted every few years until 1994), Directors asked for more analysis of several issues: macroeconomic effects of trade policies; spillovers, especially from PTAs; and effects of the Uruguay Round, especially on net food importers and countries facing preference erosion. In later years, the Board also asked for staff attention to countries' positions in the Doha Round, market access for developing country exports, and trade in services. But staff interviewed for the evaluation saw the Board's decision to abandon the Comprehensive Trade Paper as a sign of reduced interest in trade issues. This perception was reinforced by the streamlining of structural conditionality in 2000 and of trade policy surveillance in 2002. Also, as criteria for streamlining trade advice emerged only gradually through 2005, staff were often unclear when to address issues.

21. Even allowing that mixed signals were inevitable in the changing global trade environment, Board guidance to staff was vague. What many staff members described to the evaluation team as "cyclicality" in the Board's interests made staff wary in addressing trade policy issues. Also, while the IMF's objectives for traditional trade barriers were clear, for new trade policies—especially PTAs and trade in financial services—they were not. For both, the Board asked for IMF engagement (though for trade in financial services this request was not made explicitly until 2002) but left loose ends as to when, against what criteria, and with what objectives. Vis-à-vis PTAs, this may have reflected concerns that staff were too exacting in pushing high standards for minimizing possible distortions from PTAs. Thus, an effort to define an institutional perspective on key PTA issues in a 2006 Board seminar met with limited success, and the staff paper for that seminar was not released to the public.

22. PDR's Trade Policy Division made a reasonable effort to filter what it saw as Board guidance to operational staff. In its comments on mission briefs and staff reports, the division rather systematically pressed missions to cover trade policies in countries with the most restrictive stances.[6] For advanced countries, where tariff and nontariff barriers tended to be low, PDR pressed for strong positions on issues such as subsidies and countervailing duties. Often a Trade Policy Division staff member participated on surveillance missions. Even after the Comprehensive Trade Paper was abandoned, PDR put several thoughtful papers on IMF work on trade policy to the Board. Management interest in trade policy was more cyclical, peaking across the spectrum of issues during 2001–03, when the Managing Director and First Deputy Managing Director were strongly committed to an active IMF role in trade issues. Recently, management has taken less interest, at times discouraging staff from covering trade policy issues in developing and advanced countries.

[5] Background Document 3 reviews guidance to staff on trade policy in surveillance and UFR.

[6] A background paper by Yang and Yoon "What Determines IMF Involvement in Trade Policy Issues?" (see www.ieo-imf.org) examines the determinants of trade policy coverage in surveillance and UFR missions and the role of PDR in the review process.

Chapter 5 IMF Advice on Trade Policy: How Well Was the Approach Carried Out?

23. IMF coverage of trade policy varied widely in range and depth across countries and over time. The basic tenets of the IMF's approach to trade policy issues are generally well supported by economic analysis (Box 3), but considerable controversy focuses on the application of its approach. This suggests three criteria against which to examine how the Fund carried out its approach: (i) How well thought out was the advice? (ii) Were macroeconomic links clear and considered? (iii) Was advice evenhanded? First for UFR and then for surveillance, we review the broad parameters of the IMF's work. Thereafter we discuss results of background studies of single countries or issues against these three criteria.

A. Trade Policy Issues in UFR Work

24. Despite a wave of trade liberalization in the late 1980s and early 1990s, trade liberalization still occupied a central spot in IMF-supported programs through 2000. This reflected partially the fact that some countries (especially certain previously centrally planned economies) had not been part of the liberalizing trend, but also the facts that some countries had pursued a measured pace of liberalization and others had stalled in their liberalization. Most countries using IMF resources had some trade reform agenda in place, and conditionality aimed to prevent derailments or quicken the pace of change. In 1996, arrangements (Enhanced Structural Adjustment

Box 3. The IMF's Approach to Trade Protectionism

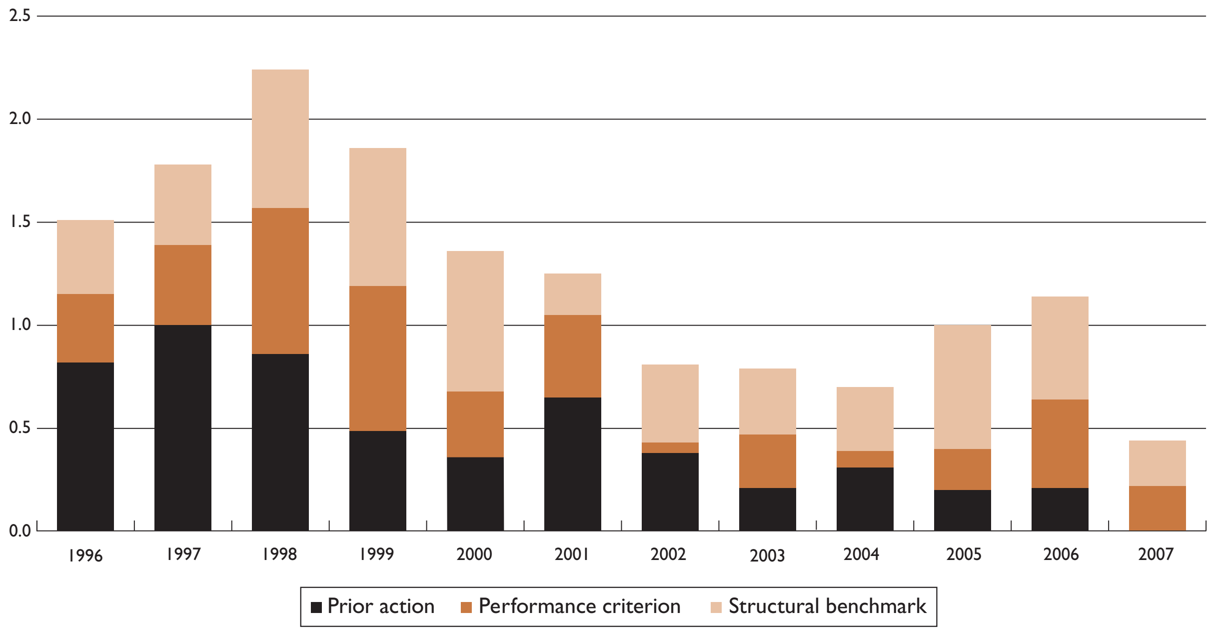
Underlying IMF advice on trade policy is rather widely accepted economic analysis. This concerns basic arguments for and against protection of domestic economic activity from foreign competition. Some reasons for protection—to "keep the money at home" or "level the playing field" are unsound. Others with some validity are to favor sectors considered important for national welfare (e.g., agriculture); to develop an infant industry; to improve short-run balance of payments positions; to raise fiscal revenue; or to improve the terms of trade (the optimum tariff argument).

These justifications, however, typically reflect second-best approaches to market failures that are often unrelated to trade. Thus, infant industry protection might look attractive when potentially competitive industries cannot attract private capital, perhaps because capital markets are undeveloped, social benefits are not internalized by the private sector, or external economies of scale exist. In such circumstances, the IMF's approach—supported by economic analysis—is that the market failure should be corrected by policy that directly targets the source of the problem (the first-best solution). For example, if domestic production is suboptimal, supply conditions should be enhanced; an indirect policy instrument such as an import tariff could support domestic producers, but by encouraging substitution away from imports and thereby causing deadweight losses. Only the optimum tariff argument is a first-best response to a trade-related market failure, but, as a beggar-thy-neighbor policy, it too should be avoided.

These economic arguments are reasonable first principles for the IMF. Also, much empirical evidence points to benefits of low and uniform tariffs for economic efficiency. However, the prevalence of global distortions from trade policies (so that countries formulate trade policy in a second-best world) and the economic success of some countries even with significant protection give critics of rapid liberalization substantial ammunition. Thus, the classic case for low trade barriers *alone* is an insufficient basis for a constructive trade policy dialogue between country authorities and the IMF. Placing advice on dismantling protectionist barriers in the context of a country's specific circumstances and constraints is critical for good policy decisions. Much of the criticism of IMF advice on trade policy revolves around this dimension—the focus of this evaluation.

Figure 1. Average Number of Trade Policy Conditions per Arrangement, 1996–2007

(As agreed in the initial program, excluding continuous performance criteria prohibiting new import restrictions)



Sources: IMF reports and IEO calculations.

Facility (ESAF), Poverty Reduction and Growth Facility (PRGF), Stand-By, and Extended) had, on average, one-and-a-half conditions (prior action, performance criterion or structural benchmark, excluding the standard continuous performance criterion prohibiting new import restrictions) on trade policy in the initial program (Figure 1). More than half of these conditions pertained to traditional trade policies and more than a third to customs administration, often supported by TA from FAD, which averaged some 20 trade-related TA reports per year during the evaluation period.

25. Conditionality on trade policy fell sharply starting in 2000, when streamlining began. The average number of trade conditions in initial programs fell below one by 2002 and below half by 2007. Conditions on issues other than customs administration virtually disappeared. This drop in trade conditionality was appropriate for several reasons. In many countries, tariff and quota barriers and export subsidies and restrictions had diminished to a point where they were not key impediments to efficiency or macroeconomic stability. Also, many governments asserted that their PTAs had taken some traditional trade policy instruments out of their hands. And active IMF trade conditionality in the late 1990s had raised many legitimate concerns about the IMF's role in pressing unilateral liberalization, about other countries' political interference in trade conditionality, and about the trade expertise of IMF staff. Scaling back this relatively heavy-handed approach, therefore, made sense. The rest of this section examines how these issues played out in case studies.

26. In the arrangements examined, trade policy advice was best thought out when staff had a history of analyzing an issue, worked with the World Bank, and built on government commitment to liberalization.[7] In the case studies for this evaluation, staff's knowledge of trade issues tended to be stronger in low-income than in emerging market countries. In some low-income countries, the IMF had a history of fairly deep engagement in trade policy on which to draw. In Ghana's 1995 ESAF arrangement, for example, reform of the cocoa sector (including a structural performance criterion on the producer price) built on previous collaboration among the IMF, World Bank,

[7] Background Documents 4 and 5 examine how the IMF handled trade policy in seven low-income countries with PRGF arrangements (Bangladesh, Ghana, Guyana, Kenya, Mozambique, Tanzania, and Vietnam) and five emerging market country arrangements (Brazil, Indonesia, Korea, Turkey, and Ukraine).

government, and stakeholders. IMF work there included well-executed studies (evaluating theoretical and practical aspects of cocoa taxation, estimating a model of cocoa supply, and discussing practices in other countries) that helped establish the fiscal effect of reforms in which the authorities had an interest. Similarly in Bangladesh, a tariff reform in the 2003 PRGF arrangement made use of past World Bank studies of the protective regime.

27. In contrast, in countries where staff had not previously been substantially involved in trade policy issues, conditionality tended to be less well thought out. This was the case in some of the emerging market countries, where staff had to switch gears rapidly from surveillance mode, in which trade policy had not been analyzed in detail. Among the five such countries reviewed, staff analysis of trade policy issues was obvious only for Brazil (where trade policy did even not feature in the 1998 program). In Indonesia and Korea, where trade policy conditionality was extensive, little evidence of deep familiarity with the issues came to light. In both these countries, medium-term trade liberalization programs were in train, and conditionality established more ambitious targets for tariff reduction—a development the authorities interviewed by the evaluation team viewed as unnecessary, though not particularly problematic. More questionable were conditions in the 1997 Indonesia program to dismantle state trading monopolies and lower export taxes. These were hastily prepared with minimal input from the World Bank and without enough attention to ensuring that new distribution channels, taxes, or institutions were in place.

28. Marshalling trade expertise from the World Bank met with mixed success. In the emerging markets examined, the World Bank was typically not active enough in trade policy to contribute significantly to program design. The exception was Indonesia, but, there, differences between Bank and Fund staff views on governance problems limited the Bank's role. In some low-income countries covered, Fund-Bank cooperation was stronger—ranging from sector-specific work in Ghana to Bank staff effectively taking control of trade policy issues in Bangladesh. Fund-Bank interaction in other low-income countries was not as obviously systematic. In some cases, IMF staff saw this as a result of the Bank's focus on other issues. And in Mozambique, a potential conflict of interest (the International Finance Corporation had a stake in one of the sugar refiners) may have explained the lack of Bank support for the IMF's position on removing the sugar tariff.

29. Some missions responded to critics' suggestions that the IMF present options for reforms, but episodes of single issues escalating to unwarranted importance occurred. Commitments or plans (such as to lower average or maximum tariff rates) were usually general enough to allow various configurations of tariff schedule changes to fulfill them. For some reforms (such as in Ghana's cocoa sector), options for how to proceed were discussed with the officials, and in Mozambique, impasses on two trade issues (taxation of raw cashew exports and tariffs on sugar imports) were addressed by commissioning outside studies. Yet, incidences of a hardening of staff positions on a single issue of questionable macroeconomic relevance still occurred. For example, in 2003, IMF insistence that the Ghanaian government reverse a parliamentary decision to raise the poultry tariff received much adverse publicity and did not reflect a deep consideration of the macroeconomic importance or merits of the issue (Box 3, Background Document 4). Less controversial from a substantive viewpoint, but still raising the profile of an essentially microeconomic issue, was the IMF's insistence on eliminating export taxes on raw sunflower seeds in Ukraine. Reasons for these incidents varied from misjudgments on the importance of the issue (in Ghana) to efforts to drive home a broad point on relinquishing state control favoring special interests (in Ukraine).

30. Data deficiencies at times compromised the quality of trade policy analysis. The most obvious example of this problem in the case studies was in Guyana where staff's understanding of the degree of protection in the 1990s turned out to be based on severely deficient data, and confusion about what steps the authorities had taken in the tariff reduction program led to a misspecified performance criterion. More broadly, experience with the IMF's Trade Restrictiveness Index (TRI) was problematic. This index provides a simple summary measure of restrictiveness and is useful for understanding changes in a country's trade policy stance. In 1998 PDR (based on Board recommendations) asked staff to provide TRI targets at the outset of all medium-term arrangements. Yet the TRI was misused as a stand-alone measure, and in 2005 management instructed staff to stop reporting TRIs. This reversal had merit, insofar as the TRI is a simply-conceived measure that does not capture many dimensions of a country's protective structure. But efforts to build an alternative index were abandoned over methodological disputes, leaving staff with no consistent way to track the stance of tariff and quota policies.[8]

[8] A background paper by Krishna, "The IMF's Trade Restrictiveness Index" (see www.ieo-imf.org) assesses the TRI and alternative measures.

31. Explicit assessments of the expected macroeconomic effects of trade policy changes were wanting. Despite PDR guidelines prescribing such assessments, only a few program documents reviewed provided quantified analyses of the effects of trade policy on growth or the balance of payments. This may reflect the scarcity, even in the literature, of solid methodologies for estimating these effects, despite considerable agreement on the medium- to long-term direction of the effects. But the lack of an explanation of expected macroeconomic effects begs the question of what was the link between (in some cases extensive) trade policy conditionality and causes of the crises. This was especially true for some of the emerging market case studies, where IMF arrangements were responses to capital account crises. In the PRGF cases, changes in trade restrictions were often part of a broader tax reform designed to reduce dependence on trade taxation. In these countries, some analyses reflected deep work on fiscal effects of trade policy changes, an area in which FAD has made substantial contributions. Still, a recurring problem (e.g., in Bangladesh and Tanzania) was underestimating negative revenue effects from tariff cuts.

32. Trade policy conditionality was not even-handed in the cases evaluated, at times due to political interference. In the PRGF countries covered, treatment of trade issues was reasonably similar across countries with comparable degrees of restrictiveness and dependence on trade. Bangladesh stands out as having had less conditionality on trade policy, though probably because the Bank took the lead on this issue. But in the emerging markets examined, the treatment was uneven. These countries all had moderately restrictive trade regimes and, except in Korea, similar dependence on trade. But conditionality on trade policy was extensive in Indonesia and Korea, absent in Brazil and Turkey, and episodic in Ukraine. Moreover, in Korea and Indonesia, but not Brazil, arrangements had commitments to bind measures agreed with the WTO to liberalize trade in financial services; Brazil has yet to ratify its commitments under the General Agreement on Trade in Services (GATS) financial services protocol. With no obvious indication that trade reforms were critical to addressing the causes of the capital account crises in these countries, political pressures on IMF management from trade partners or competitors appeared to play a role in the disparities. The result was not always substantive flaws in the policies supported, but certainly diminished credibility of IMF independence.

33. The IMF's retreat from trade policy conditionality has merit, given the conceptual and practical problems just enumerated. But the accompanying drop in trade policy analysis left gaps. All the emerging market countries evaluated except Turkey had surveillance-only status by 2004. After the arrangements, the IMF did little in-depth work on trade policy in these countries, despite their growing role in world trade. In the PRGF arrangements examined, trade policy conditionality was virtually off the table (except on customs administration) by the end of the evaluation period. Recent IMF involvement in trade policy issues was quite uneven (periodic in Bangladesh, Kenya, and Vietnam and sporadic in the others). Interviews with IMF staff in the African Department suggest that this was as much because PTAs were increasingly formulating trade policies as because conditionality had tapered off. In interviews with the evaluation team, some officials regretted gaps left by the drop in IMF work on trade policy issues: some felt, for example, that IMF views on the European Union's (EU) economic partnership agreements would have been useful for understanding micro-macro linkages in issues under negotiation.

B. Trade Policy Issues in Surveillance

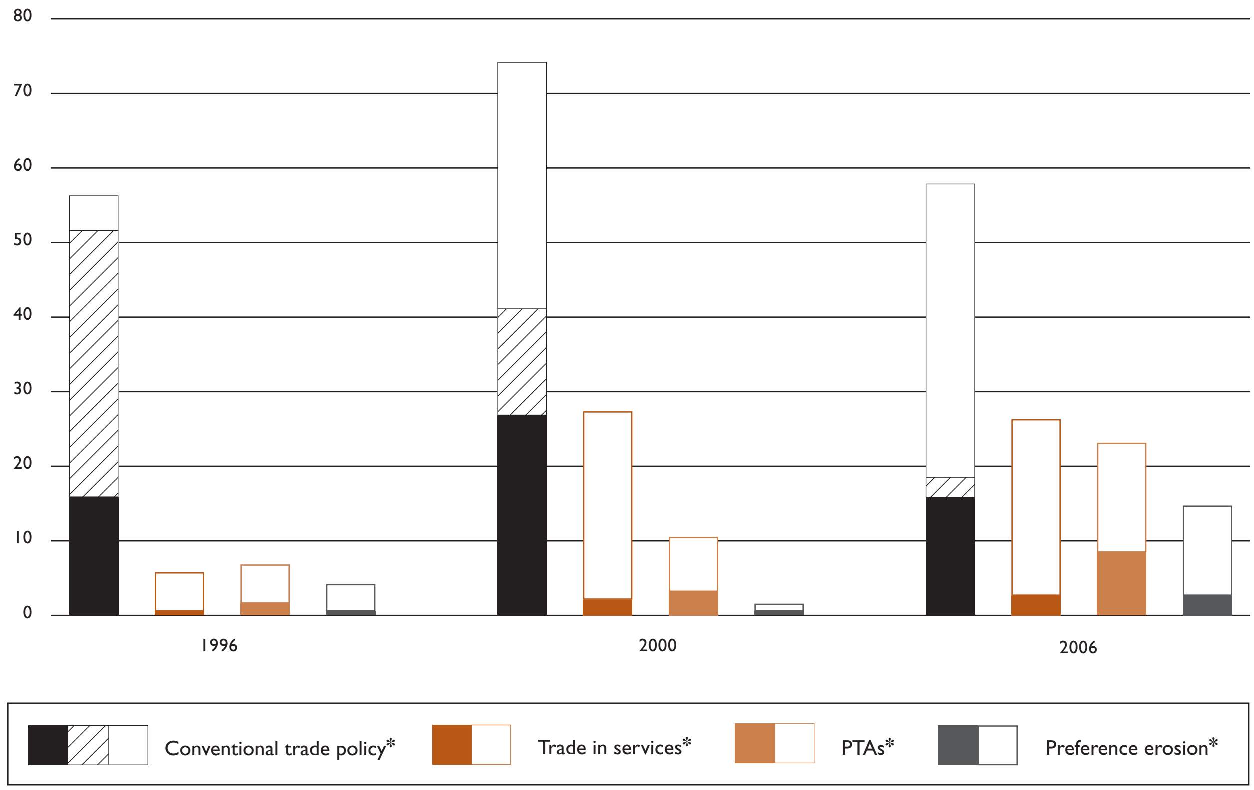
34. Surveillance over trade policy was largely handled in bilateral consultations. Whereas the Fund's *World Economic Outlook* (*WEO*) during the 15 or so years up to 2002 typically devoted a chapter to trade policy every few years, no such chapter has appeared since 2002. As *Regional Economic Outlooks* (*REOs*) took their place in the battery of staff work, only two early ones (sub-Saharan Africa 2005 and Asia-Pacific 2005) devoted chapters to trade policy. Thus despite continuing work on trade policy in RES (albeit diminishing as a share of all work), most recent surveillance work on trade policy has been done in area departments and FAD (in connection with TA and trade tax issues) and has not found an outlet in multilateral surveillance. Given the growing multilateral dimensions of trade policy issues—especially PTAs—this was a missed opportunity for surveillance.

35. Broad measures point to roughly steady coverage of trade policy issues in bilateral surveillance but decreasing analytical depth behind the views expressed. About 70 percent of Article IV reports in the three years reviewed in depth for this evaluation (1996, 2000, and 2006) had views on trade policy. Behind these averages, changes occurred.

- The trade policy issues on which consultations focused changed (Figure 2). Views expressed in staff reports shifted from traditional trade policies (tariffs and nontariff restrictions on merchandise trade) toward PTAs, trade in services and preference erosion. The shift was appropriate as new trade policy issues became important.

Figure 2. Staff Views on Trade Policies in Bilateral and Currency Union Surveillance, 1996, 2000, and 2006

(Percent of all consultations in indicated year)

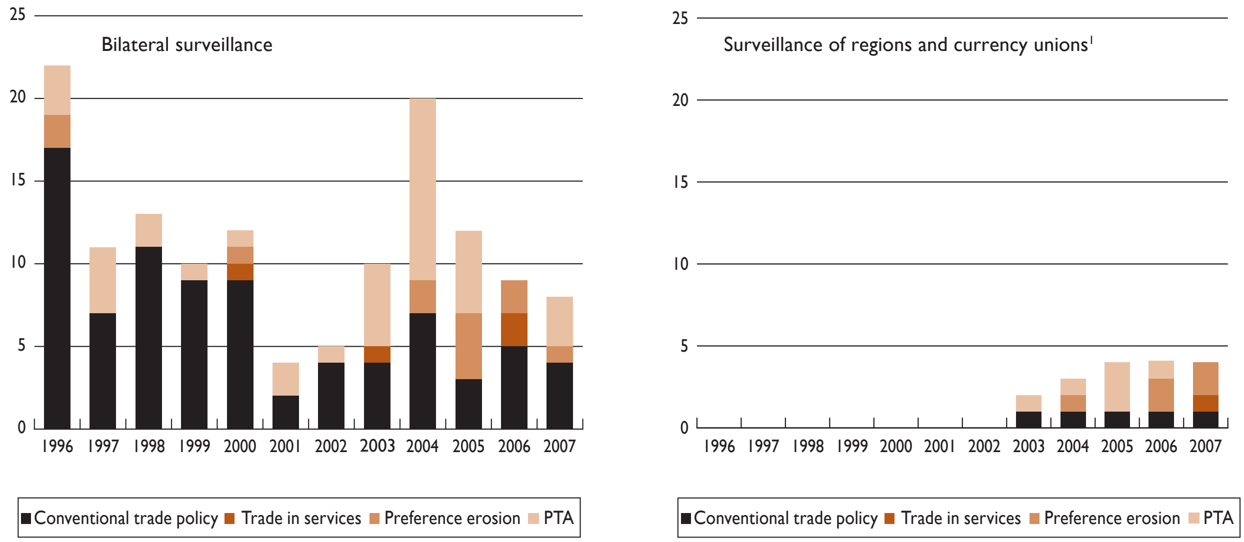


Sources: IMF reports and IEO calculations.

* Dark portion indicates views backed by obvious staff analysis or other in-depth analysis; patterned portion indicates views backed only by descriptive material in background documents; white portion indicates views with no obvious analytical or descriptive backing.

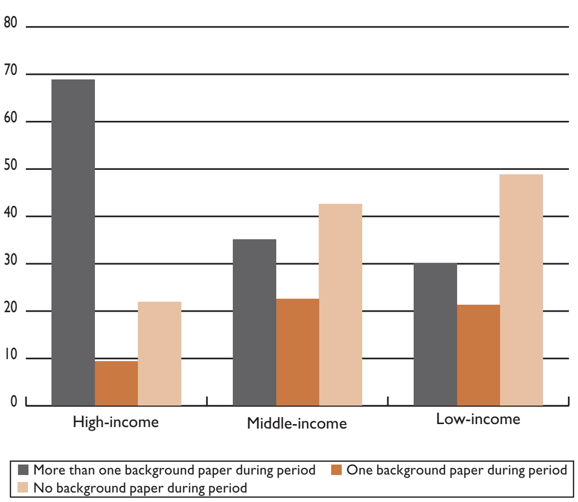
- The share of staff reports where views were expressed on trade policy and obviously backed by *any* analysis (from inside or outside the IMF) or description dropped from about 75 percent in 1996 to 25 percent in 2006 (Figure 2). Views not backed by obvious analysis or description of trade policy fit various characterizations: advice that reflected academic consensus on an issue, but little specificity to the country concerned; advice so general that its content was minimal; or advice that missed opportunities for a more persuasive approach.
- The amount of in-depth work for surveillance varied widely over time. During 1996–2007, the number of background papers containing analysis (that is, more than simple description) of trade policy—the simplest measure of depth—varied between 23 and 4 per year (Figure 3, left panel). But a welcome development was the rise, starting in 2003, of in-depth trade policy work in consultations with currency unions and other Board papers for some African and Western Hemisphere groupings (Figure 3, right panel).
- Staff's analytical work on trade policy for surveillance was quite concentrated (Figure 4). Over the evaluation period, staff carried out multiple analyses of trade policy for some countries, but none for many others. Thus for about 20 percent of advanced countries and 50 percent of low-income countries, no analysis of a trade policy issue appeared in any background paper for the country or for a regional arrangement to which the country belonged during 1996–2007.

Figure 3. Staff Background Papers with Trade Policy Analysis, 1996–2007
(Number per year)



Sources: IMF Article IV background papers and IEO calculations.
[1] Currency unions covered by IMF surveillance are the Central African Economic and Monetary Community (CEMAC), the Eastern Caribbean Currency Union (ECCU), the euro area, and the West African Economic and Monetary Union (WAEMU).

Figure 4. Distribution of Background Papers with Trade Policy Analysis, 1996–2007[1]



Sources: IMF Article IV background papers and IEO calculations.
[1] Number of countries in each category as a percent of all countries in the given income group.

36. Given these trends, the case studies of surveillance focused on two types of work: that on three advanced countries (two systemically important countries—Japan and the United States—and Norway, a smaller country with very high agricultural protection and many PTAs) and that on two new trade policy issues (PTAs and trade in financial services).

Bilateral surveillance in advanced countries[9]

37. Though two key trade policy issues—agricultural protection and PTAs—were common to the three countries examined, the depth of coverage varied substantially. Distortions in agriculture, which had implications for other food producers and domestic efficiency, were criticized strongly in Article IV consultations in all three countries, but supporting background work varied widely. In 2001–02 for the United States (during and immediately after the debate on the pivotal 2002 Farm Bill) and 2005 for Japan, staff views were backed by good analytical or empirical work; officials interviewed for the evaluation acknowledged the quality of the work. In contrast, in Norway no background work

[9] Background Document 6 presents case studies underlying this section.

lent depth to staff views. Staff reports for Norway criticized high agricultural protection (especially for its harmful effects on developing countries), but the officials did not regard the issue as a significant part of the consultations. The treatment of PTAs was also uneven. While the North American Free Trade Agreement (NAFTA) was frequently in the focus of U.S. surveillance through 2004 (with good analytical background work), in neither Japan (where PTAs have become important rather recently) nor Norway (which is party to many PTAs, mainly through the European Free Trade Association) have background papers been produced.

38. During the 1990s, Article IV staff reports for the United States and Japan provided a record of ongoing trade policy changes. Early in the period, U.S. selected issues papers (SIPs) catalogued the use of antidumping or countervailing duties in an effort to put pressure on the authorities to resist protectionist measures following the Asia crisis devaluations even when such measures did not violate WTO obligations. For Japan, SIPs through 1997 detailed changes in trade policies in the preceding year and generally urged a liberal stance. The discontinuation of these descriptions removed a rather tedious part of the IMF's work at a time when the WTO's TPRs were covering much the same ground.

39. After 2004 for the United States and more recently for Japan and Norway, consultations backed off trade issues. For the United States, staff reports and Board summings up became increasingly pro forma in calling for liberal trade policies and support for the Doha Round. Macroeconomic effects of two Congressional bills—the 2008 Food Conservation and Energy Bill (which included provisions expected to raise agricultural subsidy payments) and the Energy Independence and Security Act of 2007 (which raised subsidies for ethanol production and many believe contributed to food price increases)—were not addressed in staff reports. In explaining this change in approach, staff pointed not to any perception that the macroeconomic importance of trade policies had diminished, but rather to the pressure to focus on financial issues and meet word count limits in staff reports.

Surveillance of PTA issues[10]

40. The unevenness in the treatment of PTAs in advanced countries is characteristic of surveillance of PTAs across regions and income levels. The incidence of in-depth views in staff reports on PTAs rose from virtually nil in 1996 to about 10 percent of consultations in 2006, but this was still a small share for an issue that dominated trade policy changes. Views in staff reports ranged from support for to caution about a country's involvement in PTAs, often with no apparent justification for the differing perspectives. Three factors seem to explain these characteristics of the coverage.

- Except in large countries, PTAs entail some loss of national autonomy over trade policies. The IMF has a framework for consultation with four currency unions, but no modalities for surveillance over trade policies of PTAs. In bilateral consultations, staff claimed, national authorities often fence off policies that fall within the purview of PTAs, and staff were reluctant to inject themselves in bilateral or regional affairs. Thus, while the volume of analytical and empirical work on PTAs in RES and area departments suggests researchers identified important macroeconomic or systemic effects of PTAs, the uptake in staff reports, let alone *WEO*s and *REO*s, was tepid.
- Weak data, not just in the IMF but universally, on many aspects of PTAs (trade flows through PTAs, tariff rates in PTAs, specifications of rules of origin, and even a precise roadmap of PTA membership) were an impediment.
- Gaps in Board guidance on the IMF's approach to PTAs seem to have discouraged staff interest in PTAs. Moving beyond the simple assertion in 1994 that most-favored-nation liberalization working toward global free trade is the first-best policy, the Board in 1999 supported a general definition of best practices for the design and implementation of PTAs. But these broad parameters left questions about the role the IMF should play in PTA issues, and efforts to address those questions in a 2006 Board seminar were not fully successful.

Thus, gaps in the guidance, together with the difficulties of addressing an issue that is politically sensitive and logistically complicated, meant that staff analysis of PTAs found less reflection in the IMF's operational work than it could or should have.

41. In what sorts of PTA issues might the IMF have played a larger role? The IMF made good contributions to assessing trade creation and diversion (e.g., for NAFTA and the Central America-Dominican Republic Free Trade Agreement (CAFTA-DR)), the costs for developing countries of preference erosion (e.g., for the Caribbean region), and fiscal effects of PTAs (e.g., for CAFTA-DR). But these have been episodic, and (particularly given limitations on the WTO's role) light IMF involvement in other PTA issues meant that macro-critical issues often went unaddressed. The Fund should have more uniformly addressed how the proliferation of PTAs could affect

[10] A background paper by de Melo, "Preferential Trade Agreements in IMF Economic Work, 1996–2007: An Assessment" (see www.ieo-imf.org) examines IMF work on PTAs.

the scope for protectionism and how specifications of rules of origin or membership in multiple PTAs could affect competitiveness and growth. At a regional level, the limited analysis of the EU's approach to negotiating economic partnership agreements—an issue with macro implications for many African countries—was regrettable. And given that PTAs often brought deep, behind-the-border integration, the IMF should have been involved in anticipating how provisions in these agreements affected competitiveness as well as economic and financial stability.

Surveillance of trade in financial services[11]

42. Trade in financial services is central to IMF concerns about financial stability, but has not received enough direct attention. In its 2005 review of the IMF's role in trade policy, the Board explicitly encouraged staff to become more involved in this issue, but gave no guidance on objectives or a conceptual framework. With little follow-up from either the Board or management, more than half of staff responding to the IEO's survey indicated that they were not aware of this guidance. Of those who were, about half said they had responded actively or moderately.

43. Evaluating work on trade in financial services is difficult because the parameters of the issue are tough to pin down. Discussions with staff revealed differing views about whether the crux of the issue was trade flows per se, liberalization of foreign direct investment (needed for financial institutions to establish bricks-and-mortar presence in another country), restrictions on profit remittances, or financial supervision (including home-host regulatory issues). Some staff felt they had addressed many of these issues in Financial Sector Assessment Program (FSAP) or surveillance work, even if they were not coordinated under the rubric of trade in financial services. A serious impediment to focused work on trade in financial services is the virtual absence of measures of the degree of restrictiveness of countries' financial services sectors.

44. Those staff reports that clearly sought to address policies affecting trade in financial services tended to urge greater openness almost indiscriminately. Typically, staff advocated greater openness (eliminating explicit barriers to foreign entry, but also urging sale of government-owned banks or shares in banks) as a means to increase domestic bank capital, reduce concentration of ownership, sharpen competition and/or attract risk management skills. Rarely did staff reports or Board summings up call attention to trade in financial services issues arising in countries' WTO or PTA negotiations. Seldom did they directly assess risks, costs, or benefits of opening to trade in financial services. Notable exceptions were in a 2006 SIP on the role of South African banks in neighboring countries and a 2000 SIP on Cambodia's WTO accession negotiations.

45. In contrast, the IMF's *Global Financial Stability Report* (*GFSR*) and its predecessor the *International Capital Markets Report* (*ICMR*) kept trade in financial services issues in view, albeit sporadically. On occasion, chapters were devoted to the changing landscape of trade in financial services and its implications for financial stability. In 2000 and 2007, chapters reviewed the risks and benefits of cross-border bank ownership, providing a useful set of benchmarks against which bilateral surveillance or FSAP teams could have evaluated experiences with opening financial markets in individual countries.

46. Greater involvement in trade in financial services would require more attention to issues arising in WTO accession or PTA negotiations. The evaluation team heard support for such engagement from several sources. Some country officials said that they had struggled to understand the macroeconomic and financial implications of issues coming up in such negotiations. WTO staff and committee members acknowledged that the dynamics of trade negotiations do not lend themselves to the kind of oversight that the IMF could provide of related financial issues. Some institutional cooperation on this issue occurred (a 2003 PDR/Monetary and Financial Systems Department seminar on financial sector implications of the GATS negotiations brought together IMF, European Commission, and U.S. Federal Reserve staff) but with little effect.

Trade finance

47. Trade finance received regrettably little attention in the IMF during the evaluation period.[12] This topic is beyond the scope of the evaluation, but, given its current importance and concerns some officials voiced to the evaluation team, it warrants mention. The history is short. In the years after the outbreak of the Asia crises, the WTO Director General approached the IMF with ideas for addressing trade finance vulnerabilities. Independently, in 2003, PDR organized a conference (with participation from the private sector and international organizations) and

[11] A background paper by Stern, "Trade in Financial Services: Has the IMF Been Involved Constructively?" (see www.ieo-imf.org) examines IMF work on trade in financial services.

[12] Since the evaluation period, the Strategy, Policy, and Review Department started a project on this issue.

identified possible actions involving public and private sectors with a supporting role for the IMF. In response to staff's presentation of conclusions, the Board supported a rather hands-off role for the IMF. These efforts, which paralleled initiatives at the WTO, produced little concrete action, partly because other players stepped in to fill the gap. Nor were IMF staff active in considering trade finance issues in surveillance. Present setbacks to trade finance speak to the inadequacy of the response.

Chapter

6 How Effective Was the IMF's Work on Trade Policy Issues?

48. There are no straightforward metrics for assessing the effectiveness of the IMF's involvement in trade policy issues. Three approaches are therefore taken in this evaluation. At the broadest level, and consonant with some of the academic literature, is there evidence that IMF involvement increased trade volumes? More modestly, was IMF advice, whether in surveillance or conditionality, implemented through lasting policy changes? And even more modestly, did IMF involvement get issues on the table or productively into the public debate?

49. Though subject to serious measurement problems, there is some evidence to support a positive effect of IMF involvement on trade volumes. The methodology used to find such effects (a gravity model) can only be used to detect possible effects of IMF conditionality, because discrete observations on involvement are needed. An earlier study, which found that trade policy conditionality does have a positive effect on trade flows over the medium term, was replicated for this evaluation (with updated data and an effort to address technical problems), and weak evidence of a favorable effect was found.[13]

50. The reflection of IMF conditionality in lasting changes in trade policy was spotty. For the most part, conditions on trade policy were implemented, even if with delays. But at least partial subsequent reversals were common. Many of the low-income countries examined imposed supplementary duties within a few years of tariff cuts undertaken during IMF arrangements. Many also moved aggressively to PTAs, leaving staff of the view that trade liberalization was off the table for bilateral negotiations. Among the emerging market countries, the record was at least as uneven. In Korea and Indonesia when conditionality essentially accelerated an ongoing program of tariff cuts, changes tended to persist. But other conditions on state monopolies and export taxes (especially in Indonesia and Ukraine where some issues were particularly contentious) tended not to result in lasting changes.

51. Often IMF involvement was not particularly effective even on the third criterion for effectiveness—getting issues into the public debate. Occasionally, press coverage of IMF views on trade policy issues revealed a constructive debate: reports on the work on preference erosion in the context of the Bangladesh program stand out in this respect. But often the IMF seems to have polarized public opinion on an issue of dubious macroeconomic import. In survey results, neither authorities nor staff saw much of a role for the IMF in generating a constructive debate in the context of a lending arrangement.

52. Interpreting the effectiveness of surveillance requires more subtlety. Objectives of surveillance are broader than those of conditionality. While some advice would ideally be implemented immediately, most is put forward for consideration or as a marker for best practice. Often too, trade policy advice is delivered in such general terms (for example, support the conclusion of the Doha Round or pursue multilateral liberalization alongside agreements on PTAs) that implementation or the influence of the IMF could only be defined impressionistically. In the surveillance case studies, policies were not obviously changed in line with IMF views. But did the name-and-shame approach in the U.S. staff reports in the late 1990s help forestall protectionist tendencies? Might some rules of origin have been more complex had the IMF not urged simplicity? Such questions have no definitive answers.

53. Survey results put a fairly favorable light on effectiveness. The IEO survey asked both officials and IMF staff whether IMF advice in four areas (trade in goods, trade in services, PTAs, and customs) enhanced the debate on trade-macro linkages, promoted a change in the right direction, and/or prevented changes in the wrong direction. Some 50–60 percent of official respondents *who had discussed trade policy with an IMF mission* saw IMF advice as highly or somewhat effective, though for PTAs the percentage dropped to about 30. Some 80 percent of staff respondents whose mission had

[13] The methodology and results are presented in a background paper by Yoon, "Re-evaluating the Effectiveness of Trade Conditions in Fund-Supported Programs" (see www.ieo-imf.org).

provided trade policy advice felt the advice was highly or somewhat effective in all four areas, with PTAs again somewhat lower.

54. Interviews with country officials revealed a mix of views about the IMF's effectiveness on trade policy issues. Many officials declined interview requests or did not respond to the survey, stating that they had had no interaction with the IMF on trade policy. But those who spoke with the evaluation team had diverse impressions.

- Trade policy is formulated by segments of the government that typically did not talk to IMF missions and therefore IMF advice was delivered to the wrong audience.
- IMF advice would need to be packaged more persuasively to significantly help governments make the case for more liberal trade policies against vested interests.
- The IMF's expertise on trade policy issues was not as strong as on other macroeconomic issues and therefore its advice lacked credibility.
- By not focusing actual advice (as opposed to research) on PTAs, the IMF took itself out of a central debate on trade policy.
- If its trade policy advice—even the generic "stick to multilateral liberalization and cut agricultural subsidies"—ceased, the IMF would be seen as accepting protectionism.

55. Doubts about the trade policy expertise of IMF staff surfaced in interviews, though official and staff survey responses were more reassuring. About 50 percent of officials responding to the survey saw the expertise of IMF missions on trade policy as high or moderate, though another 40 percent indicated no view. About 30 (45) percent of staff respondents felt their mission team had at least one member strongly (moderately) qualified to take positions on trade policy. In interviews, several staff members expressed confidence that they could draw on the expertise of economists in the (old) Trade Policy Division should their mission have needed it. Staff interviews pointed to a view that trade policy is an unfunded mandate of the IMF.

CHAPTER

7 Findings and Recommendations

A. Findings

56. The substantial swing in IMF involvement in trade policy during the evaluation period went too far on each side. The interventionist approach of the late 1990s, when the IMF played an uneven but at times aggressive role in trade policies through conditionality, gave way to substantial reluctance to state strong positions even on trade policies that have macroeconomic import. Several factors undoubtedly affected this swing: the establishment of the WTO, overall streamlining of the IMF and prioritization of financial issues, and, possibly, complacency stemming from a long period of high growth in world trade.

57. The establishment of the WTO changed the institutional landscape, but did not eliminate the need for an IMF role in trade policy. The IMF, with near-global membership, strong procedures for surveillance, and a mandate to promote macroeconomic stability in a globalized economy, has a key role to play in calling attention to systemic and macroeconomic implications of trade policy developments. Yet this is not the role the IMF has played of late. Rather, country officials see the IMF as sidelined on key trade policy issues (especially PTAs), and staff have increasingly demurred in expressing views beyond general endorsements of liberalism and multilateralism. This has left a worrisome gap. Without a strong IMF presence on these issues, the global debate misses a critical player.

58. Cooperation with other organizations on trade policy issues worked, though some potential synergies were or could be lost. Though a formal framework exists for cooperation and coherence in the work of the WTO and IMF, the scope for tensions (for example, between multilateral and unilateral approaches to liberalization or market-based and trade policy responses to balance of payments pressures) was evident during the evaluation period. Informal contacts between staff of the two institutions and the IMF's diminishing role in trade conditionality kept flare-ups at bay. But other potential tensions, especially with respect to possible charges of exchange rate manipulation for trade purposes, lie below the surface. As for other institutions pursuing approaches to trade policy more similar to the IMF's, work with the World Bank was on occasion strong, but that with the OECD, UNCTAD, and regional development banks was unfortunately not frequent.

59. In charting a course for the IMF on trade policy issues, the Executive Board's guidance to staff was appropriately general in scope, but too vague. Because trade policy encompasses a wide range of issues, not all of which are relevant from a macroeconomic perspective in every country or region, the Board appropriately broadened the range of issues staff might address and asked for selectivity. But on some issues—particularly PTAs and trade in services stand out—the objectives and approach for IMF involvement were not made clear. Nor were the criteria for macro-criticality that were to guide staff decisions on when to become involved in trade policy issues. Without such clarity, staff are unlikely to be effective in looking out for trade policy-related threats to macroeconomic and financial stability.

60. The IMF has rightly scaled back its use of conditionality on trade liberalization. Conditionality on trade policy in IMF lending arrangements during the 1980s and early 1990s probably contributed to a beneficial reduction in very high and distorting trade barriers. But, particularly early in the evaluation period, trade conditionality exceeded a reasonable definition of macro-critical, went beyond staff's technical competence, and fell prey to political interference from large shareholders of the IMF.

61. Surveillance of trade policies had a mixed record. On some important trade issues, bilateral surveillance provided excellent analysis and a strong voice for changing policies that harmed global stability. Messages from Article IV reports were at times tough both on advanced countries (particularly on agricultural subsidies and contingent protection) and on developing countries (where high tariff and nontariff barriers were part of a web of features that raised business costs, fiscal revenue reforms needed to accompany trade liberalization, and preference erosion created uncertainties). Still, the record of IMF involvement was uneven across countries and

over time. Also, some important trade policies—from the perspective of spillovers and macroeconomic stability—were not addressed forcefully.

62. Two such issues stand out for not receiving the attention their macroeconomic and systemic importance merited. Much of the global action on trade policy in recent years has occurred through PTAs, an area in which IMF surveillance—bilateral, regional and multilateral—did not fully engage. When views on PTAs were expressed in staff reports they differed considerably across countries (some favorable, some cautionary, and some bland) with no apparent reason for the differences. And a fair amount of analytical and empirical work on PTAs undertaken by IMF staff frequently did not find voice in the IMF's advice. In many countries, missions' reluctance to engage on PTA issues meant that trade policy was effectively taken off the table in IMF surveillance discussions.

63. Even more serious from the perspective of the IMF's core mandate is the meager attention to trade in financial services. Although the *GFSR* on occasion addressed the risks and benefits of liberalizing trade in financial services, bilateral surveillance was less thorough, tending indiscriminately to urge greater openness to foreign financial service providers with little direct assessment of risks. More explicit guidance on objectives of and approaches to surveillance of trade in financial services—as well as better use of tools for tracking openness to trade in financial services—would have facilitated work in this area.

64. Efforts to assess the effectiveness of IMF advice on trade policies did not yield strong conclusions. Trade policy conditionality was typically implemented (frequently with delays) but was often partially reversed later. Because trade policy advice in surveillance tended to be less precisely specified than conditionality and to have a medium-term focus, assessing its effectiveness would have required a counterfactual. Results from interviews and surveys are mixed but broadly do not refute the notion that IMF advice is effective at least in keeping trade policy issues on the table.

B. Recommendations

65. **Board guidance.** The Board should commit to periodic re-evaluation of its guidance on objectives of, approaches to, and modalities of staff work on trade policies. Regular reviews of guidance should be undertaken in the context of assessments of current global trends in trade and trade policy. This exercise should be much less ambitious than the 1994 Comprehensive Trade Paper, but it would serve a similar purpose—to keep staff and the Board up to date on developments in trade and trade policy important to the macroeconomic orientation of the IMF's work and to refresh Board guidance of the IMF's role in trade policy issues.

66. **Trade policy in UFR.** Having scaled back conditionality on trade policy, the IMF must engage on the issues with borrowing countries through a strong advisory role. Countries will need not only to be supported in resisting protectionist pressures, but also to have plans for providing trade finance, influencing decisions within their PTAs, and reforming trade policies in ways that reduce the costs of doing business. Staff and the Board need to articulate what role the IMF should play to this end and how it should work with other institutions, especially the World Bank. Another important objective in scaling back conditionality is to eliminate the scope for political interference from member countries with global interests. All countries should commit to eschewing such interference.

67. **Surveillance over trade policies.** The IMF's main role in trade policy issues in the future will likely be through surveillance. Four immediate initiatives are needed.

- The Board should establish guidance on the role and approach of the IMF in PTAs. The IMF is uniquely situated to advise countries on the macroeconomic implications of their PTAs and to call attention to the systemic effects of and vulnerabilities from PTAs. Activism in this role would involve no compromises in the IMF's support for multilateral liberalization through reciprocal trade concessions, but it would inject IMF analysis into this fast-moving area of trade policy.
- The Board should establish guidance on the role and approach of the IMF in trade in financial services. The IMF needs to move beyond what has often been uncritical support for liberalization of trade in financial services—a position that has at times been inconsistent with the IMF's more cautious approach to more general risks from inadequate financial supervision and prudential control. Surveillance should be actively involved in understanding and anticipating problems in financial services commitments through PTAs and the WTO.
- Trade policy—particularly involving PTAs—should be addressed periodically in multilateral and regional surveillance. Much of the value added that the IMF can bring to assessing trade policy developments comes from its ability to place them in a global context—an approach well suited to the *WEO* format. Assessments of PTA issues also lend themselves to *REO*s. Disseminating to the IMF's bilateral missions views reached in such regional contexts would provide obvious economies of scale.

- The IMF should recommit to evenhandedness in its trade policy advice. Trade policy issues in large economies, which lately have not been given as much prominence as in the past, need to come back into the IMF's focus. This need not be to the detriment of financial sector analysis, insofar as trade policy, which can be slow to change, may be addressed only once every two to three years. Also, the IMF must re-engage more broadly in low- and middle-income countries, particularly those that have seen their share of world trade rise rapidly in recent years and have regional influence.

68. **Outreach.** The evaluation team often heard the view that the IMF could be more effective on trade issues if it attempted to provide fresh macroeconomic perspectives that would help persuade elected officials and the public of the merits of liberal trade. To be effective, IMF staff and the Board must consider ways to (i) improve outreach to officials inside and outside the ministries that are the IMF's traditional interlocutors and (ii) present trade policy issues in a rigorous and persuasive manner. This will require moving away from bland statements of general support for first-best policies and toward helping countries achieve the best outcomes possible within an increasingly regionalized trading system. On PTA issues in particular, the IMF's goal should not be simply to join the chorus of advisors on microeconomic aspects of PTAs, but rather to elevate perspectives on macroeconomic effects of PTAs and to consider implications of PTAs for exchange rate policies.

69. **Data, expertise, and organization.** Three orders of business are crucial for effective engagement in trade policy issues within the IMF's limited resources. (i) A minimum level of trade policy expertise is needed. Particularly in light of recent departures of several trade economists from the IMF staff, a small but critical mass of trade policy expertise must be built to give the work on trade policies sufficient momentum. (ii) A division solely devoted to trade issues is needed to serve as the locus of interinstitutional cooperation on trade policy issues and a repository of trade expertise on which other staff can draw. (iii) Fund staff need data and measures of trade protection. The abandonment of the old TRI was reasonable, but a replacement should be considered. A good option would be to work with the World Bank to improve the timeliness of their TRI, a model-based measure to which the Bank is already committed. Also, IMF staff should work with other organizations to improve data and tools of analysis for assessing the effects of PTAs and restrictions on trade in financial services.

70. **Institutional cooperation.** As difficult as interinstitutional cooperation can be, there is no cost-effective alternative to making it work when it comes to trade policy. To spearhead such cooperation, management and a small number of senior staff need to commit to regular and formal meetings—for example, once a year—with counterparts in other key international organizations involved with trade. These meetings should cover the landscape of trade policy and trade flows so that institutions can have a common view and jointly consider how to respond to anticipated trade issues. IMF management should report to the Committee on Liaison with the World Bank and Other International Organizations and/or the Executive Board/International Monetary and Financial Committee on proceedings of the meetings and plans for staff-level coordination.

Annex

I Data and Methods

1. The evaluation essentially covers the period since the establishment of the WTO—1996 through 2007—but goes back further for some questions and focuses on the more recent past for others. The main instruments of the evaluation are: (i) desk reviews of policy documents and guidelines issued to staff, IMF Executive Board minutes, Article IV and program documents, and advocacy and outreach items; (ii) interviews of current and former IMF, WTO, and World Bank staff and government and nongovernment representatives; and (iii) surveys of IMF staff and country authorities. This annex describes the first two sources of evidence; Annex 2 describes the surveys and their main findings. Annex Table A1.1 summarizes the data sources for the various components of the evaluation.

A. Executive Board Papers, Minutes, and Guidelines to Staff

2. The evaluation used Executive Board papers and minutes of discussions reviewing the Fund's work on, and role in, trade policy (including surveillance and conditionality reviews) and related topics (e.g., IMF-WTO cooperation, trade liberalization in Fund-supported programs, revenue implications of trade liberalization, market access for developing country exports, PTAs, and the Doha Development Agenda). The evidence gathered from these sources was used to consider how the IMF Board viewed trade issues and the Fund's role in these issues over time. Summings up from these Board discussions and guidance notes issued by PDR were used to consider how staff were instructed to approach trade policy issues.

B. Surveillance Documents

3. The evaluation examined Article IV documents (including staff reports, internal briefing papers and back-to-office reports for staff missions, background papers, minutes of relevant Board discussions, and press releases) to assess the IMF's coverage of trade policy issues in bilateral surveillance. This evidence was drawn from the following (overlapping) samples:

- For the entire IMF membership, we reviewed all bilateral Article IV staff reports for 1996, 2000, and 2006.[1] If a country did not have an Article IV consultation in one of these years, the staff report from the closest earlier year was used. This yielded a total of 180 staff reports for 1996, 185 staff reports for 2000, and 190 staff reports for 2006. Each staff report was reviewed for its coverage of 11 trade policy topics: tariffs, nontariff barriers, export restrictions, antidumping/countervailing measures, export subsidies, state trading monopolies, customs administration, trade in services, PTAs, WTO, and trade liberalization in general. The coverage of each topic was given a rating from 0 to 3, where 0 indicated no coverage; 1 indicated factual reporting only; 2 indicated that the staff expressed a view or took a position on the issue but without apparent supporting analysis; and 3 indicated the staff expressed a view or took a position on the issue with some supporting analysis including, but not limited to, an SIP or recent economic developments (RED) chapter with substantive quantitative or qualitative analysis. These data were used to assess the scope and depth of trade policy coverage in bilateral surveillance across countries and over time.
- For the entire Fund membership, we reviewed all trade policy-related SIPs, REDs, and other background papers prepared for Article IV consultations for 1996 through 2008. Papers were considered trade policy-related if they contained substantive quantitative or qualita-

[1] Including three territories (Hong Kong SAR, Aruba, and Netherlands Antilles) and four currency unions (CEMAC, the ECCU, the euro area, and WAEMU) that had Article IV consultations with the IMF during the evaluation period; excluding Montenegro and Somalia, which had no Article IV consultations during the evaluation period.

tive analysis of a trade policy issue. This gave us a total of 152 papers for the whole period. These data were used to assess the depth of trade policy coverage in bilateral surveillance.

- For regional surveillance, we reviewed staff reports and background papers for four currency unions (CEMAC, the ECCU, the euro area, and WAEMU) that had regular formal or informal consultations and for other regions (e.g., Central America and the Caribbean region) for which occasional Board reports were prepared during the evaluation period.
- For 15 case study countries, which were selected for a more in-depth examination of IMF involvement in trade policy issues, we reviewed, in addition to staff reports and background papers, other documents related to Article IV consultations including internal briefing papers and memoranda, back-to-office reports, minutes of Board discussions, and public information notices and other press releases. The case study countries, which were drawn from a range of income levels and geographical regions, were: Bangladesh, Brazil, Ghana, Guyana, Indonesia, Japan, Kenya, Korea, Mozambique, Norway, Tanzania, Turkey, Ukraine, United States, and Vietnam. They were chosen to cover a diversity of experience in the trade policy dialogue with the IMF, ranging from minimal/shallow to extensive/deep engagement.

C. Program Documents

4. The evaluation examined program documents (including staff reports, internal briefing papers and back-to-office reports for staff missions, background papers, minutes of relevant Board discussions, and press releases) to assess the IMF's coverage of trade policy issues, including trade conditionality, in Fund-supported programs. This evidence was drawn from the following (overlapping) samples:

- For the entire Fund membership, we reviewed all program requests (comprising letters of intent, memoranda of economic and financial policies (MEFPs), and associated staff reports) from 1996 through 2007.[2] Altogether a total of 226 programs was considered (including 88 Stand-By Arrangements, 19 Extended Arrangements, 113 ESAF/PRGF arrangements, and 6 Policy Support Instruments) for 93 countries. Each program request was reviewed for the inclusion of conditionality (in the form of prior actions, structural performance criteria, or structural benchmarks) in 11 trade policy areas: tariffs, nontariff barriers, export restrictions, antidumping/countervailing measures, export subsidies, state trading monopolies, customs administration, trade in services, PTAs, WTO, and trade liberalization in general. To supplement this information, we used PDR's Monitoring of Fund Arrangements (MONA) database to identify trade conditions that were added after the initial request for all the programs in our sample. Taken together, these data were used to assess the incidence and scope of trade conditionality during the evaluation period.
- For 12 case study countries, we reviewed all program documents starting from 1996 (or earlier in some cases) through 2008. The case study countries were Bangladesh, Brazil, Ghana, Guyana, Indonesia, Kenya, Korea, Mozambique, Tanzania, Turkey, Ukraine, and Vietnam. The documents included staff reports, letters of intent, MEFPs, internal briefing papers and memoranda, back-to-office reports, ex post assessments, minutes of Board discussions, and press releases. The case study countries were chosen to cover varied experiences and outcomes, ranging from minimal to substantial trade conditionality.

D. Other Documents

5. Other IMF outputs used in this evaluation include: FSAP reports, IMF working papers, IMF publications (including the *WEO* and *REOs*), management speeches, and internal memoranda and notes on trade policy issues.

6. The evaluation also used various external documents, including reports by the WTO Secretariat, WTO TPRs, minutes of relevant WTO meetings, World Bank reports (including the 2004 evaluation of World Bank support for trade), academic papers, and media reports drawn from Factiva.

E. Interviews

7. As part of the evaluation, we interviewed 79 current and former IMF staff and held five focus group meetings with 26 participants from the A14–B4 level staff. We also interviewed current and former officials from 21 countries and staff of five international and regional institutions, and representatives from six civil society organizations.

[2] Programs that began before 1996 were not included. For multi-year ESAF/PRGF programs, only the first-year request was reviewed.

Table A1.1. Data Sources Used in the Evaluation

		Surveillance Documents			Program Documents					
	Board Papers and Minutes	Staff reports for 1996, 2000, and 2006	SIPs	All Article IV documents, 1996–2007	Initial request docu-ments plus MONA data	All program-related documents	Other Fund Documents[1]	External Documents[2]	Interviews	Survey
Evaluation report	×	×	×	×	×	×	×	×	×	×
Background documents										
"The Legal Mandate"	×								×	
"Cooperation Between the IMF and the WTO"	×						×	×	×	
"Guiding the IMF's Involvement in International Trade Policy"	×						×		×	
"IMF Involvement in Trade Policy Issues in Low-Income Countries: Seven Case Studies"				×		×		×	×	
"Trade Conditionality in IMF-Supported Programs in Emerging Market Countries: Five Case Studies"				×		×	×	×	×	
"IMF Surveillance of Trade Policies: General Observations and Case Studies of Advanced Countries"		×	×	×			×		×	
Background papers										
"Preferential Trade Agreements in IMF Economic Work 1996–2007: An Assessment" (de Melo)	×	×	×	×			×	×	×	
"The IMF's Trade Restrictiveness Index" (Krishna)	×						×	×	×	
"What Determines IMF Involvement in Trade Policy Issues?" (Yang and Yoon)		×			×		×			
"Re-evaluating the Effectiveness of Trade Conditions in Fund-Supported Programs" (Yoon)					×					
"Trade in Financial Services: Has the IMF Been Involved Constructively?" (Stern)	×	×	×	×			×	×		

[1] Including FSAP reports, IMF working papers, IMF publications (including the *WEO* and *REOs*), management speeches, and internal memoranda and notes on trade policy issues.
[2] Including reports by the WTO Secretariat, WTO TPRs, minutes of relevant WTO meetings, World Bank reports (including the 2004 evaluation of World Bank support for trade), academic papers, and media reports drawn from Factiva.

ANNEX 2 Surveys

1. The IEO conducted surveys of IMF staff and member country officials in November 2008. The surveys were administered by ICF International. All survey recipients were advised that their responses were confidential and that individual country and staff respondents would not be identified. The survey questionnaires are included at the end of this annex.

2. The trade policy issues covered in the surveys comprised the design and implementation of trade policies narrowly defined (i.e., policies that directly and primarily aim to influence the quantity and/or value of a country's imports and exports of goods and services—exchange rate policy was not considered) and the assessment of the macroeconomic effects of these narrowly defined trade policies. Specifically, the surveys considered six different trade policy issues:

(i) Liberalization of trade in goods, including agricultural;
(ii) Liberalization of trade in services, including financial;
(iii) Preferential trade agreements (PTAs), e.g., free trade agreements, customs unions, partnership agreements, and preferential schemes;
(iv) Customs administration;
(v) Effects of a country's trade policy changes (actual or proposed) on its own GDP growth, fiscal position, or balance of payments;
(vi) Effects of a country's trade policies on other countries'/regional/global trade (including market access issues).

A. Survey of IMF Staff

3. The objective of the survey was to obtain staff views on the motivation for IMF missions to cover trade policy; cooperation with other institutions on trade policy; how well informed IMF missions were about the trade policy issues on which they took substantive positions; the effectiveness of their trade policy advice; and the role of the IMF with regard to trade policy.

Sample and response rate

4. The survey was sent to 678 staff members, grades A14 and above, in the five area departments (African (AFR), Asia-Pacific (APD), European (EUR), Middle East and Central Asia (MCD), and Western Hemisphere (WHD)) and four functional departments (FAD, Monetary and Capital Markets (MCM), PDR, and RES). Survey recipients were asked to fill out the survey whether or not they were actively involved in trade policy issues.

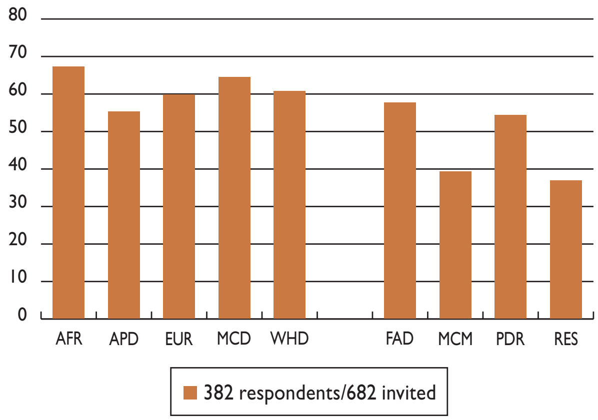
5. Respondents were asked to answer questions with respect to their experience in a single country based on at least two missions (surveillance, UFR, or TA) during 2005–07. Respondents who had been on the IMF staff for less than a year, who had been on fewer than two missions to a single country, or who worked on an EU member country during 2005–07 were directed to a subset of questions that were not country-specific.

6. The overall response rate was 56 percent (383 responses). The response rate was fairly even among area departments, but varied across functional departments (Figure A2.1). There were 308 country-specific responses in total: 281 based on missions to emerging and developing countries and 27 based on missions to advanced countries.[1] The breakdown of respondents by grade was: 178 A14 staff members, 96 A15 staff members, 86 B1–B3 staff members, and 23 B4 staff members. No B5 staff members answered the survey.

[1] Based on the most recent *WEO* classification of advanced and emerging and developing countries.

Figure A2.1. Survey Response Rate by IMF Department

(Percent of survey recipients in each department)



Main findings

IMF missions considered macroeconomic/systemic implications as the main criterion for covering a trade policy issue

7. Where trade policy issues were discussed, respondents were asked to characterize the reason(s) their mission covered each issue (Question 8), choosing from among the following options: macroeconomic or systemic implications; request from the authorities; request from the World Bank or other institution; request from management; request from an Executive Director of another country; and other reasons. More than one reason could be specified for each issue covered. The first reason—“macroeconomic or systemic implications”—was cited most often for all trade policy issues, followed (substantially behind) by “request from the authorities” and “other reasons” (Figure A2.2).

8. Where there were trade policy issues that were not discussed, respondents were asked to characterize the reason(s) their mission decided not to raise the issue (Question 9), choosing from among the following options: there were no obvious macro-linkages or systemic implications; the mission lacked time, expertise, or resources; the World Bank took the lead on the issue; there was a potential conflict with WTO commitments or negotiations; management gave instructions not to raise the issue; a Board member requested the issue not be raised; and other reasons. As before, more than one reason could be specified for each issue not covered. The most frequently cited reason for not covering a trade policy issue was that it had no obvious macro linkages or systemic implications (Figure A2.3). “Other” reasons were chosen almost as frequently but were not elaborated. (In focus group interviews, some staff members noted that word counts in staff reports could have been a constraining factor.)

IMF staff cooperated quite closely with the World Bank on trade policy issues but less so with other institutions

9. Respondents were asked to rate their cooperation with staff from other institutions with regard to trade policy issues in the country on which they were working (Question 12). Cooperation with the World Bank was quite close, with at least 50 percent of respondents characterizing the contact as frequent to occasional in surveillance, UFR, and FSAP work and around 25 percent in TA and research (Table A2.1). In contrast, no respondents reported close cooperation and fewer than 10 percent reported occasional cooperation with the WTO across all areas of trade work. This likely reflects the much smaller size and different institutional setup of the WTO Secretariat compared to the IMF. There are no country economists in the WTO Secretariat with whom IMF area department staff could naturally interact. Instead, area department staff and mission teams usually directed their trade policy questions to PDR’s Trade Policy Division, which served as the Fund’s main channel of communication with the WTO Secretariat. The majority of respondents also reported negligible cooperation on trade work with staff from other institutions, such as the OECD and regional development banks. In focus group interviews, IMF staff indicated that their interactions with staff from these organizations tended to be based on personal rather than institutional contacts.

10. Respondents were then asked how often they drew on resources from other institutions, such as country-specific reports on trade policy, research papers, and trade policy data (Question 13). Again,

Figure A2.2. Reasons for Covering Trade Policy Issues

(Percent of respondents for each issue)

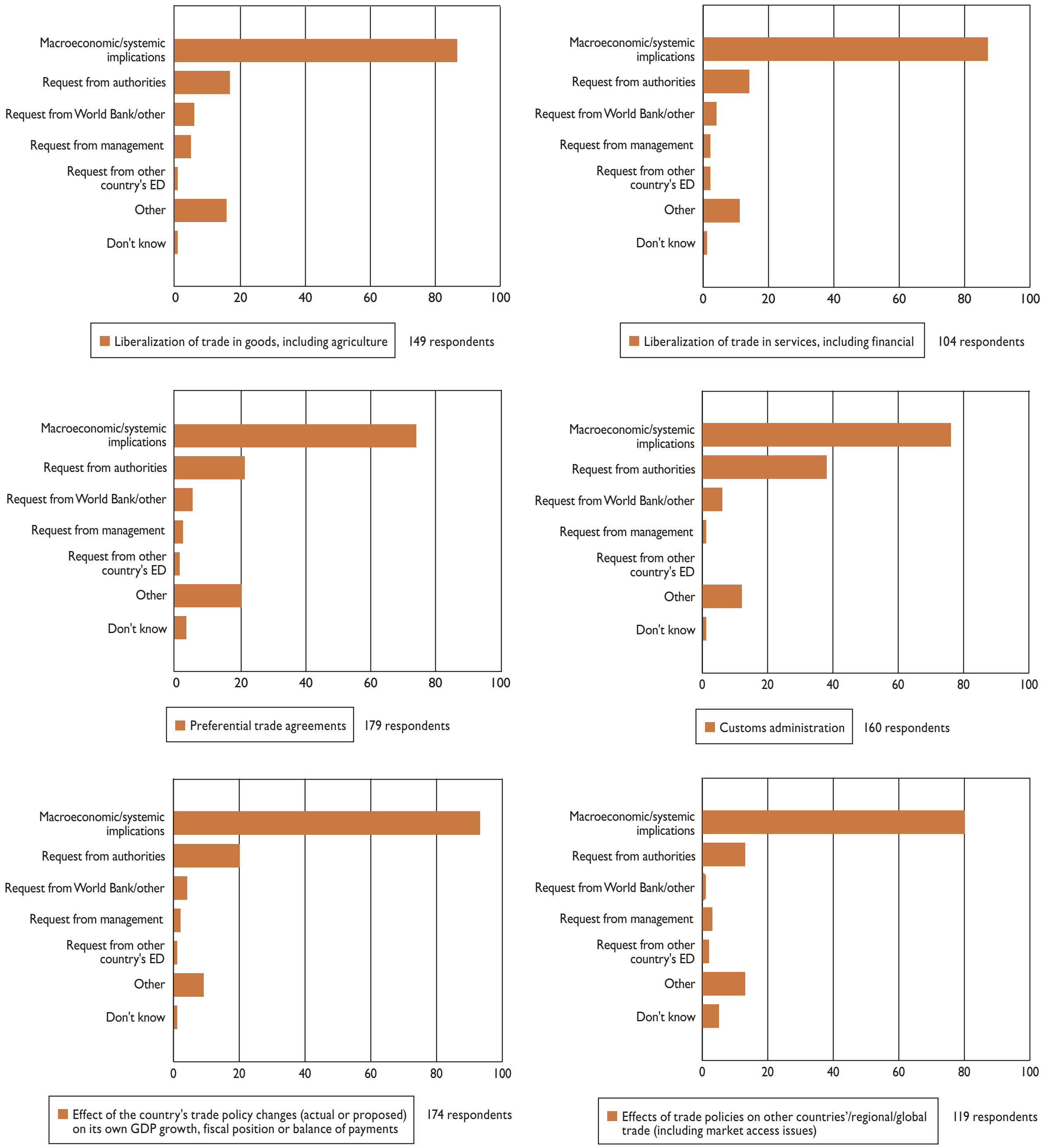


Figure A2.3. Reasons for Not Raising a Trade Policy Issue

(Percent of respondents for each issue)

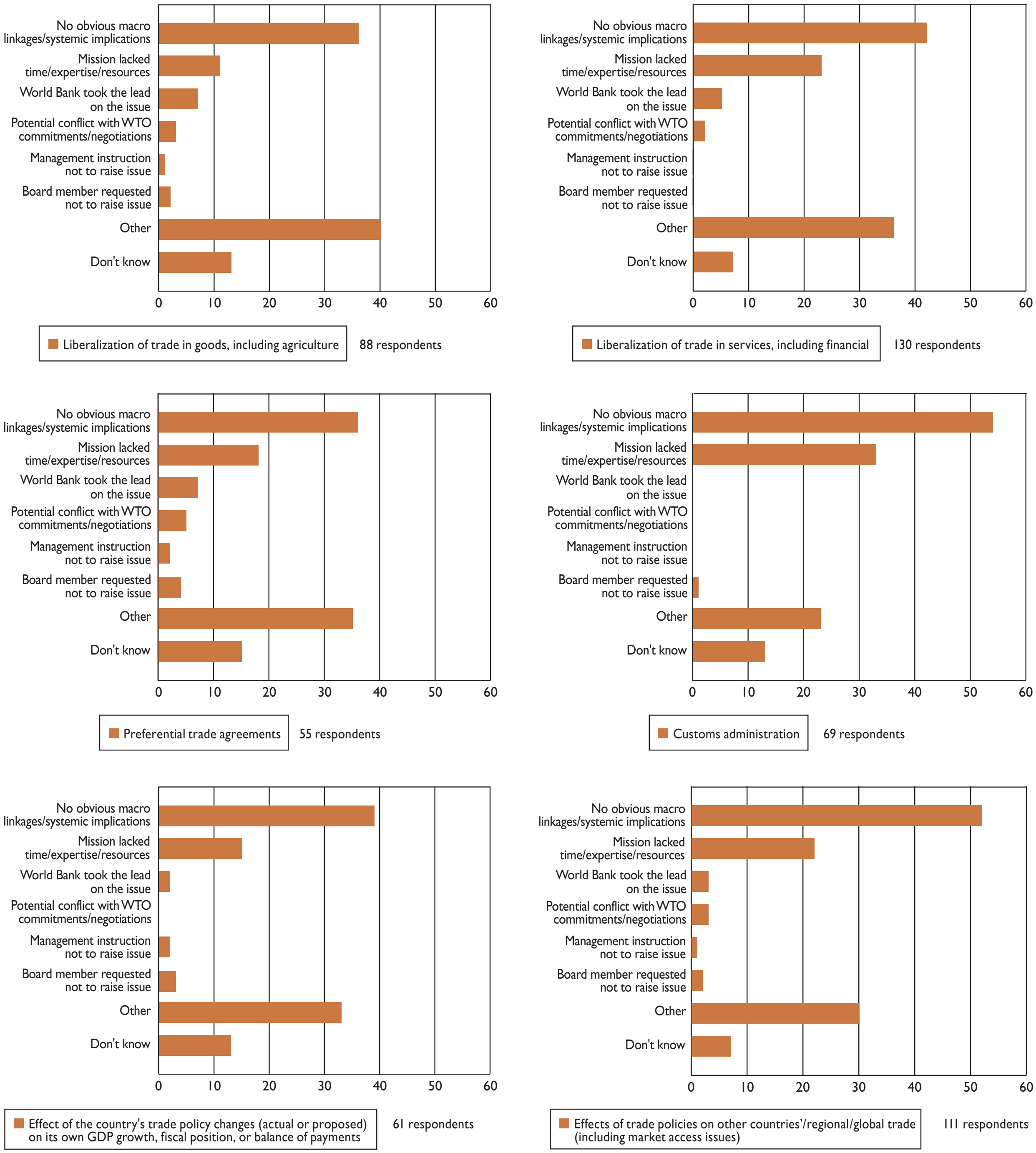


Table A2.1. Cooperation with the World Bank and Other Institutions
(Percent of respondents)

	Surveillance (186 respondents)	UFR (127 respondents)	TA (50 respondents)	FSAP (20 respondents)	Research (308 respondents)
Vis-à-vis the World Bank, percent of respondents reporting:					
Close/frequent cooperation	22	35	20	30	5
Occasional cooperation	33	31	6	20	19
Negligible cooperation	27	18	16	5	33
Cooperation not applicable	9	2	2	15	6
Vis-à-vis the WTO, percent of respondents reporting:					
Close/frequent cooperation	0	0	0	0	0
Occasional cooperation	9	2	6	0	3
Negligible cooperation	61	65	32	55	45
Cooperation not applicable	19	20	4	15	12
Vis-à-vis other institutions (e.g., OECD, regional development banks, etc.), percent of respondents reporting:					
Close/frequent cooperation	7	7	10	0	2
Occasional cooperation	19	16	4	10	10
Negligible cooperation	47	50	24	45	44
Cooperation not applicable	17	14	6	10	12

respondents were most familiar with World Bank resources—53 percent used country-specific reports by the World Bank on trade policy, 45 percent used World Bank research papers on trade policy, and 44 percent used World Bank trade data or indicators at least sometimes (Table A2.2). Around 40 percent of the respondents reported having sometimes or always referred to the WTO's TPR for their country. 56 percent of the respondents said they drew on in-house (IMF) research. A major portion of the respondents did not use resources from other agencies. This could reflect the fact that some institutions that work on trade only cover certain countries or regions. For example, of the respondents who worked on an advanced country, 71 percent said they always or sometimes used country-specific reports from the OECD and 62 percent said they always or sometimes used research from the OECD.

IMF staff considered their missions reasonably well informed on trade policy issues

11. For each trade policy issue covered by their mission, respondents were asked the basis for the mission's specific position on the issue, choosing one or more from among the following options: analytical/empirical studies (in-house or external) specific to the country; analytical/empirical studies not specific to the country (e.g., based on cross-country panel-data analyses); views of other agencies (e.g., the World Bank, WTO, OECD); pressure from another IMF member; the "Washington consensus"; or other grounds (Question 14). Across the six trade policy issues, the most common basis was analytical/empirical studies, followed by views of other agencies (Figure A2.4). Interestingly, 12 percent of respondents (across all grades) cited the Washington consensus as the sole basis for their mission's position on each trade policy issue that was covered.

12. For missions that covered one or more trade policy issues, respondents were asked to characterize the relevant trade policy qualifications of their mission team (Question 17). Fully 75–90 percent of respondents rated their team's qualifications as strong or fair, meaning that at least one member of the team had clear expertise or had some analytical or operational background in the area (Figure A2.5). Only 6–21 percent considered their team's trade policy expertise to be weak or superficial. In focus

group interviews, several staff members pointed out that PDR's Trade Policy Division provided more than adequate backstopping on trade policy issues even if no trade economist was on the mission team.

IMF staff felt that their trade policy advice was on average well received by country authorities and at least somewhat effective in promoting good policies

13. For missions that covered one or more trade policy issues, respondents were asked to characterize the extent of the authorities' agreement with the mission's position on each issue (Question 18). For the most part, respondents felt that there was strong to moderate agreement by the authorities with the mission's position (Figure A2.6). This was reflected across all trade policy issues, with the strongest agreement in customs administration, an area where the IMF advice is often provided through TA. Fewer than 10 percent of respondents reported little to no agreement on any one policy issue.

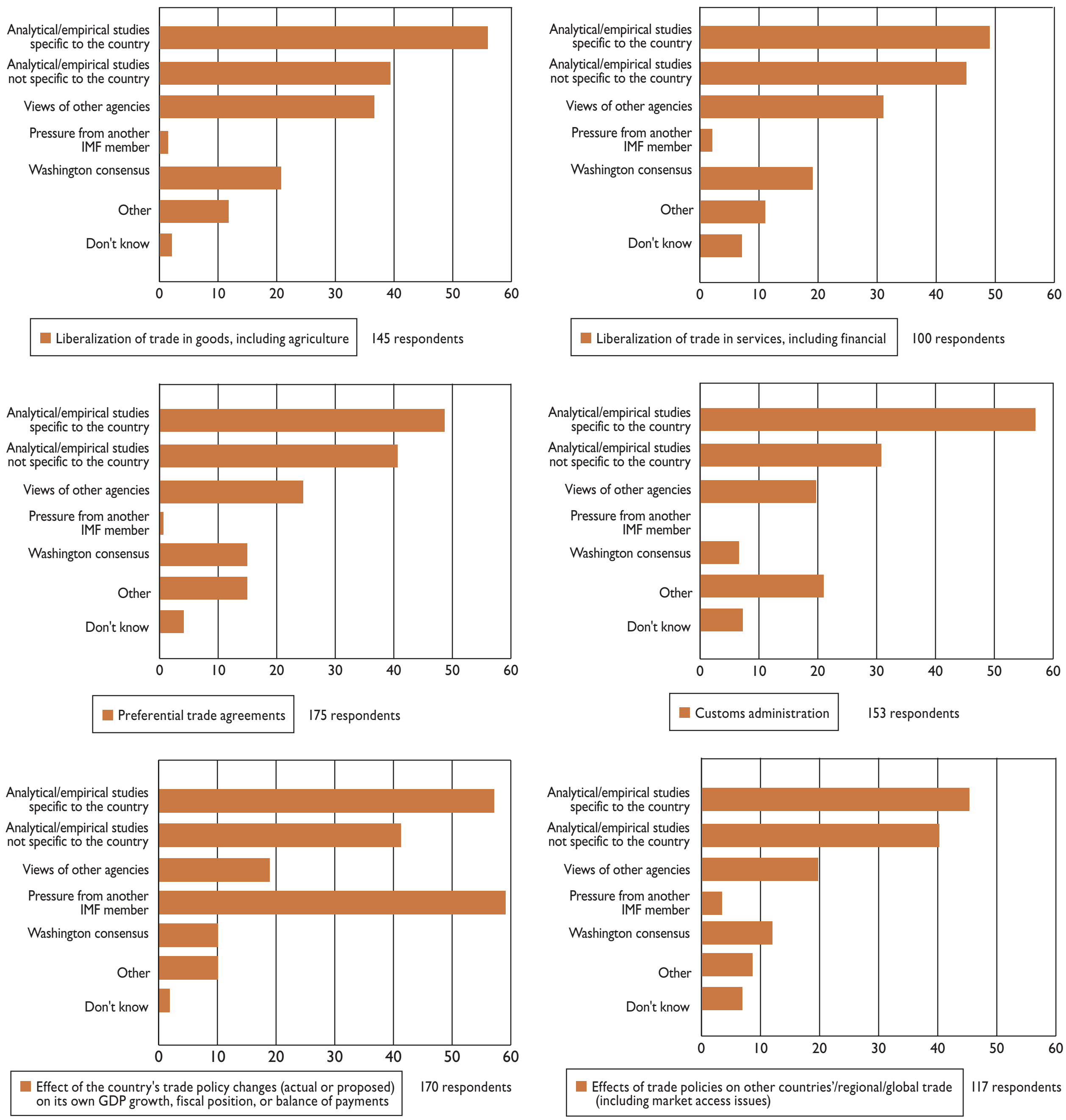
14. Respondents were then asked to rate the effectiveness of their mission's trade policy advice. For missions that covered one or more trade policy issues, respondents were asked, to the best of their knowledge, how the authorities responded to the mission's advice on each issue (Question 21). 57–69 percent of respondents reported that their mission's

Table A2.2. Use of Resources from the World Bank and Other Institutions
(Percent of respondents)

	World Bank	WTO	OECD	Regional Development Banks	UNCTAD	Other
Percent of 308 respondents reporting using:						
Country-specific reports on trade policy						
Always	20	11	2	5	N/A	3
Sometimes	33	28	13	27	N/A	19
Never	11	18	35	25	N/A	17
Research (e.g., working papers) on trade policy						
Always	11	3	2	2	N/A	2
Sometimes	34	15	15	24	N/A	16
Never	12	30	31	25	N/A	21
Trade policy data or indicators						
Always	15	7	1	N/A	4	1
Sometimes	29	20	14	N/A	17	16
Never	15	25	33	N/A	29	22

Figure A2.4. Basis for the Mission's Specific Positions on Trade Policy Issues

(Percent of respondents for each issue)



advice was largely or partially implemented (Figure A2.7). The results were similar for advanced and developing country missions.

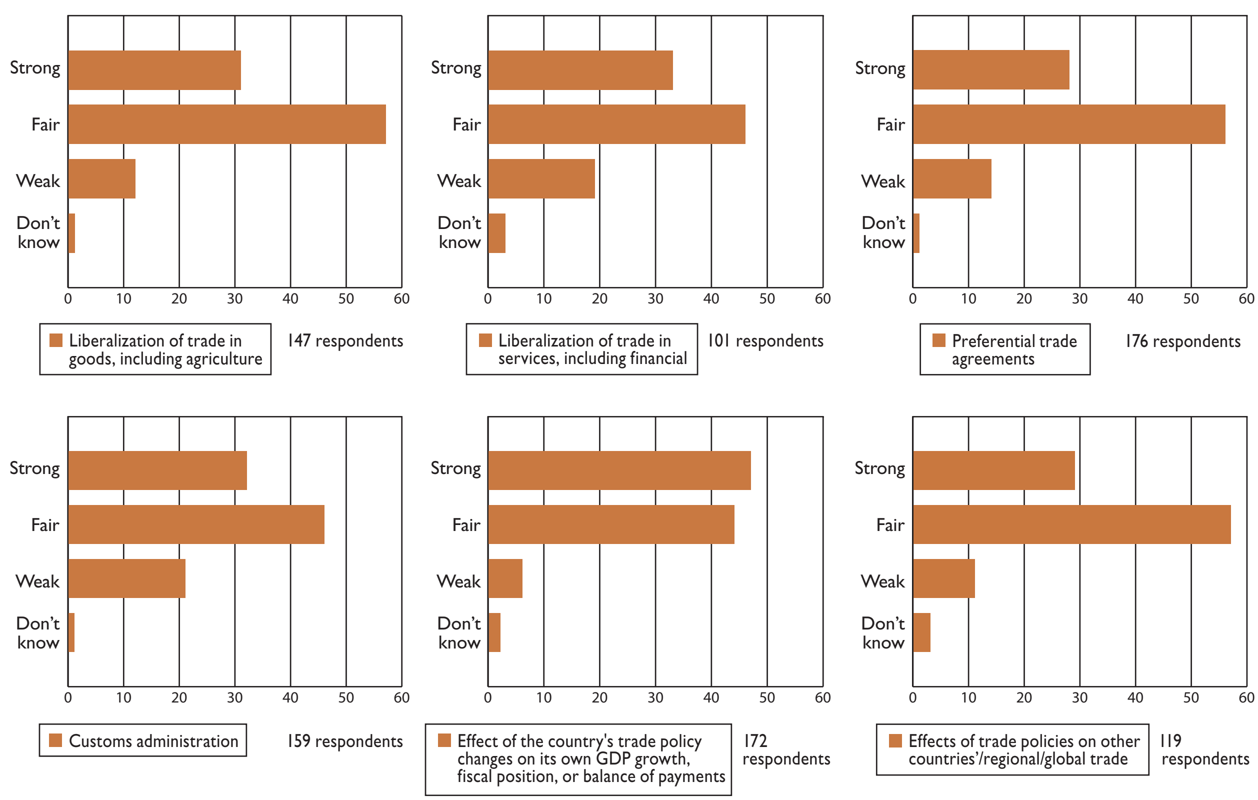
15. Respondents were also asked if, on average, their mission's advice on trade policy issues—regardless of whether the authorities implemented or agreed with them—was effective in enhancing the debate on trade-macro linkages, promoting change in the right direction and/or preventing change in the wrong direction (Question 22). The majority of respondents believed that their mission's advice was highly or somewhat effective (Figure A2.8).

The IMF has a role to play in trade policy issues

16. Finally, all survey respondents were asked what the IMF's role in trade policy should be, given the IMF's institutional mandate and putting aside any resource constraints that the IMF may face (Question 23). Respondents were asked to choose one or more options among the following: advising on how to liberalize trade policies; calling attention in Article IV consultations to instances when countries change trade policies in a protectionist direction; assessing effects of trade policy changes on fiscal revenues, the balance of payments, growth, and (for trade in services) financial sector stability; occasional coverage of global or regional trade policy issues in the *WEO* or *REO*s; advocating multilateral trade liberalization through public outreach efforts; other activities; or no role at all. Only 2 percent of the 383 respondents said that the IMF should have no role in trade policy. The majority of respondents felt that the IMF has some role to play, especially in assessing the effects of trade policy changes on fiscal revenues, the balance of payments, growth, and financial sector stability; calling attention in Article

Figure A2.5. Qualifications of the Mission Team to Take Positions on Trade Policy Issues

(Percent of respondents for each issue)



IV consultations in instances where countries change policies in a protectionist direction; and occasionally covering global/regional trade policy issues in the *WEO* or *REO*s (Figure A2.9).

B. Survey of Country Officials

17. The objective of the survey was to obtain IMF member country officials' views on: the motivation for IMF missions to cover specific trade policy issues; the quality of IMF work on trade; the effectiveness or usefulness of IMF trade policy advice; and the role of the IMF with regard to trade policy.

Sample and response rate

18. Two surveys were sent to every IMF member country: one to the ministry of finance and one to the ministry of trade (or their equivalent agencies).[2] In total, 326 surveys were sent out. Country officials were asked to answer the survey questions based their experience with the IMF during 2005–07. If their ministry/government agency did not have active discussions with the IMF on trade policy during that period, they were directed to a subset of questions that were not country-specific. The survey was open from November 2008 to April 2009.

19. A total of 71 completed responses was received. Most of these (51) were from finance ministry officials (including two responses from central bank officials)—the Fund's traditional interlocutors. 20 responses came from trade ministry officials.

[2] Surveys were not sent to individual EU member countries. Instead, surveys were sent to the European Commission: one to the Directorate-General for Economic and Financial Affairs and one to the Directorate-General for Trade.

Figure A2.6. Extent of the Authorities' Agreement with the Mission's Position on Trade Issues
(Percent of respondents for each issue)

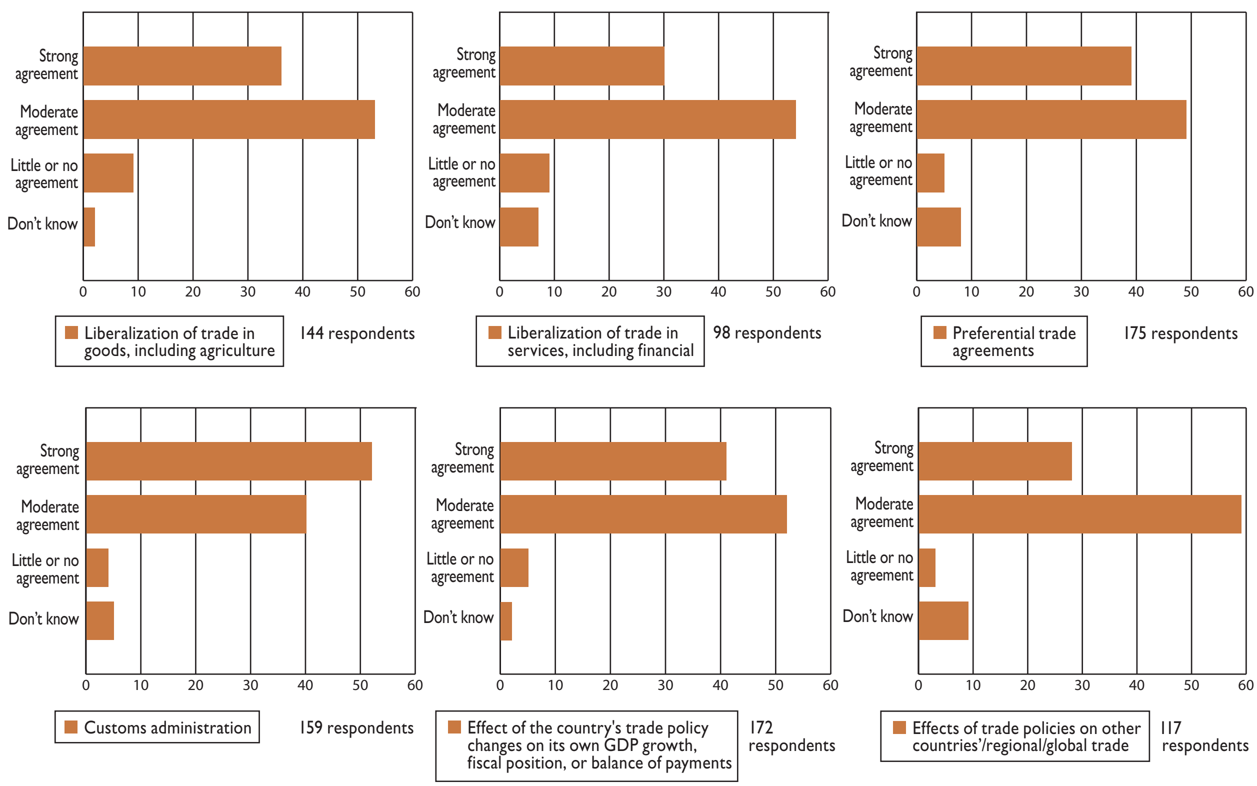


Figure A2.7. How the Authorities Responded to the Mission's Trade Policy Advice

(Percent of respondents for each issue)

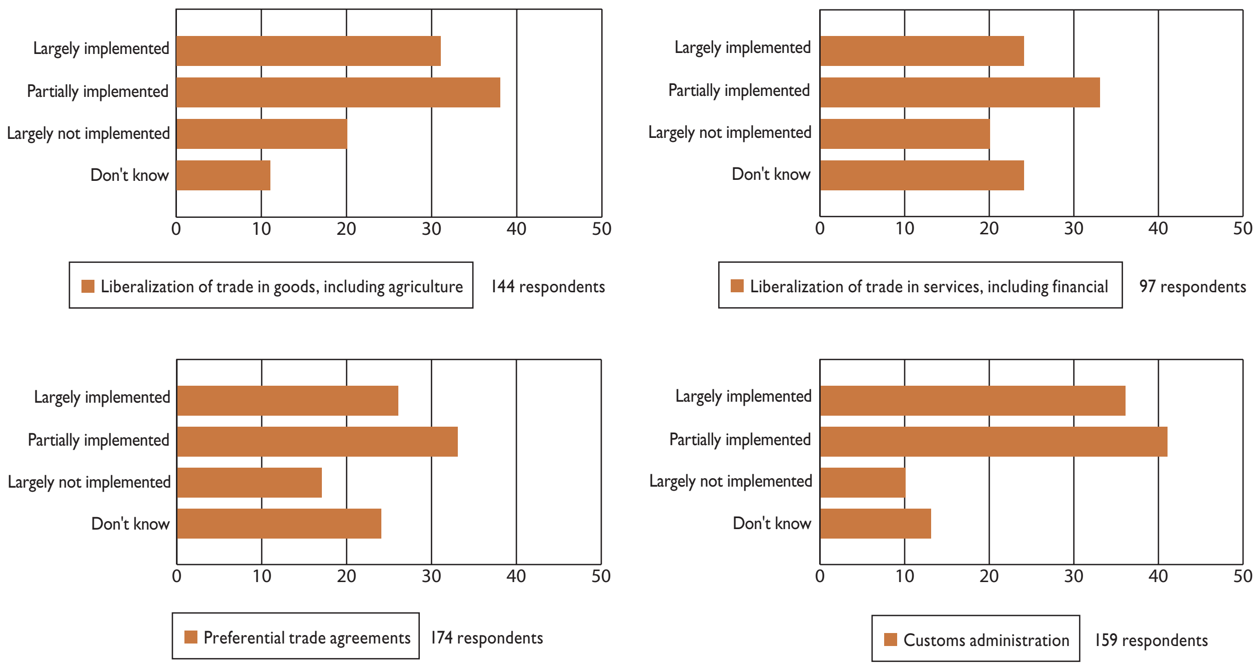


Figure A2.8. Perceived Effectiveness of the Mission's Trade Policy Advice

(Percent of respondents for each issue)

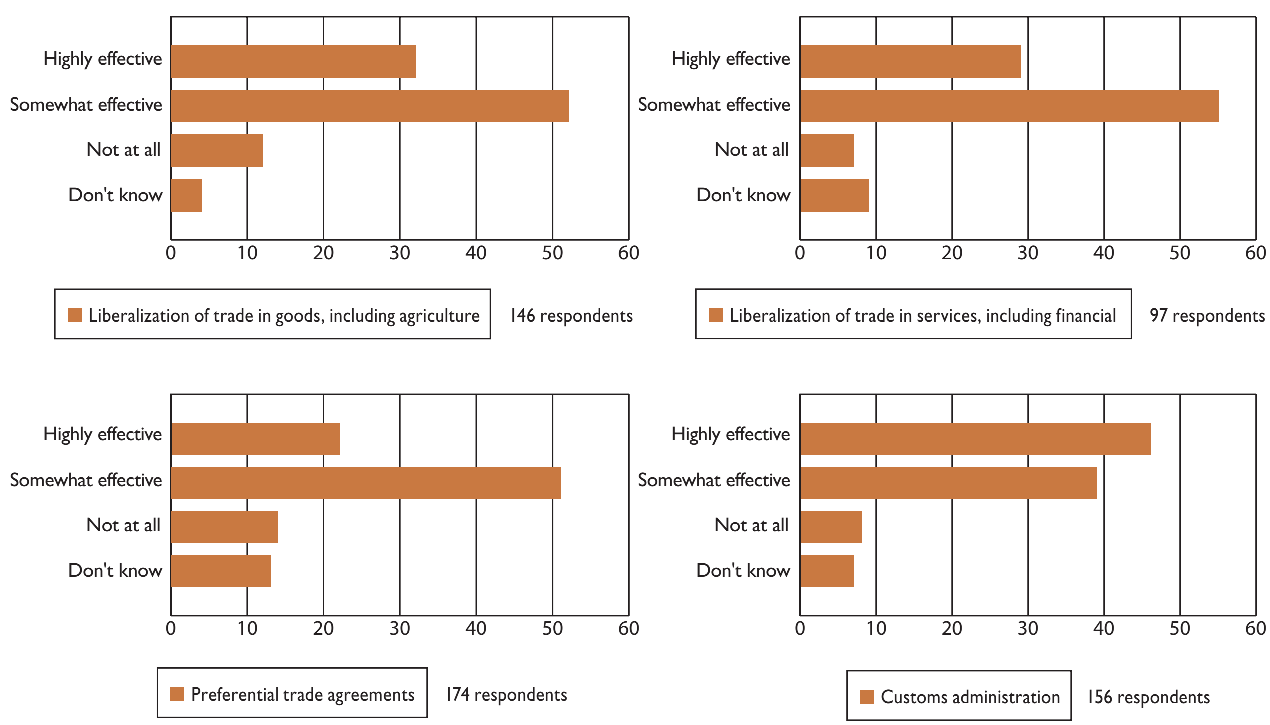
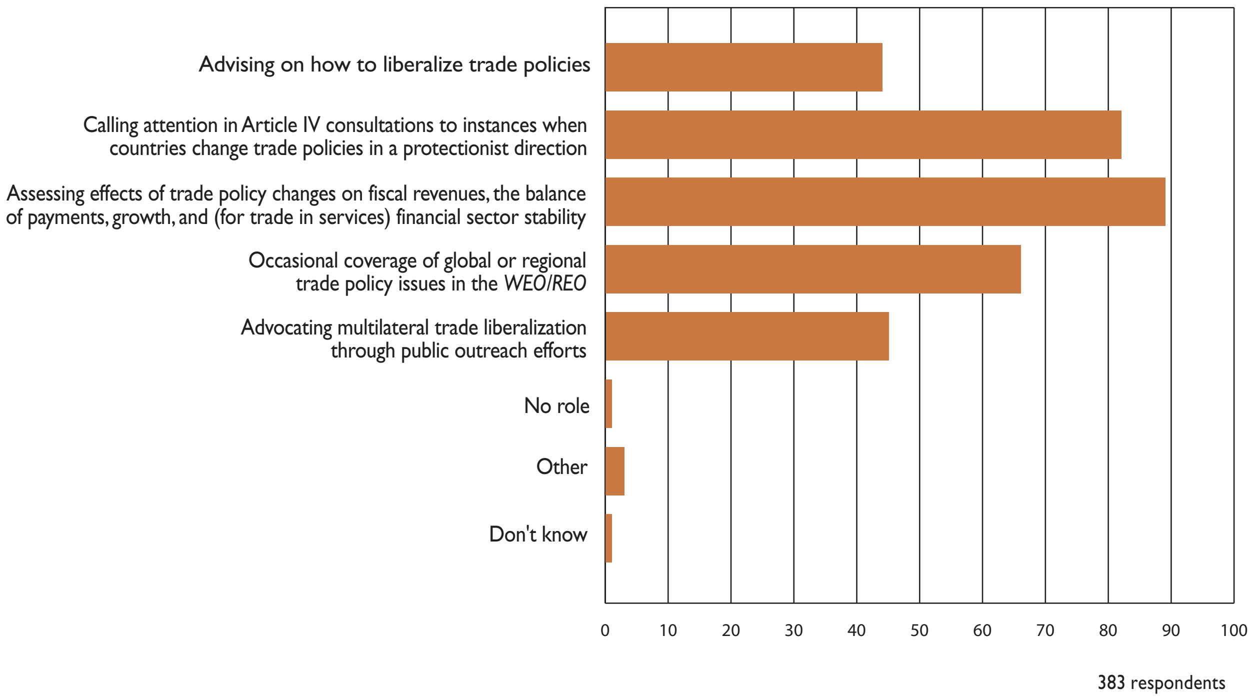


Figure A2.9. What Should the IMF's Role in Trade Policy Be?
(Percent of respondents)



Most of the responses (58) were from emerging and developing countries; only 12 responses came from advanced countries. The breakdown of responses by region (based on IMF area departments) was: 27 percent from the Asia-Pacific region, 21 percent each from Africa and the Western Hemisphere, 20 percent from Europe, and 11 percent from the Middle East and Central Asia.

20. The response rate was extremely low—less than 20 percent on average (28 percent for finance ministry officials and 12 percent for trade ministry officials). The low response rate is itself an indication of the extent to which the Fund has disengaged from trade policy issues in the last few years—many officials declined to participate in the survey on the grounds that they did not discuss trade policy with the IMF.

21. Among those officials who did answer the survey, 34 percent did not recall discussing any of the six trade policy issues with IMF missions during 2005–07. When trade policy issues were discussed, it was usually in the context of Article IV consultations. No trade ministry respondent recalled having had discussions with IMF TA or UFR missions. The trade policy issues that officials said they most commonly discussed with IMF missions were the effect of the country's trade policy changes on its macroeconomic variables (e.g., GDP growth, fiscal position, or balance of payments) and PTAs. (There was no appreciable difference between the types of trade policy issues discussed with the ministry of finance and the ministry of trade.)

22. Because of the low response rate, the results of the survey may not be representative of IMF membership as a whole and should be interpreted with caution.

Main findings

Macroeconomic and/or systemic effects seemed to be the main motivation for IMF missions to raise trade policy issues

23. When trade policy issues were discussed with the IMF mission, respondents were asked what they thought motivated the mission to raise the issue(s), choosing one or more from among the following options: the mission believed that the trade policy issue had important implications for the country's growth, fiscal, or balance of payments outcomes; the mission believed that the country's trade policies had systemically and/or regionally important effects; the mission had been asked by another IMF member country to raise the issue; the mission was

supporting the World Bank or other international institution which was taking the lead (Question 3). Most of the 48 respondents felt that the primary motivation for the IMF mission to raise the issue was that the issue had macroeconomic implications (Figure A2.10). This is consistent with the finding from the staff survey.

The IMF's trade policy advice was largely consistent with the World Bank's advice but not always consistent with the views of other institutions

24. For each trade policy issue discussed with the IMF, respondents were asked if IMF advice/conditionality/TA took into account their country's commitments to and ongoing negotiations in the WTO (Question 7) and if IMF advice was consistent with that from other institutions, including the World Bank (Question 8). More than 30 percent of the 25–32 respondents said the IMF took into account their WTO commitments most of the time (Table A2.3). The majority of respondents viewed the advice from the IMF and the World Bank as fully consistent across all trade policy issues. However, with regard to other institutions, the responses were split three ways among "fully consistent," "at times inconsistent," and "don't know." These findings suggest that interinstitutional cooperation may not be working as well as it could be but the small number of responses precludes a firm conclusion.

Respondents generally found IMF missions to be open-minded and adequately qualified to discuss trade policy issues

25. Based on their experience during 2005–07, respondents were asked to characterize the main approach of the IMF mission to trade policy issues in their country (Question 4). Almost two-thirds of the 48 respondents believed that the IMF was open-minded (Figure A2.11).

26. Respondents were then asked to rate the IMF mission's expertise on the trade policy issues that were discussed: strong (at least one member of the IMF team had clear expertise in the area); fair (at least one member of the IMF team had some analytical or operational background); or weak (no member of the IMF team seemed to have more than a superficial background) (Question 5). More than three-fourths of respondents for each issue rated the IMF mission team's qualifications as strong or fair. Again, the small number of responses for each issue precludes any firm conclusions; however, the findings here broadly reflect the findings from a similar question in the staff survey.

27. Next, for each trade policy issue discussed with the IMF, respondents were asked to rate the quality of the IMF mission's analytical assessment of

Figure A2.10. Perceived Motivation of the Mission to Raise Trade Policy Issues
(Percent of respondents for each issue)

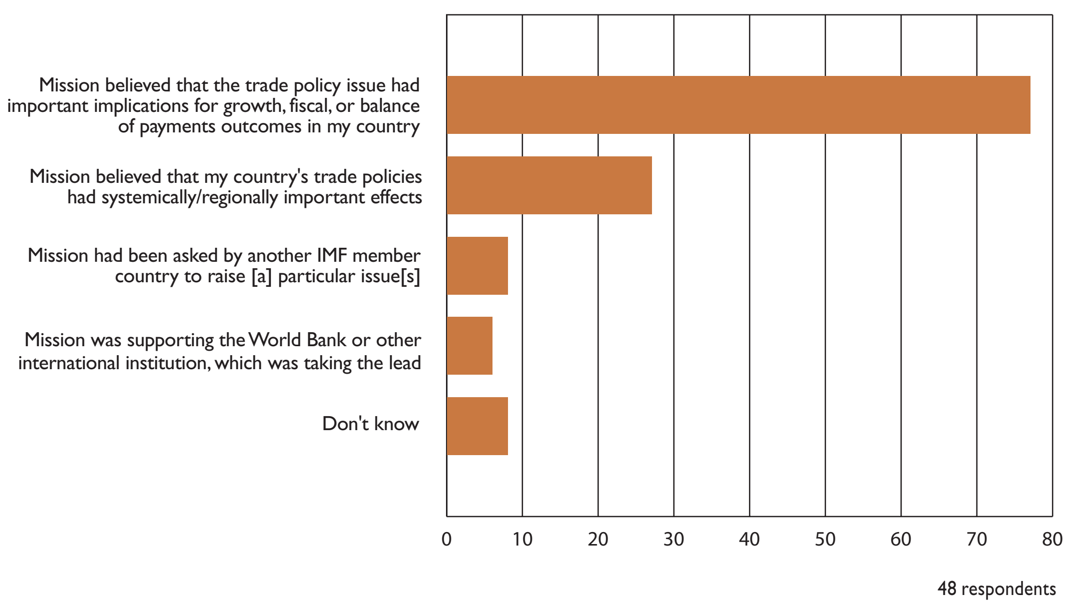


Table A2.3. Comparison of IMF Advice with Advice from the World Bank and Other Institutions

(Percent of respondents for each issue)

	Liberalization of Trade in Goods, Including Agriculture (26 respondents)	Liberalization of Trade in Services, Including Financial (25 respondents)	Preferential Trade Agreements (32 respondents)	Customs Administration (30 respondents)
Vis-à-vis the World Bank's trade policy advice, percent of respondents reporting:				
IMF advice was fully consistent	42	36	38	53
IMF advice was at times inconsistent	8	4	6	7
IMF advice was mostly inconsistent	0	0	0	0
Don't know	15	12	19	13
World Bank did not discuss trade policy	35	36	35	27
Vis-à-vis trade policy advice from other institutions, percent of respondents reporting:				
IMF advice was fully consistent	23	24	16	27
IMF advice was at times inconsistent	23	24	25	30
IMF advice was mostly inconsistent	0	4	0	0
Don't know	31	24	28	23
Other institutions did not discuss trade policy	15	16	22	17
Vis-à-vis commitments to or negotiations at the WTO, percent of respondents reporting:				
IMF advice took these into account most of the time	31	40	31	37
IMF advice took these into account sometimes	27	20	28	27
IMF advice rarely took these into account	4	4	9	3
Don't know	15	20	16	20
Country is not a WTO member	23	16	22	10

the macroeconomic effects of trade policy changes it advocated (Question 9). The results vary across trade policy issues. For customs administration, most of the 29 respondents rated the quality of the IMF's analysis as high (Figure A2.12). For the other issues, 30–40 percent of respondents (the majority in the case of PTAs and trade in services) said that no assessment was provided by the IMF mission for the trade policy changes it advocated. For the more traditional goods trade liberalization issues, almost 40 percent of the 26 respondents rated the quality of the mission's analysis as high.

28. Respondents were also asked if they thought the IMF was evenhanded in its trade policy advice or if it pressed most strongly in a particular group of countries (advanced, middle-income, or less-developed) for removing restrictions on trade (Question 11). More than a third of the respondents said they did not know (Figure A2.13). Of the rest, the largest proportion felt the IMF pressed less-developed countries most strongly on trade liberalization. Only 17 percent of respondents felt that the IMF showed no bias.

Figure A2.11. Main Approach of the Mission to Trade Policy Issues

(Percent of respondents)

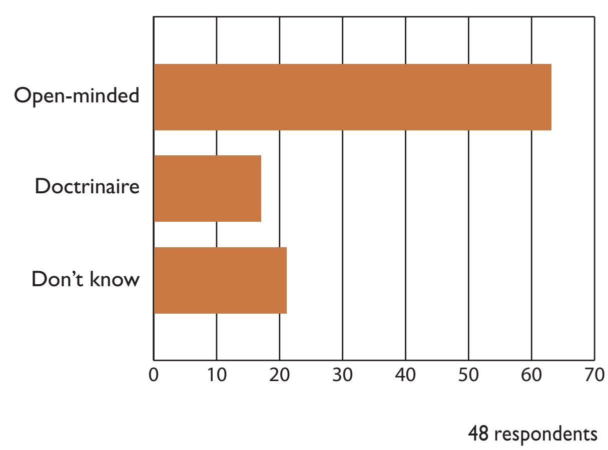
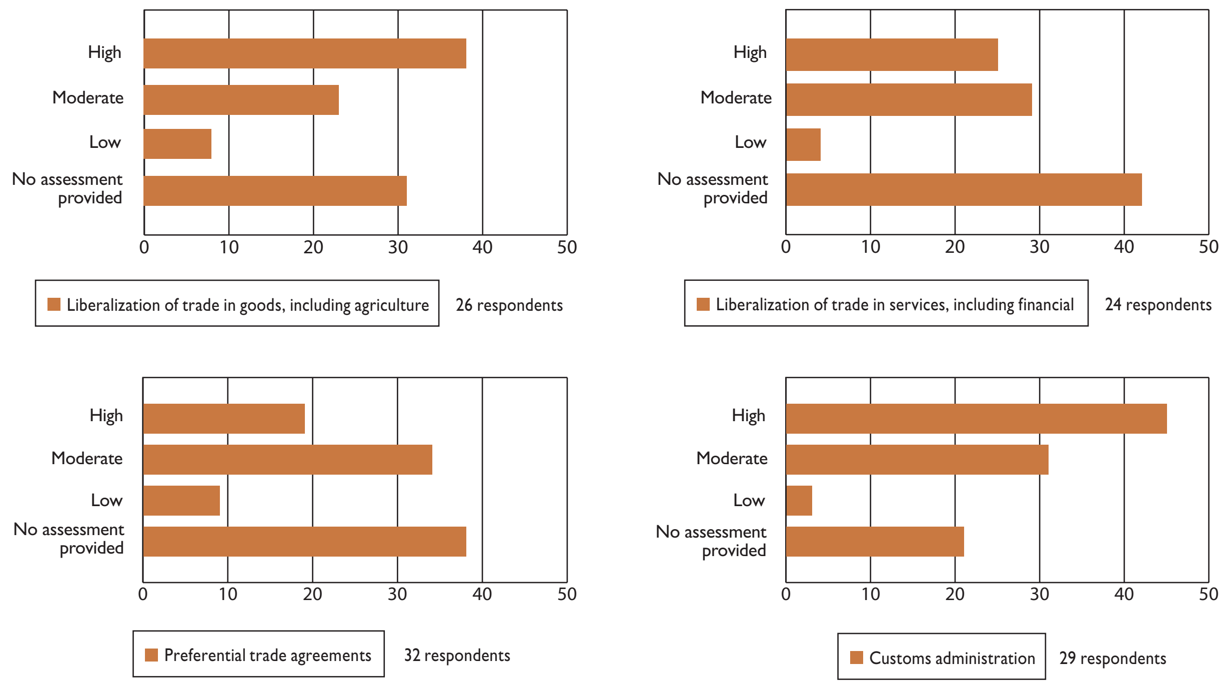


Figure A2.12. Quality of the Mission's Analytical Assessment of the Macroeconomic Effects of Trade Policy Changes It Advocated

(Percent)



The IMF's trade policy advice mostly met with agreement and was found to be at least moderately effective in promoting good policies

29. For each trade policy issue discussed with the IMF mission, respondents were asked to characterize the extent of their ministry's agreement with the mission's position (Question 12). In general, across all issues, respondents felt that there was strong to moderate agreement with the mission; very few believed there was little or no agreement (Figure A2.14). These findings broadly matched those from the staff survey.

30. For each trade policy issue discussed with the IMF mission, respondents were asked how effective the mission's recommendations/conditionality/TA was in enhancing the debate—within or outside the government—and/or promoting a change of policy (Question 15). For issues related to the liberalization of trade in goods and services and to customs administration, more than half of the respondents considered the IMF's advice to be moderately to very effective. For PTA issues, the majority of respondents were unable to provide a view on the Fund's effectiveness in enhancing the policy debate (Figure A2.15).

31. As to whether the IMF's advocacy of multilateral trade liberalization (e.g., through speeches and

Figure A2.13. Which Group of Countries Did the IMF Press More Strongly for Removing Restrictions on Trade?

(Percent of respondents)

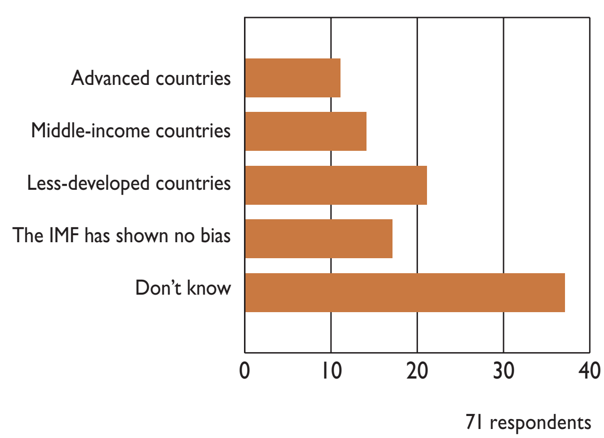
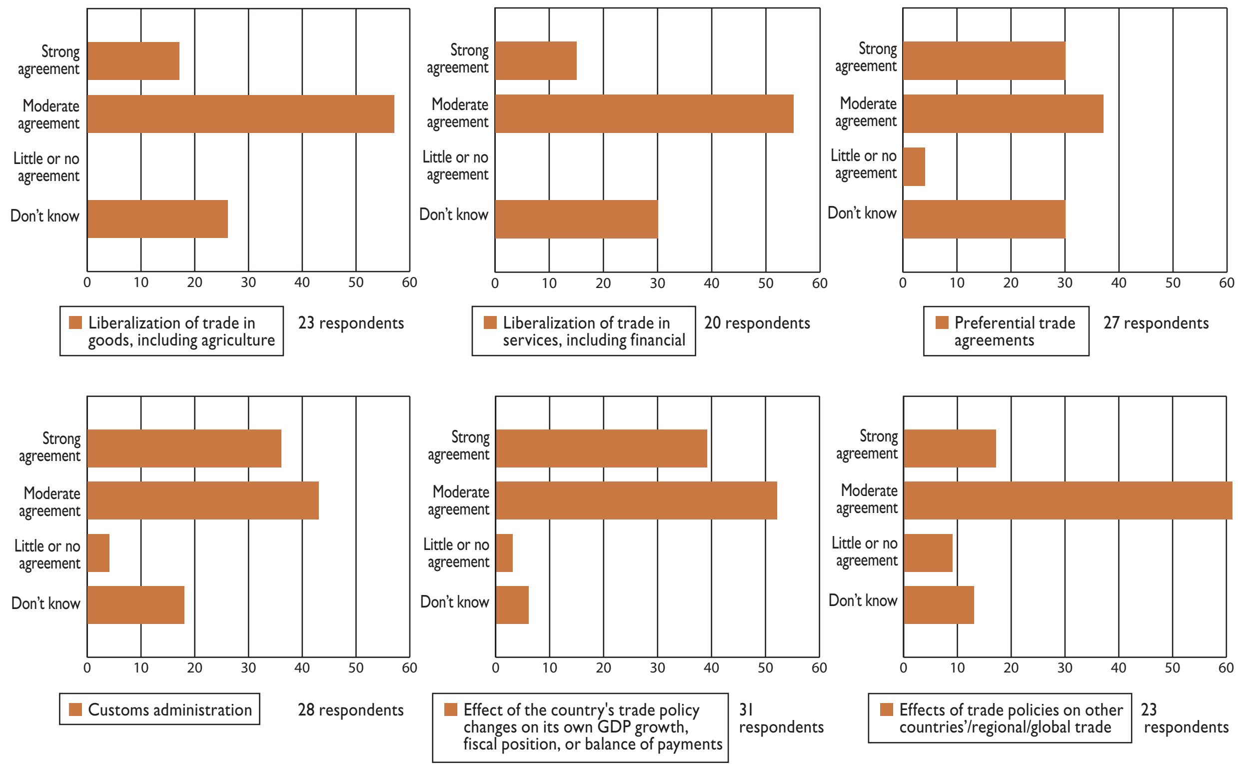


Figure A2.14. Extent of the Authorities' Agreement with the Mission's Position on Trade Issues

(Percent of respondents for each issue)



press statements by high-level IMF staff and through IMF publications such as the *WEO* and *REO*s) was worthwhile, more than three-fourths of all respondents answered "yes" or "probably so." Only 14 percent felt that the IMF's advocacy was not or probably not worthwhile (Figure A2.16).

The IMF has a role to play in trade policy issues, but it is not the only player

32. All survey respondents were asked what the IMF's role in trade policy should be, choosing one or more possibilities from the same options as provided in the staff survey (Question 19). None of the respondents thought that the IMF had no role to play. Three-fourths of the respondents felt that the IMF had a role to play in assessing the effects of trade policy changes on fiscal revenues, the balance of payments, growth, and financial sector stability (Figure A2.17). The responses were similar to those from the staff survey, except that a much higher proportion of the surveyed staff (82 percent) than of the surveyed country officials (41 percent) felt that the IMF should call attention in Article IV consultations to instances when countries changed trade policies in a protectionist direction.

33. Finally, all respondents were asked whether another institution would have been well placed to fill the gap if the IMF had not addressed the trade policy issues it did (Question 20). Across all trade policy issues, the overwhelming majority of respondents said that another institution possibly could have addressed the issue in the absence of the Fund; only 6–13 percent felt that no other institution could have filled the gap (Figure A2.18).

Figure A2.15. Effectiveness of the Mission's Trade Policy Advice in Enhancing the Debate and/or Promoting a Change of Policy
(Percent)

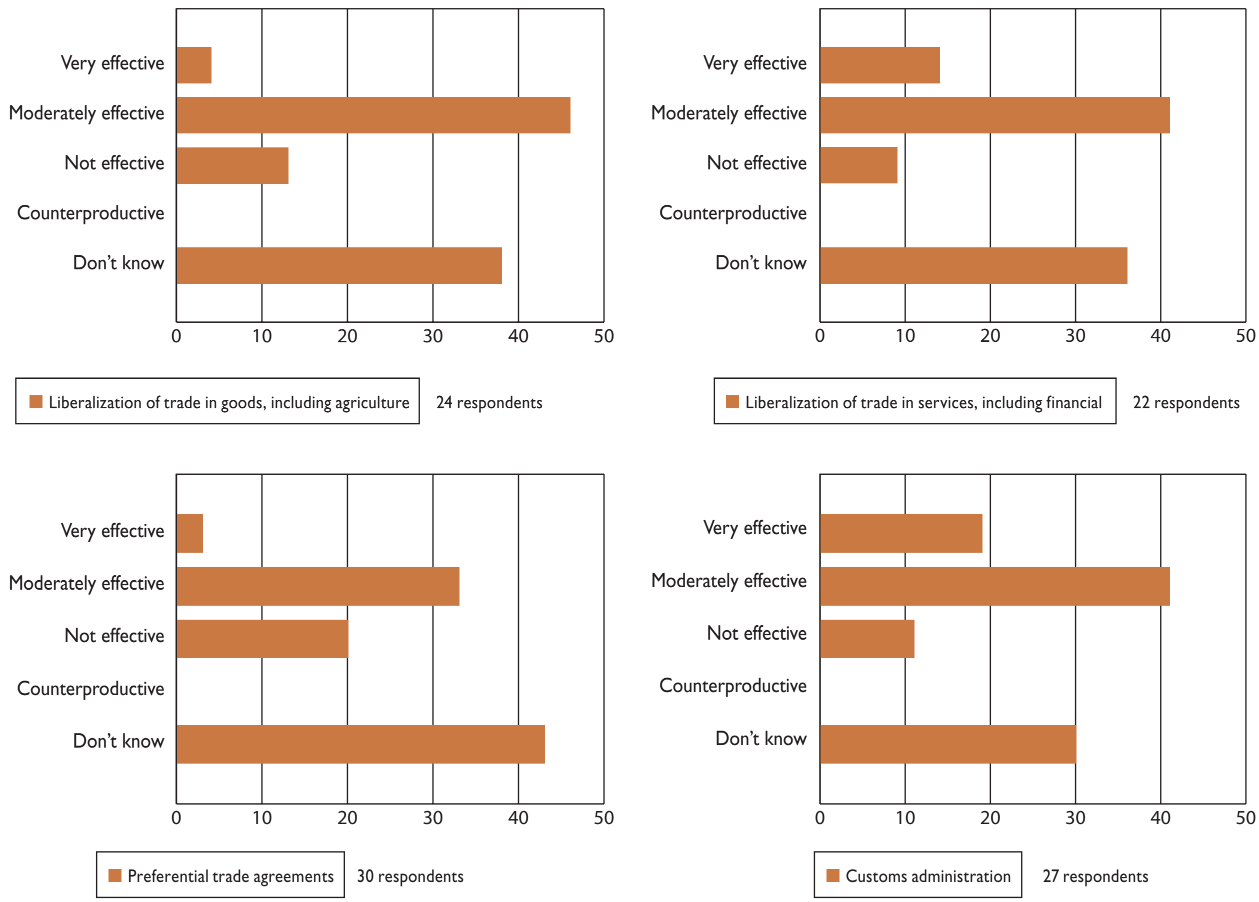


Figure A2.16. Is the IMF's Advocacy of Multilateral Trade Liberalization Worthwhile?
(Percent of respondents)

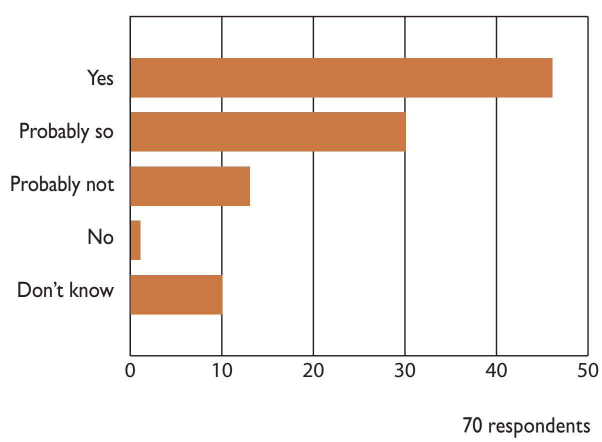


Figure A2.17. What Should the IMF's Role in Trade Policy Be?

(Percent of respondents)

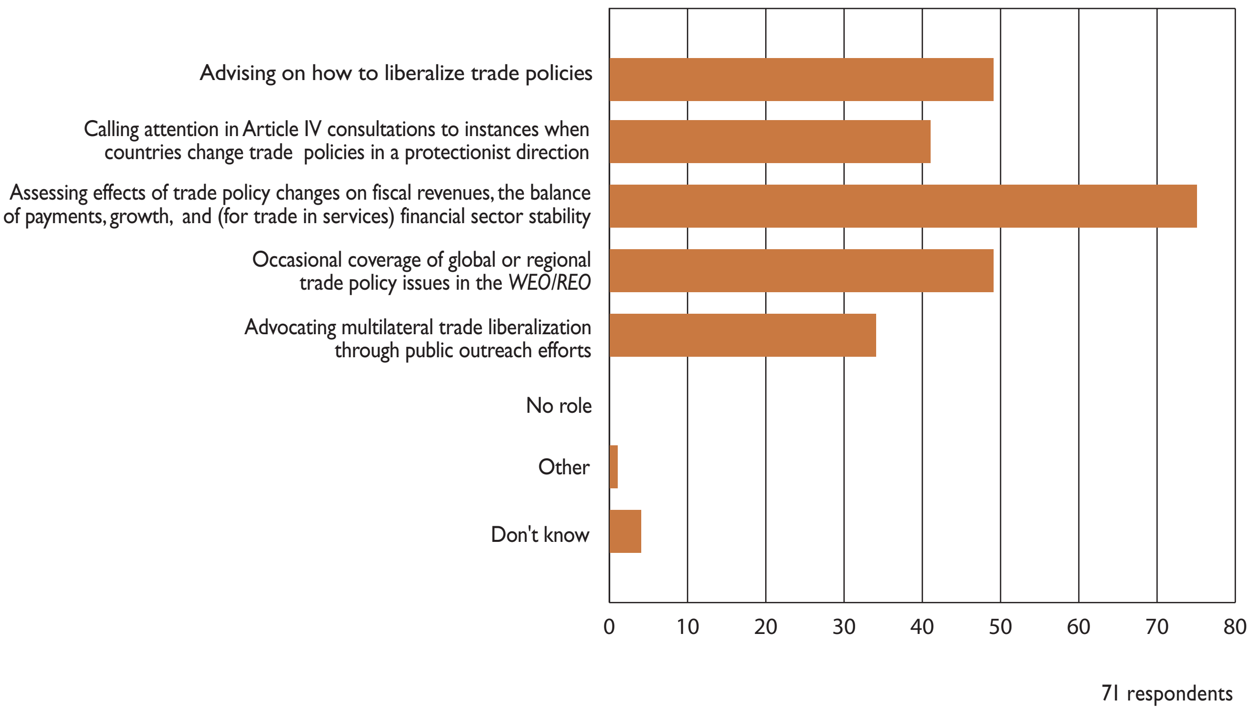
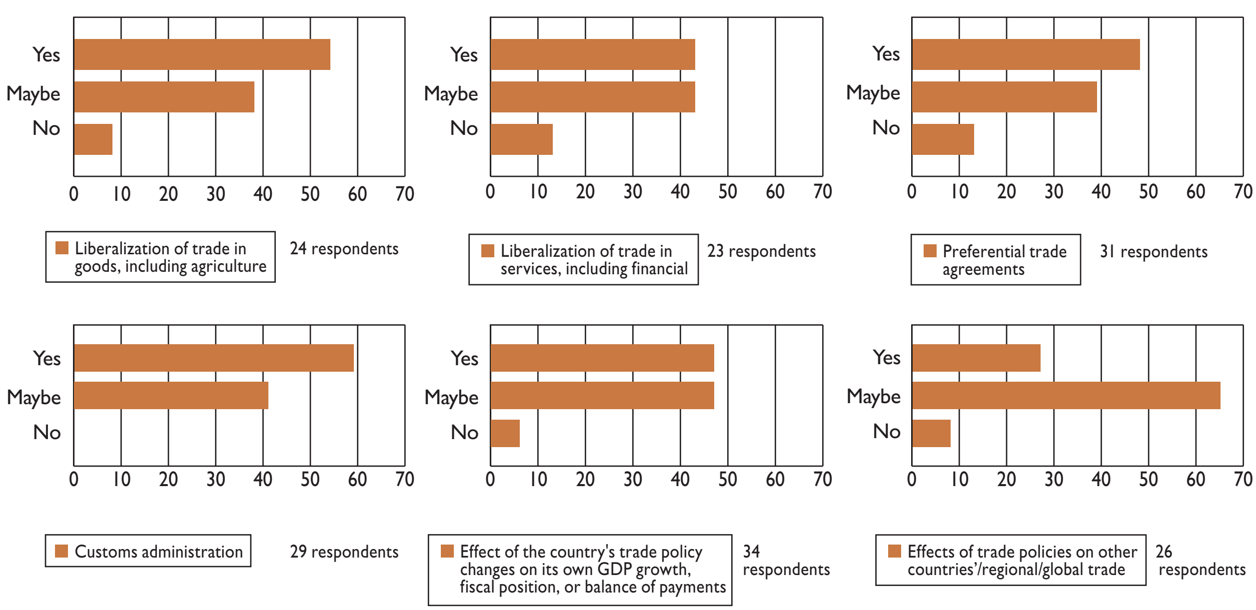


Figure A2.18. Would Another Institution Have Been Well Placed to Fill the Gap if the Mission Had Not Addressed the Trade Issue?

(Percent of respondents for each issue)



STAFF SURVEY QUESTIONNAIRE

This survey gathers information on your views on the IMF's involvement in international trade policy issues during 2005–07. Conclusions and recommendations from the evaluation are dependent on receiving high participation rates from A14–B5 staff in functional and area departments—*regardless of whether you personally were actively involved in trade policy issues.*

The survey should take no more than 20 minutes to complete. The survey is constructed to direct you to parts that are relevant to your experience as revealed by your specific responses to questions early in the survey. Information provided will be strictly confidential: it will be used only by ICF International (ICF) and the Independent Evaluation Office (IEO) of the IMF to evaluate the IMF's approach to international trade policy issues. Findings will be published only in summary form without attribution to any individual, mission, or department.

Trade policy issues referred to in this survey comprise:

(i) the design and implementation of trade policies narrowly defined (policies that directly and primarily aim to influence the quantity and/or value of a country's imports and exports of goods and services—exchange rate policy is not considered in this survey);

(ii) the assessment of the macroeconomic effects of these narrowly defined trade policies.

A. QUESTIONS FOR CLASSIFICATION PURPOSES

1. Did you make more than one visit during 2005–2007 to a single country as a member (including head) of a surveillance, use of Fund resources (UFR), or technical assistance (TA) mission?

a—"Yes (go to questions 2a, 3a, and 4)," b—"No (go to question 2b)"

2a. Of the countries that you visited more than once during 2005–07, which did you visit most recently? Please answer all of the questions in this survey with respect to your experience working on this country.

[Drop-down menu of countries]

2b. Were you a Fund staff member for more than one year during 2005–07?

a—"Yes (go to question 3b)," b—"No (go to questions 6 and 23)"

3a. Which department were you in the first time you visited the country specified above?

a—"AFR," b—"APD," c—"EUR," d—"MCD," e—"WHD," f—"PDR," g—"FAD," h—"MCM," i—"RES"

3b. Please indicate the department in which you spent the most amount of time during 2005–07. Please then answer the remaining questions on the basis of your average overall Fund experience over the past three years.

a—"AFR," b—"APD," c—"EUR," d—"MCD," e—"WHD," f—"PDR," g—"FAD," h—"MCM," i—"RES"

4. Please indicate the purpose(s) of the missions to the specified country. *(Please check all that apply.)*

a—"Article IV surveillance," b—"Use of Fund resources (UFR)," c—"Technical Assistance (TA)," d—"FSAP"

5. Do you recall ever having had discussions with [Country] during 2005–07 in any of the following areas? *(Please check all that apply.)*

a—"Yes," b—"No"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g. free trade agreements, customs unions, partnership agreements, preferential schemes)

(iv) Customs administration
(v) Effects of the country's trade policy changes (actual or proposed) on its own GDP growth, fiscal position or balance of payments
(vi) Effects of trade policies on other countries'/regional/global trade (including market access issues)

B. YOUR EXPERTISE ON TRADE POLICY ISSUES

6. On which trade policy issues do you feel that your expertise is strong enough to provide substantive advice to countries on trade policy issues and respond confidently to any critics? *(Please check one for each issue.)*

a—"Fully confident," b—"Reasonably confident," c—"Not confident"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of the country's trade policy changes (actual or proposed) on its own GDP growth, fiscal position or balance of payments
(vi) Effects of trade policies on other countries'/regional/global trade (including market access issues)

C. ADEQUACY OF GUIDANCE ON HOW/ WHEN TO COVER TRADE POLICY ISSUES

7. Overall, do you feel you understood the circumstances in which your mission(s) should and should not have covered the following trade policy issues in [Country] during 2005–07? *(Please check one for each issue.)*

a—"Mostly," b—"Sometimes," c—"Rarely"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of the country's trade policy changes (actual or proposed) on its own GDP growth, fiscal position or balance of payments
(vi) Effects of trade policies on other countries'/regional/global trade (including market access issues)

8. How would you characterize the reasons your mission(s) covered the following trade policy issues in [Country] at any point during 2005–07? *(Please check all that apply for each applicable issue.)*

a—"Macroeconomic/systemic implications," b—"Request from authorities,"
c—"Request from World Bank/other institution," d—"Request from management,"
e—"Request from other country's ED," f—"Other," g—"Don't know,"
h—"N/A (Mission did not address this issue)"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of the country's trade policy changes (actual or proposed) on its own GDP growth, fiscal position or balance of payments
(vi) Effects of trade policies on other countries'/regional/global trade (including market access issues)

9. How would you characterize the reasons your mission(s) decided not to raise one or more trade policy issues in [Country] during 2005–07? *(Please check all that apply for each applicable issue.)*

a—"No obvious macro linkages/systemic implications,"
b—"Mission lacked time/expertise/ resources," c—"World Bank took the lead on the issue,"

d—"Potential conflict with WTO commitments/negotiations,"
e—"Management instruction not to raise issue," f—"Board member requested not to raise issue,"
g—"Other," h—"Don't know," i—"N/A (Mission did address this issue)"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g. free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of the country's trade policy changes (actual or proposed) on its own GDP growth, fiscal position or balance of payments
(vi) Effects of trade policies on other countries'/regional/global trade (including market access issues)

10. In 2005, the Board encouraged staff to increase attention to the impact of trade restrictions in services, including financial services. Were you aware of this guidance during 2005–07?

a—"Yes," b—"No (go to question 12)"

11. How would you characterize your response in [Country] during 2005–07 to the request for greater involvement in trade in services (including financial) issues? *(Please check one.)*

a—"Active," b—"Moderate," c—"None," d—"Don't know"

D. COOPERATION BETWEEN IMF AND OTHER INSTITUTIONS

12. How would you describe your cooperation on trade policy issues for [Country] with staff from other institutions during 2005–07? *(Please check one for each row.)*

a—"Close/frequent," b—"Occasional," c—"Negligible,"
d—"N/A ([Country] does not get advice from this institution)"

World Bank staff

(i) Surveillance
(ii) UFR work
(iii) TA
(iv) FSAP
(v) Research

WTO Secretariat staff

(vi) Surveillance
(vii) UFR work
(viii) TA
(ix) FSAP
(x) Research

Other (e.g., OECD, BIS, regional development banks)

(xi) Surveillance
(xii) UFR work
(xiii) TA
(xiv) FSAP
(xv) Research

13. Which of the following resources did your mission(s) to [Country] draw upon at some point during 2005–07? *(Please check one for each row.)*

a—"Always," b—"Sometimes," c—"Never," d—"Don't know," e—"N/A"

Country-specific reports on trade policy by:

(i) WTO (Trade Policy Review)
(ii) World Bank (Country Focus/Economic Sector Work)
(iii) OECD
(iv) Regional development banks
(v) Other

Research (e.g., working papers, occasional papers) on trade policy by:

(vi) IMF
(vii) WTO Secretariat
(viii) World Bank
(ix) OECD
(x) Regional development banks
(xi) Other

Trade policy data/indicators compiled by:

(xii) WTO Secretariat
(xiii) World Bank (e.g., overall trade restrictiveness indices)
(xiv) OECD
(xv) UNCTAD
(xvi) Other

E. TOOLS AND RESOURCES DEVOTED TO ANALYSIS OF TRADE POLICY

14. What was the basis for the mission's specific positions on trade policy issues in [Country] during 2005–07? *(Please check all that apply for each applicable issue.)*

a—"Analytical/empirical studies (in-house or external) specific to [Country],"
b—"Analytical/empirical studies not specific to [Country] (e.g., panel-data analyses),"
c—"Views of other agencies (e.g., World Bank, WTO, OECD),"
d—"Pressure from another IMF member," e—"Washington Consensus," f—"Other,"
g—"Don't know," h—"N/A (Mission did not address this issue)"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of the country's trade policy changes (actual or proposed) on its own GDP growth, fiscal position or balance of payments
(vi) Effects of trade policies on other countries'/regional/global trade (including market access issues)

15. How much did you use the Trade Restrictiveness Index (TRI) compiled in PDR as background for the work on [Country] during 2005-07? *(Please check one.)*

a—"Often," b—"Occasionally," c—"Rarely," d—"Never," e— "Don't know"

16. Based on your experience in [Country] during 2005–07, how difficult was it for the mission to identify trade policy changes that moved [Country] in a protectionist direction? *(Please check one.)*

a—"Not difficult," b—"Somewhat difficult," c—"Very difficult," d—"Don't know/didn't try"

17. How would you describe the qualifications *your mission team* to [Country] had during 2005–07 to take positions on the following trade policy issues? *(Please check one for each applicable issue.)*

a—"Strong: at least one member of the team had clear expertise in this area,"
b—"Fair: at least one member of the team had some analytical background,"
c—"Weak: no member of the team seemed to have more than a superficial background,"
d—"Don't know," e—"N/A (Mission did not address this issue)"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of the country's trade policy changes (actual or proposed) on its own GDP growth, fiscal position or balance of payments
(vi) Effects of trade policies on other countries'/regional/global trade (including market access issues)

F. DIALOGUE WITH AUTHORITIES

18. How would you characterize the extent of the authorities' agreement with the mission's positions on the following trade policy issues in [Country] during 2005–07? *(Please check one for each applicable issue.)*

a—"Strong agreement," b—"Moderate agreement," c—"Little or no agreement," d—"Don't know," e—"N/A (Mission did not address this issue)"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of the country's trade policy changes (actual or proposed) on its own GDP growth, fiscal position or balance of payments
(vi) Effects of trade policies on other countries'/regional/global trade (including market access issues)

19. How would you characterize the reasons for any disagreements some or all of the authorities had with the staff's position on the following trade policy issues in [Country] during 2005–07? *(Please check one for each applicable issue.)*

a—"Difference in basic economic analysis," b—"Domestic political considerations," c—"Administrative constraints on implementation," d—"Conflicts with broader trade policy strategy (e.g., WTO negotiations)," e—"Other," f—"Don't know," g—"N/A (Mission did not address this issue)"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of the country's trade policy changes (actual or proposed) on its own GDP growth, fiscal position or balance of payments
(vi) Effects of trade policies on other countries'/regional/global trade (including market access issues)

20. How would you characterize any domestic resistance in [Country] from outside the government to the thrust of the mission's advice during 2005–07 in the following areas on trade policy? *(Please check one for each applicable issue.)*

a—"Strong and broadly based in the population," b—"Strong, but concentrated in certain groups," c—"Moderate," d—"Little or none," e—"Don't know," f—"N/A (Mission did not address this issue)"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration

G. EFFECTIVENESS

21. When the mission(s) discussed trade policy issues in [Country] during 2005–07, to the best of your knowledge, how did the authorities respond? *(Please check one for each applicable issue.)*

a—"Largely implemented," b—"Partially implemented," c—"Largely not implemented," d—"Don't know," e—"N/A (Mission did not address this issue)"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration

22. On average, do you think the positions of your mission(s) on trade policy issues in [Country] during 2005–07 (regardless of whether the authorities implemented or agreed with them) were effective in enhancing the debate on trade-macro linkages, promoting change in the right direction and/or preventing change in the wrong direction? *(Please check one for each applicable issue.)*

a—"Highly," b—"Somewhat," c—"Not at all," d—"Don't know," e—"N/A (Mission did not address this issue)"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration

H. OPTIMAL ROLE FOR IMF IN TRADE POLICY ISSUES

23. Putting aside resource constraints that the IMF may face but recognizing the IMF's institutional mandate ("to promote the expansion and balanced growth of world trade"), what do you think the IMF's role in trade policy should be? *(Please check all that apply.)*

a—"Advising on how to liberalize trade policies,"
b—"Calling attention in Article IV consultations to instances when countries change trade policies in a protectionist direction,"
c—"Assessing effects of trade policy changes on fiscal revenues, the balance of payments, growth, and (for trade in services) financial sector stability,"
d—"Occasional coverage of global or regional trade policy issues in the *WEO/REO*,"
e—"Advocating multilateral trade liberalization through public outreach efforts,"
f—"No role," g—"Other," h—"Don't know"

GOVERNMENT OFFICIALS SURVEY QUESTIONNAIRE

This survey relates mainly to any discussions you had on trade policy issues with IMF missions [Article IV surveillance, use of Fund resources (UFR), and technical assistance (TA)] during 2005–07. It also includes some general questions on your views about the IMF's role in trade policy issues.

The survey should take no more than 20 minutes of your time to complete. The information requested will be strictly confidential: it will be used only by ICF International and the Independent Evaluation Office (IEO) of the IMF to evaluate the IMF's approach to international trade policy issues. Findings will be published only in summary form without attribution to any individual or country.

The electronic version of this survey is constructed to direct you to parts of the survey that are relevant to your experience as revealed by your specific responses to questions early in the survey. If you are using the hard copy (either because you prefer it or you are using a translation) boxes where you can indicate that a question is not applicable to you are included.

The survey has been sent to two ministries/government agencies—the finance ministry and the trade ministry (or their functional equivalents)—in each country that is a member of the IMF. ICF will collect responses from each ministry in your country separately. As the head of one of these two ministries/government agencies, your input is essential to this evaluation whether or not your ministry/government agency was actively involved in discussions on trade policy with IMF staff.

Trade policy issues referred to in this survey comprise:

(i) the design and implementation of trade policies narrowly defined (policies that directly and primarily aim to influence the quantity and/or value of a country's imports and exports of goods and services—exchange rate policy is not considered in this survey);

(ii) the assessment of the macroeconomic effects of these narrowly defined trade policies.

If your country had a lending arrangement with the IMF during 2005–07, please answer the questions based on your overall experience with IMF missions during the period, taking into account that trade policy issues may have been discussed or TA received even when no trade policy conditionality was finally agreed. If your country did not have a lending arrangement, please answer the questions based on your overall experience during 2005–07 with surveillance and/or TA missions. If trade policy was discussed on only one occasion during 2005–07, please answer the questions with respect to that single occasion.

A. QUESTIONS FOR CLASSIFICATION PURPOSES

1. Which ministry/government agency do you represent?

a—"Ministry of Finance (or equivalent government agency),"
b—"Ministry of Trade (or equivalent government agency)," c—"Other (please specify)"

2. Do you recall ever having had discussions with any type of IMF mission during 2005–07 in the following areas? *(Please check all that apply.)*

a—"Article IV Surveillance," b—"Use of Fund Resources (UFR)," c—"Technical Assistance (TA)," d—"None"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of your country's trade policy changes (actual or proposed) on its growth, fiscal position and balance of payments
(vi) Effects of your country's trade policy on other countries (including market access issues)

B. IMF STAFF EXPERTISE ON AND APPROACH TO TRADE POLICY ISSUES

3. When an IMF mission raised trade policy issues with your ministry/government agency during 2005–07, *what do you think* motivated the IMF mission to raise them? *(Please check all that apply.)*

a—"Mission believed the trade policy issue had important implications for growth, fiscal, or balance of payments outcomes in my country,"
b—"Mission believed my country's trade polices had systemically/regionally important effects,"
c—"Mission had been asked by another IMF member country to raise [a] particular issue[s],"
d—"Mission was supporting the World Bank or other international institution, which was taking the lead," e—"Don't know"

4. The IMF's mandate is to "promote the expansion and balanced growth of world trade." Within this mandate, from your experience during 2005–07, how would you characterize the *main approach* of the IMF missions to trade policy issues in your country? *(Please check one.)*

a—"Open-minded," b—"Doctrinaire," c—"Don't know"

5. How would you characterize the IMF mission's expertise on trade policy issues you discussed with them during 2005–07? *(Please check one for each issue listed.)*

a—"Strong: at least one member of the team had clear expertise in this area,"
b—"Fair: at least one member of team had some analytical or operational background,"
c—"Weak: no member of the team seemed to have more than a superficial background,"
d—"Don't know,"
e—"My ministry/government agency did not discuss this issue with the IMF mission"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of your country's trade policy changes (actual or proposed) on its growth, fiscal position and balance of payments
(vi) Effects of your country's trade policy on other countries (including market access issues)

6. How would you characterize the IMF mission's contribution to the discussions of each of the following trade policy issues with your ministry/government agency any time during 2005–07? *(Please check one for each issue listed.)*

a—"Mission's own views featured at least once,"
b—"Mission sought information, but did not express views,"
c—"Mission only repeated views of other institutions (such as the World Bank),"
d—"No mission covered this issue with my ministry/government agency"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
v) Effects of your country's trade policy changes (actual or proposed) on its growth, fiscal position and balance of payments
(vi) Effects of your country's trade policy on other countries (including market access issues)

C. COOPERATION BETWEEN IMF AND OTHER INSTITUTIONS CONCERNED WITH TRADE POLICY ISSUES

7. In your experience during 2005–07, did IMF advice/conditionality/TA on trade policies adequately take into account your country's commitments to and ongoing negotiations in the WTO? *(Please check one for each issue listed.)*

a—"Most of the time," b—"Sometimes," c—"Rarely," d—"Don't know," e—"Not a WTO member"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration

8. In your experience during 2005–07, how did IMF advice/conditionality/TA on trade policy relate to that of other international institutions? *(Please check one for each issue listed.)*

a—"Fully consistent," b—"At times inconsistent," c—"Mostly inconsistent," d—"Don't know," e—"We did not discuss trade policy with this institution," f—"No mission covered this issue"

World Bank

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration

Any other institution

(v) Liberalization of trade in goods, including agriculture
(vi) Liberalization of trade in services, including financial
(vii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(viii) Customs administration

D. QUALITY OF TRADE POLICY ADVICE FROM IMF MISSION

9. How would you rate the quality of the IMF mission's analytical/quantitative assessment of the macroeconomic effects (on the balance of payments, fiscal position, or GDP growth) of the *trade policy changes it advocated* during 2005–07? *(Please check one for each issue listed.)*

a—"High," b—"Moderate," c—"Low," d—"No assessment provided," e—"Mission did not advocate any trade policy changes"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration

10. How would you rate the quality of the IMF mission's analytical/quantitative assessment of the macroeconomic effects (on the balance of payments, fiscal position, or GDP growth) of any *trade policy changes your country implemented during 2005–07*—whether the IMF mission supported or did not support them? *(Please check one for each issue listed.)*

a—"High," b—"Moderate," c—"Low," d—"No assessment provided," e—"No trade policy changes with potential macro effects were made"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration

11. A key aim of the IMF is to be even-handed in its advice to countries. In your opinion, in which group of countries did the IMF press most strongly for removing restrictions on trade (in merchandise, agriculture, or services, including financial services) during 2005–07?

**a—"Advanced countries," b—"Middle-income countries," c—"Less-developed countries,"
d—"The IMF has shown no bias," e—"Don't know"**

E. EFFECTIVENESS OF IMF MISSION'S ADVICE ON TRADE POLICY

12. How would you characterize the extent of your ministry/government agency's agreement with the IMF mission's positions on trade policy? *(Please check one for each issue listed.)*

**a—"Strong agreement," b—"Moderate agreement," c—"Little or no agreement," d—"Don't know,"
e—"Mission did not provide advice on this aspect of trade policy"**

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of your country's trade policy changes (actual or proposed) on its growth, fiscal position and balance of payments
(vi) Effects of your country's trade policy on other countries (including market access issues)

13. How would you characterize the reasons for any disagreements your ministry/government agency had with the IMF mission's position on the following trade policy issues during 2005–07? *(Please check all that apply.)*

**a—"Difference in basic economic analysis," b—"Domestic political considerations,"
c—"Administrative constraints on implementation,"
d—"Conflicts with broader trade policy strategy (e.g., WTO negotiations)," e—"Other,"
f—"Don't know, g—"No disagreement/Mission did not provide advice on this issue"**

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of your country's trade policy changes (actual or proposed) on its growth, fiscal position and balance of payments
(vi) Effects of your country's trade policy on other countries (including market access issues)

14. How would you characterize any resistance from outside your government to the thrust of the IMF mission's advice during 2005–07 in the following areas of trade policy? *(Please check one for each issue listed.)*

**a—"Strong and broadly based in the population," b—"Strong, but concentrated in certain groups,"
c—"Moderate," d—"Little or none," e—"Don't know,"
f—"Mission did not provide advice on this aspect of trade policy"**

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration

15. How effective was the IMF mission's trade policy recommendations/conditionality/TA in enhancing the debate—within or outside the government—and/or promoting a change of policy on trade policy issues? *(Please check one for each issue listed.)*

**a—"Very effective," b—"Moderately effective," c—"Not effective,"
d—"Counterproductive," e—"Don't know," f—"IMF mission did not address this issue"**

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)

(iv) Customs administration

16. In 2004 the IMF introduced the Trade Integration Mechanism (TIM) to augment lending to countries suffering from preference erosion as a result of multilateral trade liberalization. Regardless of whether your country participated in this mechanism, how would you characterize its contribution to increasing support for multilateral trade liberalization? *(Please check one.)*

a—"Not aware TIM existed," b—"Very important," c—"Somewhat important,"
d—"Not important," e—"No views on its contribution"

17. Do you think that the IMF's advocacy of multilateral trade liberalization (e.g., through speeches and press statements by high-level IMF staff and IMF publications such as the *World Economic Outlook* and *Regional Economic Outlooks*) is worthwhile? *(Please check one.)*

a—"Yes," b—"Probably so," c—"Probably not," d—"No," e—"Don't know"

F. OPTIMAL ROLE FOR IMF IN TRADE POLICY ISSUES

18. Putting aside resource constraints that the IMF may face and recognizing the IMF's institutional mandate, what do you think the IMF's role in trade policy should be? *(Please check all that apply.)*

a—"Advising on how to liberalize trade policies,"
b—"Calling attention in Article IV consultations to instances when countries change trade policies in a protectionist direction,"
c—"Assessing effects of trade policy changes on fiscal revenues, the balance of payments, growth, and (for trade in services) financial sector stability,"
d—"Occasional coverage of global or regional trade policy issues in the *WEO/REO*,"
e—"Advocating multilateral trade liberalization through public outreach efforts,"
f—"No role," g—"Other," h—"Don't know"

19. In your view, if the IMF mission (surveillance, UFR, or TA) had not addressed the trade policy issues that it did during 2005–07, would another international institution (e.g., the WTO, World Bank, OECD) or regional institution (e.g., regional development bank) have been well placed to fill the gap? *(Please check one for each issue listed.)*

a—"Yes," b—"Maybe," c—"No," d—"IMF did not address this issue in my country"

(i) Liberalization of trade in goods, including agriculture
(ii) Liberalization of trade in services, including financial
(iii) Preferential trade agreements (e.g., free trade agreements, customs unions, partnership agreements, preferential schemes)
(iv) Customs administration
(v) Effects of your country's trade policy changes (actual or proposed) on its growth, fiscal position and balance of payments
(vi) Effects of your country's trade policy on other countries (including market access issues)

Background Documents

Background Document

I

The Legal Mandate[1]

A. Introduction

1. The legal mandate for the IMF's involvement in international trade policy issues is articulated in Article I(ii) of the Articles of Agreement, which specifies that a purpose of the IMF is:

> ...to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

2. This mandate is broad and less specific about the precise nature of the IMF's role in trade policy issues than about its role in exchange rate policy. The term "facilitate" in Article I(ii) encompasses any actions or policies that will encourage or ease the expansion of international trade.[2] And, unlike the IMF's mandate for exchange rate policy, this general mandate for the promotion of international trade is not spelled out in much more detail in other provisions of the Articles of Agreement.

3. Though the IMF has a broad mandate to facilitate the expansion of trade, it does not have regulatory jurisdiction over international trade.[3] Thus, though it can prohibit exchange restrictions on payments and transfers for current international transactions, the Fund cannot prohibit its members from imposing trade restrictions. As noted by Siegel (2002), "while a restriction on payments for particular imports is covered by Fund jurisdiction, an outright ban on the imports (i.e., the underlying transaction) is not. Fund members are obliged to avoid restrictions that are not maintained consistently with the Fund's Articles, but the Articles impose no such obligation with respect to trade restrictions."

4. Distinguishing between trade and exchange restrictions was central to delineating the jurisdiction of the IMF. The IMF has interpreted the concept of restrictions on payments and transfers for current international transactions, as set out in Article VIII, Section 2(a), using a technical criterion, rather than by considering the motive or economic effect of the restrictions.[4] By contrast, an interpretation that considered the authorities' motivation (such as for balance of payments reasons) would have encompassed trade restrictions. Likewise, since trade and exchange restrictions can have comparable effects on the balance of payments, an interpretation that considered their economic effect would have extended IMF jurisdiction to trade restrictions. In the event, the Fund has defined "restrictions" in Article VIII, Section 2(a) by a technical principle that applies to the financial aspect of "whether it [the restriction] involves a direct governmental limitation on the availability or use of exchange as such," making a clear distinction between the exchange and the underlying trade transaction.[5]

5. Despite acceptance inside and for the most part outside the IMF that the IMF has a mandate to engage in trade policy issues, some external critics have argued otherwise. Akyüz (2005) views the IMF's trade-facilitating role as relating to its function of promoting "a stable system of exchange rates and payments" as a means of ensuring "a predictable trading environment." He therefore argues that the IMF is "trespassing in trade policy" when it engages in trade policy issues, which are "a matter for multilateral

[1] This chapter has benefited from the insights in Annex I in IMF (2005). However, it reflects entirely the views of the IEO and not those of the Executive Board or Legal Department of the IMF.

[2] As noted by Gold (1986), "[t]he nuance of the word…'facilitate' in Article I expresses the idea of encouraging or easing and not controlling" the expansion of international trade as a purpose of the IMF.

[3] Regulatory jurisdiction or authority is "understood in the sense of requiring, proscribing, validating and invalidating practices" (Gold, 1986), "with the consequence that a member is in violation of its obligations if it applies a measure that the organization fails to approve or expressly disapproves" (Gold, 1975).

[4] Article VIII, Section 2(a), which gives the IMF regulatory jurisdiction over restrictions on payments and transfers of current international transactions, states that "…no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions."

[5] IMF (2006), Decision No. 1034 (60/27). Gold (1986) discusses the debate surrounding the interpretation of the restrictions on payments and transfers for current international transactions.

negotiations elsewhere in the global system." Woods (2006) and Saner and Guilherme (2007b) contend that trade liberalization is beyond the core legal mandate of the IMF.

6. The broad mandate for the IMF's role in trade policy issues has largely been interpreted within key modalities for specific activities of the IMF: Article IV, which governs surveillance; Article V, which requires that IMF financial support and technical assistance be consistent with its purposes as delineated in Article I; and Article X, which governs IMF cooperation with other international organizations.

B. Surveillance

7. The mandate for trade policy advice in surveillance is also quite general. Article IV (Obligations Regarding Exchange Arrangements) requires the IMF to oversee the international monetary system and monitor members' compliance with the general obligations specified in Article IV, Section 1. These obligations include that each member "direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability" and "seek to promote stability by fostering orderly economic and financial conditions." This comes alongside obligations related to exchange and exchange rate policies, also specified in Article IV.

8. From an economist's perspective, this mandate involves both a passive and an active role in the surveillance of trade policy issues. The passive role, suggested in the 1977 and 2007 Surveillance Decisions, is that the IMF should consider the implications of trade policies in assessing the appropriateness of a country's exchange rate regime and its macroeconomic and financial prospects.[6] The active role, suggested in Article IV, Sections I(i) and I(ii), involves inter alia the provision of advice on trade policies that will promote growth and external stability.[7]

9. Surveillance of trade policy in practice has also aimed to discourage actions that entail adverse cross-country spillovers. The Executive Board has called for surveillance of trade policies of systemically important countries if these policies have a global or regional impact, even if they do not hamper the country's own macroeconomic prospects. Article IV does not call for assessing such direct cross-country impacts of a country's trade policies; specifically, the Article does not specify obligations to conduct economic and financial policies in a manner that does not adversely impact another member's economy. (This contrasts with the Article IV obligations on exchange rate policies, where members have "a duty not to manipulate exchange rates in order to gain a competitive advantage" (IMF, 2004: Appendix I). However, Article XII, Section 8 and Article I(i) permit the IMF to discuss issues that are important for the IMF, but do not fall within the scope of surveillance. "Stated differently, while they [such spillover effects] are discussed in the context of an Article IV consultation, they are not the subject of surveillance under Article IV" (IMF, 2004).[8]

10. The IMF's interpretation of the mandate for surveillance of trade policy is not without its critics. Saner and Guilherme (2007a) argue that Article IV suggests a narrow role for IMF surveillance of trade policy issues. They note that IMF "surveillance activities ought to fall under the microcosm of exchange measures and policies taken by the Fund membership." Therefore, "generic trade measures,… unless specifically enacted for balance of payments reasons, fall totally outside of the scope of Article IV" and are "an objectionable legal amplification of the Fund's mandate under Article IV."

C. Conditionality

11. The mandate for applying conditionality to trade policies is somewhat more direct. Article V, Section 3 (Conditions Governing Use of the Fund's General Resources) empowers the IMF, consistent with the purposes outlined in Article I, to adopt policies on the use of its resources to help members resolve balance of payments difficulties. Article I(v) states that the IMF should make its resources temporarily available to members, subject to adequate safeguards, to provide them "with the opportunity to correct maladjustments in their balance of payments, without resorting to measures destructive of national

[6] The 1977 Decision on Surveillance Over Exchange Rate Policies and the 2007 Decision on Bilateral Surveillance over Members' Policies (which replaced the 1977 Decision in June 2007) note that "[i]n its surveillance...the Fund shall consider the following developments as among those which would require thorough review and might indicate the need for discussion with a member: [one such development is] the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments."

[7] As noted in Gold (1986), "'economic policies' and 'economic conditions' [for promoting growth and stability] in Article IV, Sections I(i) and I(ii) could be taken to imply concern with trade policies."

[8] This discussion of the mandate for IMF surveillance notes that the legal basis for the discussion of issues outside the scope of surveillance is Article I(i), which states that one of the purposes of the IMF is "to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems." Further, it notes that Article XII, Section 8 permits the IMF "to communicate its views informally to any member on any matter arising" under the Articles. Also see Annex I in IMF (2005).

or international prosperity."[9] Some external commentators interpret these articles as mandating conditions to prevent the intensification of trade restrictions, but not conditions with other objectives.

12. The IMF, however, interprets this mandate as providing the basis for two types of trade policy conditionality: a continuous performance criterion prohibiting trade restrictions for balance of payments reasons and structural trade policy reforms. The IMF has noted that trade measures that are "destructive of national or international prosperity" are more likely to worsen maladjustments in the balance of payments and less likely to restore the external viability that is the objective of the IMF's financial support. Such trade measures also make it more likely that the use of IMF resources will not be temporary (IMF, 2005). Gold (1986) states that "the IMF would not be observing the injunction to apply adequate safeguards if it concentrated exclusively on the measures and policies that were within its regulatory authority [such as exchange restrictions] and ignored other measures and policies [such as trade restrictions] that had comparable effects on the balance of payments."

13. Some external commentators have criticized the IMF's imposition of structural trade policy conditions as extending beyond its mandate. Buira (2003) argues that structural trade policy measures are outside the IMF's core areas of competence and that the IMF should "keep itself within its original simplified mandate by giving advice and technical assistance within its areas of competence." Saner and Guilherme (2007a, 2007b) assert that "the establishment of 'adequate' solvency safeguards does not bear the same meaning as a legal carte blanche to demand all-encompassing structural reforms from a Fund member" particularly those beyond its core legal mandate. Therefore, they contend that "adequate solvency safeguards to address balance of payments problems should not extend to trade policies" and that the "Fund usurps its legitimacy [when it] engage[s] in much broader reforms that include trade liberalization."

[9] "These safeguards take various forms, such as limits on how much can be borrowed, conditions on the loans, measures to deal with misreporting or arrears, or 'safeguards assessments' of central banks" (IMF, 2008).

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Background Document

2 Cooperation Between the IMF and the WTO

A. Background

1. The creation of the WTO at the end of the Uruguay Round prompted the IMF to examine its role in trade policy issues and its relationship vis-à-vis this new institution. The Fund had developed an informal collaborative relationship with the secretariat of the General Agreement on Tariffs and Trade (GATT), focusing mainly on consultations about import restrictions that were adopted for balance of payments reasons. But the WTO's mandate extended beyond the agreement on trade in goods embodied in the GATT to agreements on trade in services and on intellectual property rights, as well as policies on dispute resolution and trade policy surveillance (Box 1).

2. Both institutions had a mandate for cooperation. Article X of the IMF's Articles of Agreement—which predated the WTO and, indeed, the GATT—called on the Fund to cooperate with "any general international organization and with public international organizations having specialized responsibilities in related fields." Article III:5 of the WTO Agreement was more specific, calling on the WTO to cooperate with the Fund (and the World Bank Group) "with a view to achieving greater coherence in global economic policymaking." The challenge was how to strengthen the collaboration that had existed between the Fund and the GATT, so as to avoid potential inconsistencies and conflicts.

3. After the creation of the WTO, the IMF refocused its existing infrastructure for liaising with the GATT to examine cooperation issues with the WTO. The Executive Board's Committee on Liaison with the Contracting Parties to the GATT (CGATT), which had been formed in 1950 to advise the Board on issues relating to the IMF's relationship with the GATT, was renamed the Committee on Liaison with the WTO (CWTO), and charged with helping to establish arrangements for the IMF's relationship with the WTO and advising the Board on issues relating to that relationship. The IMF's Office in Geneva, set up in 1965 to forge closer relations with the GATT and the United Nations Conference on Trade and Development (UNCTAD), was charged with liaising with the WTO (and other Geneva-based international organizations) in conjunction with the then Policy

Box 1. Scope of the WTO Agreement

The Agreement Establishing the World Trade Organization (or the WTO Agreement) mandated the WTO to "provide the common institutional framework for the conduct of trade relations among its members" in matters related to the following areas, included as annexes to the agreement:

- Trade in goods (Annex 1A: Multilateral Agreements on Trade in Goods)—incorporating the GATT 1994 plus agreements in 12 areas: (i) agriculture; (ii) sanitary and phytosanitary measures; (iii) textiles and clothing; (iv) technical barriers to trade; (v) trade-related investment measures (TRIMS); (vi) antidumping; (vii) customs valuation; (viii) preshipment inspection; (ix) rules of origin; (x) import licensing; (xi) subsidies and countervailing measures; and (xii) safeguards.
- Trade in services (Annex 1B: General Agreement on Trade in Services (GATS)).
- Intellectual property rights (Annex lC: Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)).
- Dispute settlement (Annex 2: Dispute Settlement Understanding).
- Trade policy review (Annex 3: Trade Policy Review Mechanism).
- Civil aircraft, government procurement, dairy, and bovine meat (Annex 4: Plurilateral Trade Agreements)—only for WTO members that have accepted those agreements.

Development and Review Department (PDR) and the Legal Department. The Board saw no need, at the time, to create new institutional structures within the Fund to liaise with the WTO (IMF, 1995a).

4. Both institutions defended their respective jurisdictions, but grey areas and areas of conflict emerged. The IMF's Geneva Office and Legal Department worked to preserve the clarity of the legal relationship that had existed under Article XV of GATT 1947, specifically with regard to exchange measures, on which it was expected that the WTO would defer to the IMF's findings and its jurisdiction.[1] Nonetheless the possibility remained—especially given the strengthened dispute settlement procedures of the WTO—that exchange measures consistent with the IMF's Articles could be subject to countermeasures under the WTO (IMF, 1994c).[2] More generally, there were issues of jurisdictional consistency that remained unresolved from GATT days, and had their roots in different approaches to distinguishing between trade and exchange measures. Whereas the IMF used a technical criterion to delineate between trade and exchange measures, the GATT had at times favored a different approach based on the effect on trade of the measure in question; this opened the door for exchange measures that had trade effects to fall under the WTO's jurisdiction as well (IMF, 1994c). IMF staff favored seeking an early resolution to these issues, but the Board was divided and left the matter for further discussion with the WTO (IMF, 1995a). A case involving China's accession to the WTO soon illustrated how conflicts of jurisdiction could arise and how problematic they could be (Box 2). The inclusion of certain capital transfers within the jurisdiction of the WTO was also potentially problematic: the General Agreement on Trade in Services (GATS) was "the first agreement of universal (as opposed to regional) application" that took a step toward liberalization of capital movements—a tendency that was not yet reflected in the IMF's Articles of Agreement (IMF, 1994c).[3]

Box 2. Conflict of Jurisdiction: The Draft Protocol on China's Accession to the WTO

At issue was the unprecedented inclusion (by the United States) in the draft protocol on China's accession to the WTO of obligations relating to the exchange system. Specifically, the draft protocol required that China bring its foreign exchange regime into conformity with the obligations of Article VIII of the IMF by an agreed date, and limited its rights to use foreign exchange restrictions in the future.

Fund staff objections, which were communicated to the Board in a statement in March 1995, were several (IMF, 1995b). For a start, the draft protocol contravened the ministerial declaration in the Uruguay Round Final Act that recognized explicitly the IMF's jurisdiction over exchange matters. Further, Article XV 9 of the GATT 1994 recognized the right of a WTO member that was also an IMF member to maintain exchange controls/restrictions in accordance with the IMF's Articles. By removing that right for China, the protocol would effectively create two classes of IMF members—an outcome inconsistent with the IMF's principle of uniformity of treatment of its members.

At the Board discussion of China's Article IV consultation in March 1995, the U.S. Executive Director exhorted the Fund to take a more activist stance in encouraging countries to accept Article VIII and to state its claims more strongly in the area of exchange restrictions lest it lose its jurisdiction by default (IMF, 1995c). The following year, the Managing Director sent the staff statement and a formal request to the WTO's Working Party on China's Accession to drop all references to exchange measures under IMF jurisdiction from the draft protocol. There was considerable tension regarding this matter at the WTO. Although the IMF was invited to attend the working party's meeting in March 1996, the Fund representative was told that his intervention at the meeting would be unhelpful; the IMF statement was not read at the meeting but submitted in written form and entered as part of the working party's formal report. The language of the draft protocol was not modified at that time.

China accepted Article VIII in December 1996. But the language of the accession protocol was not resolved for another five years, involving discussions among Fund staff, the U.S. administration, the Chinese authorities, and the WTO working party. China acceded to the WTO in December 2001.

[1] Their concern was with an interpretative note in Annex 1A of the draft WTO Agreement. The note indicated that in the event of an inconsistency or conflict between the GATT 1994 text containing Article XV and one of the other 12 multilateral agreements on trade in goods, the latter would have precedence. Their intervention led to the insertion of a Declaration on the Relationship of the WTO with the IMF in the Uruguay Round Final Act reaffirming that the relationship established in the GATT agreement be carried into the WTO except as otherwise provided (IMF, 1994a).

[2] In contrast to the IMF staff's interpretation, it was "apparently the understanding in some GATT circles" that the Declaration on the Relationship of the WTO with the IMF would not suffice to protect a measure consistent with the Fund's Articles from a finding of violation under one of the other multilateral agreements on trade in goods (IMF, 1994c).

[3] Article VI of the IMF's Articles of Agreement allows IMF members to impose capital controls and allows the Fund to request a member to do so in certain situations. The GATS, on the other hand, proscribes the application of restrictions on any capital transactions inconsistently with WTO members' specific commitments regarding such transactions, except in case of the need to safeguard the balance of payments or "at the request of the Fund" (GATS Articles XI and XII).

B. Cooperation in Principle

5. Absent a legal solution to the problem of overlapping jurisdictions, both organizations agreed that enhanced cooperation was key. To start, PDR issued two guidance notes to staff on the topic (Table 1). The first (IMF, 1995e) covered aspects of collaboration with the WTO such as balance of payments consultations, consistency of policy advice and obligations, staff contacts, and exchange of documents, research, and information. The second (IMF, 1995f) dealt specifically with the consistency of IMF advice with WTO rules ("WTO consistency"), highlighting various WTO rules that Fund staff needed to be aware of in the course of program design, surveillance activities, and technical assistance. As explained in the latter note, the role of staff was to be familiar with the issues so that potentially inconsistent policy advice could be identified at an early stage and alternatives explored. PDR's Trade Policy Division and the Geneva Office would assist missions in identifying potential inconsistencies and consult informally with the WTO Secretariat if necessary. Once a potential inconsistency was identified, the mission was to advise the national authorities to clarify the issue directly with the WTO; it was not to enforce WTO rules or the country's obligations under the WTO.

6. Guidance to staff was clear about how far IMF trade policy advice and conditionality could go. The guidance provided that while the IMF could not recommend policies that would violate a country's WTO commitments, it was "perfectly valid" for Fund advice and program design to encompass unilateral trade liberalization that went beyond a country's WTO commitments so long as there was no "cross-conditionality" (i.e., as defined by the guidance, so long as the country was not required to make a binding commitment to the WTO on trade liberalization undertaken in the context of a Fund-supported program). For example, Fund staff could not, in the context of a comprehensive tax reform, ask a country to increase some tariffs above their WTO bindings. But staff could—and were encouraged to—ask a country to lower some (applied) tariffs below their WTO bindings in order to "improve economic efficiency,"

Table 1. IMF Guidelines on WTO Cooperation

	Date
Board discussions on trade	
The Relationship of the WTO with the Fund: Institutional and Legal Aspects of the WTO—Concluding Remarks	January 1995
The Fund-WTO Cooperation Agreement—Summing Up	July 1996
Fund Support for Trade-Related Balance of Payments Adjustments—Summing Up	April 2004
Review of Fund Work on Trade—Summing Up	March 2005
Doha Development Agenda and Aid for Trade—Summing Up	November 2005
Doha Development Agenda and Aid for Trade—Summing Up	September 2006
Aid for Trade: Harnessing Globalization for Economic Development—Summing Up	September 2007
PDR guidance memos to area departments	
Collaboration with the WTO	April 1995
Reference Note on WTO Consistency	November 1995
WTO Committee on Balance of Payments Restrictions	October 1996
Note on Import Surcharges	January 1999
Developments in World Textiles Markets: Implications for Fund Surveillance	August 2003
Operational Guidelines for Fund Support for Trade-Related Balance of Payments Adjustments	September 2004
Other guidelines	
Agreement between the IMF and the WTO	December 1996
Report of the Managing Director, President, and Director-General on Coherence	October 1998

Source: IMF.

as long as the country was not made to bind its tariffs in the WTO at the lower level (IMF, 1995f).

7. Explicit arrangements for IMF-WTO cooperation were set out in the Cooperation Agreement signed by the two institutions in December 1996 (IMF, 1996d). These included arrangements for staff from each institution to attend the meetings of the others' governing bodies and procedures for the exchange of documents and other information (Box 3). The agreement largely formalized the collaboration mechanisms that had existed between the Fund and the GATT, and most of its elements were uncontroversial.[4]

8. The most debated item had to do with the IMF's voice in WTO dispute settlement panels. The IMF had requested the ability to communicate its views at dispute settlement panels in the WTO in cases that the Board determined directly involved the Fund's mandate. The WTO was disinclined to allow IMF participation in the panels, arguing that the Fund needed to maintain an impartial role in the proceedings. In the end it was agreed that in cases where the IMF's jurisdiction was involved and where the measure in dispute was covered by the IMF's Articles, written submissions by the Fund would suffice to inform the panel and such submissions would be incorporated in the formal record of the panel proceedings. However, it remained unclear as to whether the panel was required to receive, and treat as authoritative, the IMF's information on the consistency of exchange measures with the IMF's Articles (IMF, 1996c).

9. The concept of coherence in global economic policymaking took longer to flesh out. The idea first emerged in the early stages of the Uruguay Round negotiations, when the focus was on exchange rate and trade policies; Ostry (1999) noted that "the term 'coherence' was essentially a euphemism for curbing extreme swings in exchange rates."[5] But in the

[4] The new elements included the transmittal to the WTO of the summings up of Article IV consultation discussions and of Article IV consultation reports of Fund members seeking accession to the WTO, and the issue of WTO observer status in selected Board meetings. The idea of participation by WTO staff in Article IV missions had been discussed early on but the Board agreed that it was not a priority (IMF, 1994b).

[5] The issue of greater policy coherence and closer interagency collaboration was discussed in the 1980s by the Uruguay Round negotiating group on the Functioning of the GATT System. Interest in

Box 3. Key Arrangements for IMF-WTO Cooperation Specified in the 1996 Cooperation Agreement

Balance of payments consultations

- The IMF will participate in consultations carried out by the WTO Committee on Balance of Payments Restrictions on measures taken by a WTO member to safeguard its balance of payments.

Representation

- The IMF will invite the WTO Secretariat to send an observer to Executive Board meetings on trade policy issues and matters of common interest. The WTO will invite the IMF to send an observer to meetings of its Ministerial Conference, General Council, and certain committees, working groups, and bodies.

Information and document exchange

- The IMF and the WTO will make available to each other in advance the agendas and relevant documents for the meetings to which they are invited. In addition, the IMF will make available to the WTO Secretariat the agendas of the Executive Board meetings at the time of their circulation in the Fund, and the WTO will make available to the Fund the agendas of the Dispute Settlement Body at the time of their circulation in the WTO.
- The IMF must inform the WTO of any decisions approving restrictions on the making of payments or transfers for current international transactions, decisions approving discriminatory currency arrangements or multiple currency practices, and decisions requesting a Fund member to exercise controls to prevent a large or sustained outflow of capital.
- The IMF and WTO must share their reports with each other (staff reports and related background staff papers on Article IV consultations and on use of Fund resources from the IMF; trade policy review reports, summary records and reports to/of various WTO councils, bodies, and committees from the WTO), subject to a confidentiality constraint.

Informal consultations

- IMF and WTO Secretariat staff must consult with each other on issues of possible inconsistency between measures under discussion with a common member and that member's obligations under the WTO Agreement or the IMF's Articles of Agreement.

Dispute settlement

- The IMF will inform in writing the relevant WTO body (including dispute settlement panels), considering exchange measures within the Fund's jurisdiction, as to whether such measures are consistent with the Articles of Agreement of the Fund.

Declaration on the Contribution of the World Trade Organization to Achieving Greater Coherence in Global Economic Policymaking that was attached to the Uruguay Round Final Act, the concept of coherence was widened to include "consistent and mutually supportive policies" among the international institutions with responsibilities in "structural, macroeconomic, trade, financial and development aspects of economic policymaking." In 1995, a High Level Working Group on Coherence (HLWGC), consisting of senior staff from the IMF, the World Bank, and the WTO, was formed to recommend ways of achieving coherence in economic policymaking. The working group's report—the Report of the Managing Director, President, and Director-General on Coherence (or the 1998 Coherence Report)—identified several issues that fell under this rubric, noting that the list would be flexible and subject to regular review by the HLWGC (IMF, 1998e) (Box 4). Exchange rate and debt issues were not on the list—the WTO Secretariat had sought to include them but Fund (and Bank) staff had argued forcefully against their inclusion and won.

10. Ideas on how to achieve coherence in global economic policymaking did not extend far beyond the mechanisms outlined in the Cooperation Agreement. The principle behind the IMF-WTO Cooperation Agreement and a similar agreement between the WTO and the World Bank was that regular communication and information sharing would ensure that the three institutions were formulating consistent and mutually supportive policies in their respective areas of responsibility. The 1998 Coherence Report highlighted that regular meetings would take place among the three institutions at the management, senior staff, and technical levels to discuss issues of common interest.

11. Criticism of the coherence objective came from both ends of the spectrum. Schott (1998) criticized the recommendations in the Cooperation Agreement and 1998 Coherence Report as insufficient. He suggested that the WTO open a small office in Washington to facilitate high-level contacts with the IMF and the World Bank and that the two institutions do more to induce countries to implement and sustain trade liberalization—the IMF by making its trade conditionality binding in the WTO, and the WTO by devising a system for providing credit in current or prospective negotiations for trade reforms to be undertaken in the context of Fund-supported programs. Civil society organizations, on the other hand, saw the IMF, the World Bank, and the WTO as "ganging up to force countries to comply with liberalization policies" (Bretton Woods Project, 1999; Rowden, 2001; Caliari, 2003).

Box 4. Coherence Issues Highlighted in the 1998 Coherence Report

Common policy issues

- Trade liberalization as the outcome of WTO-based negotiations versus unilateral trade reforms in the context of programs supported by the IMF (and the World Bank).
- Transitory adverse implications of trade liberalization on the balance of payments, fiscal accounts, and certain social indicators.

Operational issues

- Consultations on trade restrictions imposed for balance of payments reasons.
- Trade policy surveillance of the world economy and individual countries.
- Helping interested countries prepare for WTO accession.
- Preferential trade agreements.
- Building human and institutional capacity in developing countries to design and implement efficient reform policies and to facilitate their integration into the global economy.

Issues to be addressed at both policy and operational levels

- Trade prospects for developing countries.
- Efficiency versus revenue aspects of tariffs.
- Potential effects of agricultural trade liberalization on net food importers and least developed countries.

C. Cooperation in Practice

12. In practice, IMF-WTO cooperation has been shaped by important institutional and operational differences between the two institutions. Aside from their distinct albeit overlapping legal jurisdictions noted earlier, the two institutions differ in the nature of their obligations, their organizational structure, and their domestic governmental constituencies (Siegel, 2002). WTO rules stem from negotiations among WTO members and are enforced by the members; unlike the IMF, the WTO itself has no power to oversee/enforce the compliance of each member with its obligations.[6] And while the IMF has an Executive

the issue was motivated by persistent current account imbalances that had emerged, notably between the United States and Japan, and that tended to generate protectionist pressures (Ostry, 1999; Auboin, 2007).

[6] WTO members' obligations to the institution are limited to such matters as participation in trade policy reviews and fulfillment of

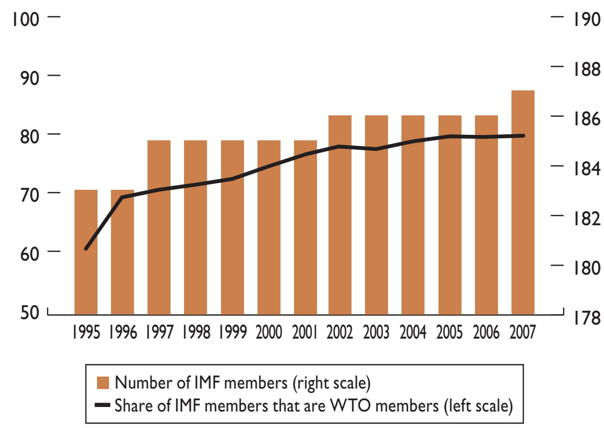
Board, the WTO's decisions are made by the WTO membership as a whole—by ministers or by their ambassadors or delegates. In the IMF, staff and management play an important role by making recommendations to the Executive Board on the Fund's daily activities. In the WTO, delegations conduct much of the work on the trade obligations in their capacity as representatives of their countries; the staff of the WTO, who number only about a quarter those of the IMF, perform a secretariat role (Jackson, 2006).[7] The two institutions represent different domestic governmental constituencies—finance ministries in the IMF, and trade, commerce, or foreign ministries in the WTO. The two institutions also have different memberships—not all IMF members are WTO members and vice versa—though the difference narrowed during the evaluation period (Figure 1).

13. On the IMF side, all interactions with the WTO were channeled through a small group of staff. The Fund's representative to the WTO, based in the Office in Geneva (which was closed in 2008), was the primary point of contact. The representative worked closely with, and reported to, the Trade Policy Division in PDR. The Office in Geneva was responsible for day-to-day working relations with the WTO, including monitoring various WTO standing and negotiating bodies and reporting on their meetings. It reported to PDR's Trade Policy Division on a daily/weekly basis. Senior PDR staff members participated in the HLWGC, which met on an ad hoc basis through 2001. In 2003, Fund staff suggested new mechanisms for IMF-WTO cooperation to handle consultations at the institutional level, such as the establishment of a permanent body that would meet on demand, but management did not take up these suggestions.

14. The effectiveness of the Cooperation Agreement has not been reviewed regularly. The only review to take place was conducted by PDR and the Office in Geneva in 1998 (IMF, 1998c). The review, which was requested by the Executive Board at the time of approval of the agreement, concluded that IMF-WTO cooperation had proceeded smoothly—the cooperation mechanisms had been implemented as envisaged, there had been management and staff contacts at all levels, and no inconsistencies had been reported—with only modest budgetary implications for the Fund.

Figure 1. IMF and WTO Membership

(Percent)



Sources: IMF and WTO.

Balance of payments consultations

15. The most widely known form of IMF-WTO cooperation took place in the context of the WTO's Committee on Balance of Payments Restrictions (CBR). Under WTO rules, subject to specified conditions, a country facing balance of payments difficulties may apply import restrictions to "safeguard its external financial position" (GATT Article XII) and/or, if it is a low-income developing country, to "ensure a level of reserves adequate for the implementation of its program of economic development" (GATT Article XVIIIB). Similar rules apply to restrictions on trade in services (GATS Article XII). The rules require that import restrictions imposed for balance of payments purposes be reviewed by the CBR, in consultation with the IMF.[8]

16. The IMF's role was to provide the CBR with input with which to decide each case. This input consisted of an update of recent economic developments in the consulting country and, in countries engaged in full consultations, a statement focusing

administrative responsibilities.

[7] The responsibilities of the WTO Secretariat include providing administrative and technical support for WTO delegate bodies (councils, committees, working parties, and negotiating groups) for negotiations and the implementation of agreements; providing technical support for developing countries; undertaking trade policy analysis and reviews; assisting in the interpretation of WTO rules and precedents in the resolution of trade disputes; and dealing with accession negotiations for new members and providing advice to governments considering membership.

[8] Under Article XV:2 of GATT 1994, the CBR is required to "consult fully" with the IMF and to "accept the determination of the Fund as to what constitutes a serious decline in the contracting party's monetary reserves, a very low level of its monetary reserves or a reasonable rate of increase in its monetary reserves, and as to the financial aspects of other matters covered in consultation in such cases." GATS Article XII:5(e) contains similar language, requiring that the CBR's conclusions "be based on the assessment by the Fund of the balance-of-payments and the external financial situation of the consulting Member."

on the country's current and prospective balance of payments situation. The IMF statement was prepared by the relevant area department in consultation with PDR; approved by the Board, usually on a lapse-of-time basis; and delivered to the committee by the Fund's representative to the WTO. Fund staff preparing this statement were directed by three PDR guidance notes: the 1995 note on WTO consistency (IMF, 1995f), a 1996 note on WTO CBR consultations (IMF, 1996b), and a 1999 note on import surcharges (IMF, 1999a) (Table 1).

17. PDR guidance to staff was unequivocal about the IMF's position on trade restrictions used for balance of payments reasons. Staff were instructed to "discourage the use of trade restrictions as a tool for balance of payments management" in their trade policy advice (IMF, 1995f). Although WTO rules allowed for import surcharges under certain circumstances, and surcharges had had "a limited impact on the macroeconomy" in practice, "the Fund oppose[d] surcharges in the great majority of cases" because they created distortions, hindered structural change, and ran counter to the Fund's "goal of promoting open international trade" (IMF, 1999a). Furthermore, the GATT Articles allowing trade restrictions for balance of payments reasons had been drafted in the 1940s, when fixed exchange rates were the norm. Under flexible exchange rates, trade restrictions such as import surcharges were seen to be "redundant and inefficient in addressing the balance of payments situation" (IMF, 1999a).

18. But the guidance was less consistent with regard to how far the IMF statement could go. According to the 1996 guidance note on CBR consultations, the IMF statement had to: (i) identify, through "an evaluation of a country's reserve position and policies," whether there was a balance of payments need at the time the trade restrictions were introduced; (ii) address the question of whether the country still had a balance of payments problem, based on assessments of its reserve adequacy and "the gamut of macroeconomic and structural policies" as described in staff reports and summings up; and (iii) determine the macroeconomic policy combination that would be needed to restore a sustainable balance of payments and how long this would take (IMF, 1996b). The guidance note warned staff not to make a direct judgment on the trade restrictions in question ("This is the jurisdiction of the WTO...") but encouraged staff to comment on whether the trade restrictions were assisting the balance of payments adjustment and, if not, to "call for their early or phased removal, with some indication of a reasonable timetable for such action" (IMF, 1996b). The 1999 guidance note on import surcharges was more circumspect—the IMF statement, it noted, should present the available information on the level and evolution of reserves, as well as on potential risk factors, and avoid even a "direct judgment on the adequacy of a country's reserves," let alone a judgment of whether the surcharge was justified (IMF, 1999a).

19. In practice, the IMF statements almost always called for an early removal of the import restrictions. During 1995–2007, the CBR held 41 consultations with 16 countries (Table 2).[9] Of these, 28 involved a statement from the Fund. A spate of consultations with transition countries (Romania, Hungary, Bulgaria, and the Czech and Slovak republics) in the late 1990s mainly involved import surcharges imposed under GATT Article XII. Most of the other cases involved a handful of developing countries—notably India, Pakistan, Bangladesh, and Nigeria—invoking GATT Article XVIIIB. In more than 80 percent of the cases, irrespective of the assessment of the balance of payments situation, the IMF statement said the import restrictions were inappropriate and should be eliminated. Only in two cases—Pakistan and Bangladesh—did the IMF statements not comment on the restrictions under consideration. The CBR agreed with the IMF's view on the trade measure(s) in roughly half of the cases.[10] The most notable case of disagreement was India's, which could not be resolved by the CBR, escalated into a trade dispute, and called into question the IMF's role in the CBR consultations (Box 5).[11]

20. Fewer CBR consultations took place after 2000. The last new case considered by the CBR within the evaluation period was the Slovak Republic's introduction of a temporary import surcharge in 1999. By the beginning of 2001, that surcharge had been eliminated, as had the restrictions imposed by Romania and Pakistan, leaving only one country—Bangladesh—that still maintained trade restrictions for balance of payments reasons. Bangladesh's case was concluded in 2007.[12]

[9] During the transition from the GATT to the WTO in 1995, the WTO CBR held consultations jointly with the GATT CBR. There have been no consultations under GATS Article XII.

[10] In the other cases, the CBR either called for further consultations or judged the import restriction(s) to be in compliance with the relevant GATT provision. The CBR was bound by GATT Article XV to accept the IMF's view on the country's balance of payments situation, but not on the trade measure(s) in question. The 1999 guidance note on import surcharges noted that the CBR's decisions were "based on precedent and interpretation of the rules and the consensus of the Committee members, rather than economic efficiency" (IMF, 1999a).

[11] The only other case where the CBR was unable to reach a conclusion was Nigeria's (1996–98). Nigeria subsequently revised its timeframe for elimination of its import restrictions from five years to three; no dispute was filed.

[12] In the first new case in a decade, Ecuador in early 2009 invoked GATT Article XVIIIB to impose various import restrictions for one year. The IMF was invited to consult with the CBR in April 2009.

Table 2. WTO CBR Consultations, 1995–2007

Year	Number of Consultations: With no Fund statement	Number of Consultations: With Fund statement	Countries (An * indicates continuation of earlier consultation(s); the number in parentheses denotes the number of consultations in that year)
1995	3	6	South Africa*, Egypt*, Hungary, Slovak Republic*, Turkey*, Brazil, Sri Lanka*, Philippines*, India*
1996	0	5	Nigeria*(2), Tunisia*, Slovak Republic*, Hungary*
1997	3	8	India*(2), Nigeria*(2), Pakistan (2), Bangladesh*, Tunisia*, Czech Republic, Bulgaria, Slovak Republic
1998	1	1	Nigeria*, Bulgaria*
1999	1	2	Romania, Bangladesh*, Slovak Republic
2000	2	4	Bangladesh*(2), Pakistan*(2), Romania*, Slovak Republic*
2001	1	0	Bangladesh*
2002	2	0	Bangladesh*(2)
2003	0	0	
2004	0	1	Bangladesh*
2005	0	0	
2006	0	0	
2007	0	1	Bangladesh*
Total	13	28	

Source: WTO.

21. Was IMF-WTO cooperation responsible for the drop in the use of the balance of payments provision? As noted earlier, IMF staff had long had misgivings about the use of trade restrictions for balance of payments reasons, but went along with the WTO in deference to the latter's jurisdiction.[13] It is possible that IMF advice could have led some countries to decide against invoking the balance of payments provision during the evaluation period, although evidence on this would be difficult to uncover. For countries that did decide to invoke the balance of payments provision, however, there is no evidence that the IMF helped to hasten the removal of the restrictions.[14]

Document/information exchange and informal consultations

22. The exchange of documents and data between the IMF and the WTO proceeded smoothly during the evaluation period. The procedures for the exchange of documents, agendas, and databases and for the IMF to inform the WTO of exchange restrictions approved were as described in the 1998 PDR review of the Cooperation Agreement.

23. However, the extent to which both institutions internalized the information received was uneven. By end-2007, 111 countries that were members of both the IMF and the WTO had had at least one trade policy review (TPR), and more than three-quarters of these TPRs drew on the country's recent IMF Article IV or use of Fund resources (UFR) report(s). By contrast, fewer than three-fifths of these TPRs were cited in IMF reports.[15] According to WTO Secretariat staff, TPRs used IMF reports and data as definitive sources particularly on exchange rate

[13] Anjaria (1987) noted that GATT Article XVIIIB was frequently abused by developing countries. The IMF was not alone in its disapproval of trade restrictions for balance of payments reasons; trade economists such as Irwin (2000) have characterized the balance of payments exception as "bad trade policy" that should not have been built into international trade rules.

[14] Although IMF staff were told to discourage the use of trade restrictions for balance of payments reasons, in Fund-supported programs they were not to "directly link the use of Fund resources to (or call directly for) the disinvocation by the country of GATT Articles XII or XVIII:B or GATS Article XII," to avoid stepping into the WTO's jurisdiction (IMF, 1995f). When Pakistan abolished its import restrictions ahead of schedule, its delegate made clear to the CBR that the move was not part of the Fund-supported program in place at the time (WTO, 2000).

[15] But IMF staff regularly commented on draft TPR reports. Up to a few years ago, IMF staff commented on WTO Accession Working Party reports as well.

Box 5. India and the IMF's Role in CBR Consultations

India consulted in the WTO's CBR in 1995 and 1997 over its use of quantitative restrictions on a range of imports. At the consultations, the IMF representative stated that India's gross official reserves were comfortable and that India's external situation could be well managed using macroeconomic policy instruments alone, without recourse to quantitative restrictions. The Indian representative argued that account had to be taken of the large share of volatile capital inflows and short-term liabilities in India's balance of payments as well as the "developmental aspect" of removing the restrictions (WTO, 1997). A few (developing country) committee members agreed with India, but a larger number of (advanced country) members disagreed and seconded the IMF's view. The CBR failed to reach an agreement, leaving the matter open for dispute settlement.

Two weeks later, the United States filed a formal complaint at the WTO against India's quantitative restrictions. The dispute settlement panel requested, and received in July 1998, written input from the IMF on a number of questions regarding India's external position. The Fund explained that its assessment of reserve adequacy was based on the size of existing and potential claims on reserves—in the case of India, the sum of outstanding short-term liabilities (by remaining maturity) and potential outflows of portfolio investment (as proxied by the stock of portfolio investment after marking to market) (IMF, 1998b). The panel ruled against India in April 1999; the ruling was upheld by the Appellate Body in August 1999.

In the meantime, India pushed to include as an implementation issue in the Doha Round a complete review of GATT Article XVIII, including the way in which reserve adequacy was assessed for developing countries, the IMF's role in the CBR consultation process, and the nature of the Fund's input (WTO, 1999b). It argued that the Fund had overstepped its boundaries when it prescribed a timetable for the removal of India's trade restrictions during the 1997 consultations with the CBR (WTO, 2002c). To facilitate the WTO's discussions of this implementation issue, Fund staff assisted the WTO Secretariat in preparing two background notes on the determination of reserve adequacy (WTO, 1999a and 2002b), and also wrote a specially commissioned piece on the subject (IMF, 2003c). Despite numerous rounds of discussions at the WTO, no consensus could be reached on the appropriate role and analytical input of the Fund; the issue remains unresolved.

and macroeconomic issues, but it was not evident that IMF staff used TPRs to nearly the same extent in their coverage of trade policy issues. In a survey of Fund staff (grades A15–B4), one-quarter of the respondents reported never having read a TPR and only 15 percent reported always reading TPRs.

24. Informal consultations between IMF and WTO Secretariat staff were the preferred avenue for information exchange. The informal consultations typically were channeled through PDR's Trade Policy Division and/or the Office in Geneva. Some 17 such consultations took place in the first half of 1996 (on topics as varied as Guinea-Bissau's tariff bindings, Argentina's export rebates, and Bahrain's GATS commitments), though IMF staff members indicated that their frequency declined to approximately 10–12 a year after that.[16] On a handful of occasions, IMF staff members visited the WTO for informal consultations en route to/from their mission site.

25. Known cases of inconsistency were few, suggesting that IMF-WTO information exchange, while imperfect, was satisfactory overall. During the evaluation period, there were only two cases where IMF advice/conditionality was challenged in WTO disputes: Argentina's statistical tax on imports (1996–98) and Korea's corporate restructuring measures (2002–05) (Box 6). Even in the best of circumstances, inconsistencies were not unlikely, since the WTO Secretariat was not authorized to provide definitive interpretations of WTO rules; only the dispute settlement panels were. The panels occasionally sought, and received, information from the IMF to aid their deliberations, but, as illustrated in the two dispute cases in Box 6, they were not obliged to do so.[17] It should be noted that there is, in any case, no exception under the WTO's obligations for measures taken in the context of a Fund-supported program.

[16] There is no systematic record of informal consultations with the WTO Secretariat on consistency issues, though PDR made an effort to collect this information in 1995 and part of 1996.

[17] In 1998, the WTO panel requested information and the IMF's views on India's external position (Box 5). In 2004, the WTO panel requested information and the IMF's views on the Dominican Republic's "foreign exchange commission," in the context of a dispute brought by Honduras concerning measures imposed by the Dominican Republic on the importation and internal sale of cigarettes (IMF, 2004c). In 2007, the WTO panel requested information on Antigua and Barbuda's gambling services data, in the context of a dispute brought by Antigua and Barbuda against the United States concerning measures affecting the cross-border supply of gambling and betting services (IMF, 2007c).

Box 6. WTO Disputes Involving IMF Advice/Conditionality

In 1996, the United States brought a dispute against Argentina concerning, inter alia, the latter's imposition of a statistical services tax on selected imports. Argentina argued that the tax was part of a policy package agreed in an IMF-supported program and to challenge it was a case of "cross-conditionality." Indeed, the memorandum of economic policies for an extension of Argentina's IMF arrangement included the tax as one of the fiscal measures that the government had approved to achieve its programmed fiscal surplus (IMF, 1995d). However, this argument was rejected by the panel (and by the Appellate Body), and the case was decided in favor of the United States. The dispute panel(s) did not seek the IMF's view on the tax, even though both parties to the dispute supported such consultation. Although the final outcome of the case was "not objectionable" to the Fund, Fund staff considered the lack of consultation "regrettable" and, at the April 1998 meeting of the Dispute Settlement Body, stated for the record that the Fund was always ready to be consulted by dispute panels in such cases (IMF, 1998c).

In 2002, the European Union brought a dispute against the Republic of Korea concerning subsidies to the latter's shipbuilding industry, including, inter alia, corporate restructuring measures in the form of debt forgiveness, debt and interest relief, and debt-to-equity swaps provided through government-owned and government-controlled banks. Korea argued that these restructuring measures had been agreed with the Fund under a Stand-By Arrangement in 1997, and that they were taken on a strictly commercial basis and were not specific to a company or industrial sector. As in the earlier Argentina case, the dispute settlement panel did not seek the Fund's view on the measures. But Fund staff were invited to respond to a statement made by the Korean delegation at a meeting of the WTO Working Group on Trade, Debt, and Finance; the staff's statement supported Korea's position (IMF, 2003a). In 2005, the panel rejected the EU's claims that the debt restructurings of Korean shipyards involved subsidization.

Representation and research cooperation

26. Attendance by IMF and WTO staff at each other's meetings proceeded largely as planned. During 1997–2007, WTO Secretariat staff attended on average one to five IMF Executive Board meetings each year as observers. The meetings included certain *World Economic Outlook (WEO)* discussions and CWTO meetings and one country-specific meeting. The IMF was granted observer status in almost all WTO bodies (Figure 2).[18] Staff of the Geneva Office attended the working level meetings and reported back to PDR's Trade Policy Division; these reports were distilled into periodic updates for the Board (or the CWTO) on WTO activities of interest to the Fund.[19] IMF staff sometimes contributed substantively to WTO meetings either through oral statements or briefings or through analytical notes circulated in advance (see Table 3 for the main examples). Records of meetings of the HLWGC are sketchy; according to IMF and WTO Secretariat staff, those meetings stopped after 2001. The first—and only—joint IMF-World Bank-WTO seminar was held in Geneva in June 1999 on the topic of regionalism. Plans to hold such tripartite seminars at regular intervals did not materialize, although once every few years IMF staff presented seminars or participated in workshops at the WTO.[20]

27. Regular visible interaction took place at the management level. The WTO Director-General attended most IMF-World Bank Spring and Annual Meetings and used these opportunities to address the International Monetary and Financial Committee (IMFC) and/or the Development Committee and press for their support in advancing the WTO's agenda.[21] The IMF Managing Director or his First Deputy attended and addressed all but one of the WTO Ministerial Conferences; s/he also attended three WTO General Council meetings—one in

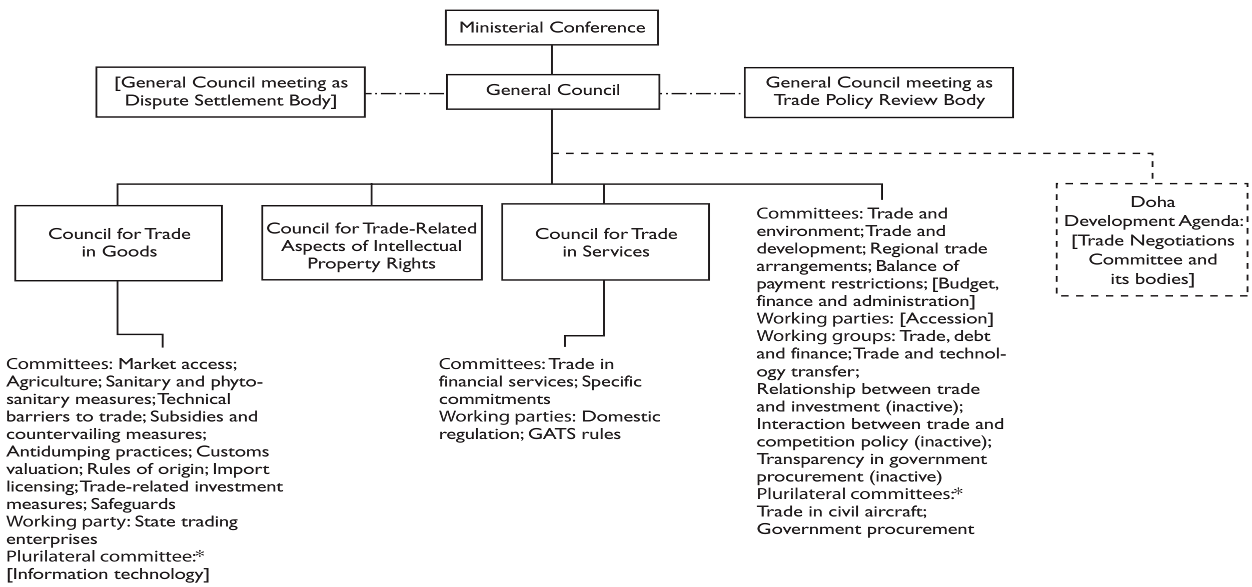
[18] The exceptions were the Trade Negotiations Committee (TNC), the Dispute Settlement Body (DSB), the Accession Working Parties, and the Committee on Budget, Finance and Administration. The IMF's request for observer status in the TNC and its subsidiary bodies was not granted because of a political impasse that was unrelated to the Fund, although IMF staff were invited on an ad hoc basis to meetings of the Negotiating Group on Trade Facilitation. IMF staff were also invited as observers to some accession working party meetings and to meetings of the DSB at which matters of jurisdictional relevance to the Fund were discussed (see Box 6). The IMF did not seek access to the Committee on Budget, Finance, and Administration.

[19] After mid-2005, PDR took over the job of updating the Board on WTO activities.

[20] For example: Fiscal Affairs Department (FAD) staff participated in a WTO workshop on technical assistance and capacity building in trade facilitation in May 2001 and a WTO seminar on technical assistance in customs valuation in November 2002; Research Department staff presented papers on the growth implications of WTO accession for developing countries and the effectiveness of trade conditions in Fund-supported programs at the WTO in May 2006. WTO staff participated in a Fund seminar on trade reforms and regional integration in Africa in December 1997.

[21] Senior WTO staff attended and addressed the IMFC deputies' meetings.

Figure 2. WTO Structure



Source: WTO.

Square brackets denote committees/working parties in which the IMF does not have observer status.

Plurilateral committees (denoted by *) inform the General Council or Goods Council of their activities although these agreements are not signed by all WTO members. The Trade Negotiations Committee is in charge of negotiations of new trade agreements. All other committees and councils are in charge of implementing existing trade agreements.

2003 and two in 2004—where coherence was the topic of discussion. There was also significant informal or less visible communication between IMF management and the WTO Director-General, the extent of such communication depending to some extent on the personal interests of, and relationships between, the individuals involved. For example, the First Deputy Managing Director and Economic Counselor made a special visit to the WTO in August 2002 to discuss possible new areas of cooperation (IMF, 2002a). Box 7 illustrates one instance of high-level IMF-WTO cooperation.

28. These contacts provided opportunities to explore other, ad hoc forms of cooperation but the partnership was asymmetric. Cooperation was typically initiated by a WTO request for IMF research/analysis or policy-related support. For example, in 2002, the WTO asked the IMF to (re)visit the issue of the revenue implications of trade liberalization and to provide an analytical perspective on some of the proposals made by developing country delegations for special and differential treatment in the WTO (IMF, 2002a). Overlaps in IMF and WTO efforts were rare; Box 8 illustrates one such instance. There were no instances of the IMF requesting WTO support. The asymmetry is not surprising, given the disparity in staff size between the IMF and the WTO Secretariat.

29. IMF staff provided research and analysis but this rarely served as the basis for WTO decisions. Table 3 lists some examples of IMF research/analysis provided to the WTO. By all accounts, the WTO Secretariat was highly appreciative of the IMF's work and valued the ability to call on the Fund for such support. But the IMF's research/analysis did not seem to have had much impact on final outcomes in the WTO. In most (but not all) cases, the Fund's input was used as a basis for discussion but few discussions led to any definite conclusions (Box 9).

Financial support

30. Until 2004, the IMF declined to create new lending facilities to support coherence objectives. The first such request came in 1995 when the WTO Director-General asked the IMF (and the World Bank) to consider providing special assistance for net food-importing developing countries (NFIDCs), whether by establishing a new facility to help them cope with a terms of trade deterioration caused by agricultural trade liberalization, or by giving them priority in access to existing facilities, or by soften-

Table 3. Main Examples of IMF Contributions to the Work of WTO Bodies

Committee on Agriculture (CAG)	
1996–2007	Each year as part of the annual monitoring exercise mandated by the WTO Ministerial Decision on the possible negative effects of the Uruguay Round reform program on least-developed countries (LDCs) and net food importing developing countries (NFIDCs), Fund staff presented a statement to the CAG discussing trends in world food prices and outlining Fund resources to meet the needs of its low-income members.
September 1996	Fund staff presented a statement at the CAG meeting on September 25–26, 1996, outlining how existing Fund facilities could help LDC/NFIDCs cope with higher food prices and how those facilities had been used by such countries during the recent rise in world food prices.
December 2001	The Fund's representative to the WTO participated in an interagency panel to explore ways and means for improving access by LDC/NFIDCs to multilateral programs and facilities and to consider the establishment of a revolving fund. The panel's report, released in June 2002, contained suggestions for modifying the Fund's Compensatory Financing Facility (CFF) and concluded that an ex post revolving fund would not be useful.
Working Group on Trade and Investment (WGTI)	
October 1997	Fund staff prepared a note, "Implications of the Relationship Between Trade and Investment," summarizing Fund publications on trade and investment and related issues. The note was discussed in the WGTI meeting on October 6–7, 1997, during which the Fund representative updated the WGTI on the proposed amendment of the IMF's Articles of Agreement to include capital account liberalization as one of the Fund's purposes.
November 1998	Fund staff prepared a note on the IMF's definition of foreign direct investment (FDI) in response to a WGTI request. The note was discussed in the WGTI meeting on November 25–26, 1998, where no agreement was reached as to whether the WGTI should adopt the Fund's definition of FDI.
General Council	
May 1999	Fund staff made a presentation at the General Council's informal meeting on coherence on May 27, 1999, about the results of the Interim Committee meeting of the previous month and work being undertaken in the Fund that could be of interest in the context of preparations for the Seattle Ministerial Conference.
June 1999	Fund staff assisted the WTO Secretariat in preparing a note on "The Treatment of 'Monetary Reserves' in WTO Balance-of-Payments Committee Consultations."
January 2001	The paper, "Revenue Implications of Trade Liberalization" by Fund staff (Ebrill, Stotsky, and Gropp, 1999) was discussed at the General Council's informal meeting on coherence on January 18, 2001.
January 2003	Fund staff prepared four notes in response to the WTO's request for the Fund's analytical perspective on some of the proposals made by developing countries for special and differential treatment. The notes were on: (i) "Trade Restrictions for Balance of Payments Purposes"; (ii) "Financing of Losses from Preference Erosion"; (iii) "Export Financing and Duty Drawbacks"; and (iv) "Liberalizing Trade and Safeguarding Public Revenues." Fund (FAD) staff gave an informal seminar on (iv) at the WTO for developing country delegations on January 23, 2003.
Working Group on Trade, Debt and Finance (WGTDF)	
April 2002	Fund staff briefed the WGTDF on the Fund's financing facilities, the IMF–World Bank Heavily Indebted Poor Countries (HIPC) Initiative, and Fund initiatives to strengthen the international financial architecture.
September 2002	Fund staff sent two chapters from the September 2002 *WEO* ("Essays in Trade and Finance" and "Trade and Financial Integration") to the WGTDF. In the WGTDF meeting on September 30, 2002, the joint IMF–World Bank paper on "Market Access for Developing Country Exports—Selected Issues" was highlighted during the discussion on trade and debt.
May 2004	Fund staff briefed the WGTDF on the main results of the Fund seminar on "Trade Finance in Financial Crises," held in Washington in May 2003.
October 2004	Fund staff prepared a paper on "Exchange Rate Volatility and Trade Flows—Some New Evidence," updating a 1983 study that the Fund had prepared for the GATT. The paper, which concluded that exchange rate volatility was "probably not a major policy concern" from the perspective of enhancing trade, was discussed in the WGTDF meeting on October 4, 2004. (Clark, Tamirisa, and Wei, 2004).
Committee on Trade in Financial Services (CTFS)	
July 2002	Fund staff briefed the CTFS on the Fund's Financial Sector Assessment Program (FSAP).
April 2003	Fund staff prepared a note on "Financial Sector Stability, Reform Sequencing and Capital Flows," including an annotated list of key IMF publications on capital account liberalization.
Committee on Balance-of-Payments Restrictions (CBR)	
October 2002	Fund staff gave a statement in the CBR meeting on October 2, 2002 summarizing the Fund's views on reserve adequacy and capital account vulnerabilities and the evolution of the indicators used by the Fund in assessing reserve adequacy.
Committee on Agriculture—Subcommittee on Cotton (SCC)	
April 2005	Fund staff informed the SCC about the Fund's cotton seminar, to take place in Cotonou on May 18, 2005. The seminar would assess the macroeconomic consequences of cotton price developments and consider steps toward achieving the Millennium Development Goals in the African region.
July 2005	Fund staff reported on the Fund's cotton seminar held in Cotonou on May 18, 2005.
WTO Secretariat—Development and Economic Research	
December 2005	Fund staff sent the WTO's Chief Economist two notes providing an analytical perspective on Doha Round issues in the run-up to the 2005 WTO Ministerial Conference: "Will the Doha Round Lead to Preference Erosion?" and "Does Import Protection Discourage Exports?"

Sources: IMF and WTO.

Box 7. IMF-WTO Cooperation to Forestall Protectionism in the Wake of the Asian Financial Crises

The financial crises that began in Asia in 1997 were a major test of coherence in global economic policymaking. While the immediate focus and primary concern of the IMF was to restore financial and macroeconomic stability in the affected countries, it soon became clear that a lasting solution had to involve the global system: with exports from East Asia expected to rise significantly partly as a result of currency devaluations, there was concern that protectionist pressures in importing and export-competing countries could lead to a downward spiral of worldwide recession.

The IMF and the WTO were mindful of this risk. The heads of the two institutions and the World Bank issued joint statements in October 1998 and November 1999 emphasizing the importance of policy coordination and the need to keep markets open (IMF, 1998f and 1999d). The IMF made a special effort to press home those points in its Article IV surveillance of the United States, where the steel industry was lobbying for protection (IMF, 1998d and 1999b).

The WTO regarded the cooperation as successful in forestalling a rise in protectionism. The 1999 WTO *Annual Report* noted that there was "no evidence of a return to protectionist measures" in 1998 and 1999 and that some crisis-hit countries even further liberalized their trade regimes (a number of them in the context of Fund-supported programs) (WTO, 1999c). The IMF's 1999 *World Economic Outlook* was somewhat more guarded, noting that there were some protectionist reactions in Asia, Latin America, and the transition economies (e.g., selective tariff increases) and in large importing countries (e.g., antidumping actions), although the reactions were relatively limited and did not cause major disruptions to global trade flows (IMF, 1999c).

Box 8. IMF-WTO Cooperation on Trade Finance in Financial Crises

During the Asian financial crises, many countries found that trade financing dried up along with other forms of short-term capital flows, disrupting trade and hindering the recovery of economic growth and the balance of payments. The WTO Director-General raised the issue with the heads of the IMF and the World Bank in October 1998 (WTO, 1998a), and the HLWGC discussed it in November 1998 when the three institutions agreed to "monitor the situation closely" (WTO, 1998b).

In October 2002, WTO staff made a direct appeal to the IMF for help in putting together a response on this issue for WTO members ahead of the 2003 Ministerial Conference (IMF, 2003b). Meanwhile, PDR—the Official Financing Division, not the Trade Policy Division—made preparations for a seminar on the topic to be held at IMF headquarters in May 2003, with participants from the private and public sector, academia, and research institutions, but not the WTO. The IMF Managing Director announced the seminar at the WTO General Council meeting on coherence two days before it took place (Köhler, 2003).

The IMF seminar identified various solutions involving the private sector, the government, regional development banks, and official bilateral credit agencies, but only a supporting role for the Fund, limited to seeking out and/or coordinating efforts to address trade finance declines. (IMF, 2003f). The seminar served as a basis for discussions in the WTO's Working Group on Trade, Debt and Finance (WGTDF). In January 2004, the WTO invited the same group of participants from the IMF seminar to its own seminar in Geneva to examine how the WTO could contribute to the solutions that emerged from the earlier seminar (WTO, 2004).

Although the problem of trade finance in financial crises fell squarely within the "coherence" rubric, IMF-WTO cooperation in this case was hardly ideal. Neither institution was instrumental in ameliorating the problem at the time—perhaps because other players stepped in quickly in various ways. And when it came to putting together the lessons from the experience and formulating a framework for the future, both institutions seemed to be working in parallel, leading to a duplication of efforts by PDR and the WGTDF.

ing their program conditionality.[22] The IMF maintained that its existing facilities—notably the Compensatory Financing Facility (CFF) and, to a lesser extent, the Enhanced Structural Adjustment Facility

[22] The 1995 WTO ministerial decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries noted that those countries could be "eligible to draw on the resources of international financial institutions under existing facilities, or such facilities as may be established, in the context of adjustment programmes, in order to address such financing difficulties" (http://www.wto.org/english/docs_e/legal_e/35-dag_e.htm).

Box 9. Five Examples of IMF-WTO Research Cooperation

In 2002, IMF (Research Department and FAD) staff prepared four notes in response to a request by the WTO for help in analyzing proposals made by developing countries on its "special and differential treatment" provisions. The notes were circulated to WTO members in early 2003 (IMF, 2003c).

The note on "Trade Restrictions for Balance of Payments Purposes" addressed the proposal by India for a complete review of GATT Article XVIII including the implications of capital account mobility on the assessment of reserve adequacy and justification for import restrictions (see Box 5). The note summarized IMF (and other) work underlying the shift from current to capital account considerations in the assessment of reserve adequacy since the late 1990s. It argued that trade restrictions were not the first-best policy for achieving a targeted reserve growth rate during normal times or for dealing with reserve losses during a current or capital account crisis. There is no evidence that this note was used by the CBR or Trade Negotiations Committee in their subsequent deliberations on the proposal (which remains in abeyance).

The note on "Financing of Losses from Preference Erosion" addressed the proposal by least developed countries (LDCs) that they be compensated for the loss of export preferences resulting from a reduction of most-favored-nation (MFN) tariff rates under the Doha Round. The note estimated that a 40 percent cut in MFN tariffs by the so-called Quad (Canada, the European Union, Japan, and the United States) would lead to losses from preference erosion of less than 2 percent of exports for LDCs as a group and more than 5 percent of exports for only five LDCs. In light of this and the fact that the losses were anticipated, permanent, and spread out over time, the note argued that financing could be done in the context of existing IMF facilities. As it represented one of the few serious attempts to quantify the problem of preference erosion, the note attracted much attention within and outside the WTO.

The note on "Export Financing and Duty Drawbacks" addressed proposals by developing countries that: (i) they be allowed to provide export financing at the London interbank offered rate or on terms offered by developed-country credit agencies; and (ii) they be allowed to provide uniform duty drawbacks to all exporters and that duty drawbacks be extended to all inputs, including capital goods. On (i), the note argued analytically and empirically that the proposals would amount to export subsidization, which was not the first-best policy to overcome distortions in domestic capital markets. On (ii), the note argued that the attractiveness of the proposals in practice would depend on the strength of the country's tax administration, for example, countries with relatively strong tax administrations (including a value-added tax crediting mechanism) should not favor the uniform drawback scheme and could be allowed to extend duty drawbacks to capital goods. There is no evidence that this note was discussed in the WTO.

The note on "Liberalizing Trade and Safeguarding Public Revenues" did not address a specific proposal but spoke to concerns expressed by many developing countries regarding the revenue impact of trade liberalization. The note largely reinforced the conclusions of an earlier IMF paper (Ebrill, Stotsky, and Gropp, 1999) that was circulated and discussed in the WTO General Council and the Trade Negotiations Committee. It stressed that the impact of trade policy reform on fiscal revenue need not be significant (if tariff cuts were directed at bound rates and peak rates) and in any case could be ameliorated via accompanying measures such as a reduction in exemptions and special regimes, modernization of customs administration, and measures to strengthen the domestic tax system. The note formed the basis for an informal seminar by IMF staff for developing country delegations at the WTO in January 2003.

In 2004, after repeated requests by the WTO, IMF (Research Department) staff prepared a paper on "Exchange Rate Volatility and Trade Flows—Some New Evidence" (Clark, Tamirisa, and Wei, 2004). The paper, which updated a 1983 IMF study for the GATT (IMF, 1983), addressed concerns expressed by several WTO members that exchange rate volatility could undo the effects of price-based trade restrictions and generate pressure for additional protection (or reduce their incentive for further trade liberalization). The paper covered a broader group of countries than the 1983 study (which focused exclusively on advanced countries) and used different volatility measures and up-to-date estimation techniques. But the main conclusion was similar to that of the 1983 study, that is, that the negative correlation between exchange rate volatility and trade was empirically small and not robust. The paper was (briefly) discussed at a meeting of the WTO's Working Group on Trade, Debt and Finance in October 2004.

(ESAF), which was the forerunner of the Poverty Reduction and Growth Facility (PRGF)—were sufficient to help NFIDCs cope with higher food prices (WTO, 1995).[23] NFIDCs demurred, noting that the CFF had been of limited use to them, partly because of its limited product coverage (cereals only), conditionality (if drawn in conjunction with an upper-credit-tranche-type arrangement), and nonconcessional terms. The IMF Board reviewed the CFF in 2004 in conjunction with its review of instruments and financing options for low-income countries. The Board acknowledged that the CFF, because of its nonconcessional nature, was not an attractive option for low-income countries facing temporary shocks, and recommended subsuming its function in the PRGF, but put off the decision to eliminate the CFF for another three years (IMF, 2004a). The CFF was eliminated in 2009.

31. The IMF stayed its ground as requests grew for financial support to offset developing countries' expected loss of preferences associated with trade liberalization under the Doha Round. In a research note prepared for the WTO, IMF staff estimated that the upper-bound aggregate and individual country-level impact of preference erosion as a result of most-favored-nation (MFN) tariff reductions by the Quad (Canada, the European Union, Japan, and the United States) would probably be "very small" (IMF, 2003c; see Box 9). Given the special characteristics of the problem—losses from preference erosion were a permanent shock, they could be anticipated, and their actual impact was spread out over time—and that only a handful of developing countries were expected to be seriously affected, the paper argued convincingly that any financing could be channeled through existing IMF medium-term adjustment facilities.

32. Then, in a turnabout in 2004, the IMF created the Trade Integration Mechanism (TIM), its most visible coherence initiative. The TIM was designed to assist countries facing balance of payments shortfalls that resulted from trade liberalization measures undertaken by other countries. (Examples included preference erosion due to MFN tariff reductions, adverse changes in food terms of trade caused by the elimination of agricultural subsidies, and loss of export markets caused by the expiration of quotas under the WTO Agreement on Textiles and Clothing (ATC).)[24] The TIM is not a lending facility; it cannot be accessed on a stand-alone basis but only in the context of a Stand-By Arrangement (SBA) in the upper credit tranches, or arrangements under the Extended Fund Facility (EFF) or the PRGF.[25] TIM financing is determined under the access policies applicable to the underlying facility, with the possibility of an augmentation of up to 10 percent of quota per arrangement if the actual balance of payments impact turns out to be worse than expected (IMF, 2004b). In announcing the TIM at the WTO, the First Deputy Managing Director emphasized that very few countries were expected to use it, likening it to an "insurance policy" that would provide "reassurance" to governments and policymakers and "make it easier for them to embrace the Doha Development Agenda" (Krueger, 2004).

33. Critics were unimpressed. Civil society commentators saw the creation of the TIM as a superficial attempt to rescue the Doha Round and urged developing countries to think carefully about it before making any changes in their trade positions. The main criticisms of the TIM were that: (i) it did not provide additional resources; (ii) it was not concessional (unless activated in the context of a PRGF) or free of conditionality; (iii) it did not provide easy and fast access to financing—IMF staff had first to forecast the impact of the trade measure(s) on the affected country's balance of payments; (iv) it only covered (partially) balance of payments shortfalls and not the broad spectrum of trade-related adjustment costs; and (v) it was likely to be scrapped in a few years or subjected to more stringent requirements, as the CFF had been before it (Caliari and Williams, 2004).[26]

34. Demand for the TIM was low. Only three countries—Bangladesh, Madagascar, and the Dominican Republic—had taken advantage of the TIM by the end of the evaluation period, all citing adverse impacts of the termination of the WTO ATC in January 2005 (Box 10). A 2003 PDR guidance note had identified 16 countries as "highly vulnerable" to the phase-out of textile and clothing quotas (IMF, 2003e).[27] A 2005 PDR memo to management identified a further five countries as likely to suffer a significant macroeconomic impact from the reform of the EU sugar sector (IMF, 2005c). Fund missions explored the TIM option with several IMF mem-

[23] The CFF was established in 1963 to assist countries experiencing either a sudden shortfall in export earnings or an increase in the cost of cereal imports, often caused by fluctuating world commodity prices. The CFF has not been used since 1999 (IMF, 2004a).

[24] Although the creation of the TIM stemmed from concerns raised by developing countries in the WTO's Doha Round negotiations, any Fund member—whether or not a member of the WTO—is eligible for TIM assistance.

[25] Designed to help countries address short-term balance of payments problems, SBAs typically last one to two years. The EFF is designed to help countries address longer-term balance of payments problems requiring fundamental economic reforms; EFF arrangements typically last three years. Both arrangements are nonconcessional and subject to surcharges at high access levels.

[26] See also Mekay (2004) and Bretton Woods Project (2004).

[27] The economies were Bangladesh, Cambodia, Cape Verde, Egypt, Macedonia, Macao SAR, Maldives, Mauritius, Mongolia, Morocco, Nepal, Pakistan, Romania, Sri Lanka, Tunisia, and Turkey.

bers including Albania, Fiji, Lesotho, Mauritius, and countries in the Caribbean region but there were no takers; few of those countries had a Fund-supported arrangement at the time and the others were not keen to begin one. Fund staff saw two reasons for the low demand for the TIM: the trade liberalization proposed under the Doha Round had not yet taken place, and several countries that might have accessed the TIM after the ATC expired did not experience balance of payments problems, given other mitigating factors. Staff dismissed the idea that conditionality may have made the TIM unattractive, arguing that the conditionality in the three programs that included recourse to the TIM was unlikely to have been very different without the TIM (IMF, 2006a). However, at least a few countries were clearly put off by the need to request a full-blown Fund-supported program just to obtain TIM insurance. Mauritius, for example, eschewed this option in favor of assistance under the Aid for Trade initiative (IMF, 2006a); Fiji, Lesotho, and countries in the Caribbean region also declined TIM assistance as they did not have a Fund program in place (IMF, 2004d, 2005e, 2007b).

35. The TIM did not seem to help much to advance the Doha Round. Although it was hailed by some (including the WTO) as a concrete and timely response to the difficulties faced by the Round after the collapse of the WTO's Cancun summit, its contribution was marginal—and the Doha Round is not much closer to a conclusion.

36. The IMF also introduced other policies to assist low-income countries; though not undertaken as part of Fund-WTO cooperation, these were considered to contribute to the coherence objective. Two

Box 10. Implementing the TIM

The first step in implementing the TIM was identifying those countries that were likely to need it. A 2003 PDR guidance note had identified 16 countries as "highly vulnerable" to the phase-out of textiles and clothing (T&C) quotas. However, the list was based on simulations using 1997 data, and missed many countries whose T&C sectors did not take off until the late 1990s. For the 16 "highly vulnerable" countries, staff were instructed to monitor and evaluate the impact of quota removal (IMF, 2003e). In practice, this was done (through a dedicated selected issues paper and/or a separate T&C export line in the balance of payments table) for fewer than half of those countries and the identification process ended up being somewhat random.

Once a country was identified as a serious TIM candidate, Fund staff were required to prepare three balance of payments projections: (i) showing how the balance of payments would have evolved in the absence of the trade event; (ii) incorporating the trade shock(s) and assuming no policy adjustment; and (iii) incorporating an adjustment effort. The so-called baseline impact—the difference between (i) and (ii)—formed the basis of a policy discussion with the authorities. The revised trade performance—the difference between (i) and (iii)—was factored into the access levels granted under the arrangement via its impact on the overall balance of payments and the associated financing gap.

In July 2004, Bangladesh became the first country to avail itself of the TIM to cope with balance of payments pressures stemming from the phase-out of T&C quotas under the Agreement on Textiles and Clothing (ATC). Bangladesh had had a PRGF arrangement in place for a year when it requested an additional SDR 53.3 million (about US$78 million) of financing in accordance with the TIM, bringing its total PRGF amount to SDR 400.3 million (about US$583 million). To calculate the baseline impact, the Fund team drew on a thorough in-house study using the Global Trade Analysis Project (GTAP) model to simulate the effects of the ATC quota phase out (Mlachila and Yang, 2004).

In January 2005, the Dominican Republic requested activation of the TIM in parallel with a Stand-By Arrangement totaling SDR 437.8 million (about US$665 million). As in the case of Bangladesh, the TIM was needed to mitigate the possible adverse effects of the phase-out of T&C quotas under the ATC. Fund staff prepared the TIM balance of payments table that was required to be attached to the authorities' memorandum of economic and financial policies, but did not explain the basis for their projections and were not asked about them during the Board discussion. The policy adjustment endorsed by the staff (and a majority in the Board) involved the implementation of the Dominican Republic-Central America Free Trade Agreement.

In July 2006, Madagascar requested activation of the TIM in parallel with a three-year PRGF arrangement with the Fund totaling SDR 55.0 million (about US$81 million). The TIM was requested to address the balance of payments impact of the termination of the ATC in early 2005 and the expected termination in 2007 of the third party provision under the U.S. African Growth and Opportunity Act (AGOA). The TIM balance of payments table that was attached to the request contained judgmental forecasts; an earlier selected issues paper had discussed the difficulty of quantifying the impact of the T&C shock and provided a qualitative assessment of the impact of the ATC and AGOA III termination based on interviews with and a survey of T&C exporters (Khemani, 2005).

such initiatives introduced in 2005 were the Exogenous Shocks Facility (ESF) and the Multilateral Debt Relief Initiative (MDRI). The ESF was established to provide concessional financing to low-income members facing sudden adverse events such as terms of trade shocks, natural disasters, or sudden declines in demand for their exports.[28] The ESF carries the same interest rate and repayment terms as the PRGF and is open to low-income IMF members without a PRGF arrangement. Under the MDRI, the IMF agreed to cancel its debt claims on a group of low-income countries. Financial resources from the IMF's MDRI were counted as part of the WTO's Cotton Development Assistance, and the ESF was considered as part of the IMF's Aid for Trade strategy (see below) (WTO, 2006a; and OECD, 2007). The ESF was not used until 2008, after it was modified to increase and speed up access and to streamline its requirements.

Technical assistance

37. The IMF joined the WTO and other multilateral agencies in the Integrated Framework for Trade-Related Technical Assistance for Least Developed Countries (IF), though its role was relatively limited.[29] The IF was designed to facilitate the coordination of trade-related technical assistance and to promote an integrated approach to help least-developed countries (LDCs)—as designated by the United Nations (UN)—to enhance their trade opportunities. IMF staff played a catalytic role in the early years of the IF (when the initiative was encountering various difficulties and showing little tangible progress) by offering concrete suggestions for improvement; many of those suggestions were endorsed in a subsequent independent review of the IF (IMF, 2000a). The new approach defined the IF management structure, the sources of its financing, and the role of each agency, with the WTO managing the IF, the World Bank leading the "mainstreaming" process (i.e., the process of integrating trade policies into country-led poverty reduction strategies), and the UNDP administering the IF Trust Fund. The IMF's role was largely limited to supporting the World Bank in the mainstreaming process, through contributions on macroeconomic and exchange rate developments to Bank-led diagnostic trade integration studies (DTISs).[30] Almost all of the Fund's technical assistance that was applied in the IF context was for customs administration and tariff reform. By the end of the evaluation period, FAD had fielded customs administration missions to about three-quarters of the IF countries.

38. The IMF's role in the Aid for Trade initiative, too, was peripheral. The IMF and the World Bank jointly developed the original proposal and organized a consultation process with the WTO and other stakeholders in 2005 (IMF, 2005b).[31] Aid for Trade comprises technical assistance; capacity building; institutional reform; investments in trade-related infrastructure; and assistance to offset adjustment costs, such as fiscal support to help countries make the transition from tariffs to other sources of revenue (IMF, 2005d). Aid for Trade is open to all developing countries, unlike the IF, which is open only to UN-designated LDCs. The IMF Board endorsed the Fund and Bank staffs' proposals to operationalize Aid for Trade, including enhancing and redesigning the IF and exploring new financial mechanisms as appropriate, but it noted that the Fund's involvement should be limited to "selective interventions within its mandate and core areas of competence, including the macroeconomic implications of changes in trade policies and in the global trade environment, and tax and customs reform advice" (IMF, 2005f and 2006b). The Board saw no need for the Fund to offer financial support beyond what was available under existing Fund facilities.

39. IMF (FAD) staff nevertheless played an important supporting role in the WTO's trade facilitation negotiations. These negotiations sought to codify key customs practices in a binding agreement; negotiation modalities required WTO members to "undertake a collaborative effort" with the IMF, World Bank, UNCTAD, the Organization for Economic Cooperation and Development (OECD), and the World Customs Organization, "to make technical assistance and capacity building more effective and operational and to ensure better coherence."[32] One FAD staff member was closely (but not directly)

[28] Shocks due to known erosions in trade preferences (which the TIM was designed to address) were to be considered on a case-by-case basis but were unlikely to qualify for the ESF. Shocks to NFIDCs from deterioration in food terms of trade would qualify for the ESF.

[29] The other institutions were the World Bank, the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Program (UNDP), and the International Trade Centre. The IF was inaugurated by the six agencies at the WTO's high-level meeting on integrated initiatives for least developed countries' trade development in October 1997.

[30] Staff from area departments and PDR's Trade Policy Division commented on draft country DTISs and technical reviews. Staff from PDR's Trade Policy Division and/or the Office in Geneva represented the IMF in the IF's interagency steering committee and management board.

[31] The proposal was developed in response to a call by G-7 finance ministers at their meeting of February 5, 2005 for additional assistance to countries to ease adjustment to trade liberalization and to increase their capacity to take advantage of more open markets. The call was echoed by the Development Committee and the IMFC at their 2005 Spring and Annual Meetings and by the G-8 in Gleneagles in July 2005.

[32] Annex D of the Decision Adopted by the General Council on August 1, 2004 (http://www.wto.org/english/tratop_e/dda_e/draft_text_gc_dg_31july04_e.htm#annexd).

involved in the trade facilitation negotiations, explaining technical details and providing practical information to negotiators so that they could formulate their positions. The same FAD staff member also played a prominent role in joint work on a needs assessment tool and process for LDCs to assess what they needed to do to comply with the technical measures that were likely to be in the trade facilitation agreement, and even facilitated in one such assessment (for Bangladesh in October 2007).

40. Overall during the evaluation period, the IMF (Board, management, and staff) struck the right balance in its involvement in trade-related technical assistance and capacity building. The Board's decision to limit the IMF's involvement to its areas of core competence was reasonable. Fund staff stayed within the boundaries prescribed by the Board: they made useful, practical contributions in their areas of expertise (e.g., customs administration) and did not get involved in work outside their areas of core competency, despite the WTO's appeals for deeper involvement in the IF and Aid for Trade.[33]

D. Overlap in IMF-WTO Cooperation

41. The IMF and the WTO have fundamentally different—and possibly inconsistent—approaches to trade liberalization. The WTO's approach involves reciprocal liberalization in a multilateral setting; the IMF's approach involves unilateral liberalization. The WTO's approach provides more leeway for developing countries, especially LDCs (for example, by allowing them to phase in trade policy reforms more gradually and to make use of exceptions for development purposes); the IMF's approach is to apply economic principles uniformly across its membership.

42. Some developing countries have complained that the IMF's trade policy advice/conditionality disregarded the policy space they are entitled to under WTO rules. Several such complaints were heard at the WTO during the evaluation period. For example, in 1999, India argued that the IMF's trade policy advice and statements to the CBR did not make special considerations for developing countries as required under WTO rules (Box 5). In 2001, Mongolia appealed (unsuccessfully) to the WTO to intervene after the Fund—in the conditionality associated with the 1997 ESAF-supported arrangement—refused to allow the Mongolian government to impose a 30 percent export duty on raw cashmere that had been approved as part of Mongolia's WTO accession commitments (Tsogtbaatar, 2005; IMF, 1997a). In 2002, a representative of the African Group at the WTO noted that Malawi was unable to "use its tariff flexibility negotiated under the WTO because its applied rates had been lowered more rapidly and bound [sic] under the IMF and the World Bank lending conditionalities" despite the fact that Malawi was an LDC "entitled to certain exceptions and transitional periods within the WTO" (WTO, 2002a).

43. IMF staff have taken the view that because the IMF's trade policy advice/conditionality is designed to improve economic efficiency it can—and indeed, often should—encompass reforms that go beyond a country's WTO commitments. This notion is heavily emphasized in guidance notes to staff, with the caveat that countries should not be required to make binding commitments to the WTO on the trade liberalization undertaken in the context of a Fund-supported program. Table 4 shows that during 1996–2007, tariff conditionality featured in the Fund-supported programs of more than a quarter of the IMF member countries that were also members of the WTO. Tariff conditionality typically took the form of a requirement to lower the maximum or average tariff rate to a particular figure. Although Fund staff have been careful in their programs to avoid cross-conditionality in the strict legal sense, countries have on occasion committed to bind in the WTO trade reforms (other than tariff reductions) undertaken as part of a Fund-supported program.[34]

44. The relationship between multilateral trade liberalization and unilateral trade reform was the first item on the coherence agenda. During the Uruguay Round, many developing countries maintained that their bargaining power in trade negotiations had been weakened by unilateral trade reforms that they had undertaken in the context of Fund-supported programs without reciprocal concessions from their trading partners. They were loath to undertake any further trade liberalization unless a system was devised whereby they could receive credit in future trade negotiations for previous "autonomous" (unilateral) trade liberalization.[35] Fund staff rejected

[33] The limited role of the IMF (vis-à-vis the other IF agencies, for example) is evident from the agency profiles and data on Aid for Trade commitments that are reported in the joint OECD-WTO review of Aid for Trade (OECD, 2007).

[34] The most frequently cited examples are Korea and Indonesia during the Asian financial crises. Indonesia's 1997 program included commitments by the government to implement ahead of schedule the ruling of the WTO dispute panel in a case involving its automobile industry; to phase out its local content program for motor vehicles in line with its WTO commitment; and to lift restrictions on branching of foreign banks and on foreign investment in listed banks as part of its WTO GATS negotiations (IMF, 1998a). Korea's 1997 program included a commitment to make binding under the WTO liberalization of financial services as agreed with the OECD (IMF, 1997b). See Background Document 5 for more on these two cases.

[35] In the Uruguay Round negotiations, credit for tariff bindings was given, and other autonomous liberalization measures were recognized, through a bilateral request-and-offer approach, but no

Table 4. Tariff Conditionality in IMF-Supported Programs, 1996–2007

	Number of Countries	Number of Countries with Fund-Supported Programs During 1996–2007[1]	Number of Countries Subject to IMF Tariff Conditionality During 1996–2007[2]	Proportion of Countries Subject to IMF Tariff Conditionality During 1996–2007 (Percent)	Proportion of Program Countries Subject to IMF Tariff Conditionality During 1996–2007 (Percent)
WTO members[3]	146	77	40	27	52
High-income countries[4]	30	1	0	0	0
Middle-income countries[4]	57	26	15	26	58
Low-income countries[4]	59	50	25	42	50
Of which: LDCs[5]	32	27	13	41	48
WTO accession countries[6]	28	14	10	50	71
Middle-income countries	13	5	3	23	60
Low-income countries	5	9	7	47	78
WTO nonmembers[7]	10	0	0	0	0

Sources: IMF, WTO, and IEO.
[1] Includes only programs that started between January 1, 1996 and December 31, 2007.
[2] Includes only tariff measures specified as prior actions, performance criteria, or structural benchmarks.
[3] IMF members that were also WTO members as of December 31, 2007.
[4] Based on *WEO* classification. Low-income countries are PRGF-eligible countries.
[5] Based on UN designation. (See http://www.wto.org/english/thewto_e/whatis_e/tif_e/org7_e.htm.)
[6] IMF members that were WTO observers (in the process of accession to the WTO) as of December 31, 2007.
[7] IMF members that were nonmembers of the WTO as of December 31, 2007.

this argument on the grounds that IMF conditionality related to applied rather than bound tariffs; they argued that since WTO negotiations covered the latter, cuts on the former imposed by a Fund-supported program should not affect the country's negotiating advantage at the WTO (IMF, 2003d).

45. The IMF's position on unilateral trade liberalization is by and large based in economic theory. It is well understood in theory that under perfect competition the optimum tariff for a small economy is zero, and that hence such an economy would have nothing to lose and everything to gain by unilateral tariff liberalization. A theoretical first-best case for trade policy (such as an import tariff or export tax) can be made for a large economy that can affect its terms of trade with such a policy, or under imperfect competition, but these arguments are normally considered to have insufficient general applicability to warrant departing from free trade. Bhagwati (2007) puts it plainly: "The truth of the matter is that free trade is alive and well among economists, their analytical arguments in favor of it, developed with great sophistication in the postwar theory of commercial policy, having hardly been dented by any original arguments by the few economists...arrayed against it."

46. But the political economy aspects of trade policymaking are important too. Indeed, the accepted riposte to the theoretical first-best case for trade policy—the optimum tariff argument—is a political economy argument: namely, the possibility of retaliation (Bhagwati, 2007). The academic literature has shown that the (perceived) optimum tariff may be positive even for a small economy once political economy considerations come into play (such as differential weights attached to the welfare of different groups in the economy).[36] In a world with positive optimum tariffs—whether based on market power or political economy factors—Bagwell and Staiger (2002) show that the WTO's system of reciprocity and enforcement rules is an efficient route to trade liberalization. While IMF staff should not be expected to factor political economy considerations into their trade policy advice, they should be aware that country authorities (and the multilateral trading system) do take such considerations into account. It is entirely appropriate for IMF staff to remind country authorities of the economic arguments behind trade policy in the surveillance context. But it is less appropriate for the IMF to use its leverage to push the eco-

common multilateral approach or formula was found. In 2003, the WTO adopted modalities for the treatment of autonomous liberalization in the area of trade in services (WTO, 2003), but no framework has been agreed for trade in goods.

[36] See Rodrik (1996) for a survey of political economy models.

nomic arguments ahead of all other trade policymaking considerations in a program context.

47. By requiring unilateral trade liberalization through program conditionality, the Fund may have complicated the process of multilateral trade liberalization. To Fund staff, only actual tariffs mattered, not tariff bindings. But tariff bindings were not irrelevant—they determined the parameters for trade policy within the multilateral framework. Program conditionality to lower a country's actual tariffs—but not its bound tariffs—increased the country's so-called binding overhang (i.e., the gap between bound and applied tariffs). Table 5 shows average bound and applied tariff rates in 2007 for IMF members that are also WTO members: while the rates are not directly comparable because of less than full binding coverage in most cases, they suggest that binding overhang can be substantial in developing countries, particularly LDCs. The Fund cannot compel or impel all countries to maintain low applied tariffs at all times. Baldwin (2008) likens tariff bindings that greatly exceed applied tariffs to options whose value to the WTO member increases with volatile (domestic and global) economic conditions. During bad times, a member may choose to raise its tariffs up to their bindings without breaching its WTO commitments—as was done, for example, by some Asian and Latin American countries in the late 1990s. The WTO's TPRs usually draw attention to large and/or increasing gaps between a member's bound and applied tariff rates, because these gaps create uncertainty in trade policymaking. Hence the Fund's practice of using program conditionality to lower but not bind tariffs has not much advanced the WTO's goal of creating a freer *and predictable* multilateral trading system.

E. Gaps in IMF-WTO Cooperation

48. Gaps remain in cooperation between the two institutions. Three issues that can have, and have had, macroeconomic implications are worth highlighting: exchange rate manipulation, trade in financial services, and preferential trade agreements (PTAs).

Table 5. IMF-WTO Members: Average Tariffs and Tariff Bindings, 2007

	Binding Coverage[1] (Percent)	Average Bound Tariff [2]	Average MFN Applied Tariff [2]
All products			
IMF-WTO members[3]	82.5	35.0	9.2
High-income countries[4]	95.9	7.9	5.2
Middle-income countries[4]	92.5	30.0	8.7
Low-income countries[4]	66.0	53.5	11.8
Of which: LDCs[5]	58.0	61.6	13.0
Nonagricultural products			
IMF-WTO members	79.8	26.1	8.2
High-income countries	95.2	4.9	3.4
Middle-income countries	91.4	26.0	7.6
Low-income countries	60.8	36.9	11.2
Of which: LDCs	51.6	42.7	12.7
Agricultural products			
IMF-WTO members	100.0	51.7	16.2
High-income countries	100.0	26.4	17.6
Middle-income countries	100.0	46.1	16.3
Low-income countries	100.0	70.0	15.5
Of which: LDCs	100.0	76.0	15.1

Source: World Tariff Profiles, 2008 (http//:www.wto.org/english/res_e/reser_e/tariff_profiles_e.htm).

[1] Share of Harmonized System (HS) six-digit subheadings containing at least one bound tariff line.

[2] Simple average of the ad valorem or ad valorem-equivalent HS six-digit duty averages.

[3] IMF members that were also WTO members as of December 31, 2007.

[4] Based on *WEO* classification. Low-income countries are PRGF-eligible countries.

[5] Based on UN designation (see http://www.wto.org/english/thewto_e/whatis_e/tif_e/org7_e.htm).

Exchange rate manipulation

49. The two institutions did not come to grips with the potential jurisdictional overlap between trade and exchange rate measures. As noted earlier, the IMF considers exchange rate measures to fall solely within its jurisdiction but there is a possibility that exchange rate measures with significant trade effects may fall within the WTO's jurisdiction as well. The question of exchange rate misalignment and trade was too sensitive for inclusion in the coherence agenda.[37] Instead, the WTO couched the issue in more neutral terms of exchange rate volatility and trade and commissioned the Fund to prepare a study on this topic. The IMF study (Clark, Tamirisa, and Wei, 2004), however, concluded that exchange rate volatility was "probably not a major policy concern" for trade flows (Box 9). The issue resurfaced during the Asian financial crises of the late 1990s, when large currency devaluations by some crisis-hit countries (in certain cases under IMF programs) generated pressure for trade policy responses in some of their main trading partners (Box 8). It came up again more recently in the context of U.S. allegations that China was undervaluing its currency in order to gain an export advantage.

50. The potential jurisdictional overlap has been viewed by outsiders as a serious flaw in IMF-WTO cooperation. In September 2004, an alliance of American manufacturing companies and labor unions petitioned the U.S. government to take legal action against China at the WTO for keeping the value of its currency fixed against the dollar.[38] Schwartz (2005) noted that although it was the IMF's responsibility to forestall currency manipulation, "the petitioners asserted that they had turned to the WTO for a remedy because the IMF was not doing its job." The Bush administration rejected the petition but the issue received the support of many politicians. According to Hufbauer, Wong, and Sheth (2006), "[s]ome 20 out of 25 China bills introduced between 2003 and 2005 alleged an unfair Chinese trade advantage from the undervalued renminbi." In June 2007, a group of U.S. legislators introduced the Currency Exchange Rate Oversight Reform Act to establish a stronger approach to identifying currency manipulation and imposing consequences including requesting the Fund to engage the offending country in special consultations over its misaligned currency and, in serious cases, requesting dispute settlement consultations in the WTO. Brainard (2007) suggested that the proposed legislation was necessary because "the WTO and especially the IMF [had not been] up to the task of grappling with China's undervalued yuan."

51. In June 2007, the IMF adopted a new Surveillance Decision, which, inter alia, aimed to clarify the concept of exchange rate manipulation. According to the 2007 Surveillance Decision, an IMF member country would be considered to be "acting inconsistently with Article IV, Section 1(iii)"—that is, "manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members"—if the Fund determines that: (i) the country is engaging in policies targeted at, and actually affecting, the level of its exchange rate; and (ii) the country is doing so "for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate" in order "to increase net exports" (IMF, 2007a). To date, the Fund has not declared any member to be in violation of Article IV, Section 1(iii).

52. The new Surveillance Decision has not satisfied the critics. Sanford (2008) argued that IMF-WTO cooperation could be strengthened to resolve their "disparate treatment of currency manipulation," whereby the Fund has no capacity to enforce its prohibition of exchange rate manipulation while the WTO has the capacity to adjudicate trade disputes but it is unclear whether currency disputes fall within its jurisdiction. Along the same lines but more concretely, Mattoo and Subramanian (2008) argued that the IMF has not been effective in addressing currency manipulation "[f]or reasons of inadequate leverage and eroding legitimacy" and that the two institutions should thus cooperate "with the IMF providing the essential technical expertise in the WTO enforcement process" under "new rules in the WTO to discipline cases of significant undervaluation that are clearly attributable to government action."

53. The possibility of a case of exchange rate manipulation being adjudicated by *both* the Fund and the WTO could be problematic. It is beyond the scope of this evaluation to assess the IMF's 2007 Surveillance Decision. However, it is worth noting that one cannot rule out the possibility of a WTO member bringing a dispute or countervailing case to the WTO regarding exchange rate manipulation, or the WTO panel arriving at a different judgment than the Fund. As noted earlier, there is no guarantee that an exchange rate measure sanctioned by the IMF will be immune from challenge at the WTO; no legal precedent has been set to date.

[37] Auboin (2007) notes that such wording would have "created acrimony" amongst WTO members. A 1989 meeting of the Director-General of GATT and the heads of the Bretton Woods institutions concluded there was not enough evidence to link exchange rate misalignment and protectionism and that in any case such problems were the "least amenable to improvement through action by the international agencies themselves" (Sampson, 1998).

[38] See www.chinacurrencycoalition.org/petition.html.

54. Neither institution has openly discussed how such a scenario could play out. Understandably, neither is anxious to take on this thorny issue but their silence has been interpreted as a lack of cooperation. In fact, at the technical level, IMF and WTO Secretariat staff have discussed the issue on several occasions. They are clear about how they would work together if an exchange rate manipulation case were brought before the WTO, though they are less clear about what would happen if a WTO panel reached a different decision than the Fund. The closest public statement on this issue was by WTO Director-General Lamy when he said in an October 2007 speech that it was up to the IMF, not the WTO, to decide whether China or any other country was following an appropriate currency policy.[39]

Trade in financial services

55. Trade in financial services is an obvious area of potential IMF-WTO overlap, but during the evaluation period little collaboration took place between the two institutions to clarify the main issues. In 2005, the IMF Board noted "the possible overlap between services trade negotiations and traditional areas of Fund advice relating, for example, to financial sector liberalization and financial vulnerabilities" but simply encouraged the staff to "increase the coverage of trade in services" (IMF, 2005a).

56. There is significant debate concerning regulation versus liberalization of trade in financial services. The GATS contains a number of provisions allowing countries to regulate financial services in the general interest, particularly in the case of balance of payments difficulties or for prudential reasons.[40] The interpretation of "prudential reasons" has turned out to be quite contentious, with the debate centering on the tension between the need for appropriate prudential measures and restrictions on market access for foreign providers of financial services. While most advanced economies are pushing at the WTO for greater and faster financial services liberalization, many developing countries, drawing from the lessons of the Asian financial crises, prefer a slower pace of liberalization commensurate with their development of financial supervisory capabilities.

57. Fund staff could have lent their expertise to this debate much as FAD staff assisted the WTO's trade facilitation group in customs administration issues. By the end of the evaluation period, no financial services negotiations had taken place at the WTO since the first round of negotiations ended in December 1997, and the WTO's Committee on Trade in Financial Services (CTFS), which was established as a negotiating group for the financial services agreement, had lain dormant for ten years. But even if no opportunity arose to assist in negotiations, the Fund could have found a way to share its financial sector expertise more effectively with WTO members needing informational support. The two presentations made by Fund staff at the CTFS (Table 3)—one describing the main features of the Financial Sector Assessment Program (FSAP) and the other analyzing the link between financial sector reform and capital account liberalization—were too general in content to be of much help to the delegations.

Preferential trade agreements

58. The question of how the IMF and the WTO should respond to PTAs was recognized early on as an important item on the coherence agenda. PTAs—mostly in the form of free trade agreements and partial scope agreements—have grown exponentially in number since the early 1990s and are now a prominent feature of the global trading system. According to the WTO, more than 200 are currently in force and their number is expected to double by 2010. Many PTAs go well beyond merchandise trade liberalization to areas such as trade in financial and other services, investment flows, and other disciplines. Though the WTO has formal jurisdiction over them, PTAs are typically negotiated and implemented outside the active involvement of any of the major international organizations.[41] The 1998 Coherence Report called for a coherent approach by the Fund, the World Bank, and the WTO "to ensure that these arrangements contribute to a liberal and more integrated trading system and facilitate the process of multilateral liberalization" (IMF, 1998e).

[39] "Leave currency surveillance to IMF—WTO head," *Reuters*, October 22, 2007.

[40] Article XII of the GATS allows a WTO member to "adopt or maintain restrictions on trade in services on which it has undertaken specific commitments, including on payments or transfers for transactions related to such commitments" in the event of serious balance of payments and external financial difficulties (or threat thereof), provided, among other things, that such restrictions do not violate the Fund's Articles of Agreement (http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm). Paragraph 2 of the GATS Annex on Financial Services states that a WTO member "shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system" (http://www.wto.org/english/tratop_e/serv_e/10-anfin_e.htm).

[41] WTO members are required to notify the WTO when entering into a PTA such as a customs union or free trade area. The WTO's Committee on Regional Trade Agreements (CRTA) is responsible for examining individual agreements. However, the committee's work has been hampered by a lack of agreement among WTO members on how to interpret the criteria for assessing the consistency of such agreements with WTO rules (WTO, 2006b). As a result, only a handful of agreements have been considered by the CRTA to date.

59. The economics of PTAs is complex. While PTAs can be trade liberalizing, they are discriminatory and some observers therefore fear that their proliferation could lead to trade diversion and jeopardize progress toward global free trade. Nonetheless, given that PTAs are here to stay, the focus of multilateral institutions like the WTO should be, and increasingly has been, on how to design them to make them building blocks rather than stumbling blocks for multilateral trade liberalization. In December 2006, the WTO established (on a provisional basis) a transparency mechanism that provides for timely notification of any PTA to the WTO and for a factual presentation by the WTO Secretariat describing the features of the PTA. The plan is for the WTO to release a complete list of PTAs that have been agreed, along with data on trade flows under them. This will enable researchers to look systematically at the characteristics and design of PTAs and perhaps identify best practices for designing PTA architecture.

60. The IMF has not been involved in this important discussion. The only contribution by the Fund was a descriptive paper presented at a joint IMF-WTO-World Bank seminar on regionalism in June 1999. Since then, the WTO has organized three high-level seminars on PTAs—in April 2002, November 2003, and most recently on "Multilateralizing Regionalism" in September 2007—with substantive participation from the World Bank, OECD, regional development banks, think tanks, and academia, but not the IMF. In reviewing the Fund's work on trade in 2005, the Board "emphasized that regional trade agreements, if appropriately structured, can provide immediate economic benefits and can be complementary and compatible with multilateral liberalization" (IMF, 2005a). Yet during the evaluation period Fund staff made minimal contributions to the active and ongoing discussions at the WTO and elsewhere on how to structure PTAs to ensure their compatibility with multilateral liberalization.

F. Summary and Conclusions

61. IMF-WTO cooperation during the evaluation period was mostly low-key, sometimes close, and often lopsided. The Cooperation Agreement was implemented as envisaged and close cordial working relationships were cultivated between Fund staff (the Office in Geneva and PDR's Trade Policy Division) and staff in the WTO Secretariat. Fund management maintained regular contact with the WTO Director-General. The intensity of IMF-WTO interaction varied, from high during the WTO's formative years (1995–96) and following the Doha and Cancun ministerial meetings (2001–04) to low in the more recent past. Statutory cooperation (CBR consultations on trade restrictions for balance of payments purposes) dwindled after 2000. Ad hoc cooperation mainly took the form of WTO requests for IMF analysis/research (which the Fund always satisfied) and financial support (which the Fund mostly tried to resist).

62. Conspicuous joint initiatives were largely absent. Due to limitations of capacity, the IMF remained a minor partner in the IF and Aid for Trade initiatives. The IMF's only attempt at an exclusively trade-related initiative—the TIM—received a limited response.

63. Due to organizational and other differences between the two institutions, there was negligible duplication of work. In the early days of the WTO there were concerns that its trade policy surveillance would duplicate some of the Fund's Article IV work, but those concerns were not borne out. Unlike IMF surveillance documents, WTO TPRs are prepared on a much longer cycle, up to once every six or more years for developing countries. The macroeconomic information in TPRs was drawn from Fund documents, though Fund staff did not much use TPRs as a resource.

64. Cooperation was sufficient to prevent any major inconsistencies or disputes between the two organizations. Inconsistencies (i.e., Fund advice or conditionality that violates a country's WTO commitments) are difficult to detect unless they are brought for dispute settlement at the WTO. Only two such cases occurred during the evaluation period, and the verdicts in both cases were favorable to the Fund though the dispute panels did not consult the Fund in either case.

65. Since the mid-2000s the IMF has steadily cut down on resources and time spent on WTO cooperation. The staff complement of the Geneva Office was reduced from five (a director, a senior economist, and three administrative assistants) to two (a senior economist and an administrative assistant) in 2002, and the office was closed in 2008. Also in 2008, PDR's Trade Policy Division was subsumed into a new division (of about the same staff size) with responsibility for trade, institutions, and policy review. The Research Department's trade unit (later the trade and investment division) was eliminated in 2007. The CWTO stopped meeting after 2004 and was not reconstituted in 2006. In 2008, it was replaced by the Committee on Liaison with the World Bank and Other International Organizations, which has the broader mandate to liaise with international organizations including the WTO. As of the time of writing, the new committee has not met.

66. This move is questionable given the gaps that remain in cooperation between the two institutions. The two institutions have yet to satisfactorily address how they will cooperate on important issues that affect their work and/or mandates. PTAs are a prime

example of an issue with far-reaching implications for the work of both the WTO and the IMF, yet during the evaluation period the two institutions did not collaborate to develop a coherent approach to PTAs. The situation is similar regarding the liberalization of trade in financial services—where comparative advantage suggests that the IMF could play a bigger role in the debate—and regarding the question of exchange rate manipulation—where it remains untested and hence unclear whether the WTO dispute settlement mechanism would defer to the Fund.

67. The two institutions need to reconcile the fundamental differences in their approaches to trade liberalization. The IMF's position on unilateral trade liberalization has a sound economic basis. This makes the IMF a valuable voice in advising countries on trade policy in the surveillance context because it brings an objective macroeconomic perspective that the WTO cannot provide. But problems arise when the IMF imposes unilateral trade liberalization on a country in a program context. Doing so does not help multilateral trade liberalization much (because the IMF does not affect tariff bindings) and it could even hurt (if the country refuses to make further concessions in multilateral negotiations). To resolve this, the IMF should either work with the WTO to make its trade conditionality bind and to develop a framework for granting negotiating credit for such liberalization (like the one for the GATS) or—a simpler solution—the Fund should eschew trade conditionality altogether.

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Background Document

3 Guiding the IMF's Involvement in International Trade Policy

A. Introduction

1. The IMF stepped up its trade policy advice in the wake of the balance of payments crises of the 1970s and 1980s. The crises demonstrated the flaws in the inward-oriented industrial development strategies, based on import substitution, that many developing countries had pursued. Through surveillance and conditionality, the IMF stepped up its role in guiding changes in trade policy that would help countries to achieve a greater outward orientation and to reduce their reliance on compressing domestic demand to restore a sustainable balance of payments position. Trade liberalization gained pace in the 1990s as many developing countries, including most previously centrally planned economies, embarked on tariff and nontariff reforms, often in the context of IMF-supported programs. During 1987–93, structural trade policy conditionality ranked third behind financial sector/exchange system and fiscal structural conditionality across a broad spectrum of IMF arrangements (IMF, 2001b).[1]

2. By the mid-1990s, IMF advice on trade policies of developing countries was very active, and Executive Directors were urging greater attention to spillover effects of advanced countries' policies as well. In discussing the 1994 Comprehensive Trade Paper (IMF, 1994a), Directors generally agreed that staff coverage of trade policy was "broadly appropriate," but several of them saw scope for increased study and analysis in two areas: (i) the macroeconomic implications of trade policies, including the impact of protectionist actions both on the domestic economy and on trading partners (subsidies and discriminatory taxation in industrial countries were especially highlighted); and (ii) the spillover effects of regional trade integration on regional partners and third countries, given the trend toward preferential trade agreements (PTAs), primarily by industrial countries. Directors reiterated that the design of effective trade reforms in IMF-supported programs should give due consideration to the revenue impact and to complementary macroeconomic policies, particularly the appropriate exchange rate policy. They emphasized the importance of close collaboration with the World Bank in the design of trade liberalization. Directors requested that the implications of the Uruguay Round for individual countries, especially net food importers and countries facing erosion of trade preferences, be monitored to ascertain any needs for transitional adjustment and financing (IMF, 1994b, 1994c).

3. This paper evaluates whether guidance on the IMF's role in trade policy issues during 1996–2007 was timely, clear, well focused, and comprehensive. This guidance was set by the IMF Executive Board and management with input from the then Policy Development and Review (PDR) and Legal Departments. General guidance was primarily contained in: Board summings up of periodic reviews of bilateral surveillance and conditionality and associated PDR operational guidance notes; summings up of periodic reviews of the IMF's work on trade and joint IMF-World Bank policy papers; and trade-specific PDR guidance notes (Annex Table 1). Within this broad framework of guidance, views on specific trade policy issues were established in Board meetings on bilateral surveillance, the use of Fund resources, and trade-related policy papers.

4. This paper is structured as follows. The next section discusses guidance on the objectives and coverage of trade policy issues in IMF activities. The following three sections assess guidance on specific trade policy issues: tariff and nontariff reforms, trade in services, and PTAs. The section after that briefly reviews the guidance on assessing the effects of changes in trade policy, in particular on fiscal revenue, the balance of payments, growth and poverty; it also discusses guidance on complementary policies for effective trade reforms. The final section concludes.

[1] Structural conditionality comprises performance criteria, structural benchmarks, and prior actions.

B. Objectives and Coverage of IMF Involvement in Trade Policy Issues

5. The Executive Board laid out general objectives, especially early in the evaluation period, for the Fund's advice on trade policy through surveillance or conditionality. In 1997, in discussing a staff paper on trade liberalization in IMF-supported programs, Directors observed that "trade liberalization, as a complement to appropriate macroeconomic and other structural policies, should play an increasingly important role in the context of Fund-supported medium-term adjustment programs designed to foster sustainable high quality growth." They pointed also to a "need to promote trade liberalization in non-program countries in the course of the Fund's surveillance activities." An important goal of trade reforms was to promote "transparency and good governance by reducing incentives for lobbying for protection and opportunities for rent-seeking, and by eliminating administrative discretion" (IMF, 1997). In 2002, the Board reaffirmed the IMF's objective in trade policy in the statement that the IMF "has an important role to play in promoting and actively supporting trade liberalization among its members" (IMF, 2002e). The Board has not explicitly changed this underlying objective, although the effort to streamline structural conditionality has implied taking a less activist approach to trade reform than previously.[2]

6. Despite the absence of an explicit change in objective, the Board progressively broadened the scope of its requests for IMF involvement in trade policy issues. Guidance to staff in the initial years of the evaluation period focused on the traditional trade policy issues of tariff and nontariff barriers to trade in goods. Thereafter, the Board began to emphasize the systemic impact of developed country trade policies and an explicit extension of the IMF's advice to trade in services. Toward the end of the evaluation period, the Board requested a further broadening of the IMF's involvement in trade policy issues to cover countries' views on multilateral trade negotiations, for countries that were key players.[3]

7. As the scope of IMF involvement in trade policy issues widened, Directors called for greater selectivity of coverage in surveillance. Thus, the 2002 Surveillance Guidance Note (IMF, 2002c) advised that coverage of trade policy was essential in (i) "countries where serious trade distortions hamper macroeconomic prospects," and (ii) "countries whose trade policies have systemic (global or regional) implications." In 2004, Directors again requested greater selectivity of coverage in trade policy issues, to focus on "issues that have an important influence on stability and growth prospects" (IMF, 2004d). Consequently, the 2005 Surveillance Guidance Note (IMF, 2005e) further clarified and elaborated on the selectivity criteria. It noted that the level of coverage should range "from substantial to none, depending on the staff's judgment on the relevance of trade developments for macroeconomic prospects." The 2005 note added to the existing two criteria a third one, specifying that coverage is expected for "countries where the balance of payments or fiscal accounts are vulnerable to trade developments."

8. A parallel process occurred for conditionality on trade policy. The effort to streamline Fund conditionality established a greater burden of proof of need for trade policy conditionality. In 2000, at the start of the streamlining initiative, the Executive Board called for a more parsimonious application of structural conditionality in IMF-supported programs. Accordingly, the current conditionality guidelines (IMF, 2002f) advise that "conditions will normally consist of macroeconomic variables and structural measures that are within the Fund's core areas of responsibility."[4] Conditions outside the Fund's core areas of responsibility require a "more detailed explanation of their critical importance."

9. It took substantial time to clarify criteria for selecting which trade policy issues to cover, however, and the discussion made more progress with regard to surveillance than conditionality. Soon after the streamlining effort began, several Directors observed that the distinction between core and noncore areas of the IMF's responsibility could be blurred and confusing (IMF, 2000a). In the context of surveillance, in 2000 the Board moved away from a core/noncore distinction of the IMF's areas of responsibility to a "hierarchy of concerns" (IMF, 2000b). PDR—responding to continued uncertainty among staff about when to cover trade policy issues—prepared a 2005 Board paper (IMF, 2005a) that outlined "key considerations" for the selection of trade policy topics (Table 1). These operational considerations signaled priorities for staff in choosing trade policy issues in surveillance and provided focus to Directors' views. Directors agreed that there was "additional scope for more selectivity in the coverage of trade issues" and

[2] The initiative to streamline structural conditionality began in September 2000 with the Managing Director's interim guidance note on the topic (IMF, 2000f).

[3] In 2005, staff were asked to report on the authorities' views on major initiatives in the World Trade Organization if the country had a central role in these initiatives (IMF, 2005e).

[4] The guidelines note that conditions should be applied parsimoniously and should be "(i) of critical importance for achieving the goals of the member's program or for monitoring the implementation of the program, or (ii) necessary for the implementation of specific provisions of the Articles or policies adopted under them." The prohibition on import restrictions for balance of payments reasons, a continuous performance criterion in lending arrangements, falls within this latter category.

Table 1. Coverage of Trade Issues in Article IV Reports—Operational Considerations

Trade Issues	When to Cover in Staff Report?
Reform of trade regime	
Merchandise trade	Decision to report based on degree of restrictiveness/distortion of trade regime and importance of policy changes during reporting period; staff could use benchmark levels, e.g., of average tariff rates or an index of the trade policy stance, to determine a "presumption" of coverage.
Services trade	In principle as for merchandise trade reform; special attention to financial services trade, and to trade negotiations at the regional and global level that might affect the regulatory framework for services.
Fiscal aspects and customs administration	Criteria as for other fiscal revenue sources; cover if significant enough to require adjustment in other revenues or in public expenditure.
Spillover effects	Cover where measurable impact on world prices or exports of other countries; prima facie evidence includes prominence in trade disputes or negotiations.
Multilateral agenda	
WTO negotiations	Report on initiatives in which country plays a central role, either as a proponent or defensively; report on overall strategy if country is a leading player in the multilateral negotiations.
Macro vulnerabilities	Presumption that should be covered if country meets certain criteria related to vulnerability to preference erosion, food terms of trade changes, or the expiry of textiles quotas.[1]
Regional trade initiatives	No easy benchmarks, but presumption that should report where trade creation/diversion is significant, the agreement entails regulatory changes in areas of importance from a growth/stability perspective, or there are significant changes in institutions (e.g., the ability of a country to set tariffs or collect customs duties).

Source: IMF (2005a), Table 4.

[1] The criteria actually used include cut-off points of, respectively: (i) an estimated 2 percent or larger decline in export unit values associated with a 40 percent erosion of preferences; (ii) a larger than 20 percent ratio of net food imports over total exports; (iii) a composite measure of vulnerability based on the concentration of textiles exports, quota utilization and capacity for adjustment. See also IMF (2004a).

endorsed these considerations as "helpful in guiding individual country teams in decisions on the selection of topics" (IMF, 2005d).[5] This discussion did not explicitly distinguish core from noncore responsibilities. Indeed, by the time of the 2007 Surveillance Decision the use of the terms "core" and "noncore" had been discontinued in surveillance except in a colloquial sense.

10. In conditionality discussions, however, the core/noncore distinction persisted. The conditionality guidelines still in force at end-2007 (IMF, 2002f) note that the IMF's core areas of responsibility comprise "macroeconomic stabilization; monetary, fiscal, and exchange rate policies, including the underlying institutional arrangements and closely related structural measures; and financial system issues related to the functioning of both domestic and international financial markets." Given the many interactions between trade policies and each of these core issues, it has remained quite unclear when trade policy should be considered core. Together with the general streamlining of structural conditionality, this has left a considerable lack of clarity about when trade policy issues should be covered.

11. An update of the conditionality guidelines would be useful, particularly in light of the mixed experience with trade policy conditionality (its technical merits, extent of explicit assessment of macroeconomic effects, compatibility with countries' positions in the World Trade Organization (WTO), and effectiveness). Moreover, with several countries having significantly liberalized their traditional trade policy restrictions, consideration of guidelines for deeper trade reforms to tackle behind-the-border restrictions is needed.

12. Cyclicality in signals from both the Board and management about their expectations for the IMF's role in trade policy was another source of confusion to staff. In interviews for this evaluation, senior staff noted that in some instances the Board and management had encouraged and subsequently discouraged a trade agenda. As an example of the waning of Board interest in trade policy issues, staff pointed to the discontinuation of the Comprehensive Trade Paper following the last such paper in 1994. This paper (IMF, 1994a) provided a "periodic major

[5] The extent of dissemination of these operational considerations outside of PDR is unclear as they are not included in the current guidelines on surveillance (IMF, 2005e).

review of international trade policy issues and their implications for the work of the Fund." Though staff interpreted the discontinuation of the paper as an expression of diminished interest in trade issues, several instances subsequently arose in which Directors appeared to want staff to be involved, for example in trade conditionality in some of the large late 1990s emerging market programs and in market access for developing country exports. Interest in the Doha Round negotiations went through a similar cycle, with spikes in 2003 and 2005 and limited-to-no interest at other times. A strong emphasis on trade policy issues was signaled in 2003, with the formation of the Trade Unit in the Research Department (renamed the Trade and Investment Division in 2005), but this group was disbanded in 2006.

C. Tariff and Nontariff Barriers

13. Much of the IMF's advice on trade policy has focused on traditional forms of tariff and nontariff barriers to trade. At least until 2000, most of this advice was directed at trade liberalization in developing countries in the context of IMF lending arrangements. The approach to trade policy in that context carried over to surveillance of trade policies in developing countries that did not have IMF lending arrangements. In about 2000, responding to requests from many sources for greater emphasis on spillover effects, the IMF stepped up its surveillance of trade policy issues in advanced countries. This section reviews guidance for both of these activities.

Tariff and nontariff policies in highly protected countries

14. Guidance on tariff and nontariff reforms in the more highly protected countries focused on the appropriate scope, sequencing, and pace of trade reforms. Directors addressed these issues in detail in their 1997 discussion of trade liberalization in Fund-supported programs. The 1999 guidelines by PDR for designing and implementing trade policy reforms (IMF, 1999c) restate and elaborate on this guidance; they have not been substantively updated since then.

- *Scope*. The 1999 guidelines contain a comprehensive list of trade policies that discriminate between domestic and foreign goods and that should be addressed in a trade reform program: tariffs, nontariff barriers (NTBs), export restrictions, tax exemptions, trade-related subsidies, and behind-the-border trade barriers such as nontransparent customs administrative procedures. The guidelines provide focused guidance on key aspects of a trade reform program such as the tariffication of quantitative restrictions and steps to attain low and uniform tariff levels.[6] They recommend changing domestic policies and structures that "foster anticompetitive practices which could negate the benefits of trade liberalization" and ensuring that the advice given is consistent with a member's WTO commitments.[7]
- *Sequencing*. The guidelines call for early elimination of the most distortionary aspects of a trade regime such as quantitative restrictions and other NTBs, export restrictions, and exemptions prior to embarking on a tariff reform program. However, they advise that tariff reforms need not wait for the full elimination of NTBs. This sequencing of trade reforms (together with an early elimination of trade-related subsidies) should address fiscal concerns, particularly because the tariffication of NTBs is likely to increase revenues.
- *Pace*. The guidelines advise that the speed of trade reform should be adapted to specific country circumstances, including the "initial degree of trade restrictiveness, the country's administrative capacity and likely short-term adjustment costs." They recommend a "phased reduction" for most countries, with a front-loading of trade liberalization measures, and a "pre-announced timetable for implementing further reforms." The experience of successful reformers that completed trade liberalization in around seven years is noted as instructive.

15. At the time the 1999 guidelines were prepared, Directors differed on the extent to which fiscal concerns should affect the pace of trade liberalization. Discussing the revenue implications of trade liberalization, some Directors cautioned against downplaying the revenue losses from trade liberalization and the difficulties in developing alternative revenue sources (IMF, 1999b). They noted that these considerations necessitated a "more pragmatic approach" to trade liberalization. However, most Directors felt that trade reform should not be "unduly delayed," since often the revenue impact of trade reforms had not been "overly burdensome." The 1999 PDR guidelines combine both positions and advise that "fiscal considerations necessitate a more pragmatic approach

[6] The guidelines advise that "specific tariffs should be converted to ad valorem rates," that "other duties and charges should be amalgamated into the tariff structure at the outset of the tariff reform program," and that "ideally the program should aim to unify the tariff structure at rates of between 5 and 10 percent" (IMF, 1999c).

[7] The guidelines state that trade policy advice should be guided by efficiency considerations and as such, trade reforms may need to proceed at a faster and deeper pace than required under WTO obligations. However, IMF staff should be careful to ensure "WTO consistency" of any recommended policies; a reference note on "WTO consistency" (IMF, 1995) should guide such concerns.

to trade reform.... At the same time [they] should not unduly delay trade reform" (IMF 1999c).[8]

16. After several developing (especially transition) countries had resorted to import surcharges during the 1990s to correct fiscal and balance of payments problems, PDR issued a note broadly opposing such a response. The note (IMF, 1999a) outlined a case against "the great majority of" import surcharges since, even as second-best policies, these were a "poor way of addressing macroeconomic imbalances." It encouraged staff to oppose the introduction of import surcharges and, in the event these were imposed, to recommend that they be "uniform across all imports, on a temporary basis and subject to a preannounced timetable for elimination."

17. For the most part, these pieces of guidance provided a clear, comprehensive, and focused framework for the design and implementation of effective trade reforms. The guidance encompassed the major issues for trade liberalization (pace, scope, and sequencing) and identified priorities. It appropriately focused on eliminating the most restrictive trade barriers, with some (though limited) attention to behind-the-border policies, especially customs administration. The generality of the framework provided for customizing trade reforms to country-specific circumstances and avoided a one-size-fits-all approach.

18. This guidance remains relevant. The global wave of trade reform in the 1990s largely focused on first-generation trade reforms—eliminating quantitative restrictions and rationalizing tariff structures. But while many countries have reduced tariff and nontariff restrictions quite significantly, many others are still tackling these issues. The guidance, with its general and best-practices framework that accommodates various stages of a country's trade reform, therefore remains relevant.

Surveillance of advanced country tariff and nontariff barriers

19. In the early 2000s, the Executive Board began to place greater emphasis on surveillance of trade policies of advanced countries and their systemic implications. During 2001–05, Directors consistently emphasized bilateral and multilateral surveillance of the global or regional impact of advanced country trade policies, in addition to coverage of the domestic implications of trade restrictions. By 2002, Directors elevated (and in 2004 reaffirmed) the systemic impact of advanced country policies to among the issues at "the apex of the IMF's hierarchy of concerns" in surveillance (IMF, 2002b, 2004d).[9] And in 2005, Directors asked that coverage of the spillover effects of trade policy be extended to "larger middle-income countries" (IMF, 2005d).

20. Particular emphasis was placed on surveillance of the systemic implications of trade-distorting subsidies. In 2002, Directors noted the importance of surveillance of domestic trade-distorting subsidies, not only where these significantly hindered macroeconomic prospects but also where they hampered developing country growth and poverty reduction. In 2005, a few Directors requested assessments of debt sustainability for those developing country agricultural exporters that absorbed most of the impact of advanced country agricultural subsidies. Because "Fund policy advice is in the direction of reduction of subsidies," inconsistencies with WTO obligations were unlikely (IMF, 1995).

21. The Board's attention to market access in advanced countries complemented the Doha Development Agenda, which raised the status of these issues. In 2002, Directors noted that eliminating advanced country trade barriers (market access restrictions) will "improve [developing country] prospects for durable growth and poverty reduction and ensure their successful integration in the globalized economy." They stressed that the IMF should systematically raise "awareness of the benefits of free trade and of the costs imposed by market access restrictions in the Fund's bilateral and multilateral surveillance activities" (IMF, 2002e).

22. Another motivating factor behind the increased emphasis on advanced country trade policies was the importance of symmetry in IMF surveillance. During various Board discussions, several developing country Directors pressed for evenhandedness in the coverage of trade policy issues in and pressures for trade liberalization on developing and developed countries (IMF, 2002a, 2003c, 2005c).

23. That said, Directors from both advanced and developing countries have, over time, attached differing priorities to market access issues, sometimes at the expense of clarity in the guidance the Board provided. Based on minutes of various Executive Board meetings, developed/developing country viewpoints have differed on three aspects related to spillover effects of trade policies:

- Several developing country Directors stressed that multilateral surveillance and IMF research should focus on the systemic costs of trade barriers in industrial countries (IMF, 2000a, 2002a, 2004e, 2005c), while several advanced

[8] The advice to design trade reforms with due regard to the revenue impact was also emphasized in 2001 (IMF, 2001d).

[9] Though spillover effects of policies of systemically important countries were highlighted in guidance prior to 2001, the specific and consistent emphasis on surveillance of *trade* policy spillovers was stepped up in 2001.

country Directors pushed for extending the IMF's focus to market access in large developing countries (IMF, 2001e, 2002a, 2002d, 2005c).

- In 2005, some developing country Directors pressed for a more proactive role for the IMF in restraining trade-distorting measures in industrial countries. They encouraged staff to provide specific recommendations for trade policy reforms in Article IV reports and to give these issues more emphasis in the policy dialogue with country authorities. A few advanced country Directors, however, were wary of a heightened role for the IMF in this area and cautioned against impinging on the work of the WTO (IMF, 2005c).
- Some developing country Directors stressed that market access was an integral component of strategies to promote the supply response and growth prospects of developing countries (IMF, 2001e, 2002d). Some advanced country Directors, however, placed particular emphasis on supportive domestic reforms to engender supply responses and growth in developing countries (IMF, 2002d). This difference in emphasis was forcefully illustrated in the 2005 Article IV consultation for Mali (IMF, 2005h).

24. Only in 2005 did the Executive Board lay out clear guidelines for when surveillance should cover trade policies because of their spillover effects. Prior to 2005, various Directors had pointed to several circumstances when trade restrictions that impede developing country exports should be covered. In 2005, the Board specified that trade policy spillover effects of large industrial and middle-income countries should be covered "where [there is a] measurable impact on world prices or exports of other countries; prima facie evidence includes prominence in trade disputes or negotiations" (IMF, 2005a).

D. Trade in Services

25. Trade in services entered the IMF policy agenda rather recently. In several respects this is not surprising. Trade in services moved on to the global trade policy agenda only with the establishment of the WTO and creation of the General Agreement on Trade in Services in 1995. Moreover, trade in services is a complex subject to analyze given its heterogeneity and the paucity of information on barriers to trade in services. Nevertheless, trade in financial services in particular lies at the heart of the IMF's mandate on financial stability. Keeping up with the pace of events in this area should have been a priority for the IMF.

26. Explicit Board attention to trade in services issues started only in 2002. PDR's operational guidance note following the 2002 biennial surveillance review briefly noted that coverage of "policies on services … is essential in countries where serious trade distortions hamper macroeconomic prospects" (IMF, 2002c).[10] In 2005, Directors "noted the growing importance of trade in services, and the possible overlap between [WTO] services trade negotiations and traditional areas of Fund advice relating, for example, to financial sector liberalization and financial vulnerabilities. They encouraged the staff to increase the coverage of trade in services, as more information [became] available" and noted that collaboration with the World Bank, Organization for Economic Cooperation and Development, and WTO would be necessary (IMF, 2005d).

27. Despite the encouragement to increase surveillance of services trade, little effort was made to identify criteria for selecting the aspects that surveillance should cover. The operational guidance (IMF, 2005e) states in general terms that "[s]taff is encouraged to pay increased attention to the impact of trade restrictions in services (including financial services)". Further operational guidelines similarly focus on financial services (Table 1 above). Without specific criteria for when or which nonfinancial services fall within the IMF's interest, conflicting views by some Directors during Board discussions were a source of confusion to staff. Specifically, in 2006, a few Directors eschewed staff work in the Article IV consultation with Korea on trade in educational services, arguing that this was a topic beyond the IMF's core competency (IMF, 2006h). On the other hand, a few Directors requested discussion and analysis of trade in wholesale and retail services in the euro area and cross-border labor mobility (IMF, 2006f).

28. Guidance on key issues such as the appropriate pace, scope, and sequencing of services trade liberalization was also scant, particularly for financial services. Guidance in connection with the Financial Sector Assessment Program (IMF, 2004c) notes the importance of institutional preconditions, such as adequate banking supervision and prudential regulation, as well as attention to the impact of competition on domestic financial institutions. But, in contrast to guidelines on reform of trade in goods, guidelines for advice on the pace and scope of financial services liberalization and coordination with financial account liberalization were not well developed.

[10] The precedent for the explicit mention of trade policies on services in the operational guidance note is unclear.

E. Preferential Trade Agreements

29. The Board has mostly taken a cautious line on PTAs that has, by holding strictly to the ideal, stymied IMF involvement in this potentially systemically important issue. In 1994 in the wake of the completion of the Uruguay Round, Directors noted that the "first-best policy [is that] of most-favored-nation liberalization and the goal of global free trade." Though they felt that PTAs had not hindered multilateralism, they cautioned that "unfettered regionalism was not without risk." They saw the role of the IMF as emphasizing that PTAs be developed as "building blocks" rather than "stumbling blocks" to multilateral trade liberalization (IMF, 1994d). The 1999 PDR guidelines (IMF, 1999c) elaborated on the Board's guidance, outlining Board recommendations on best practices for design and implementation of PTAs: at a minimum, PTAs should be consistent with obligations under GATT Article XXIV;[11] include transparent and liberal rules of origin and access provisions for new members; and be accompanied by multilateral liberalization. But the guidelines went beyond the Board's guidance: they advised that PTAs should not merely meet WTO-consistency requirements but should also be "all-encompassing, applying to virtually all trade between partners without exempting any sectors," and have a transitional phase "preferably significantly less than the maximum ten years set out in the WTO."

30. Criteria for determining when PTAs should be addressed in surveillance were not clarified until 2005. In 1994, the Board noted that "Article IV consultations might benefit from more analysis of the implications of regional trading arrangements for members and nonmembers alike" (IMF, 1994d). Not until 2005 were operational considerations brought to bear, resulting in the advice that PTAs should be covered "where trade creation/diversion is significant, the agreement entails regulatory changes in areas of importance from a growth/stability perspective, or there are significant changes in institutions (e.g., the ability of a country to set tariffs or collect customs duties)" (Table 1). The 2005 Surveillance Guidance Note (IMF, 2005e) advises staff to report on official views on PTAs "if the member has a central role in these initiatives." It does not specifically advise on priorities for coverage of the implications of PTAs for nonmembers.

31. The Board has not explicitly addressed the potentially important implications of the evolving scope of PTAs for the IMF's work. PTAs, once mainly covering merchandise trade only, now frequently include provisions on investment and services (including financial services). This creates the risk that financial services liberalization may occur faster under PTAs than regulators deem prudent. Provisions for capital restrictions among PTA partners may limit the use of capital controls in times of financial stress and may be inconsistent with IMF obligations for nondiscrimination (Siegel, 2004). These types of issues indicate the need for guidance on PTA-related issues that overlap with the work and mandate of the IMF.

32. Neither has the Board provided clear guidance on how the IMF's advice on trade policy should handle the logistical complexities of PTAs. The proliferation of PTAs implies a loss of national autonomy in aspects of trade policy formulation, and important aspects of the question of how IMF surveillance or indeed conditionality should interface with PTA commitments have not been addressed. In 1997 and 2005, the Board advised staff to complement bilateral surveillance of PTAs with "discussions at the regional level on the occasion of staff visits to countries where regional trade organizations are located" (IMF, 1997, 1999c, 2005d).[12] In 1998 and 2005, frameworks were outlined for surveillance over the common trade polices of countries that were members of the euro area, Central African Economic and Monetary Community, Eastern Caribbean Currency Union, and West African Economic and Monetary Union (IMF, 1998a, 2005i). But for other countries, the question of the modalities of surveillance over PTAs was left open. Also, the guidance did not address how to handle conditionality when trade policy measures are outside a country's full control.

33. These complications overlaid substantial cyclicality in Board views on PTAs. In 1994 and 1999, the Board adopted a largely cautionary stance on PTAs, but in several subsequent Article IV consultations, Directors were more positive and commended countries' PTA initiatives as providing benefits and complementing multilateralism (IMF, 2000e, 2001c, 2005b, 2006a, 2006b, 2006c, 2006d, 2006h, 2006k). Indeed, in the 2005 Board review of Fund work on trade, several Directors explicitly disagreed with staff concerns that the proliferation of PTAs posed a systemic risk and observed that staff were

[11] Namely, the formation of a PTA must not result in trade barriers toward nonmembers higher than those prior to the formation of the PTA, trade barriers should be eliminated or reduced on substantially all trade among members, and there should be a schedule for implementation within a reasonable period.

[12] Also, the 2005 Surveillance Guidance Note (IMF 2005e) states that the "Trade Policy Division of PDR is available to advise … when Article IV missions to countries that are host to important regional trade institutions are expected to meet with these institutions."

overly negative about PTAs (IMF, 2005c).[13] In the summing up, Directors recognized that multilateralism was the preferred course, but emphasized that "appropriately structured" PTAs "could provide immediate economic benefits and could be complementary and compatible with multilateral liberalization" (IMF, 2005d). But the following year, after the suspension of WTO trade negotiations in mid-2006, Directors viewed the systemic impact of PTAs less favorably. During the 2006 euro area Article IV consultation, several Directors expressed concern that the proliferation of PTAs threatened multilateralism, and a few Directors urged restraint on PTAs by major trading blocs (IMF, 2006f). This sentiment was also reflected in the summing up of a discussion on trade policy developments in late 2006, which noted that though well designed PTAs can benefit members, "excessive proliferation of PTAs can undermine the non-discrimination principle on which the multilateral trading system is based" (IMF, 2006g).

34. An informal Board seminar paper sought unsuccessfully to clarify the IMF's message on PTAs. The paper (IMF, 2006i) took a strong position on PTAs, acknowledging that countries that engaged in PTAs experienced both costs and benefits but noting that excluded countries typically suffer adverse economic consequences. It proposed that Article IV reports would "benefit from a more qualified approach to PTAs, contrasting the potential gains to a participant with possible costs to third countries." The paper underscored the systemic implications of PTAs, and advised that bilateral discussions should highlight the importance of designing PTAs to complement multilateralism, including committing to a complementary reduction of trade barriers on a most-favored-nation (MFN) basis. It noted that the IMF should "call on members to reflect individually and collectively on ways to protect the multilateral trade system from the effects of a proliferation of such agreements." The Board did not endorse the positions espoused in this paper, and the paper was not published. In interviews, senior IMF staff indicated that they felt the opinions in the paper were politically sensitive, particularly the proposal on committing to complement PTAs with MFN-based liberalization.

F. Assessing Domestic Effects of Trade Policy

35. The Executive Board consistently emphasized the role of the IMF in helping countries to assess the macroeconomic effects of trade policies. The emphasis here has been on the potential adjustment costs of trade reforms, specifically for the balance of payments and fiscal revenue; the impact of trade liberalization on growth and poverty; and complementary policies for maximizing benefits from trade reforms. Even as the Board urged staff to be more selective in covering trade policies, Directors noted that the "Fund will continue to have a major role to play in helping members address the potential adjustment costs and any associated financing needs arising from more open international trade" (IMF, 2005g).

Balance of payments impact of trade policy

36. Directors noted that the balance of payments impact of trade liberalization was an important consideration for IMF financing. In 1999 and 2004, Directors reaffirmed that the IMF should support members' trade reform efforts by providing resources for short-term balance of payments adjustment needs (IMF, 1999b, 2004b). However, operational guidance on how to evaluate the balance of payments impact of a country's own trade reforms has been scant. The guidance on financial programming (IMF Institute, 2008) provides a framework for assessing the balance of payments that centers on estimating exports and imports as a function of price competitiveness and income.[14] It notes that changes in the trade policy regime can affect trade and foreign direct investment flows, and should be considered as an additional determining factor, but does not explicitly discuss how to do so.

37. Directors have highlighted that in surveillance and in determining financing needs, the Fund should consider the balance of payments impact of trade policy actions taken by other countries (external trade policies). In 2002 and 2005, Directors noted that IMF surveillance should assess macro-vulnerabilities "stemming from shifts in trade flows or changes in the rules of the world trading system." They specifically highlighted the impact on "low-income countries most susceptible to terms of trade shocks or the erosion of trade preferences" (IMF, 2002e, 2005d). In 2003, the Board urged staff to discuss in Article IV consultations the balance of payments impact of the removal of quotas on textiles and clothing, where relevant (IMF, 2003c). The creation of the Trade Integration Mechanism in 2004 explicitly endorsed the consideration of the balance of payments impact of external trade policies in decisions on IMF financing.

38. The operational guidance on assessing the balance of payments impact of external trade policies

[13] The views of these Directors on the complementarity of PTAs with multilateralism also differed from management views, which rather consistently underscored the systemic risk posed by PTAs (e.g., Köhler, 2003; IMF, 2005j).

[14] Financial programming is a quantitative approach utilized by IMF economists for assessing macroeconomic developments.

in surveillance was clear. PDR guidance notes identified specific external trade policies that should be assessed ("vulnerability to preference erosion, food terms of trade changes, or the expiry of textiles quotas") and provided detailed criteria for determining coverage in surveillance (Table 1 above, footnote 1). A 2003 guidance note (IMF, 2003b) provided further criteria and rules of thumb for assessing the balance of payments impact of the elimination of textile and clothing quotas. This guidance also identified countries highly vulnerable to the removal of quotas as well as those likely to benefit.[15]

Fiscal impact of trade policy

39. Directors noted that though the revenue impact of trade reforms need not be adverse, trade liberalization could entail fiscal costs. In 1997 and 1999, Directors emphasized that the fiscal impact of trade reforms depends on country-specific circumstances and the design of the reform, and need not be adverse (IMF, 1997, 1999b). In 1999, several Directors noted that in most circumstances a short-term revenue loss was acceptable, given the potential for trade reforms to "bolster the supply side of the economy and hence enlarge the revenue base over the medium term" (IMF, 1999b). In 2005, Directors observed that several low-income and some middle-income countries had had difficulty offsetting losses of trade tax revenues. However, they were encouraged by the experiences of other countries that had recovered lost tariff revenues by developing alternative domestic revenue measures (IMF, 2005d).

40. Guidance on the revenue consequences of trade liberalization was clear and provided focused advice on generating compensating revenues. In 1997 and 1999, Directors noted the importance of the appropriate sequencing of trade liberalization for addressing fiscal costs (IMF, 1997, 1999b). They stressed that the domestic tax system should be reformed in the initial stages of trade liberalization, given the "long gestation period" of many of these reforms. They advised that broad-based domestic consumption taxes, notably value-added taxes (VATs) and stronger tax and customs administrations, were key for addressing the loss of tariff revenues. Directors also noted that tax reform recommendations should be adapted to the country's economic structure. Operational guidance on the revenue implications of trade liberalization (IMF, 1998b) further elaborated on best practices for introducing or strengthening a VAT and for modernizing and simplifying tax and customs administrations systems and procedures in developing countries.[16]

41. Directors encouraged the use of fiscal technical assistance in addressing any fiscal costs of trade liberalization. In 1997, Directors gave "high priority" to technical assistance to help countries implement revenue-enhancing or revenue-neutral trade reforms or—when trade reforms had adverse revenue effects—to help countries develop compensating revenue sources (IMF, 1997). In 1999, Directors noted that the IMF "should stand ready to provide additional technical assistance" to address the revenue impact of trade reforms, particularly in countries whose administrative capacity was limited and which had not made enough progress in identifying alternative revenue measures (IMF, 1999b). In 2001, Directors observed that tax and customs administration and tax reforms have often been "essential in facilitating a smooth transition to more liberal trade regimes, with minimal impact on fiscal revenue." They encouraged technical assistance to "continue to play a vital role in laying the groundwork for successful trade liberalization" (IMF, 2001d). During 2004–07, Directors reiterated their support for intensified technical assistance in tax and customs reforms, including within the Integrated Framework (IF) and Aid for Trade initiatives (IMF, 2004b, 2005g, 2006g, 2007).

Growth and poverty impacts of trade policy

42. Directors saw trade liberalization as good for growth and poverty alleviation, but noted its potential short-term output and social costs. Among the benefits of trade reforms, Directors routinely noted favorable effects on economic efficiency, growth, and poverty. In 1999 and 2001, they also noted that trade reforms could entail short-term output and employment costs (IMF, 1999b; 2001d). In 2005, some Directors encouraged staff to produce research on the relationship between trade and growth and poverty alleviation (IMF, 2005d). In 2007, several Directors called for "further recognition" in both the IMF's and World Bank's work "of the importance of trade for poverty reduction—the benefits for growth and living standards" (IMF, 2007).

[15] PDR also issued several other notes discussing specific trade events likely to cause significant macroeconomic adjustment costs and identified affected countries (IMF, 2005f, 2006e, 2006j). Though these notes were issued to inform management, they also benefited country teams identifying macro-vulnerabilities stemming from external trade policies.

[16] For example, the paper notes that the VAT should involve a "single rate and minimal exemptions, and a threshold to exclude the smaller enterprises." Typical tax and customs administration reforms should include computerization, "strengthening of audit," and "adoption of effective procedures for a national system of unique taxpayer identification numbers." Directors endorsed the analysis in this paper as "providing useful guidance for Fund-supported programs and surveillance" (IMF, 1999b).

43. Directors favored "mainstreaming" trade issues into the Poverty Reduction Strategy Paper (PRSP) process. In 2001, 2002, and 2005, Directors pressed for systematic integration of trade policy issues into the PRSP framework, asserting that trade policies should be an integral component of low-income countries' overall development strategies (IMF, 2001e, 2002d, 2005c). In 2005, 2006, and 2007, Directors noted that a full-fledged trade development strategy was often missing from the PRSP process, and anticipated that an enhanced IF and Aid for Trade framework would help remedy this problem (IMF, 2005g, 2006g, 2007). Directors also repeatedly noted the importance of addressing the social costs of trade liberalization in IMF activities—an objective that they felt would best be reached through collaboration with the World Bank. The 2005 Surveillance Guidance Note (IMF, 2005e) recommended that "staff should be especially cognizant of the large scope for drawing on World Bank information" on social and related issues.

Complementary policies

44. Directors repeatedly underscored the importance of a sound macroeconomic framework for the success of trade liberalization efforts. In 1997, 1999, and 2001, guidance emphasized that trade liberalization "works best when appropriately sequenced with macroeconomic and structural reforms in the context of a clearly formulated medium-term framework" (IMF, 1997, 1999c, 2001d). In 1999 and 2001, Directors identified the appropriate exchange rate policy as a crucial supportive policy for ensuring the success of trade liberalization efforts (IMF, 1999c, 2001d).

45. The Board, however, left substantial scope for discretion in defining an appropriate exchange rate policy for supporting trade liberalization. The general guidance on trade policy (for example, the 2005 Surveillance Guidance Note (IMF, 2005e)) notes that an appropriate exchange rate policy is a necessary complement to a successful trade reform, but it does not provide specifics or even factors for consideration in determining what exchange rate policy is appropriate during liberalization. A selective review of 29 Article IV Board discussions (Annex Table 2) identified occasional specific, but in some cases conflicting, views on this subject. In the 2000 Article IV consultation for India, Directors noted that exchange rate "flexibility would be needed in the period ahead to allow the real effective exchange rate to adjust to changing circumstances, including progress toward trade liberalization" (IMF, 2000d). But during the 2000 Article IV consultation for Morocco, Directors were divided on the appropriate exchange rate policy. Several of them advised a more flexible exchange rate policy to enhance competitiveness, given the "added competitive pressures" from trade liberalization. Others considered the current fixed exchange rate as appropriate "when viewed against the strength of external accounts and the need for preserving financial stability, [and given that] productivity gains realized as structural reforms take hold would improve competitiveness" (IMF, 2000c).[17]

46. Directors also pressed for complementary structural and institutional reforms for fostering a strong supply response to trade liberalization. In 1997, the Board called for ensuring "an appropriate overall policy mix and a critical mass of complementary structural measures including financial sector reform, privatization, and other external reforms" (IMF, 1997). Structural policies were also considered important for the success of the Aid for Trade initiative and for taking advantage of any improvements in market access stemming from ongoing WTO negotiations. Thus, in 2002, in discussing market access issues, Directors identified as priority areas the removal of anti-export biases, infrastructure development, efficient financial services, and institutional and legal reforms crucial for attracting foreign direct investment (IMF, 2002d). In 2007, they pointed to governance issues as an additional factor determining the success of Aid for Trade efforts (IMF, 2007).

47. Guidance appropriately encouraged collaboration with the World Bank. In 2004, Directors underscored the need for close collaboration with the World Bank in providing policy advice on complementary structural reforms (IMF, 2004e). Directors also welcomed Aid for Trade and the IF as mechanisms for facilitating a supply response to fully exploit trade opportunities in developing countries.

G. Findings and Recommendations

48. Although the underlying objectives for IMF involvement in trade policy were clear and consistent, support for actual involvement was less than uniform across constituencies and over time. Directors broadly agreed that trade liberalization, taking into account governments' ownership and appropriate support from other policies, was beneficial for economic efficiency and long-term growth and stability. But their signals as to the importance of trade policy issues for the work of the IMF varied over time. Flexibility in directing the activities of the IMF

[17] Also, during the 2000 Tunisia Article IV Board discussion, "Directors observed that the (CPI-based) real exchange rate...will become a less reliable indicator of competitiveness in the context of trade liberalization." They "supported the central bank's recent decision to broaden the set of indicators used to guide exchange rate policy" but did not elaborate (IMF, 2001a).

is important, but this cyclicality at times became a source of frustration and confusion to staff and affected their ability to plan.

49. Guidance on the coverage of trade policy issues was for the most part timely and reflective of key developments in global trade policy. During the evaluation period, the Board broadened the range of trade issues on which the IMF should engage—from an initial focus on trade in goods and tariff and nontariff reforms to an eventual focus on trade in services, countries' positions in multilateral trade negotiations, and the systemic impact of developed-country trade policies. This broadening reflected the evolving global trade policy agenda following the creation of the WTO and, after 2001, key issues in the Doha Development Agenda. The single most obvious and important exception to this pattern of timeliness concerned trade in financial services, where IMF coverage lagged behind that of both the WTO and many PTAs.

50. The weakest point in the guidance on coverage concerned the Fund's involvement in trade policy issues in lending arrangements. Though conditionality on trade policy all but vanished in the past few years, it is not clear that this is well justified by an absence of macro-critical trade policy issues. The vague (and therefore rather confusing) distinction between "core" and "noncore" areas of the Fund's responsibility formally remains a consideration in decisions on trade policy coverage in lending arrangements, and it has remained quite unclear when trade policy should be considered "core." The equally vague "macro-criticality" criterion is also at play. *An updating of the conditionality guidelines is needed—with clear indications of how these terms should be interpreted in the context of trade policy conditionality. And, with several countries having significantly liberalized their traditional trade policy restrictions, consideration of guidelines for deeper trade reforms to tackle "behind-the-border" restrictions is also needed.*

51. On traditional trade policy issues of tariff and nontariff reforms, guidance on the IMF's role was generally clear, comprehensive, and focused. It provided a general framework drawing on best practices for the pace, scope, and sequencing of trade reforms, that could be tailored to country-specific circumstances. As regards advanced countries' trade policies, however, differing emphases by developing and advanced country Directors clouded the consistency of the guidance provided. In particular, there was a broad divide between developing and advanced country Directors on priorities for surveillance and the role of the IMF, as well as on the relative importance of market access for the growth prospects of developing countries.

52. On the newer trade policy issues of trade in services and PTAs, guidance was less comprehensive, clear, and focused. Board guidance on services trade is clearly at a nascent stage; it does not yet identify what areas, except for financial services, are relevant to the IMF's work. And, even in the area of trade in financial services—at the heart of the Fund's mandate on financial stability—it does not address the appropriate pace and scope of liberalization or how such liberalization should be coordinated with other policies such as financial account liberalization. *A thorough consideration of the IMF's approach to trade in financial services is needed.* The guidance on PTAs has sent conflicting and changing signals on the Fund's position and on how and whether staff should address any systemic risks posed by the proliferation of such agreements. Guidance has also been limited on the implications of the evolving scope of PTAs for the work of the IMF and on the logistical difficulties of advising on trade policies that are outside a country's full control. *Clearer guidance is needed on PTA-related issues that overlap with the work and mandate of the IMF.*

53. On the assessment of effects of trade policy, the clarity, focus, and comprehensiveness of the guidance were mixed. Guidance on the revenue impact of trade reforms was clear, comprehensive, and focused. Though guidance on the growth and poverty impacts of trade liberalization was general, it appropriately relied on collaboration with the World Bank for specificity. Guidance on the balance of payments impact of trade policies, while clear on objectives, was less clear about how to evaluate the balance of payments impact of a country's own trade reforms. Surprisingly, very little guidance was given on considerations behind exchange rate policy during trade reforms. *Even as the IMF gradually reduces its involvement in conditionality on trade reforms, clear positions on optimal exchange rate policy during trade liberalization should be explored.*

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Annex Table 1. Guidance on the IMF's Approach to International Trade Policy Issues, 1996–2007

		The IMF's Role in Trade Policy	Surveil-lance	Condition-ality	Tariffs and NTBs	Trade in Services	PTAs	Effects of Trade Policy
Surveillance reviews: Summings up and operational guidelines								
Summing Up by the Chairman—Biennial Review of the Implementation of the Fund's Surveillance over Members' Exchange Rate Policies and of the 1997 Surveillance Decision (SUR/95/24)	February 1995							
Surveillance Review—Staff Operational Guidance Note (SM/95/22 Supplement 3)	April 1995							
The Chairman's Summing Up at the Conclusion of the Biennial Review of the Implementation of the Fund's Surveillance over Members' Exchange Rate Policies and of the 1997 Surveillance Decision—Outstanding Issues (SUR/95/39)	April 1995							
Summing Up by the Chairman—Biennial Review of the Implementation of the Fund's Surveillance over Members' Exchange Rate Policies and of the 1997 Surveillance Decision; and Transmittal of Fund Documents to Other International Organizations (SUR/97/38)	April 1997							
Staff Operational Guidance Note Following the 1997 Biennial Surveillance Review (SM/97/178)	July 1997		X					
Summing Up by the Acting Chairman—Biennial Review of the Implementation of the Fund's Surveillance and of the 1997 Surveillance Decision (SUR/00/32)	March 2000							
Summing Up by the Chairman—Biennial Review of the Implementation of the Fund's Surveillance and of the 1997 Surveillance Decision (SUR/02/42)	April 2002		X		X			
Summing Up by the Chairman—Biennial Review of the Implementation of the Fund's Surveillance and of the 1997 Surveillance Decision: Follow Up (SUR/02/81)	July 2002							
Operational Guidance Note for Staff Following the 2002 Biennial Surveillance Review (SM/02/292)	September 2002		X		X	X		X
The Chairman's Summing Up—Biennial Review of the Implementation of the Fund's Surveillance and of the 1997 Surveillance Decision (SUR/04/80)	August 2004		X					X
Surveillance Guidance Note (SM/05/156)	May 2005		X		X	X	X	X
Conditionality reviews: Summings up and operational guidelines								
Concluding Remarks by the Acting Chairman—Conditionality Review: Distilling the Main Messages and Direction for Further Work (SUR/94/129)	November 1994							
Streamlining Structural Conditionality—Interim Guidance Note (IMF, 2000f)	September 2000							
Concluding Remarks by the Chairman—Conditionality in Fund-Supported Programs (BUFF/01/36)	March 2001							

Annex Table 1 *(continued)*

		The IMF's Role in Trade Policy	Surveil-lance	Condition-ality	Tariffs and NTBs	Trade in Services	PTAs	Effects of Trade Policy
Summing up by the Chairman—Streamlining Structural Conditionality: Review of Initial Experience; IMF-World Bank Collaboration on Program Conditionality; and Conditionality in Fund-Supported Programs—External Consultations (BUFF/01/122)	August 2001							
Concluding Remarks by the Chairman—The Modalities of Conditionality: Further Considerations (BUFF/02/13)	February 2002							
Summing Up by the Acting Chair—Lessons from the Real-Time Assessments of Structural Conditionality (BUFF/02/59)	April 2002							
2002 Conditionality Guidelines (SM/02/276)	September 2002			×				
Operational Guidance on the New Conditionality Guidelines (IMF, 2003a)	May 2003			×				
The Acting Chair's Summing Up—Review of the 2002 Conditionality Guidelines (BUFF/05/59)	January 2005							
Operational Guidance Note on the 2002 Conditionality Guidelines (SM/06/14)	January 2006			×				
Board discussions on trade								
The Acting Chairman's Summing Up at the Conclusion of the Discussion on the Comprehensive Trade Paper (BUFF/94/82)	August 1994	×	×		×		×	×
Summing up by the Acting Chairman—Regional Trade Arrangements (BUFF/94/93)	October 1994		×				×	
Summing up by the Acting Chairman—Trade Liberalization in Fund-Supported Programs (BUFF/97/108)	October 1997		×	×	×		×	×
Concluding Remarks by the Acting Chairman—Revenue Implications of Trade Liberalization (BUFF/99/22)	February 1999	×		×	×			×
Concluding Remarks by the Acting Chair—Trade Issues: Role of the Fund (BUFF/01/43)	September 2001	×	×	×	×			×
Concluding Remarks by the Acting Chairman—Market Access for Developing Country Exports (BUFF/02/165)	September 2002	×	×		×			×
The Acting Chair's Summing Up—Fund Support for Trade-Related Balance of Payments Adjustments (BUFF/04/72)	April 2004	×		×				×
The Acting Chair's Summing Up—Review of Fund Work on Trade (BUFF/05/45)	March 2005	×	×		×	×	×	×
The Acting Chair's Summing Up—Doha Development Agenda and Aid for Trade (BUFF/05/187)	November 2005	×						×
The Acting Chair's Summing Up—Doha Development Agenda and Aid for Trade (BUFF/06/143)	September 2006	×					×	×
The Acting Chair's Summing Up—Aid for Trade: Harnessing Globalization for Economic Development (BUFF/07/133)	September 2007	×					×	×

Annex Table 1 (*concluded*)

		The IMF's Role in Trade Policy	Surveillance	Conditionality	Tariffs and NTBs	Trade in Services	PTAs	Effects of Trade Policy
PDR trade-related guidance memos to area departments								
Reference Note on WTO Consistency (IMF, 1995)	November 1995	×			×			
Note on Import Surcharges (IMF, 1999a)	January 1999	×			×			
Guidelines on Designing and Implementing Trade Policy Reforms (IMF, 1999c)	July 1999	×			×		×	×
Developments in World Textile Markets—Implications for Fund Surveillance (IMF, 2003b)	August 2003							×
Other guidance referenced in the text								
Revenue Implications of Trade Liberalization—Overview (SM/98/254)	November 1998	×			×			×
Surveillance over the Monetary and Exchange Rate Policies of the Members of the Euro Area (SM/98/257)	November 1998						×	
Operational Guidance Note on Financial Sector Surveillance in Article IV Consultations (IMF, 2004c)	May 2004					×		
Operational Guidelines for Fund Support for Trade-Related Balance of Payments Adjustments (SM/04/343)	September 2004							
Fund Surveillance over Members of Currency Unions (SM/05/429)	December 2005						×	
Financial Programming and Policies (IMF Institute, 2008)								×

Annex Table 2. Selected Review of Board Discussions Referenced in the Text

Minutes of Executive Board Meeting 99/100—Lebanon: 1999 Article IV Consultation (EBM/99/100-3)	September 1999
Minutes of Executive Board Meeting 99/133—Kenya: 1999 Article IV Consultation (EBM/99/133-1)	December 1999
Minutes of Executive Board Meeting 00/26—Monetary and Exchange Rate Policy of the Euro Area (EBM/00/26-1)	March 2000
Minutes of Executive Board Meeting 00/57—Morocco: 2000 Article IV Consultation (EBM/00/57-2)	June 2000
Minutes of Executive Board Meeting 00/60—India: 2000 Article IV Consultation (EBM/00/60-2)	June 2000
Minutes of Executive Board Meeting 00/60—West African Economic and Monetary Union: Recent Developments and Regional Policy Issues in 1999 (EBM/00/60-3)	June 2000
Minutes of Executive Board Meeting 00/73—Vietnam: 2000 Article IV Consultation (EBM/00/73-3)	July 2000
Minutes of Executive Board Meeting 00/107—Syrian Arab Republic: 2000 Article IV Consultation (EBM/00/107-2)	November 2000
Minutes of Executive Board Meeting 00/116—Brazil: 2000 Article IV Consultation (EBM/00/116-1)	November 2000
Minutes of Executive Board Meeting 01/13—Tunisia: 2000 Article IV Consultation (EBM/01/13-2)	February 2001
Minutes of Executive Board Meeting 01/28—South Africa: 2000 Article IV Consultation (EBM/01/28-3)	March 2001
Minutes of Executive Board Meeting 05/87—Dominica: 2005 Article IV Consultation, Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Requests for Waiver of Nonobservance of Performance Criterion, Financing Assurances Review, and Extension of Repurchase Expectations (EBM/05/87-3)	October 2005
Minutes of Executive Board Meeting 05/106—Mali: 2005 Article IV Consultation, Second and Third Reviews Under the Poverty Reduction and Growth Facility, and Request for Waiver of Nonobservance of Performance Criteria; Poverty Reduction Strategy Paper—Implementation Report for 2003 and 2004 (EBM/05/106-1)	December 2005
Minutes of Executive Board Meeting 06/4—Nicaragua: 2005 Article IV Consultation, Seventh, Eighth, and Ninth Reviews Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Financing Assurances Review, and Requests for Rephasing, Waiver of Performance Criteria, and Extension of the Arrangement; Poverty Reduction Strategy Paper; Joint Staff Advisory Note (EBM/06/4-4)	January 2006
Minutes of Executive Board Meeting 06/4—Nepal: Report on Noncomplying Disbursement and Recommendation for Waiver of Nonobservance of Performance Criterion; 2005 Article IV Consultation (EBM/06/4-5)	January 2006
Minutes of Executive Board Meeting 06/6—Ecuador: 2005 Article IV Consultation (EBM/06/6-4)	January 2006
Minutes of Executive Board Meeting 06/48—Canada: 2006 Article IV Consultation (EBM/06/48-1)	May 2006
Minutes of Executive Board Meeting 06/49—Tunisia: 2006 Article IV Consultation (EBM/06/49-1)	May 2006
Minutes of Executive Board Meeting 06/50—Brazil: 2006 Article IV Consultation; Ex Post Evaluation of Exceptional Access in 2002–05 Stand-By Arrangement (EBM/06/50-3)	May 2006
Minutes of Executive Board Meeting 06/63—Central African Economic and Monetary Community: Staff Report on Common Policies of Member Countries (EBM/06/63-1)	July 2006
Minutes of Executive Board Meeting 06/65—Bolivia: 2006 Article IV Consultation (EBM/06/65-1)	July 2006
Minutes of Executive Board Meeting 06/68—El Salvador: 2006 Article IV Consultation (EBM/06/68-4)	July 2006
Minutes of Executive Board Meeting 06/69—Euro Area Policies (EBM/06/69-2)	July 2006
Minutes of Executive Board Meeting 06/82—Korea: 2006 Article IV Consultation (EBM/06/82-3)	September 2006
Minutes of Executive Board Meeting 06/86—Morocco: 2006 Article IV Consultation (EBM/06/86-3)	October 2006
Minutes of Executive Board Meeting 06/101—Pakistan: 2006 Article IV Consultation (EBM/06/101-1)	November 2006
Minutes of Executive Board Meeting 06/107—India: 2006 Article IV Consultation (EBM/06/107-1)	December 2006
Minutes of Executive Board Meeting 07/4—Eastern Caribbean Currency Union: Report for the 2006 Regional Discussions (EBM/07/4-1)	January 2007
Minutes of Executive Board Meeting 07/33—West African Economic and Monetary Union: Common Policies of Member Countries (EBM/07/33-1)	April 2007

Background Document 4

IMF Involvement in Trade Policy Issues in Low-Income Countries: Seven Case Studies

A. Introduction

1. This paper examines the IMF's involvement in trade policy issues in low-income countries. The Fund's involvement has occurred through surveillance, conditionality, and other advice in the context of lending programs under the Enhanced Structural Adjustment Facility (ESAF) and its successor, the Poverty Reduction and Growth Facility (PRGF), and through technical assistance. Because of their medium-term horizon and emphasis on growth and poverty reduction, ESAF/PRGF-supported programs have tended to feature stronger structural adjustment components (including trade reform) than those typical of short-term lending arrangements, and often the structural measures have been designed in cooperation with the World Bank. A number of low-income countries also qualify for IMF assistance in the form of debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative. Low-income countries that do not want or need IMF financial assistance may make use of the Policy Support Instrument (PSI), a nonfinancial mechanism under which the Fund provides advice, monitoring, and endorsement of their economic programs.[1]

2. The paper focuses on the IMF's trade policy advice and program conditionality in seven case study countries: four African (Ghana, Kenya, Mozambique, and Tanzania), one Caribbean (Guyana), and two Asian (Bangladesh and Vietnam).[2] All seven countries had arrangements under the ESAF and/or PRGF during 1996 to 2007. Tanzania and Mozambique began programs under the PSI in 2007. In the African countries and Guyana the Fund had a relatively continuous program involvement over the period, while in the Asian countries, lending arrangements were interspersed with stretches of surveillance only (Table 1).

3. The seven countries had widely varying ratings on the Fund's Trade Restrictiveness Index (TRI) during the evaluation period. Table 2 shows the TRI ratings from 1997, when the index began to be systematically compiled, to 2005, when staff were instructed to stop using it in their reports.

4. All but one of the seven countries have been members of the World Trade Organization (WTO) since 1995. Vietnam acceded to the WTO in 2007, the end of the evaluation period. As developing countries, all seven are entitled to so-called special and differential treatment under certain WTO rules, for example, longer transition periods to implement certain WTO agreements, higher priority in developed-country commitments on access to their markets, more opportunities to benefit from developed-country preferential tariff schemes, and technical assistance. Three of the seven—Tanzania, Mozambique, and Bangladesh—have been designated as least developed countries (LDCs) by the United Nations (UN). As such, they are entitled to benefit from the Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries (IF). Tanzania and Mozambique have completed the first phase of the (revamped) IF process—the preparation of a diagnostic trade integration study (DTIS)—while Bangladesh has not applied to be included (Table 3).

5. The IMF became involved in a wide range of trade policy issues in these countries, with varying degrees of conditionality and effectiveness. Programs in all seven countries included plans for tariff reductions and simplifications and/or reform of customs administration. Most of the programs included some conditionality on these issues, mainly before 2001 when the IMF began streamlining its conditionality. Beyond these traditional trade policy issues, other issues such as subsidies, trade in services, export taxes, and preferential trade agreements (PTAs) were addressed in some of the programs. Increasing attention was paid—typically quite expertly—to fiscal, trade, and structural aspects of preference erosion. The treatment of trade policy issues was backed by varying degrees of Bank-Fund cooperation and of in-house Fund expertise. The correlation between the

[1] The PSI is not a lending arrangement but a form of technical assistance.

[2] Trade-related technical assistance will be noted where applicable but an assessment of its content and implementation is beyond the scope of this evaluation.

Table 1. Seven Case Study Countries: History of IMF Arrangements

Type of Arrangement	Date of Arrangement	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Tanzania (date of Fund membership: September 10, 1962)				
SAF[1]	October 30, 1987	October 29, 1990	74.90	74.90
ESAF	July 29, 1991	July 28, 1994	181.90	85.60
ESAF	November 8, 1996	February 7, 2000	181.59	181.59
PRGF	April 4, 2000	August 15, 2003	135.00	135.00
PRGF	August 16, 2003	February 26, 2007	19.60	19.60
Kenya (date of Fund membership: February 3, 1964)				
SAF	May 15, 1989	March 31, 1993	71.00	71.00
ESAF	December 22, 1993	December 21, 1994	45.23	45.23
ESAF	April 26, 1996	April 25, 1999	149.55	24.93
PRGF	August 4, 2000	August 3, 2003	190.00	33.60
PRGF	November 21, 2003	November 20, 2007	150.00	150.00
Mozambique (date of Fund membership: September 24, 1984)				
SAF	June 8, 1987	June 7, 1990	42.70	42.70
ESAF	June 1, 1990	December 31, 1995	130.05	115.35
ESAF	June 21, 1996	June 27, 1999	75.60	75.60
ESAF/PRGF	June 28, 1999	June 28, 2003	87.20	78.80
PRGF	July 6, 2004	July 5, 2007	11.36	11.36
Ghana (date of Fund membership: September 20, 1957)				
SAF	November 9, 1988	March 5, 1992	102.25	102.25
ESAF	November 9, 1988	March 5, 1992	286.30	286.30
ESAF	June 30, 1995	May 2, 1999	164.40	137.00
ESAF/PRGF	May 3, 1999	November 30, 2002	228.80	176.22
PRGF	May 9, 2003	October 31, 2006	184.50	184.50
Guyana (date of Fund membership: September 26, 1966)				
SAF	July 13, 1990	December 20, 1993	34.44	34.44
ESAF	July 13, 1990	December 20, 1993	47.08	47.08
ESAF	July 20, 1994	April 17, 1998	53.76	53.76
ESAF/PRGF	July 15, 1998	December 31, 2001	53.76	24.88
PRGF	September 20, 2002	September 12, 2006	54.55	54.55
Vietnam (date of Fund membership: September 21, 1956)				
SBA[2]	October 6, 1993	November 11, 1994	145.00	108.80
ESAF	November 11, 1994	November 10, 1997	362.40	241.60
PRGF	April 13, 2001	April 12, 2004	290.00	124.20
Bangladesh (date of Fund membership: August 17, 1972)				
SBA	December 2, 1985	June 30, 1987	180.00	180.00
SAF	February 6, 1987	February 5, 1990	201.25	201.25
ESAF	August 10, 1990	September 13, 1993	345.00	330.00
PRGF	June 20, 2003	June 19, 2007	400.33	316.73

[1] Structural Adjustment Facility.
[2] Stand-By Arrangement.

Table 2. Seven Case Study Countries: Trade Restrictiveness Index (TRI)

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Tanzania	7	7	6	6	5	5	5	5	5
Kenya	6	6	6	6	6	6	6	6	6
Mozambique	3	2	2	2	2	2	2	2	2
Ghana	5	5	5	5	6	5	5	5	5
Guyana	5	5	5	5	5	5	5	5	5
Vietnam	8	8	9	9	9	9	9	9	9
Bangladesh	8	8	8	8	8	8	7	7	6

Table 3. Seven Case Study Countries: WTO Relationship and IF Status

	Date of Membership	Trade Policy Review (TPR)	Integrated Framework (IF) status
Tanzania (LDC)	January 1, 1995	February 2000; October 2006[1]	DTIS completed (2005)
Kenya	January 1, 1995	January 2000; October 2006[1]	Not eligible
Mozambique (LDC)	August 26, 1995	January 2001	DTIS completed (2004)
Ghana	January 1, 1995	February 2001	Not eligible
Guyana	January 1, 1995	October 2003	Not eligible
Vietnam	January 11, 2007	n.a.	Not eligible
Bangladesh (LDC)	January 1, 1995	May 2000; September 2006	No DTIS

[1] Joint TPR for Kenya, Tanzania, and Uganda.

success of trade policy components of programs and the degree of depth of either Fund expertise or Bank-Fund collaboration was high.

6. The case studies assess Fund advice/conditionality on trade policy issues with respect to its quality and effectiveness. Specifically:

- Were staff recommendations based on a coherent theoretical framework and sufficiently detailed knowledge of micro-macro linkages to allow a reasonable assessment of their implications?
- In cases where trade policy conditionality was used, was it well designed, and were its scope and scale commensurate with the macroeconomic effects of trade policy distortions?
- How effective was the collaboration between the Fund and the World Bank (and/or other agencies)?
- Were trade policy recommendations implemented in a timely manner with approximately the effects intended? Were the implemented policies sustained?

We define favorable outcomes as those where IMF support and analysis appear to have contributed to changes in trade policy that are likely to have increased economic efficiency, and growth, or to have better positioned countries to offset the revenue impact of trade liberalization. Poor outcomes are those where no policy changes occurred, or where changes occurred but were later reversed, or where IMF advice or conditionality prompted serious and high-profile objections.

B. Tanzania

Background

7. Tanzania's trade regime was liberalized significantly starting in the 1980s but was still considered restrictive in the mid-1990s. During 1988–95, most import restrictions were removed, as were virtually all taxes and restrictions on exports. Several tariff reforms were implemented during this period, and by 1996 the number of tariff bands had been reduced to five (with rates ranging from zero to 40 percent), though the average nominal tariff rate still exceeded 20 percent. Duty exemptions and remissions, mainly on industrial inputs, were granted to selected importers including the public sector (Kanaan, 1999).

8. In the mid-1990s, Tanzania belonged to two overlapping regional organizations: the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA).[3] Under the COMESA treaty, members agreed to reduce tariffs for one another by 80 percent by 1998 and by 100 percent—thus establishing a free trade area—by 2000. The SADC protocol on trade also envisaged intraregional preferences, to be established over eight years beginning in 2000, with the creation of a free trade area by 2008, a customs union by 2010, a common market by 2015, monetary union by 2016, and a single currency by 2018.

9. Tanzania signed the Cross-Border Initiative (CBI) in 1993, setting the direction for its trade reform program for the rest of the decade.[4] The CBI was a common policy framework that aimed to facilitate cross-border activities among 14 participating countries in Eastern and Southern Africa and the Indian Ocean through a coordination of ongoing reform programs, including those with IMF and World Bank support. The CBI was not a PTA even though its objectives were generally consistent with

[3] At the beginning of 1996, SADC members were Angola, Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe; and COMESA members were Angola, Burundi, the Comoros, Eritrea, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Rwanda, Seychelles, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zaïre, Zambia, and Zimbabwe (IMF, 1996c).

[4] Besides Tanzania, the other CBI participants were Burundi, the Comoros, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Swaziland, Uganda, Zambia, and Zimbabwe. The CBI was cosponsored by the Fund, the World Bank, the European Union, and the African Development Bank.

those of COMESA, SADC, and other regional PTAs, and had been endorsed by those organizations.[5] A set of core measures was adopted in August 1993, and a road map for further trade liberalization was endorsed in March 1995 that included the elimination of tariffs on intraregional trade and the convergence of external tariffs to a trade-weighted average of 15 percent, both by October 1998 (IMF, 1996c).

Policy dialogue and trade conditionality

10. Tanzania had three back-to-back arrangements with the IMF during the evaluation period, all containing some form(s) of trade conditionality: an ESAF-supported program from 1996–2000, followed by two PRGF-supported arrangements (2000–03, 2003–07). A PSI-supported arrangement began in 2007. The IMF's trade policy dialogue with Tanzania was conducted against a backdrop of a weak revenue base and active involvement in regional PTAs.

11. The 1996 ESAF-supported program incorporated a plan for tariff reform derived largely from the CBI's road map for trade liberalization. The signatories to the CBI had committed voluntarily to put in place by October 1998 a common external tariff with three nonzero tariff bands and a 20–25 percent maximum tariff. This was an ambitious plan for Tanzania given its starting point of a five-tier system with a maximum tariff of 40 percent. Aware that the reform would have major fiscal consequences, the ESAF-supported program planned for measures in the customs area to raise the revenue ratio, such as the closure of most owner-operated bonded warehouses (a prior action) and an audit of the bonded warehouses and establishment of a monitoring system by end-December 1996 (structural benchmarks) (Annex Table 1). Alongside these initiatives, the program also pursued (i) a reform of the state monopoly on petroleum products through measures (subject to a prior action and subsequent structural benchmarks) on pricing and importation and (ii) measures to harmonize import taxes (structural benchmark) and tax administration (prior action and structural benchmark) in mainland Tanzania and Zanzibar.

[5] According to IMF (1996c), differences existed between the CBI and regional integration efforts of organizations such as COMESA and SADC: (i) the CBI was a policy framework, not an organization or institution; (ii) the CBI was "outward looking" in the sense that the reduction in barriers to cross-border flows among participating countries was accompanied by a reduction of most-favored-nation tariff rates; (iii) the CBI's focus was not on creating a PTA such as a customs union or common market but on policies to lower transactions costs and enhance efficiency gains from trade; and (iv) the CBI's goals were relatively flexible, generally calling for a harmonization across participants while allowing scope to accommodate differences in needs of individual countries.

12. Several compromises were made in implementing the tariff reform that, from the IMF's viewpoint, made the tariff system more complex. A technical assistance mission by the IMF's Fiscal Affairs Department (FAD) in 1998 looked more deeply into the tariff situation and concluded that there were so many anomalies in the duty structure and complexities in the exemption regime that a more comprehensive reform was needed. Such a reform could not be prepared in time for the revised CBI deadline of December 1998, but a comprehensive policy package (a structural benchmark) was eventually agreed with the authorities and a new import duty structure with rates of 5 percent, 10 percent, 20 percent, and 25 percent was announced in June 1999. However, the proposed tariff reductions provoked a sharp protectionist response from local producers, and the government compromised on some of the proposals, including by creating split rates (lower rates on certain commodities when imported as raw materials rather than finished products), imposing a range of minimum dutiable values above world market prices, and introducing so-called suspended duties (import surcharges) to protect certain domestic industries (IMF, 2000a).

13. The PRGF arrangement that was approved in June 2000 aimed to address some of the new complexities in the tariff system but by then the authorities had lost much of their appetite for unilateral trade liberalization. IMF staff noted that "substantial liberalization of the external trade regime over the course of the last four years [had] exacerbated protectionist pressures in Tanzania" (IMF, 2000a), but continued to press strongly for trade reform that would lower Tanzania's rating on the IMF's TRI from 6 (in 2000) to 3 (IMF, 2000a). Staff also noted the observation in the WTO's trade policy review (WTO, 2000b) that Tanzania's nontariff barriers were a problem.

14. In the event, the trade reforms in the 2000 PRGF-supported program were far less ambitious. In the review process, the IMF's then Policy Development and Review Department (PDR) pressed for a more rapid lowering of tariffs, including an attempt to incorporate a specific tariff reduction target as a condition for reaching the HIPC floating completion point (although the mission was unable to prevail on this point in the HIPC negotiations). In the first-year program, one structural benchmark committed the authorities to base dutiable values on international prices (except for sugar) and another to establish a new duty drawback system. Other stated goals in the authorities' memorandum of economic and financial policies entailed a review of the tariff structure. Subsequently, however, staff criticized tariff changes in Tanzania's 2001/02 budget as nontransparent and unpredictable. The budget proposed, alongside a

reduction in the number of tariff bands and the average tariff rate, the imposition of suspended duties of 10–50 percent on 12 categories of imports to counter perceived "dumping." The authorities explained that the reason for many of the additional measures was that the pace of reform required by the Fund had been too rapid and that a more gradualist approach would have led to a smoother implementation and given rise to less protectionist initiatives from the business lobby. But in the March 2002 program review, the mission, after consulting with the WTO, stressed the need to eliminate all suspended duties and introduced a structural performance criterion on committing to a timetable for their elimination (IMF, 2002a) (Annex Table 2).

15. By that time, the authorities had started to shift their attention to regional PTAs including Tanzania's membership in the newly recreated East African Community (EAC). The EAC treaty was signed in November 1999, and gave its members—Kenya, Tanzania, and Uganda—four years to formulate a protocol specifying the steps to be taken toward trade integration. Work on the technical aspects of a regional customs union began in 2000. Around the same time, Tanzania announced that it would withdraw from COMESA in September 2000, citing concerns that COMESA's plans to form a free trade area by October 2000 would harm Tanzania's industrial development. IMF staff reported but did not comment on this controversial decision (IMF, 2000a).[6] Tanzania retained its membership in SADC, which it claimed incorporated a more gradual timetable for reduction of internal and external duties and placed greater emphasis on investment in regional infrastructure.

16. The authorities also turned toward other organizations for trade policy advice and technical assistance. Tanzania was among the 12 countries that went through the first IF process in 1999–2000. That process led to a multi-donor funded program of legal and regulatory reforms to improve the environment for private sector development, whose implementation began in December 2003.[7] Tanzania was subsequently approved for the second IF process under which a DTIS was prepared under the leadership of the World Bank (IF, 2005). The Fund's involvement in Tanzania's IF was limited to a contribution on Tanzania's macroeconomic developments and prospects in the DTIS.

17. In the discussions for the 2003 PRGF and 2007 PSI arrangements the authorities presented Tanzania's commitments to PTAs as the binding constraint on trade policy. During the discussions for the 2003 PRGF-supported program, the authorities stated that further tariff reform would only be possible if agreed by all three EAC member states. Thus, no conditionality on tariff reform was included in that arrangement or thereafter. To curtail tax exemptions, the 2003 PRGF-supported program included a structural benchmark limiting the issuance of licenses for the newly established export processing zones to companies that produced exclusively for the U.S. and EU markets under the Africa Growth and Opportunity Act and Everything But Arms Initiative. Measures to streamline and strengthen customs administration, developed with the help of technical assistance from FAD, were incorporated as structural benchmarks throughout the 2003 PRGF- and 2007 PSI-supported programs.

18. The IMF continued to cover trade policy in Article IV consultations and, to some extent, program reviews, focusing on Tanzania's overlapping PTA memberships. In March 2004, the trade protocol was signed establishing an EAC customs union with a three-band common external tariff of 0, 10, and 25 percent. Implementation of the protocol was delayed to January 2005, and transitional arrangements were put in place allowing surcharges to be levied on "sensitive" products, the list of which was specific to each member country. Staff reckoned that the EAC customs union could have a "moderate revenue-losing impact" (IMF, 2004c) but urged the authorities to "deepen integration" in the EAC by lowering the maximum tariff, rationalizing overlapping memberships in PTAs, and harmonizing standards and investment incentives (IMF, 2006e).[8] Those issues were raised again in the 2007 Article IV consultation when staff recommended bringing "sensitive" products into the common external tariff and lowering the top rate (IMF, 2007f). Staff drew on a joint selected issues paper (SIP) prepared for the EAC countries (Everaert, Palmason, and Sobolev, 2006). That paper argued forcefully that overlapping PTA memberships (Tanzania's EAC partners, Kenya and Uganda, belonged to COMESA but not to SADC) would prevent the EAC from becoming a fully functioning customs union and would be impossible to maintain once COMESA and SADC also became customs unions, unless all three customs unions adopted

[6] However, a 1999 Fund update on the CBI had suggested that "excessive" PTA membership may have interfered with the pace of trade liberalization under the CBI by imposing "conflicting obligations, different and uncoordinated strategies, inconsistent external liberalization goals, and different and conflicting rules and administrative procedures" on the signatory countries (IMF, 1999i).

[7] The donors were the governments of the Netherlands, the United Kingdom, Denmark, and Sweden.

[8] The EAC customs union was expected to lower Tanzania's average tariff by almost 2 percentage points to 12.5 percent (IMF, 2004c).

the same common external tariff.[9] The authorities responded that harmonization efforts were under way and that the EAC common external tariff would be reviewed by 2010. The SIP also argued that—unless they led to a rationalization of PTAs—the ongoing negotiations on economic partnership agreements (EPAs) with the European Union could complicate the overlapping membership problems and lead to further trade diversion if not accompanied by most-favored-nation (MFN) tariff reductions.[10] No staff reports commented on the EPA until 2008 (after the EAC members signed an interim agreement with the European Union) when the mission drew attention to the modestly negative medium-term revenue impact (IMF, 2008b).

Assessment

19. For the most part, the IMF's trade policy advice to Tanzania covered the right issues and was consistent with general guidance to staff. Staff took account of the initial degree of restrictiveness of the trade regime, which was high by most standards, and the programs had trade liberalization objectives that were set in a medium-term framework.

20. But the IMF's approach to trade liberalization clashed with the authorities' approach. Given the starting point of a 40 percent maximum tariff and a very complex, nontransparent system in 1996, the CBI objective of a three-tier system with a 20–25 percent maximum tariff by October 1998 was always going to be an ambitious target, as regards both the impact on local businesses and the low tax ratio (14 percent of GDP) alongside high dependence on trade taxes (about 30 percent of tax revenues). According to the authorities, the Ministry of Finance and Ministry of Trade had made recommendations for gradualism in the phasing of tariff reforms, but IMF staff had disagreed, pressing instead for sharp reductions in tariffs and duty exemptions. The two sides approached the issue of tariff reform from different perspectives. To the IMF, the overall aim of tariff reform was to reduce protection and move toward a less distortionary, more uniform, tariff system, while the authorities—particularly the Ministry of Trade—believed that each industry needed to be examined separately and individual circumstances taken into account in deciding on the appropriate level of protection. The two approaches were difficult to bridge, particularly as staff lacked the expertise to conduct a sector-by-sector analysis. In one instance, the authorities argued that the mission team had no technical analysis to support their policy recommendation, but staff decided to take the issue directly to the President, who decided in their favor. From the authorities' viewpoint, a more gradualist approach would have led to a smoother implementation of the tariff reform and less protectionist pressure from the business lobby.

21. With hindsight, the pace of tariff reform in the 1996 ESAF-supported program was probably too ambitious. While it is not clear that slower phasing of the tariff reform would have aroused less opposition from business groups, it could arguably have allowed the authorities to deal better with the fiscal implications of lower tariff rates. The authorities claim that staff should have shown greater awareness of the fiscal constraints, including the fundamental point that tax reform was a laborious process that would take time to bear fruit. Tax revenue projections during the period of trade liberalization did tend to be overoptimistic, though revenue slippages were in part a result of delays in implementing other reforms. Indeed, consistent with its recommendation for quickening the pace of tariff reform, PDR pressed the mission to negotiate a stronger revenue effort. In 2006, a Fund technical assistance mission found that the tariff reductions in the ESAF-supported program had, despite customs reforms, led to a sharp decline in revenues from import taxes (from 1.84 percent of GDP in 1996/97 to 0.82 percent of GDP in 2004/05) and to a decline in the overall tax-to-GDP ratio, which did not start to recover until 2002/03. In its ex post assessment of Tanzania's ESAF- and PRGF-supported programs, the IMF called the revenue target under the ESAF-supported program "unrealistic" because "tax collection and administration did not keep pace with the rationalization of the tax system and tariff reform" (IMF, 2006c).

22. The IMF's efforts to improve customs administration were necessary if somewhat belated. The programs incorporated many measures to improve the effectiveness of customs administration. But despite some early efforts under the 1996 ESAF-supported program, critical areas of customs administra-

[9] Everaert, Palmason, and Sobolev (2006) noted that while EAC market access benefits were not extended to non-EAC SADC and COMESA partners, EAC members were allowed to continue with their existing obligations to SADC and COMESA. This meant that border controls had still to be maintained and rules of origin enforced within the EAC to prevent "trade deflection," for example, the possibility of SADC members using Tanzania as a transit route to Kenya and Uganda. They argued furthermore that overlapping PTA memberships added considerable complexity and costs to the trading process (due to the need to administer multiple rules of origin schemes) and impeded the harmonization of standards and technical regulations within the EAC. The same points were raised in IF (2005).

[10] Everaert, Palmason and Sobolev (2006) noted that, because at that time Tanzania was negotiating the EPA as a member of the SADC group while Uganda and Kenya were under the COMESA group, the EAC members could face different commitments vis-à-vis the European Union unless the two groups' negotiations with the European Union were closely coordinated.

tion reform only started to be addressed during the 2003 PRGF-supported program, more than a decade after the major tariff reforms were implemented.[11] Substantial amounts of technical assistance on customs administration—largely coordinated by FAD—were provided to Tanzania from 2004 onwards. The recommendations of technical assistance missions were incorporated into the later part of the 2003 PRGF-supported program as a series of structural benchmarks relating to a detailed plan of action for customs reform. Virtually all of those benchmarks were observed. At the conclusion of the 2003 PRGF-supported program, staff reported that revenues as a share of GDP had increased by about 2.5 percentage points without any increase in tax rates (IMF, 2006c), and the WTO noted "significant customs reforms in Tanzania since its last [trade policy review]." (WTO, 2006b.) But more remained to be done and the agenda was carried into the 2007 PSI-supported program.

23. The programs succeeded in lowering Tanzania's average tariff rate but not in discouraging the authorities from protectionism. The tariff reforms in the 1996 ESAF-supported program simplified the tariff system and significantly lowered the unweighted average tariff rate from 22 percent in 1997 to 16 percent in 1999. After that, the authorities reconsidered their strategy and decided to protect certain domestic industries by using other measures such as high minimum dutiable values and suspended duties. The authorities did observe the structural performance criterion (introduced in the fourth review of the 2000 PRGF-supported program in March 2002) to prepare a timetable for the elimination of all suspended duties, but the six-year phase-out period was long.

24. The IMF largely stayed away from the issue of Tanzania's overlapping PTA memberships. The Fund had supported the CBI and integrated it into the 1996 ESAF-supported program, but according to the authorities, the mission did not actively advise them on the subject of PTAs.[12] Tanzania formally withdrew from COMESA in September 2000, a year after announcing its intention to do so. Various reasons were given for the withdrawal, including burdensome membership fees and administrative costs and overlapping/duplication of objectives with EAC and SADC (which may have resonated with IMF staff) and the need to protect domestic industries (which staff could have countered had they chosen to do so). According to internal memoranda, staff were concerned that Tanzania's trade regime would become more unstable and vulnerable to lobbies after the withdrawal from COMESA. Staff were, therefore, careful to oppose any new trade policy changes that would backtrack from previous trade liberalization. The government did not change its decision to stay out of COMESA (and in SADC) despite periodic protests by the local business community that Tanzania was losing out by not rejoining COMESA, and frustration on the part of other EAC members (and the European Union) over Tanzania's indecision as to how to approach the EPA negotiations (whether to negotiate as part of the SADC group or as part of the COMESA group). The Fund's reluctance to get involved in bilateral/regional politically charged issues is understandable. Nevertheless, staff could have contributed usefully to the debate by providing unbiased analyses of the macroeconomic ramifications of various options that were on the table.[13] In October 2008, the EAC, COMESA, and SADC held their first tripartite summit in which they agreed to merge the three trading blocs into a single free trade area.[14] In December 2008, COMESA launched its own customs union with the same common external tariff structure as the EAC. SADC plans a customs union in 2010.

C. Kenya

Background

25. At the beginning of 1996, Kenya had a moderately restrictive trade system. Though tariff reforms had been implemented under earlier ESAF-supported programs, the tariff schedule still had six primary bands and a maximum rate of 40 percent. There were also numerous surcharges and various nontariff barriers. IMF staff had become increasingly concerned

[11] A November 2005 FAD technical assistance mission on tax policy estimated Tanzania's tax revenue potential and tax effort to be lower than those for most of its neighboring countries. The Fund's 2006 ex post assessment (IMF, 2006c) listed "poor customs systems and procedures" as one of the constraints that the ESAF and PRGF programs had been unable to address effectively.

[12] The CBI was succeeded in 2000 by the Regional Integration Facilitation Forum, a nonbinding and voluntary arrangement to facilitate the flow of investments into member countries and improve their trade regimes.

[13] In a working paper issued by PDR, Khandelwal (2004) computed bilateral product complementarity indices for COMESA and SADC member countries and concluded that there was asymmetric complementarity in both PTAs, meaning that the more developed economies of Egypt, Kenya, and South Africa were in a much better position to market their exports in COMESA/SADC than were the less developed members (including Tanzania). The paper found little evidence of trade diversion in COMESA and SADC and "encouraging" growth in total exports from COMESA and SADC since 2000 (though the impact the PTAs may have had on that growth could not be determined). There is no evidence that the results of the paper were discussed with the authorities.

[14] "Twenty-six African leaders resolve to form single market," *BBC*, October 23, 2008.

with Kenya's repeated imposition of import bans on food products, such as grains and dairy products, which could be authorized by the Ministry of Agriculture. Corruption and inefficiency in the customs administration was also believed to be a significant problem. At this point also, Kenya was a member of COMESA and had endorsed the CBI.

Policy dialogue and trade conditionality

26. During the evaluation period, Kenya entered into three arrangements with the IMF, but none proceeded smoothly. Under the April 1996 ESAF arrangement, only one review was completed. Similarly, the program supporting the August 2000 PRGF arrangement suffered major setbacks soon after it was initiated and only the first tranche of the arrangement was drawn. Three reviews of the November 2003 PRGF arrangement were completed, but with considerable delays; that arrangement expired in November 2007.

27. In discussions for the 1996 ESAF arrangement, the trade issue that received the most attention was the alleged dumping of subsidized cereal imports by neighboring countries. A sharp increase in cereal imports in 1995 had led the authorities to impose temporary import bans on maize, rice, wheat, and sugar. These prohibitions were subsequently converted into suspended (i.e., supplementary) duties, but IMF staff were concerned that Kenya would revert to the use of quantitative restrictions on agricultural imports, and a continuous structural performance criterion committed the authorities to avoid direct controls on prices and external trade. Staff also sought to clarify the authorities' charges of dumping by referring the authorities to the WTO, which subsequently provided technical assistance to Kenya in the preparation of antidumping legislation. The plan was to replace the suspended duties on cereal imports with WTO-consistent antidumping duties by the end of 1996. The authorities also agreed to eliminate discriminatory elements of a supplementary levy on sugar by the end of that year (IMF, 1996f) (Annex Table 3).

28. When the ESAF-supported program went off-track, Kenya's trade system became increasingly complex. Tariff reform was not a major focus of the ESAF-supported program, but Kenya's ongoing commitments to lower tariffs under the CBI were included in the authorities' memorandum of economic policies (IMF, 1996f).[15] Immediately after the program went off-track, the authorities followed the CBI plan for tariff reduction as envisaged under the program. But they also raised the suspended duties on basic food imports to very high levels in an effort to increase domestic food supply capacity (IMF, 1998c). Then, in the 1998/99 and 1999/00 budgets, nominal tariffs were raised and the scope of the suspended duties was widened to cover a range of manufactured goods with rates (5–20 percent) set at the discretion of the Minister of Finance. During the 1999 Article IV consultation, staff strongly recommended reversal of the tariff increases and called for the suspended duties to be phased out. Staff argued that the proliferation of suspended duties had made Kenya's trade regime more distortionary and less predictable and transparent, created opportunities for rent seeking, and contravened the "standstill" provisions of the COMESA treaty (IMF, 1999l).

29. Conditionality for the 2000 PRGF arrangement included the formulation of a tariff reform plan based on Kenya's commitments under the CBI. In discussions for the arrangement (in July 2000), staff stressed the need to address issues in the trade system, which they believed had become "opaque and unpredictable" (IMF, 2000d). The WTO's 2000 trade policy review for Kenya, released earlier that year, also criticized the use of suspended duties (WTO, 2000a). The authorities agreed to work with Fund and World Bank staff to develop a plan by March 2001 that would rationalize import duties in line with Kenya's commitments under the CBI (structural performance criterion (Annex Table 4)). The aim of the plan was, over a four-year period, to lower the maximum tariff (except on sugar) from 40 to 25 percent and to reduce the number of tariff bands from nine to four. Staff reported that Kenya was rated 6 on the Fund's TRI but did not indicate if and how the rating would change after the tariff reform. The authorities initially welcomed the agreement because it gave reasonable time for implementation and was designed to pave the way for Kenya's adoption of a regional common external tariff, either within COMESA or in the new EAC, which was formed in November 1999 (IMF, 2000d).

30. The 2000 PRGF-supported program also went off-track. The 2002/03 budget included several trade measures that staff saw as policy reversals. These included the exemption from duties of all capital equipment, increased tariff protection for certain local industries (the most important being steel), and continued discriminatory tariffs on wheat and sugar imports from Kenya's COMESA partners to counter allegedly "unfair trading practices" (IMF, 2003a).

31. Kenya's trade policy became increasingly oriented toward regional integration. Staff noted that Kenya's membership in two overlapping PTAs—COMESA and the EAC—could be problematic. In October 2000, Kenya joined eight other COMESA

[15] The commitments were to reduce the number of tariff bands to four and the maximum tariff to 30 percent by July 1997.

members to form a free trade area which granted a 60–90 percent preferential tariff to other COMESA members on a reciprocal basis.[16] Both COMESA and the EAC planned to establish customs unions by 2004. The authorities saw no inconsistency—they described the EAC as an "inner grouping" of COMESA that would go on a "fast track" to achieve the COMESA customs union. Staff, however, pointed to potential complications insofar as other EAC members had different arrangements: Tanzania was no longer a member of COMESA and Uganda was a member of COMESA but not the free trade area (Kozack, 2002).

32. In the 2003 PRGF arrangement, no trade conditionality was stipulated for the first year of the arrangement. The authorities indicated that they had agreed with EAC members to establish a common external tariff, and that as a step toward this goal they intended to reduce the maximum tariff rate from 35 to 25 percent in the next budget. Staff reported that Kenya was (still) rated 6 on the Fund's TRI. Staff and the authorities recognized at this time that the need for trade liberalization had also to be balanced against concerns about the revenue impact of possible tariff changes. To support the budget, modernization of the customs administration and reform of the duty drawback system were viewed as essential elements of fiscal adjustment. It was partly for this reason that structural conditionality on trade reforms was not specified upfront, but was expected to be negotiated in the context of the first program review.

33. By the time of the first review (in December 2004), Kenya had moved forward and ratified the EAC customs union protocol. The introduction in January 2005 of a common external tariff for Kenya, Tanzania, and Uganda with three rate bands (0 percent, 10 percent, and 25 percent) was very difficult for Kenya, which had previously maintained the highest rate of protection among the member countries.[17] However, a five-year transitional period was agreed under which the EAC countries could charge supplementary duties in excess of 25 percent on a list of "sensitive" products. The transitional period was expected to pave the way for the abolition of supplementary duties and for the complete elimination of tariffs on intraregional trade. The tariff reforms under the EAC customs union protocol were projected to result in revenue losses of 0.3 percent of GDP (IMF, 2004f). Trade-related attention in the program thus turned to revenue mobilization (including through the improvement of customs administration) to make up for the anticipated losses. The introduction, by end-March 2005, of simplified customs processing procedures for import and export, supported by verifiable performance indicators in a pilot office, was a structural benchmark for the second review (IMF, 2004f).

34. In subsequent missions, staff urged the authorities to work with their EAC partners to lower the common external tariff and to rationalize their overlapping PTAs. Staff considered the introduction of the EAC three-band tariff structure a "step in the right direction" for Kenya (IMF, 2004f); an SIP for the 2004 Article IV consultation (McIntyre, 2004) presented results from a trade simulation model suggesting that the EAC customs union would bring positive trade benefits for Kenya through increased flows of cheaper extraregional imports.[18] The 2006 Article IV mission urged the authorities to lower the top tariffs and bring "sensitive" products within the common external tariff.[19] The mission drew on a joint SIP prepared for the EAC countries (Everaert, Palmason, and Sobolev, 2006) that used the same trade simulation model; this paper showed that lowering the top common external tariff rate would lead to trade creation, improved efficiency of resource allocation, and welfare gains.[20] The authorities agreed that tariffs should be lowered but not immediately, noting the scheduled review of the common external tariff in 2010 (IMF, 2007b). Based on the arguments in Everaert, Palmason, and Sobolev (2006), the mission also advocated the rationalization of Kenya's PTAs which, it argued, gave rise to potentially conflicting commitments and hindered tariff reduction.

Assessment

35. Trade policy formed only a small part of the Fund's program discussions with Kenya, which were dominated by concerns about governance and other structural reforms. Staff (justifiably) viewed trade

[16] The other members of the COMESA free trade area were Djibouti, Egypt, Madagascar, Malawi, Mauritius, Sudan, Zambia, and Zimbabwe.

[17] The tariff structures in the three EAC members were very different. Kenya had eight tariff bands ranging from zero percent to 35 percent; Tanzania had four bands ranging from zero percent to 25 percent; and Uganda had three bands ranging from zero percent to 15 percent (IMF, 2003a).

[18] The simulation was based on a static, partial equilibrium model—SMART—developed jointly by the UN Conference on Trade and Development and the World Bank and widely used by negotiators of bilateral and multilateral trade agreements.

[19] The same concerns were echoed in the WTO's 2006 joint trade policy review of Kenya, Tanzania, and Uganda (WTO, 2006b).

[20] Everaert, Palmason, and Sobolev (2006) argue that the level of trade protection and tariff dispersion associated with the EAC common external tariff gave significant potential for trade diversion. In contrast, McIntyre's (2004) simulations showed "negligible" trade diversion from the EAC common external tariff. However, McIntyre (2004) noted that his results could be affected by the lack of data on informal cross-border trade within the EAC. Everaert, Palmason, and Sobolev (2006) noted that robust evidence of trade diversion would be hard to obtain given the short time since the introduction of the common external tariff.

liberalization as critical for future sustained growth (IMF, 1996f; IMF, 2003f), and most of the relevant trade issues—e.g., the relatively high level and dispersion of tariffs, overlapping PTAs, and protection of selected sectors—were raised by staff in surveillance discussions. Yet in the staff's own assessment, "[t]rade policy advice and regional issues were not prominent under Fund arrangements" (IMF, 2008c). In designing the 2000 and 2003 PRGF-supported programs, staff reported Kenya's TRI rating at 6 ("moderately restrictive") but did not indicate whether or not, or explain why, a reduction under the program would be necessary or desirable.

36. There was minimal analysis by staff of the authorities' stated objectives in selectively increasing levels of protection. Kozack (2002) observed that support for trade liberalization in Kenya was being hampered by perceptions of unfair competition (i.e., dumping by neighboring countries) and the adverse impact on some local industries. However, no sector-specific study was done of the industries where protection was being increased, nor any analysis of the food security arguments that the authorities used to justify the continued high protection of cereal production and sugar processing. Further attention particularly to this latter topic might have helped staff build greater support for reducing protection levels. The staff's approach was very much from a macroeconomic perspective, wherein the benefits of trade liberalization derived from reducing distortions: specific costs and benefits from removal of supplementary duties, for example, were not explored in any depth.

37. The postponement of trade reforms from the first year of the 2003 PRGF arrangement represented a missed opportunity to place the staff's surveillance recommendations in a program context. In line with Board guidance, staff needed to be selective in determining the coverage of structural conditionality, given that many competing and important structural reforms and governance measures were candidates for inclusion in the program. However, given Kenya's poor record in completing reviews on time, staff could perhaps have given more consideration to including some key trade measures at the beginning of the program. The deferral of trade conditionality until the first review may have helped in securing agreement with the authorities. But by the time the review went to the IMF Executive Board, a common external tariff was virtually in place, and trade policy had been effectively removed from the list of issues that could be dealt with in a program context.

38. The authorities and staff interpreted the agreement to adopt the EAC common external tariff as effectively placing the tariff regime beyond program conditionality. With an agreement in place on a customs union, it would have been unrealistic to expect a commitment from any one member on the common external tariff, which required agreement from all members of the customs union. Discretionary elements of Kenya's tariff structure, such as the supplementary duties, were still legitimate policy issues for bilateral discussion and unilateral action. Yet it seems that the elimination of supplementary duties, as urged by Fund staff during the 2006 Article IV consultation/second review of the 2003 PRGF-supported program, was not considered for inclusion in the program. The stance taken appears to reflect a view even by staff that, with the increasing importance of PTAs, Kenya's trade policy had moved beyond the IMF's immediate concern.

39. Indeed, even the limited trade policy conditionality in IMF-supported programs in Kenya did not produce much lasting result. For the most part trade conditionality during the period under review was either not met fully or was later reversed. The reversals occurred especially when the Fund-supported programs were off-track. For example, staff succeeded in convincing the authorities to avoid direct controls on food imports in the 1996 ESAF arrangement. However, the authorities replaced the import prohibitions with very high supplementary duties which continued to be levied throughout the period, including under the special arrangements of the EAC customs union. The four-year tariff reform program, formulated in 2001 with help from World Bank and IMF staff, was only partly implemented. The measures to simplify customs processing procedures (a structural benchmark for the second review of the 2003 PRGF-supported program) were not implemented.[21]

D. Mozambique

Background

40. During the 1990s, the Mozambican government was largely sympathetic to arguments for trade liberalization. In particular, it viewed an open trade system as critical for attracting badly needed foreign investment to rebuild the war-ravaged economy. In 1991, emerging from many years of civil conflict, Mozambique implemented a comprehensive trade reform with IMF technical assistance, eliminating most nontariff barriers and simplifying the tariff schedule from 34 to 5 bands (ranging from 5 percent to 35 percent). Subsequent policy changes during 1991–96 resulted in a somewhat more complex tariff regime—with widespread use of import duty exemp-

[21] The measures were later incorporated in a customs modernization project that began in 2007.

tions, for new and existing investments, as well as for political parties and nongovernmental organizations (NGOs), and a classification of imports within the tariff structure that was subject to ad hoc adjustments—but the trade system in general was considered relatively open (IMF, 1996k).[22]

41. Customs administration was a weak point. At the beginning of the evaluation period, Mozambique's tax ratio was very low (about 10 percent of GDP), with trade taxes accounting for about 2 percent of GDP. The customs administration was generally viewed as highly inefficient and corrupt, and prolonged discussions had been held on the merits of privatizing the customs service. The World Bank had recommended improvements in customs procedures, and an FAD technical assistance mission in February 1995 had drawn up a work program to help improve customs administration (IMF, 1995a).

42. In the mid-1990s, Mozambique, like Tanzania, belonged to SADC and COMESA but planned to withdraw from the latter. Mozambique signed the COMESA treaty in 1993 but never ratified it; it suspended its participation in COMESA in 1996 and formally withdrew at the end of 1997. Unlike its neighboring countries, Mozambique was not a signatory of the CBI.

Policy dialogue and conditionality

43. During 1996–2007, Mozambique had three financial arrangements with the Fund: two back-to-back ESAF-supported arrangements—the first from 1996 to 1999 and the second from 1999 to 2003—followed by a three-year PRGF-supported arrangement starting in 2004. All three programs were completed. A three-year PSI arrangement was put in place in June 2007.

44. The 1996 program targeted customs reform as a key element in the structural policy agenda. In the first-year program (May 1996) a structural benchmark was placed on signing a contract for a private company to take over the management of customs. (This led, in August 1996, to the signing of a three-year agreement with Crown Agents of the United Kingdom (IMF, 1996g)). FAD fielded two technical assistance missions on customs administration and provided a long-term consultant to assist with the implementation of customs reform during the program period. Several technical assistance recommendations from FAD were incorporated in subsequent program conditionality throughout the 1996 and 1999 ESAF arrangements (Annex Table 5 and Annex Table 6). FAD technical assistance continued to ensure the effective operation of the customs administration after management support from the Crown Agents expired in mid-2003.

45. Tariff reforms were initially designed to simplify and enhance customs revenue collection. From the outset of the 1996 program, staff identified tariff exemptions as a serious problem; completion of a study on tariff exemptions and taking measures to curtail them was a prior action for the first-year program. Difficulties in addressing this issue made it a recurring theme throughout the evaluation period. After studying the revenue impact of alternative tariff structures, the authorities modified the tariff structure in November 1996, lowering the unweighted average tariff rate from 18 percent to 11 percent. However, staff were concerned that the tariff reform—by lowering tariffs on imported inputs while raising the average tariff on consumer goods—may have increased the effective rate of protection (IMF, 1997b). Staff pressed the authorities to lower "excessively high" tariffs, narrow the range of tariffs, and curtail tariff exemptions, particularly those that were discretionary. The government agreed to lower the top import tariff rate from 35 percent to 30 percent by end-April 1999 (a structural benchmark for the third-year program, August 1998) but would not countenance further immediate reductions, citing, the continued weakness of government revenue (IMF, 1998e). Staff expected that the reduction in the maximum import tariff rate would lower Mozambique's TRI from 2 (in 1998) to 1 (IMF, 1999b).

46. In the 1999 ESAF/PRGF-supported program, Fund (and Bank) staff pushed harder for tariff reforms as the authorities began to express some reservations about the pace and content of their trade liberalization program. After lowering the top import tariff rate to 30 percent in April 1999, the authorities were reluctant to make further cuts under the new ESAF/PRGF-supported program. They also noted that future tariff reduction would need to be considered in the context of their membership in the SADC, which was preparing a trade protocol that envisaged progress toward a free trade area and a customs union. But under pressure from Fund and Bank staff, the government committed to cut the top tariff rate to 25 percent by January 2002, toward the end of the program period. The government also agreed to reassess the justification for existing surcharges on imports of cement, steel plates and tubes, and sugar (a structural benchmark for the first-year program) and—in response to IMF and World Bank staff concerns about the possible reinstatement of the ban on raw cashew nut exports—promised not to introduce (new) or increase (existing) import surcharges or export restrictions (IMF, 1999g) (Annex Table 6).

[22] In 1997, Mozambique's aggregate score on the Fund's TRI was 3 ("liberal"), based on a tariff rating of 3 ("moderate") and a nontariff barrier rating of 1 ("open").

(Box 1 describes the evolution of Mozambique's cashew nut export policy from 1992 to 1999.)

47. Toward the end of 1999, the authorities reversed their policy of trade liberalization in the cashew and sugar sectors. In the cashew sector, the export ban on raw cashew nuts was not reinstated but instead, parliament passed a bill in September 1999 raising the export tax on raw cashew nuts from 14 percent to 18–22 percent (the exact rate to be set by the government each year) and offering domestic processors priority in the purchase of raw nuts. Concerned about the efficiency costs of these measures and their adverse impact on the many poor rural households who depended on cashew nuts for cash income, IMF staff proposed, and the authorities agreed to carry out, a study evaluating and rationalizing policies for the sector. In the sugar sector, in September 1999 the government raised the variable import surcharge to 25 percent—a level representing a 60 percent nominal level of protection for the industry—in an attempt to foster the rehabilitation of the local sugar industry. The heightened protection was strongly opposed by Fund staff, who considered the policy unwise (given the presence of more efficient sugar producers in the region and distortions in the world market), costly for domestic consumers, and likely to encourage smuggling. The authorities, however, were not convinced. Staff therefore suggested that a comprehensive review of the sugar policy be undertaken and that, if the review justified the granting of temporary support to the sector, the government provide such support in the form of direct budget subsidies to the producers while phasing out protection via import surcharges. The authorities agreed to undertake the review in collaboration with the World Bank (IMF, 2000b).

48. Following intervention by the Managing Director in 2000, staff backed down from their stance on sugar sector protection. Their call to remove protection for the sugar sector had been seen by the authorities, the local public, and some NGOs as a repeat of the World Bank's unpopular—and what many considered to be discredited—policy

Box 1. Mozambique: Cashew Sector Policy

Following the long civil war in Mozambique, which ended in 1992, the cashew growing and processing industries were in total disrepair. Exports of raw cashew nuts were initially banned, then heavily restricted, in an effort to ensure cheap supplies to local processing factories. In 1994, the state-owned processing plants were sold to the private sector which began rehabilitation. In the following year, however, the World Bank, which was supporting Mozambique's economic reforms through its concessional loan window, recommended liberalizing raw cashew exports. The Bank's recommendation was based on an in-house study which concluded that Mozambique would be better off exporting raw nuts to India for processing as its own processing factories were not efficient (McMillan, Rodrik, and Welch, 2004). On the Bank's advice, the government replaced the export restriction on raw cashew nuts with an export tax of 26 percent, subsequently lowered to 20 percent in 1996 and 14 percent in 1997, with the expectation of elimination by 2000.[1]

The planned phase-out of the export tax touched off protests from the cashew processors, who claimed that they had been guaranteed a longer period of protection when they purchased the factories from the state. Furthermore, the Mozambican processors claimed that India's processing industry was subsidized. The export tax phase-out led to some processing plant closures and the unemployment of thousands of cashew factory workers. In the face of sustained criticism, the World Bank agreed to leave the export tax at 14 percent while a new study was prepared on the impact of liberalization on the cashew sector (McMillan, Rodrik, and Welch, 2004).

The new study, conducted by Deloitte and Touche and funded by the World Bank, was released in September 1997. It cast doubt on the evidence that the liberalization policy had raised farmgate prices, acknowledged that Indian subsidies tilted the playing field, and concluded that foreign exchange earnings could be higher if cashew nuts were exported in processed form rather than raw. The report recommended keeping the 14 percent export tax for three or four years to give the industry time to adjust.[2] In light of the recommendation, no further reductions were made to the export tax. However, the widespread view was that the Mozambican cashew nut industry had already been seriously, and possibly irreparably, damaged. In September 1999, a draft bill was sent to the parliament proposing that the export ban on raw cashew nuts be reinstated for 10 years.[3]

[1] "Mozambican bosses and workers united on cashews," *Reuters*, August 7, 1997.

[2] "Study finds World Bank wrong on Mozambique's cashew industry," *Pan-African News Agency*, September 5, 1997.

[3] "Liberalization of cashew exports to be reversed," *BBC*, September 21, 1999.

Box 2. Mozambique: The Sugar Surcharge Controversy

Like the cashew industry, the sugar industry was all but destroyed during Mozambique's civil war. In the early 1990s, the government invited private investors to take over sabotaged or moribund sugar mills, with the assurance that the industry would be protected against cheaper imports until it was able to regain international competitiveness. The protection took the form of a minimum reference price for imported sugar: imports of sugar below the reference price were subject to a surcharge equal to the price difference. The infant industry protection (and an export quota for the U.S. market at a guaranteed price) proved attractive to private, mainly foreign, investors. Prominent investors included the Sena Company, a Mauritian consortium planning a US$100 million rehabilitation of the Marromeu sugar mill and Ilovo, a South African company planning a US$240 million investment in the Maragra sugar plantation with financing from the International Finance Corporation (IFC). When the IMF urged that the surcharge should be phased out, the investors protested that they would be unable to recoup their investments and threatened to pull out if the government followed the Fund's recommendation.

Fund staff presented the standard arguments against infant industry protection: "If the viability of the enterprises can only be assured at the present with very high protection levels, with no prospect of future reductions, then perhaps they're not very good projects."[1] The government disagreed, painting the Fund as dogmatic and arguing that historically "all governments have done this."[2] IFC staff noted that sugar was one of the few agricultural industries that had been able to attract foreign investment and supported the government's policy. The controversy was sharpened by the perception that the Fund was not even-handed in its advice. NGOs such as Oxfam pointed out that other countries subsidized or protected their sugar producers hence it was "dogmatic and ideological" for the Fund to advise Mozambique not to protect its "low-cost sugar producers" if did nothing about the United States and European Union protecting "high-cost sugar producers."[3]

The Fund surprised observers by backing down on the sugar protection issue. The decision came at a time when the Fund was streamlining conditionality and reshaping its approach to low-income countries. The Managing Director was credited with the decision—"his reasoning was simple: given that removing sugar tariffs was not essential to promoting economic stability, there was no need to insist on it"—and Oxfam cheered, "This time, the IMF listened to reason."[4]

[1] "Mozambique faces sugar-industry debate—World Bank invests in commodity, while IMF would see it shrink," *Wall Street Journal*, June 20, 2000.
[2] "Mozambique to urge U.S. backing in IMF, World Bank," *All Africa*, June 16, 2000.
[3] "Mozambique faces sugar-industry debate—World Bank invests in commodity, while IMF would see it shrink," *Wall Street Journal*, June 20, 2000.
[4] "The listening approach to development," *Financial Times*, January 12, 2001.

for the cashew sector.[23] The then-newly appointed IMF Managing Director, on a tour of Africa in July 2000, assured the authorities that the IMF would not impose conditions and policies on countries against their interests.[24] The study of the sugar sector (a structural benchmark under the 1999 ESAF/PRGF arrangement) was undertaken by the UN Food and Agriculture Organization (FAO) and released in October 2000. It came out in support of the government's position. Staff, with little alternative but to accept its conclusions, expressed the opinion that the import surcharge should at least have a sunset clause and be rolled back over time. The authorities, however, stated only that they would review the surcharge on an annual basis (IMF, 2000h). The Fund received some favorable press for being flexible on this issue. (Box 2 provides further detail on the sugar controversy.)[25]

49. Subsequent programs (the 2004 PRGF-supported program and the 2007 PSI-supported program) touched on trade policy only briefly, mainly in the context of Mozambique's PTAs. In line with the SADC trade protocol (which Mozambique ratified in December 1999), the authorities lowered the maximum tariff rate to 25 percent in January 2003 and committed to lower it further to 20 percent in 2006 for SADC members and subsequently on an MFN basis. In Article IV discussions, staff continued to urge the authorities to liberalize trade on a multilateral (MFN) basis and to limit infant industry

[23] "IMF targets Mozambican sugar," *Pan-African News Agency*, November 24, 1999; "IMF pressure may force investors to pull out of Mozambique," *Pan-African News Agency*, May 26, 2000; "Mozambique to urge U.S. backing in IMF, World Bank," *All Africa*, June 16, 2000.

[24] "IMF will not impose conditions on African governments: Koehler," *Agence France Presse*, July 7, 2000; "IMF head says government 'free' to adopt protectionist policy," *BBC*, July 22, 2000; "Kohler demonstrates a reformist zeal," *Financial Times*, September 14, 2000.

[25] "IMF eases economic reform pressure," *All Africa*, December 6, 2000; "The listening approach to development," *Financial Times*, January 12, 2001; "IMF, World Bank, on listening tour," *All Africa*, February 8, 2001.

protection. Mozambique also received substantial trade policy advice and technical assistance from the World Bank and from other donors under the IF.[26] A DTIS prepared by the United States Agency for International Development was released in late 2004; that study incorporated work on transport and trade facilitation by the World Bank but no substantive input from the Fund (USAID, 2004). IMF staff broadly endorsed the recommendations in the DTIS except in the area of PTAs where they urged the authorities to rethink the strategy of pursuing more bilateral/regional agreements (Kvintradze, 2007). Within the IF, the World Bank provided advice and assistance on PTA issues such as membership in the Southern African Customs Union (SACU) and the EPAs that were evolving with the European Union.

Assessment

50. The focus on customs reform at the outset of the 1996 ESAF arrangement was appropriate. Given that Mozambique's trade regime was already relatively open, staff were right to concentrate on customs reform which was a pressing concern. The approach of using a private firm to take full management control during a three-year period, followed by use of the same firm in an advisory capacity for a further three years, appears to have been well thought-out and staff reported that sufficient progress had been made for the authorities to resume full control from 2003 onward. The technical assistance provided by FAD contributed substantially to this outcome and there was good use of program conditionality to ensure that key steps were implemented on time. Almost all customs reform conditionality was met on time.

51. The focus shifted justifiably to tariff policy when staff detected an increase in trade protection. Staff developed reservations about the impact of the 1996 tariff reform and called attention to their concerns. A general problem with the description of tariff reforms in Fund reports has been the tendency to focus only on maximum and/or average tariff rates; in this case, however, staff went beyond the basics and looked more deeply into the tariff structure, concluding that the tariff changes may have implied higher effective protection rates for certain industries. On that basis, they urged the authorities to review and simplify the tariff structure. Similarly in 1999, staff were alert to the protectionist swing that was implied by increases in the export tax on raw cashew nuts and the import surcharge on sugar, and discouraged the moves. In that regard, staff's actions were in line with the objectives of Fund trade policy advice as set out in the internal guidelines (IMF, 1999j).

52. The sugar controversy, however, underscored the need for technical analysis in evaluating and arbitrating on sector-specific tariff issues. The staff's general arguments against infant industry protection were supported by a substantial amount of research and evidence in the existing literature.[27] But without sector-specific knowledge, staff could not put context and specificity in their arguments and thus could not persuade the authorities to their view. The call for an independent technical study to resolve the issue was an appropriate compromise, but lacking sector-specific knowledge, staff were unable to challenge the conclusions of the FAO report. Writing much later, Kvintradze (2007) indicates that the protection did facilitate large-scale foreign investment in sugar estates located in remote areas with few other income opportunities, and that the production capacity and output of sugar mills has increased significantly in recent years. But the efficiency of Mozambican sugar production, and the question of whether the industry will eventually be able to operate profitably in the absence of the surcharge are still open issues.

53. The introduction of the Fund's streamlining initiative defused the sugar controversy.[28] After the high-profile disagreement with the World Bank over cashew sector policy, the authorities had hardened their position on infant industry protection, and the Fund needed to tread carefully in going over the same area. The Fund's acceptance of the government's position was consistent with the macro-criticality criterion for structural conditionality. Indeed, the Mozambican sugar surcharge became the standard illustration of the concept: a senior PDR staff member explained to the media that while the Fund did not consider Mozambique's sugar strategy "efficient or proper," the Fund would not press the issue because the economic cost was not so large as to cause macroeconomic imbalances.[29]

54. Fund and World Bank staff saw eye-to-eye on cashew sector policy, but less so on sugar sector policy. In the cashew debate, IMF staff supported the Bank's view and strongly opposed the increase in the export tax on raw cashew nuts. IMF staff expressed concern about the efficiency costs of the increased protection and the adverse impact on cashew farmers. But, as in the sugar case, the lack of sector-

[26] Bilateral donors included the European Union, Switzerland, the Netherlands, the United States, and Canada.

[27] See Krueger (1997) for an overview and references.

[28] The IMF's streamlining initiative, reflected in its 2002 Conditionality Guidelines, aimed at reducing the volume and scope of the Fund's structural conditionality by requiring "parsimony" in the use of conditions, and stipulated that conditions must be "critical" to the achievement of the program goals.

[29] "IMF aiming for new loan guidelines in second half of 2001," *Dow Jones*, March 21, 2002; "The softer side of the IMF," *Business Week*, November 19, 2001.

specific knowledge limited their effectiveness and led them to suggest an independent study to evaluate and help rationalize policies for the sector. The completed study recommended the liquidation of several nonviable processing plants, but it also found that newer factories, using more labor-intensive technology, needed no special assistance. In the event, the government decided to retain the 18 percent export tax, and the country's cashew industry did not subsequently perform well enough to re-establish itself as a significant player in world markets. In the sugar debate, the Fund was largely alone in arguing against infant industry protection; the World Bank Group had by then apparently changed its stance and was even financing the rehabilitation of one sugar mill through the IFC.

55. The Fund's retreat from trade policy issues after the mid-2000s was understandable but may have gone too far. There has been no shortage of trade-related advice and technical assistance available to Mozambique from other sources, particularly under the IF umbrella. While trade policy issues no longer featured in Fund-supported programs in Mozambique after 2003, staff continued to discuss trade issues in their biennial Article IV consultations during this period. Regional and bilateral trade agreements, including the EPA with the European Union, have become increasingly important; while Mozambique is not yet caught in the problems of overlapping PTAs, this could be a major issue for the period ahead, especially in light of some of the DTIS's recommendations. Kvintradze (2007) outlines some of the complexities of regional integration options for Mozambique, but further analytical and empirical work on the macroeconomic implications of various trade policy choices facing Mozambique could have been useful ahead of upcoming decisions.

56. The tax and customs reforms took time to have an effect. Through 2005, the tax-to-GDP ratio stagnated in the range of 10–12 percent, despite the substantial FAD technical assistance provided and the fact that the conditionality associated with the customs improvement project was generally observed with only a few delays in certain measures.[30] The review of duty exemptions (a structural benchmark in the 1999 ESAF/PRGF program) was eventually completed in August 2000. Based on the results, the government took some actions to limit exemptions.[31] Since 2005, as a result of the earlier fiscal revenue reforms and some discretionary tax measures, Mozambique has made progress in raising the tax ratio, and this facilitated the further reduction of the maximum tariff rate in 2007.

[30] This observation has been partly attributed to inaccurate GDP data.

[31] Some of the reductions in duty exemptions were reversed in recent years.

E. Ghana

Background

57. In 1996, Ghana was generally regarded as ahead of its neighbors in trade liberalization. Following several reforms of the trade system since the early 1980s, 1994 saw a new effort to simplify the tariff regime. This resulted in a relatively simple three-tier system, with rates of 0 percent, 10 percent, and 25 percent. The unweighted average tariff rate stood at below 15 percent. Cocoa, historically Ghana's key economic sector, was subject to relatively high export taxation and a state export monopoly.[32]

58. Ghana is a member of the Economic Community of West African States (ECOWAS), a regional group of 15 West African countries.[33] ECOWAS was founded in 1975 with the aim of establishing an economic union in West Africa, but progress toward this goal was very slow. In 1994, eight ECOWAS members—not including Ghana—formed the West African Economic and Monetary Union (WAEMU), a customs and monetary union.

Policy dialogue and trade conditionality

59. Ghana had three back-to-back ESAF/PRGF arrangements during the period under review. Structural conditionality in the first program (1995–99) focused on cocoa sector reform, energy sector reform, and divestiture from the public sector. The later programs (1999–2002 and 2003–06) focused on fiscal issues and financial sector reform as macro-critical areas for structural conditionality (IMF, 2007c). The third PRGF-supported program paid very limited attention to trade policy.

60. The IMF and the World Bank advised Ghana to liberalize its cocoa sector. Under the 1995 ESAF-supported program, the government had indicated its desire to remove the Cocoa Marketing Company's monopoly over the export of cocoa. But an independent study by a U.K.-based consultancy that had been commissioned by the government and financed under

[32] The Cocoa Board paid farmers a pre-set price in domestic currency and retained the export proceeds; the difference between the international price and the price paid to farmers, less administrative and other costs, thus formed an implicit (and variable) export tax on cocoa (Bulir, 1996). The Cocoa Marketing Company, a subsidiary of the Cocoa Board, negotiated and sold all exports of cocoa (Kanai, Pellechio, and Leite, 1998).

[33] The other ECOWAS members are Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, The Gambia, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo.

a World Bank credit recommended the continuation of the state monopoly of cocoa exports to ensure quality control and the reliability of deliveries while the rest of the cocoa sector was being deregulated and restructured (IMF, 1996h). Fund staff also urged the authorities to reduce, if not eliminate, the export tax on cocoa as part of the restructuring/deregulation of the cocoa sector (IMF, 1996h). Their advice was backed by an SIP (Bulir, 1996) that evaluated various theoretical and practical arguments for cocoa taxation, estimated a model of cocoa supply, and concluded that a modest reduction in the export tax need not harm government revenue. The Fund (and the World Bank) continued to work with Ghana on reforming the cocoa sector through the 1995 ESAF-supported program and its successor program, using conditionality to establish benchmarks for various steps in the liberalization process.[34]

61. Fund surveillance during 1996–98 covered trade policy issues largely in relation to their revenue aspects. In the 1997 Article IV consultation, staff noted a steady decline in effective import duty rates resulting from an expanding range of nontransparent tariff exemptions and problems in customs administration (IMF, 1997d). An SIP (Arjona-Gracia, Pellechio, and Crego, 1998) prepared by IMF and World Bank staff for the 1998 Article IV consultation highlighted Ghana's widespread use of zero rates and exemptions and "the relatively high top rate of 25 percent" and examined the implications of various tariff reform options for the effective tariff rate and tariff revenues.

62. Tariff reform took a more prominent role in the 1999 program supported by the ESAF/PRGF-supported program. The authorities announced that in January 2000 they would reduce the maximum tariff from 25 percent to 20 percent which represented a target for the region set by the WAEMU customs union. The authorities presented this tariff reduction as a means of deterring smuggling; it was incorporated in the program as a structural benchmark. The expectation was that this move would reduce Ghana's TRI from 5 to 4. The program also included a structural benchmark on the completion of a comprehensive review of the tariff structure to assess the prospects for further tariff reductions (by September 1999) (Annex Table 7). The government's plan was to shift, over the medium term, from reliance on trade taxes—both import tariffs and cocoa export taxes—toward taxation of domestic consumption. An analysis by Fund staff of medium-term fiscal sustainability (Pellechio, 1999) provided the basis for discussion of this strategy—specifically, the measures needed to compensate for the revenue losses from tariff and cocoa tax reform.

63. The 1999 ESAF/PRGF-supported program also addressed the continuing problem of import exemptions and customs irregularities. Staff reported a serious breakdown in controls on bonded warehouses that led to significant revenue losses (IMF, 1999k). The government undertook to investigate these incidents and identify measures to strengthen customs as a prior action for the first review of the program in November 1999. FAD provided technical assistance in this area: two reports, on "Reform of Tariff and Exemption Policies" (March 2001) and "Revenue Administration and Tariff Policy Reform" (October 2001) set out an agenda, inter alia, to deal with exemptions and combat corruption in the bonded warehouses and free zone facility. Measures to curtail import tariff exemptions were included in a supplementary package of revenue measures that was sent to parliament in June 2001 as part of the government's plan to close the fiscal financing gap for 2001 (prior action for the third review).

64. IMF staff were critical of a special import tax that Ghana introduced in 2000 to protect local producers against alleged dumping by other countries. The 20 percent import tax was imposed on about 50 selected products at the same time as the maximum tariff was reduced to the WAEMU target of 20 percent. The tax effectively raised the maximum tariff to 40 percent and increased the average nominal tariff rate by about two percent. Staff argued strongly against this measure, which they considered to be "contrary to the spirit of the tariff reform" (IMF, 2000f).[35] In the second program review in June 2000, staff added a structural benchmark to the effect that the authorities would request parliament to eliminate the special import tax or "replace it with antidumping measures if justified according to existing domestic legislation" by end-March 2001 (IMF, 2000f).

65. Staff were also critical of import and export tax increases planned by the government in 2001, but they accepted these as necessary to close the budget shortfall. The fiscal situation had deteriorated during 2000 (an election year) and the incoming government had to devise revenue and expenditure measures to shore up the public finances. A number of trade tax measures were included among the revenue measures to be submitted to parliament in June 2001 (prior action for the third review), namely

[34] A 1998 SIP (Kanai, Pellechio, and Leite, 1998) continued the discussion on options for cocoa sector reform, including a comparison with the cocoa sector in Côte d'Ivoire, Ghana's neighbor and the world's leading producer of cocoa.

[35] The WTO agreed. In Ghana's 2001 trade policy review, the WTO noted that special import taxes had been a common feature of Ghana's tariff system and that the reintroduction of the tax in February 2000 contradicted the government's policy objective of tariff reduction, and urged the government to specify a time limit for the removal of the tax (WTO, 2001).

a 5 percent import duty on certain items; a 1 percent customs processing fee on tariff-exempt imports; and a 10 percent levy on exports of lumber. Staff advised against the export tax on lumber and urged the authorities to explore "alternative nondistortionary measures to raise revenue and promote environmental conservation" in the following year's budget. Staff were, however, reassured by the authorities' plan to formulate a broader agenda for tariff reform by end-2001 (IMF, 2001c).

66. The government announced further tariff increases in 2003, just as a new PRGF arrangement was due to be considered by the Executive Board.[36] Staff were not consulted about these measures, which were designed to protect certain local industries, notably, poultry. The Ghanaian authorities believed that higher tariffs on poultry were justified because the industry, which had taken many years to establish, was unable to compete with subsidized products from the European Union and the United States. Staff viewed the measures as damaging to the government's growth and poverty-reduction strategy, stressing the impact on the poor of raising prices for two staple foods, rice and chicken. Despite initial assurances to the contrary, the authorities reported that the tariff legislation had inadvertently been given presidential assent.

67. Staff moved quickly to avert the tariff increase. In order to allow the PRGF-supported program to go forward, the finance minister had to order a public retraction and commit not to implement the tariff measures. The retraction of the tariff measures gave rise to much negative public and press comment. Attention centered on the issue of poultry tariffs (Box 3) and sparked a debate on the theoretical/ideological underpinnings of the Fund's trade liberalization policies.[37]

68. After the poultry tariff episode, the Fund had little or no involvement in trade policy issues in the 2003 PRGF-supported program or in the following period of surveillance. Ghana's trade policy became increasingly geared toward regional integration and bilateral trade agreements. The government indicated that its medium-term plans for tariff reforms were firmly linked with those of its neighboring ECOWAS member countries. In December 2004, the government launched its National Trade Policy, aimed at expanding access to regional and global markets. Staff agreed with the main elements of the National Trade Policy and noted that the government had ruled out the use of high tariffs to protect domestic industries. There was little further mention of trade liberalization. In an interview for this evaluation, Ghanaian authorities said that most of their recent interactions on trade policy had been with the World Bank, bilateral donors, and the WTO, and that the discussions had usually covered sector-specific topics which were outside the Fund's core area of expertise. The authorities observed that the Fund had been silent on the evolving EU-Ghana EPA.

Assessment

69. The Fund's coverage of trade policy issues in the earlier part of the evaluation period was appropriate. Although Ghana's trade regime was considered to be only moderately restrictive in the mid-1990s, trade policies (e.g., tariff reform and reduction of the cocoa export tax) were integral to the medium-term strategies to reform the tax system and the cocoa sector, and hence clearly both relevant and critical to the overall macroeconomic outlook.

70. In the later part of the evaluation period, the Fund appears to have missed some opportunities to contribute constructively to Ghana's trade liberalization. On more than one occasion, the authorities justified (proposed or actual) tariff increases as being necessary to counter dumping by Ghana's trading partners. Staff firmly opposed the tariff increases but did not follow up when Ghana failed to implement WTO-consistent antidumping legislation. By pressing for unilateral trade liberalization but not acknowledging Ghana's possible difficulties in responding to alleged dumping in a manner consistent with WTO rules, the Fund came across as rigid and doctrinaire.[38] Moreover, the Fund may have missed an opportunity to improve its policy coherence with the WTO (and the World Bank). After 2003, the Fund moved significantly away from trade policy issues and passed up further opportunities to advise Ghana's authorities on trade liberalization. Staff had little to say about the authorities' National Trade Policy in late-2004, or about the EU-Ghana EPA. The latter, especially, was an important and highly debated trade policy issue in Ghana and an area where the authorities have indicated that some macroeconomic analysis by the Fund could have been helpful.

71. The Fund's views on tariff and cocoa sector reform were carefully thought out. Although the

[36] Tariffs were proposed to be increased for a range of finished products (from 10 percent to 15 percent) and for rice imports (from 20 percent to 25 percent). For poultry a supplementary duty of 20 percent was proposed.

[37] See "IMF bullying of Ghana over poultry and rice tariffs criticized," *Liquid Africa*, September 30, 2004; "IMF/World Bank overriding democracy in Africa," *All Africa*, January 31, 2005; "Playing Chicken: Ghana versus the IMF," Corpwatch, June 14, 2005 (http://www.corpwatch.org/article.php?id=12394).

[38] Hoekman (2002) points out that some WTO rules, including the antidumping agreement, have "significant direct implementation costs" and making them work in low-income countries could require "wholesale reform and strengthening of a variety of institutions."

Box 3. Ghana: The Poultry Tariff Controversy

Ghana's poultry industry, which had grown strongly behind tariff barriers since the 1950s, suffered after tariff protection was reduced in 1994. From meeting virtually all domestic consumption demand in the early 1990s, domestic poultry production slowed and then declined until it supplied less than half of the domestic market in 2003. The price of imported frozen poultry (which was subject to a 20 percent tariff) was reportedly about 30–40 percent lower than that of locally produced poultry.

The Ghanaian authorities and NGOs such as Corporate Watch and Christian Aid, argued that with the lowering of protection, the Ghanaian market was being flooded by cheap subsidized frozen chicken parts from the European Union and the United States. It was feared that prolonged "dumping" of this nature would soon lead to the dismantling of the domestic poultry industry and jeopardize Ghana's food security, leaving the country vulnerable to potential shortages of staple foodstuffs.

Staff's reaction to the proposed supplementary duty on poultry was driven in large part by the standard view that a lower level of protection would allow cheaper goods for domestic consumption and (where domestic industries had higher costs) a more efficient reallocation of resources. Staff argued that higher protection would increase the prices of staple foods and would be counter-productive to poverty reduction efforts. From available information about the sector, staff understood that poultry production had been rising hence they did not see a strong prima facie case for higher protection from a sectoral viewpoint. Furthermore, staff believed that about 50 percent of Ghana's domestic production capacity related to one privately-owned agro-business poised to dominate the entire West African market and that there had been strong lobbying with the President from the owners of this large firm. Staff thus reportedly characterized the poultry tariff controversy as "a storm in a teacup."[1]

NGOs strongly objected to the Fund's "bullying" of Ghana. They saw the Fund as being heavy-handed (the head of a local NGO asked: "What remains of the sovereignty of Ghana, if laws enacted by parliament can be suspended by a mere call from the IMF?") and unfair (by forcing Ghana to backtrack on a tariff increase that was well within its WTO bindings whilst allowing the European Union and the United States to continue subsidizing their agricultural sectors).[2] In April 2005, a coalition of local and international NGOs organized a series of activities in Accra and other cities around the world to draw international attention to the "obnoxious world trade regime" allegedly perpetrated in part by the IMF.[3]

[1] "A fine trade policy at last," *All Africa*, February 21, 2005.
[2] "IMF bullying of Ghana over poultry and rice tariffs criticized," *Liquid Africa*, September 30, 2004; "IMF/World Bank overriding democracy in Africa," *All Africa*, January 31, 2005.
[3] "Campaign against unfair trade gathers momentum," *All Africa*, February 28, 2005.

Fund was not the main initiator of the tariff reforms or the lead agency behind the cocoa sector reforms, staff were well informed about the issues. The Fund's discussion on tariff reform was supported by detailed knowledge of Ghana's tariff system and tariff exemptions, and by a quantitative analysis of the implications of different tariff reform options for average and effective tariff rates and revenue collection (Arjona-Gracia, Pellechio, and Crego, 1998). Similarly, the Fund's advice on cocoa taxation was based on a thorough understanding of the cocoa sector and policies in Ghana (and in competing exporting countries) and the international cocoa market (Bulir, 1996; Kanai, Pellechio, and Leite, 1998; Leite and others, 2000). When a sharp decline in international cocoa prices in 1999 accelerated the government's cocoa reform agenda, staff revised their medium-term fiscal sustainability analysis to quantify the measures needed to bring the economy back to its original medium-term course (Pellechio, 1999).

72. The poultry tariff incident was an unfortunate exception. Unlike with cocoa, staff did not have background knowledge of Ghana's poultry sector. They were caught unawares by the tariff increase and felt compelled to respond quickly as the (2005 PRGF-supported) program was about to be discussed at the Board. In internal discussions, staff took the position that the poultry sector appeared strong enough to compete against imports and that there was not a prima facie case for additional protection. In this judgment, staff seem to have had insufficient current information about the sector's finances to fully appraise the measure. With the benefit of hindsight, the poultry sector was at that time much more vulnerable to competition from imports than staff had believed. This is not to say that the decision to block the proposed tariff increase was necessarily incorrect—there was a wide gap between domestic costs of production and import prices, and this gap had widened over time—but the rationale that staff used to deny protection for the sector was not supported by the evidence.

73. The cocoa reforms received broad support, though their implementation was slower than the

Fund would have preferred. Following the recommendations of the 1996 independent study, the government began to formulate a medium-term cocoa development strategy through a participatory process of consultation with farmers, traders, foreign importers, civil society organizations, and the World Bank (Leite and others, 2000). The strategy, adopted in April 1999, proposed to reduce the cocoa export tax gradually by increasing the producer price to 60 percent of the f.o.b. price of cocoa for the 1999/2000 crop (a structural performance criterion for the 1999 ESAF/PRGF-supported program in April 1999), and thereafter by at least 2 percentage points in each of the next two years, and to allow qualified licensed buying companies to export at least 30 percent of their domestic purchases starting in 2000/01 (a prior action for the second review of the 1999 ESAF/PRGF-supported program in August 2000). The strategy was accelerated in June 1999 when the international cocoa price plummeted and the government chose to keep the producer price unchanged, raising the producer's share to 74 percent of the f.o.b. price. In the same month, the government abolished the Cocoa Marketing Company's monopoly over cocoa exports, introduced regulations to allow licensed buying companies to export cocoa and changed the cocoa tax from an implicit tax to an explicit ad valorem tax (IMF, 2000f).[39] In 2001, staff reported that the cocoa sector reform stalled after all the eligible licensed buying companies relinquished their right to export cocoa that year to the Cocoa Marketing Company, claiming that they lacked the necessary technical capacity (IMF, 2001c).

74. The Fund was able to check the use of tariff protection, but its approach could have been more constructive. The nominal average tariff rate remained at just below 15 percent and Ghana's TRI rating of 5 in 1999 remained basically unchanged. There were two instances where tariff increases were introduced without prior discussion with staff:

- When the government levied a 20 percent special import tax on various products in the 2000 budget, staff gave the authorities until end-2000 to "ask parliament to eliminate the special import tax or replace it with antidumping measures if justified according to existing domestic legislation" (IMF, 2000f). Those actions (a structural benchmark added during the second review of the 1999 ESAF/PRGF-supported program) were observed, but with a delay: the government lowered the top rate for this tax and reduced its coverage in the 2001 budget; the tax was eventually eliminated in July 2002. Staff did not look into the reason for the delay; the authorities had claimed that they needed more time to prepare WTO-consistent antidumping measures.
- In the second instance, staff reacted more immediately to the tariff increases announced in the 2003 budget. The authorities' retraction of the announced measures (particularly the increase in poultry tariffs) was effective but highly controversial. In August 2004, the National Poultry Farmers' Association went to court to compel the government's revenue agency to implement the new (40 percent) tariff. The high court ruled in favor of the farmers but the government had moved to repeal the act legitimizing the tariff increase before the court made its ruling and in the end, the tariff increase was not implemented.[40]

75. Lasting improvements in customs administration proved difficult to achieve. Only some of the recommendations of the FAD technical assistance reports were implemented. The same problems of growing revenue losses from import duty exemptions and weak customs administration reemerged in 2007. An SIP for the 2007 Article IV consultation (Akitoby, 2007) returned to many of the issues that were being considered in 1996–98, recommending that customs procedures be strengthened by remedying customs valuation procedures and minimizing abuses in the bonded warehouses and the free zone facility. In the authorities' fiscal package to correct for budget slippages in 2007, a reduction in import duty exemptions appeared once more as an important revenue measure (IMF, 2007d).

F. Guyana

Background

76. In the mid-1990s, Guyana's trade regime was thought to be substantially liberalized. An IMF review in 1996 of the history of the trade system (IMF, 1996i) described wide-ranging trade reforms since 1988 that had transformed the trade regime from a highly protectionist, complex, and opaque system into a simpler one where import licenses were automatically issued and no longer tied to the availability of foreign exchange (except for fuel imports), and import bans applied only to 20 items

[39] The producer price mechanism was retained for the 2000/01 cocoa season to cushion farmers during the transition to the new system. It was expected that the farmer's share of the f.o.b. export price of cocoa would increase by 1 percent every year, rising from 66 percent in 1999/2000 to 70 percent by 2004/05 (IMF, 2000f). In the event, the farmgate price fell below the target level in 2000 (IMF, 2001c).

[40] "Court orders CEPS to implement new tariffs on imported poultry," *All Africa*, April 18, 2005.

related to health, medicine and firearms. The state sugar import/export monopoly Guysuco was being restructured (Box 4). Concrete steps had been taken to lower import tariffs.

77. Guyana has been a member of the Caribbean Community (CARICOM) since the Community was founded in 1973. In 1991, Guyana passed legislation to bring its import duties in line with the common external tariff of CARICOM, and the following year, it agreed along with other CARICOM member states to a phased reduction in the common external tariff from the existing rates of 0–45 percent to 5–20 percent by January 1997 (IMF, 1996i).

Policy dialogue and trade conditionality

78. During the period under review, Guyana had ESAF arrangements beginning in 1994 and 1998 (later converted to a PRFG arrangement but not fully drawn) and a PRGF arrangement beginning in 2002. Though trade policy conditionality played no major role in any of these programs, three reasonably strong trade policy efforts pervaded the program: bringing Guyana's trade policies into conformity with CARICOM; improving customs administration; and reducing, removing, or making more transparent the exemptions from customs tax.

79. The CARICOM tariff reduction schedule was incorporated into Guyana's ESAF-supported program in 1994. Fund staff had understood that Guyana had carried out the first stage of the required reduction in the maximum common external tariff rate, from 45 percent to 30 percent, in January 1994. Implementation of the second stage of the tariff reduction by February 1995 was specified as a structural benchmark in the 1994 ESAF-supported program; the target date was subsequently pushed to June 1995 (IMF, 1995b) (Annex Table 8). In March 1996, staff reported that the maximum common external tariff rate had been reduced from 30 percent to 25 percent in September 1995 (IMF, 1996d). The final phase—reduction of the maximum common external tariff rate from 25 percent to 20 percent—was specified as a structural performance criterion in the third-year ESAF arrangement with a target date of June 1997. Staff reported that the condition was met (with a delay) in November 1997 and that Guyana had thus "completed the third and final phase of [common external] tariff reductions—as agreed under CARICOM" (IMF, 1997f).

80. But staff had misunderstood Guyana's trade policy and accordingly the structural performance criterion on tariff reduction for June 1997 had been misspecified. It turned out that the tariff reduction undertaken in November 1997 was, in fact, the penultimate step in the CARICOM schedule, that is, a lowering of the maximum common external tariff rate from 30 to 25 percent, and not from 25 percent to 20 percent as staff had reported to the Executive Board. The authorities explained that the CARICOM agreement had been revised to make the final step (the reduction of the maximum tariff to 20 percent) voluntary and thus they believed that they were still in compliance with the CARICOM agreement and with the performance criterion under the 1994 ESAF arrangement.

81. Following the misreporting, further investigation of the trade system revealed substantial new

Box 4. Guyana: Sugar Industry Restructuring Prior to the Evaluation Period

The sugar sector is Guyana's main export sector. It is dominated by the Guyana Sugar Corporation (Guysuco), which was created in 1976 when the government nationalized and merged the two large sugar estates. Guysuco is the only producer of sugar in Guyana; it operates sugar estates and factories, and exports all cane products other than rum. It is the largest employer in Guyana. Guyana is a high-cost sugar producer compared with other countries. As such, the industry has traditionally depended heavily on its preferential access to foreign markets, primarily the European Union, the United States, and CARICOM countries.

According to IMF (1996i), inappropriate government policies had hampered the development of Guysuco. Examples of such policies were foreign exchange restrictions; a relatively high and volatile "sugar levy" that was tied to the differential between the EU price and the world market price for sugar; and stringent wage guidelines. Starting in the late 1980s, the government attempted to rationalize, liberalize, and privatize the industry with the support of the World Bank and the IMF. In 1993, the government agreed to develop with the World Bank a new regulatory framework that would, inter alia, remove foreign exchange restrictions, implement a flat sugar levy, and eliminate Guysuco's monopoly in the importation and sale of sugar in Guyana. However, by mid-1996, there had been still no work on the new regulatory framework although the foreign exchange surrender requirement had been reduced.

information. While the focus had been on the maximum common external tariff rate, a number of goods were actually taxed at higher rates. For example, agricultural goods, including sugar, drew a tariff of 40 percent, motor vehicles were taxed at 45 percent, and luxury goods (principally alcohol) had a tariff of 100 percent. Export taxes were levied on a range of products including sugar, while export allowances—inconsistent with WTO rules—applied to nontraditional exports. A significant number of nontariff barriers existed, such as nonautomatic restrictive licensing of sugar and rice imports and restrictive quality standards. And while imports from CARICOM members were thought to be duty-free, there were several exceptions to this rule (IMF, 1999e). To reflect the new information, Guyana's TRI was revised from a rating of 2 ("liberal") to 5 ("moderately restrictive").

82. The 1998 ESAF-supported program included measures to address some of the trade distortions that had come to light. Revisions of the sugar levy (to make it more transparent) and the import regime for Guysuco's inputs (to align it with that for other enterprises) were prior actions for the approval of the program. Reduction of the maximum import duty rate from 25 percent to 20 percent was added as a prior action during the mid-term review of the first-year program in April 1999 (Annex Table 9).

83. Fund technical assistance was provided to bolster falling customs revenues. It was found in 1999 that Guyana's declining customs revenues reflected not only tariff reductions, but also the use of a non-market exchange rate for customs valuation and an expansion of nontransparent exemptions. On the basis of FAD technical assistance, a new market-based mechanism for the exchange rate used in customs valuation was introduced as a prior action for the second year of the ESAF/PRGF arrangement in November 2000. On exemptions, an FAD technical assistance mission in May 2002 found that discretionary tax and customs duty exemptions were extensive. The mission observed that there were no published guidelines or criteria for the granting of exemptions, and that the Minister of Finance was not required to notify parliament, the cabinet, or the public on exemptions granted.

84. The 2002 PRGF-supported program tried to tackle the problem of discretionary tax exemptions but ran into strong resistance (Annex Table 10). Amendments to the Customs Act to reduce exemptions were made a prior action for the first program review in August 2003. But the amendments were later found to have codified existing discretionary tax exemptions and to have expanded, rather than limited, the scope of exemptions (IMF, 2004a). The authorities held that eliminating tax exemptions would adversely affect employment (IMF, 2004a). Two subsequent technical reviews (both structural performance criteria) were not carried out satisfactorily. The (first) review of existing exemptions and their revenue impact—a structural performance criterion for November 2004, inserted during the second program review in July 2004—was submitted late and only partly met the condition (IMF, 2005a). The (second) study, of the economic cost of existing exemptions, to be undertaken with assistance from the Fund's Caribbean Regional Technical Assistance Center (CARTAC)—a structural performance criterion for June 2005, inserted during the third program review in January 2005—was completed with a lag. Based on the findings of that study, the mission again urged the authorities to reduce existing tax exemptions, but the authorities saw little scope for making incremental changes in the system (IMF, 2006a).

85. Following completion of the PRGF arrangements, staff shifted their trade-related attention to the erosion of preferences for Guyana's sugar exports. In 2005, the European Union announced a four-year, 36 percent, phased reduction of internal sugar prices, implying a cut of a similar magnitude for import prices from African, Caribbean, and Pacific (ACP) countries with preferential access to the EU sugar market.[41] Staff reckoned that Guyana would be the most significantly affected among the sugar-exporting Caribbean ACP countries. According to their calculations, Guyana's implicit assistance from the sugar regime had averaged nearly 10 percent of both GDP and export receipts. The decline in EU sugar prices was estimated to lead to a cumulative output decline of up to 6.5 percent of GDP for Guyana by 2010, with attendant implications for the fiscal and external balances (Dyczewski, 2007; Cashin, Gold, and Mlachila, 2007). In the 2006 Article IV consultation, staff analyzed Guysuco's restructuring plan which was developed with the help of the World Bank and featured the construction of a new modern large-scale factory (Dyczewski, 2007).[42] Staff urged greater private sector participation in the sugar sector to mitigate risk and cautioned that the viability of the new factory depended on the maintenance of the 40 percent CARICOM common external tariff on sugar imports (IMF, 2007a). In the 2007 Article IV consultation, however, staff noted that the just-concluded EPA between Caribbean countries and the European Union would not deepen the sugar

[41] Under the EU's Sugar Protocol, ACP countries—including Guyana—were granted an individual country-specific quota to export sugar duty-free at EU internal prices, and an additional special preferential sugar quota to export sugar to the European Union at preferential tariff rates.

[42] The Guysuco restructuring was part of Guyana's National Action Plan for coping with preference erosion in the sugar industry, which was prepared through a consultative process with a broad range of stakeholders. The plan was partially financed by the European Union.

preference erosion and described the plan to build a new sugar factory with private sector financing as a positive step (IMF, 2008a).

Assessment

86. The Guyana case study illustrates the problems that can be encountered in obtaining up-to-date and reliable information for formulating trade policy conditionality. The country's trade regime was initially believed to be liberal and open. But as additional information became available, staff came to realize that it was actually nontransparent and moderately restrictive. In 1997, lack of accurate information on trade policy changes led to the misspecification of a structural performance criterion. While these deficiencies may have been due to lack of cooperation, or even misreporting, on the part of the authorities, problems may also have reflected staff resource constraints. Gathering data on trade policy changes is a resource-intensive activity and the task has often fallen upon a mission member (usually from PDR) who faces many other demands during mission. Data issues have, therefore, mostly surfaced through the review process or from PDR presence on a mission. While closer interagency cooperation, e.g., drawing on the WTO's trade policy reviews, could help in such resource-constrained situations, in Guyana's case no trade policy review existed before 2003.

87. Data problems aside, Fund staff made a valuable contribution on the issue of preference erosion in sugar. They helped to frame the problem in macroeconomic terms by quantifying the amount of implicit assistance that Guyana had been receiving under the EU sugar protocol and estimating the impact of preference erosion (modeled as various possible shocks to implicit assistance) on the trade balance, output growth, and the overall fiscal balance. The research made a unique contribution to the debate and effectively showcased the staff's ability to undertake macro-relevant trade-related work. Beyond that, the Fund was unable to offer much by way of adjustment assistance or advice as the authorities were not interested in the Trade Integration Mechanism (TIM), and the details of sugar sector reform were being handled by the World Bank and other developmental agencies.

88. In the area of tariff protection, it is unfortunate that Guyana's membership in CARICOM was viewed, inappropriately, as effectively circumscribing the Fund's ability to press for tariff reform. Guyana is a highly trade-dependent economy yet minimal dialogue took place between the Fund and the authorities on trade policies. This was largely the result of Guyana's membership in CARICOM—which staff interpreted as making important aspects of trade policy off-limits even for substantive advice. In 1998, while allowing (erroneously) that Guyana's average tariff was low and nontariff barriers were few, the Fund mission noted that Guyana could have benefited from further efforts to liberalize its trade, particularly by reducing tariff dispersion. This would have been possible given the relatively wide scope of exceptions under the CARICOM common external tariff (WTO, 2003). However, "recognizing the limitations for further trade liberalization deriving from Guyana's membership in CARICOM," the mission did not pursue the issue (IMF, 1998d). Guyana's reduction of its maximum common external tariff in line with the CARICOM plan had little impact on its unweighted average tariff rate which in fact rose slightly during 1997–2007.

89. The CARICOM filter through which the IMF's trade policy advice implicitly passed constrained other aspects of IMF advice as well. For example, a major focus of Fund– and World Bank–supported programs was the restructuring of Guysuco, which was sheltered by a 40 percent CARICOM tariff on imports of raw sugar, and benefited from preferential arrangements in the EU and U.S. and markets. Starting in the early 2000s, the restructuring of Guysuco was reinvigorated and given priority to help Guyana prepare for the reduction of preferential access to the EU market. Yet to try to improve Guysuco's efficiency by reducing its tariff protection and exposing it to foreign competition was basically out of the question, because this would have involved changes in the CARICOM tariff schedule.

90. The Fund made little headway in reducing discretionary tariff exemptions. Staff eventually realized that the issue of tax incentives was best addressed at the regional level, because Guyana was not alone in offering such incentives.[43] In a 2007 informal Board seminar on selected Caribbean regional issues, staff explained that the perception of increased global capital mobility had prevented Caribbean governments from unilaterally reducing existing incentive schemes, out of fear that other regional and extraregional competitors would attract away much-needed foreign direct investment. At the close of the seminar, Directors encouraged governments in the region to "weigh carefully the costs and benefits of tax exemptions and consider reducing them if possible"; they noted that "regional cooperation and coordination could play a particularly useful role" in this regard but acknowledged that regional tax harmonization treaty could be difficult to negotiate and enforce (IMF, 2007h).

[43] Bauer and others (2007) observed that special investment incentives had proliferated throughout the Caribbean region, typically in the form of generous tax holidays that provided exemptions from corporate income taxes and import duties.

G. Vietnam

Background

91. Vietnam had a highly restrictive trade system in the mid-1990s. Although market-oriented reforms had begun in the late 1980s, import and export quotas continued to be used and import permits were still required for many commodities; import shipment licensing was still universal; import certification procedures were still used as nontariff barriers; and some export licensing requirements and export duties still remained. Trade barriers protected an inefficient state-owned enterprise sector through which the authorities still used direct levers to affect economic activities. Private sector involvement in international trade was strictly limited. By 1995, little progress had been made in tariff rationalization, with tariff rates reaching 120 percent for some luxury goods.

92. Trade in financial services featured prominently in Vietnam's trade policy agenda. Since 1988, a two-tier banking system had been established, with a central banking role for the State Bank of Vietnam; state-owned banks had been transformed into multipurpose commercial banks; and a large number of nonstate banks—including representative offices and branches of foreign banks—had been licensed (IMF, 1994a). Foreign banks, however, faced restrictions: the State Bank of Vietnam was selective in allowing foreign banks to conduct full banking operations, and branches of foreign banks were restricted to accepting no more than 20 percent of their capital in local currency (dong) deposits from Vietnamese individuals and firms who did not also borrow from them. In practice, however, foreign banks tended to operate mainly in foreign currencies and concentrated on trade finance and lending that carried an explicit or implied government guarantee (IMF, 1996m).

93. In the mid-1990s, Vietnam began a process of opening to foreign trade, seeking membership in the WTO and regional trade arrangements. As part of the WTO accession process, Vietnam was expected to negotiate bilateral market access deals with all interested WTO members. At the same time, Vietnam joined the Association of South East Asian Nations (ASEAN) and signed on to the ASEAN Free Trade Area (AFTA) agreement. The AFTA agreement laid out a comprehensive schedule for the elimination of intraregional tariffs and nontariff barriers. The goal of the scheme was to reduce tariffs on all manufactured goods to 0–5 percent by 2003 (originally 2008); as a new member, Vietnam was given a longer transition period, up to 2006.

Policy dialogue and trade conditionality

94. During the evaluation period, Vietnam had two widely-spaced Fund-supported programs that incorporated different approaches to trade liberalization. The 1994 ESAF-supported program included a substantial role for unilateral trade liberalization in the package of structural reforms to transform the economy into a market economy. The 2001 PRGF-supported program included a more modest role for trade liberalization based on Vietnam's PTA commitments. Neither program was completed.

95. The 1994 ESAF-supported program aimed to move away from import substitution by lowering tariff and nontariff barriers. Staff recognized that, to avoid any adverse social or political impact, removing trade restrictions and lowering tariffs would need to go hand-in-hand with reforms of the state enterprise sector. In the first annual arrangement (October 1994) three of the seven structural conditions were in the area of trade liberalization: these were the replacement of tariffs on luxury goods and petroleum products by excise duties and a reduction in the maximum import tariff rate to 60 percent (a performance criterion); elimination of import permits for at least five commodities (a performance criterion); and a reduction in the number of commodities requiring an import shipment license (a structural benchmark) (IMF, 1994c) (Annex Table 11).

96. Two years into the ESAF arrangement, the authorities' enthusiasm for unilateral trade liberalization dimmed, and the program soon went off-track. Entering the second year of the arrangement, the authorities indicated that further trade measures would be considered in October 1996 for discussion during the midterm review in November 1996. By the time of that review, however, the authorities clearly and forcefully made known their reluctance to move ahead immediately with another round of tariff reform, citing concerns over domestic industry and employment. Staff argued that postponing the anticipated reduction in the maximum tariff would send misleading signals to foreign investors, and that once investments had been made and industries established the high tariffs would become increasingly difficult to remove (IMF, 1996m). The authorities emphasized their longer-term plans to reduce and eventually eliminate intra-ASEAN tariffs under AFTA. After the midterm review, structural reforms slowed, agreement could not be reached on a third-year program, and the ESAF-supported arrangement was allowed to lapse in 1997.

97. As Vietnam's economic performance deteriorated during the Asian crisis, the authorities intensified

trade and exchange controls. Output growth slowed markedly and, from early 1998, foreign direct investment flows and exports fell substantially, in part because of Vietnam's extensive trade and investment links with the region but also because of emerging domestic weaknesses, notably the poor performance of the state enterprise sector and stresses in the banking system. As the real effective exchange rate appreciated, the authorities responded by imposing "temporary" import bans on selected products and a foreign exchange surrender requirement. Staff expressed disapproval over the additional import controls, arguing that the Asian crisis instead lent greater urgency to trade liberalization. In the short run, staff argued, converting quotas to tariffs would help offset the potentially substantial revenue shortfall that was expected from lower import duty collections and lower profits and turnover tax receipts. In the medium term, Vietnam risked a lasting loss of export competitiveness if it could not keep pace with other countries in the region—including those most affected by the crisis, such as Thailand, Korea, and Indonesia. These countries, according to staff, were undertaking deep and comprehensive reforms to enhance the flexibility and competitiveness of their economies (IMF, 1998a).

98. Staff continued to press for unilateral trade liberalization but at the same time became more open to alternative approaches. In the 1999 Article IV consultation, they again urged the authorities to eliminate nontariff barriers and phase down tariffs, pointing to Vietnam's ("restrictive") TRI rating of 9 and highlighting the various costs of protection that were manifested in the industrial, agricultural, and services sectors (IMF, 1999f; Winglee, 1999). The authorities reiterated their preference for the more gradual pace of trade liberalization embodied in their AFTA commitments in order to ease the transition for state enterprises (IMF, 1999f). In the 2000 Article IV consultation, staff advanced the argument that since AFTA members were relatively efficient producers of manufactured goods, "liberalization under AFTA rules would strengthen Vietnam's external competitiveness." At the same time, staff argued that because Vietnam's manufacturing and agro-based industries were similar to those of other AFTA members, Vietnam's main export potential was likely to be outside AFTA. Hence, they argued, a bilateral trade agreement with the United States was "essential for a more competitive economy and for eventual WTO accession." Staff also recommended that the elimination of quantitative restrictions "be applied on a multilateral basis" (IMF, 2000c).

99. Fund staff saw the liberalization of trade in financial services as a key to reforming banks. The banking sector was dominated by four large state-owned banks, which had developed a large stock of nonperforming loans—mainly to state enterprises. In an early effort to enhance competition in the banking sector, the 1994 ESAF program had required the authorities to relax the limit on local currency lending by foreign bank branches as a prior action for the midterm review of the second-year program (in November 1996). To address long-standing problems in the state-owned commercial banks (which had worsened during the Asian crisis), staff urged the authorities to consider twinning arrangements with reputable foreign banks and to allow domestic and foreign private investment in the banks. The authorities were not keen on twinning arrangements, but were prepared to consider foreign equity participation in one small regional state-owned bank as a pilot case (IMF, 1999f).

100. In July 2000, after nearly five years of negotiations, Vietnam signed a bilateral trade agreement with the United States (USBTA).[44] The USBTA, which came into effect in December 2001, was a major step toward fully normalizing U.S.-Vietnam commercial relations. It restored reciprocal (temporary) MFN treatment between the two countries and committed Vietnam to undertake a wide range of market-oriented economic reforms such as eliminating a range of nontariff barriers to U.S. exports, significantly cutting tariffs on many U.S. exports, especially agricultural items, and opening Vietnam's market to U.S. financial and other services providers (Thacker, 2001) (Box 5).

101. In March 2001, after prolonged discussions, the Fund approved a PRGF arrangement with a trade agenda that was based on Vietnam's commitments under AFTA and the USBTA. The timing of the program was significant. In a briefing memorandum for the program negotiations, staff noted that Vietnam was still feeling the impact of the Asian crisis and that the political environment for reform was fragile, but they pointed to the conclusion of the USBTA in July 2000 as a positive sign that had resulted in a renewed focus on concluding discussions for the PRGF-supported program.[45] The tariff reforms that were envisaged under the program comprised the AFTA commitment to reduce intra-ASEAN trade tariffs to 5 percent or less (except for some sensi-

[44] Vietnam officially exchanged MFN treatment with the European Union in 1995, and with Japan in 1999.

[45] At the same time, the World Bank launched a program of advisory and technical assistance in various areas of structural reform including trade, banking, and state enterprise reform under its Poverty Reduction and Support Credit.

Box 5. Vietnam: Key Financial Services Provisions in the USBTA

Banking services
- Allow U.S. equity in joint ventures (up to 49 percent stake). After nine years, allow 100 percent U.S.-owned subsidiary banks.
- Allow U.S. equity in privatized Vietnamese banks at the same levels as Vietnamese investors.
- Phase in the right of U.S. banks to accept local currency deposits on the same basis as domestic banks over eight years for business clientele and ten years for retail depositors.

Nonbank financial services
- Allow 100 percent U.S. equity in financial and other leasing services after three years.

Insurance
- Allow U.S. joint ventures in three years and 100 percent U.S. equity in five to six years.

tive products) by 2006, and the reduction of tariffs on agricultural imports from the United States under the USBTA (Annex Table 12). Staff noted that with full implementation of the schedule of quota removal and the elimination of state monopolies on trading, only two items (petroleum products and sugar) would remain subject to quantitative restrictions. Vietnam's TRI rating would fall from 9 to 6 by 2003 (IMF, 2001e). Staff further noted that trade policies relating to petroleum products and sugar had "medium-term macroeconomic implications" but were omitted from the program because staff lacked expertise in those areas (IMF, 2001e). Drawing on World Bank research and their own calculations, staff argued that Vietnam's AFTA and USBTA commitments would enhance trade and investment flows, improve state-enterprise efficiency, and lower domestic costs (IMF, 2001b). The trade component of the program proved to be uncontroversial.

102. The PRGF-supported program ended after the second review (in July 2002) but the Fund continued to support Vietnam's trade liberalization efforts, which focused increasingly on WTO accession. No further mention was made of unilateral trade liberalization except in 2006 when staff noted that the average tariff rate was still high and urged the authorities to "continue to liberalize trade on an MFN basis" (IMF, 2006d). Rather, in successive Article IV consultations, the Fund strongly supported Vietnam's objective of securing WTO accession and urged the authorities to take all necessary steps, including putting in place needed legislation, to meet that goal. When Vietnam acceded to the WTO in January 2007, staff estimated that consumer surplus gains of 1.5–1.7 percent of GDP annually could be expected in the short and medium term and reckoned that dynamic gains arising from higher productivity and more foreign direct investment could be expected over the long run. At the same time (but in less detail), staff identified a number of challenges that could arise from WTO membership including the need to compensate for revenue losses from tariff reduction, the need to expedite reforms in state-dominated sectors and institute appropriate safety nets as the economy adjusted to freer trade, and the potential risks to macroeconomic stability with increasing financial integration (IMF, 2007g; Tumbarello, 2007).

103. Mindful that WTO accession would involve commitments to open the financial sector, IMF staff pressed with greater urgency for bank reform. Staff reiterated calls to speed up the equitization of the large state-owned banks and to provide greater scope for participation by foreign strategic investors (IMF, 2003e, 2004d, 2005d, 2006d). They drew on experiences of other transition countries to assert that opening the banking sector to foreign private investors was key to successful banking reform (Unteroberdoerster, 2003; Aitken, 2004; Unteroberdoerster, 2004). During 2001–06, the then Monetary and Finance Department fielded more than 10 technical assistance missions to Vietnam on state-owned bank restructuring and bank supervision.

Assessment

104. The Fund's coverage of trade liberalization was extensive, extended, and entirely appropriate given Vietnam's highly restrictive starting point. From 1993, when the Fund restored its lending to Vietnam, the policy dialogue with Vietnam focused on removing the remaining impediments to a market-oriented system and developing policies for growth. Trade liberalization was one of the key systemic reforms that were required and it was clear from Vietnam's highly restrictive trade regime in the early 1990s that there was much work to be done. Staff paid close attention to trade policy developments and issues in Vietnam: almost every Article IV consultation from 1996 onward included a background paper on trade policy issues. Staff advice on unilateral trade reform—to target the least transparent and most restrictive elements (e.g., quantitative restrictions and import licensing) first; aim for low and relatively uniform tariffs; and use tariff quotas or

auction licenses to obtain revenue during the transition—was in line with best practice.[46]

105. The Fund and the authorities diverged on the optimal pace of trade liberalization; this helped to derail the 1994 ESAF-supported program. The Fund (and the World Bank) pushed for a relatively speedy phase-out of nontariff barriers and reduction of tariff rates, but the authorities were not ready to remove trade protection so rapidly. In their view, the dismantling of trade barriers should only be completed gradually, in conjunction with improved retraining facilities and a more comprehensive social safety net (Shishido, 1998). In the ex post program review discussion with staff, the authorities argued that "Fund conditionality should have better reflected actual conditions in Vietnam and been more flexible in adjusting to implementation challenges." They regarded the Fund's call for a combination of rapid quota elimination and tariff reduction during the ESAF-supported program as "in conflict with WTO principles and an impediment to their negotiations on multilateral and bilateral trade agreements." In this context they saw it as a driving factor behind the suspension of the arrangement (IMF, 2004d).

106. After the breakdown of the ESAF arrangement, the IMF adjusted its approach to trade liberalization, prompting greater program ownership and compliance. The trade component of Vietnam's 2001 PRGF program differed from that in the 1994 ESAF-supported program (and from those in other case study countries) in that it largely focused on preferential rather than MFN tariff reductions. By the time of the first review of the PRGF program, staff reported that progress had been made in implementing the AFTA agreement. Outside of the AFTA framework, the removal of quantitative restrictions proceeded faster than anticipated. Although the PRGF arrangement was de facto suspended in late 2002 (due to noncompliance with the Fund's safeguards policy), the authorities pushed ahead with quota tariffication and the anticipated trade liberalization measures were realized under the AFTA agreement and other preferential arrangements. In the ex post assessment, staff characterized the progress made in trade liberalization as impressive: "program targets were exceeded; import quantitative restrictions (QRs) were reduced more rapidly than programmed, most export QRs were eliminated, commitments under USBTA and AFTA were implemented as scheduled, and active preparations began for WTO entry" (IMF, 2004e).

107. But staff support of preferential trade liberalization under the AFTA was based on expedience rather than analysis. The staff's main argument—that the AFTA partners were efficient producers of manufactured goods and thus that the promised preferential liberalization was unlikely to result in trade diversion—was not formulated in any rigorous way. In fact, a 2005 SIP (Tumbarello, 2005) noted two important aspects that cast doubt on the staff's assumption about limited trade diversion under AFTA: (i) ASEAN's MFN tariffs were higher than those in other regional groupings; and (ii) intra-AFTA trade was not always carried out at preferential rates because of complicated rules of origin regulations and bureaucratic procedures. The case for preferential liberalization in Vietnam was thus not strongly presented. Rather, it would seem, and staff involved concur, that in 2001, it was the authorities' refusal to reduce MFN tariffs, combined with political pressure to establish an arrangement with Vietnam after the conclusion of the USBTA, that led staff to move ahead opportunistically on the basis of preferential rather than multilateral tariff reduction.

108. Resource constraints prevented staff from covering all potentially important trade policy issues. Staff noted that trade policies for petroleum and sugar may have had medium-term macroeconomic implications but were not addressed in the PRGF-supported program for lack of expertise (IMF, 2001e). There was no further elaboration on what the macroeconomic implications could have been or how they could have come about, and no indication of whether the World Bank or other institution was/would be looking into the issue in the Fund's stead.[47]

109. Notwithstanding the steps taken in the PRGF arrangement, Vietnam's trade system remained highly restrictive. Trade was liberalized compared with the regime in 1996, through the conversion of many (but not all) quantitative restrictions into tariffs, the widening of private sector access to international trade, and the lowering of preferential tariffs within AFTA and other PTAs. Yet Vietnam's rating on the Fund's TRI did not budge from 9. The (unweighted) average tariff rate rose from 16.3 percent at the start of the PRGF-supported program to 18.5 percent by the time of WTO accession.[48] Important nontariff barriers remained: according to the WTO, many products that were subject to state trading were also subject to additional measures such as quantitative restrictions, surcharges and import licensing (WTO, 2006c). Vietnam became a WTO member in January 2007 with

[46] See, for example, Thomas and Nash (1991) and IMF (1999j).

[47] Winglee (1999) provided some background information on Vietnam's sugar policy, and Peiris (2003) noted that the sugar sector was experiencing financial distress with state enterprises accumulating large debts, but neither paper was referred to when the statement was made.

[48] Part of this was due to the tariffication of quantitative restrictions.

an agreement, inter alia, to lower binding tariff rates over a twelve-year transitional period.

110. The Fund's advice to open the banking sector to foreign participation emphasized only the benefits of that strategy. According to staff, cross-country experience showed that foreign ownership by a reputable bank was associated with greater performance improvement because foreign owners had more expertise and tended to be bound by regulations in their home country to make more prudent lending decisions (IMF, 2004d; Aitken, 2004). Staff highlighted the cases of Hungary, Mexico, Pakistan, and Poland, where foreign ownership was seen to have played a key role in improving bank performance (Aitken, 2004). Vietnam's banking reform situation was likened to that of China's, and even China, staff pointed out, was giving thought to privatizing a large state-owned bank by seeking a strategic foreign equity partner (Unteroberdoerster, 2004). The staff's position represented well the potential positive effects, but did not convey the balance of risks laid out, for example in Mathieson and Schinasi (2000) and more recent research (Moreno and Villar, 2005; Cull and Martínez Peria, 2007). In interviews for this evaluation, staff indicated that the authorities' cautious approach reflected their full understanding of the potential risks involved in opening the banking system, and thus no further caveats were warranted.

111. Vietnam eventually went along with the Fund's (and World Bank's) advice to liberalize trade in financial services though at least with the benefit of hindsight it is not clear that the authorities were properly prepared. The authorities initially insisted on retaining full ownership and control of the state-owned commercial banks and not relying on any outside agents of change, such as strategic foreign investors (Unteroberdoerster, 2004). Their position evolved, however, as they came to recognize that competition would intensify in response to the market-opening measures under the terms of the USBTA and, subsequently, WTO accession. In 2003, under a World Bank-sponsored project, two of Vietnam's four large state-owned banks entered into twinning agreements with foreign banks; one more state-owned bank followed suit in 2005.[49] In September 2007, a long-awaited equitization plan for Vietcombank (one of the four large state-owned banks) was approved with up to 20 percent to be allocated initially to foreign strategic investors (IMF, 2007g). The liberalization of foreign entry into the banking sector in 2007 and anticipation of intensified competition brought a flood of domestic and foreign applications for banking licenses. Concerned about the possible impact on banking soundness, the central bank tightened the criteria for granting new domestic licenses in August 2008. In the 2008 Article IV consultation, staff reported "significant shortcomings in financial transparency and banking supervision" and "gaps in the Vietnamese accounting standards with regard to valuation of financial instruments and fixed assets." Staff again warned about the risks to asset quality of Vietnamese banks (IMF, 2009).

H. Bangladesh

Background

112. Bangladesh's trade regime in the mid-1990s was restrictive, complex, and nontransparent. A wide range of trade reforms had been implemented beginning in 1990, including the relaxation of numerous quantitative restrictions and a reduction in the level and dispersion of tariffs. But by the mid-1990s, the pace of trade liberalization had practically halted, as the authorities began to feel that they might have been "too hasty" and, as a result, caused "undue damage" to some industrial sectors (IMF, 1997c). Quantitative restrictions (including outright bans) still applied to more than 100 items and tariffs were still relatively high and dispersed: there were seven tariff rates ranging from zero to 50 percent. Imports with values above a relatively low threshold were subject to a license fee of 2.5 percent on top of the applicable tariffs. Several of the trade restrictions were maintained under GATT Article XVIII and Bangladesh was required to consult with the WTO Committee on Balance of Payments Restrictions (CBR) every other year. Export restrictions (including outright bans) existed for about 20 product categories, some of them—such as flour products and wet blue leather—in order to ensure the supply of the domestic market. Garment exports were subject to Multi-Fiber Arrangement (MFA) quotas, which were set to expire on January 1, 2005, under the terms of WTO's Agreement on Textiles and Clothing (ATC) (IMF, 1996e).

113. Bangladesh's commitments under the Uruguay Round were minimal. Bangladesh agreed to bind only 0.7 percent of all six-digit Harmonized System tariff lines for industrial products—there were no bound tariffs prior to the Round—and almost all tariff bindings were set well above applied rates. Almost all agricultural tariffs had a ceiling binding of 200 percent plus other duties and charges. Most of the bindings came into effect on January 1, 1996. On trade in services, Bangladesh's specific commitment was limited to allowing foreign direct investment in the five-star hotel and lodging service subsector and the employment (in connection with this investment)

[49] "Twinning to reform," *Far Eastern Economic Review*, September 25, 2003; "ING wins second advisory mandate in Vietnam," *The Asian Banker*, October 15, 2005.

of foreigners in higher management and specialized jobs (Ibrahim, 1996).

Policy dialogue and trade conditionality

114. Trade liberalization has a long and highly controversial history in Bangladesh. Against a background of a very restrictive trade system, import substitution, and high dependence on trade taxes, the IMF and World Bank have continuously advocated liberalization. Equally, there has been determined opposition to liberalization from business interests and politicians. Over the evaluation period, the Fund was involved from a surveillance-only perspective during 1996–2002 and in the context of a PRGF arrangement approved in 2003.

115. During the surveillance period (1996–2002), the Fund emphasized that Bangladesh's growth prospects hinged on removal of the anti-export bias of the trade system (Box 6).[50] The policy advice was to reduce the restrictiveness of the system in stages, focusing on substituting tariffs for quantitative restrictions, reducing the level and dispersion of tariff rates, phasing out export subsidies, and streamlining customs procedures. Trade issues were covered quite regularly in background papers for the Article IV consultations, mainly descriptively (Lee, 1998; Dalsgaard, 2000) but sometimes analytically (Ibrahim, 1996). The authorities were loath to liberalize unilaterally as they did not consider the trade system to be restrictive compared with those of other South Asian economies. Staff responded that even if Bangladesh's trade system was broadly in line with those of neighboring countries, it was still restrictive relative to those of faster-growing economies such as Indonesia, Korea, Malaysia, and Thailand, and that cross-country experience showed that import-substituting protectionist policies tended to be associated with an overvalued exchange rate and an anti-export bias (IMF, 1997c, 1999m). Staff also noted that Bangladesh's exports were too narrowly based (with a concentration in textiles and clothing) and

[50] In 1999/2000, Fund staff reported that Bangladesh had a TRI score of 6 ("moderately restrictive"), down from 7 during 1995/96–1998/99 (Dalsgaard, 2000). In 2001, the TRI score was revised upward to 8 ("restrictive") (IMF, 2002b).

Box 6. Bangladesh: IMF Advice on Trade Policy in the Context of Surveillance (1996–2002)

1995/96 Article IV consultation (IMF, 1996b)

- Eliminate the remaining trade-related quantitative restrictions (mainly in the textile sector).
- Announce an ambitious timetable for further reduction in the level and dispersion of tariffs, including a reduction in the maximum tariff rate to 30 percent in 1996/97 with further reductions thereafter, a reduction in the number of tariff bands, and a move away from the system of official assessment of tariff values.
- Disavow import controls and exchange restrictions—even temporary—to protect the balance of payments.

1997 Article IV consultation (IMF, 1997c)

- Formulate a clear and ambitious program of medium-term trade liberalization, including the removal of remaining quantitative restrictions and a reduction in the level and dispersion of tariffs.
- Find ways to prevent the misuse, and enhance the effectiveness, of the pre-shipment inspection so as to help streamline customs procedures.

1998 Article IV consultation (IMF, 1998f)

- Adopt a program of action, including removal of the remaining quantitative restrictions early in the reform process and a phased reduction in the level and dispersion of tariffs aimed at reducing the number of tariff bands to four, and at bringing the current maximum and average tariff rates to about 25 percent and 15 percent, respectively, over a four-year period.
- Take measures to reduce corruption in the customs administration such as publishing a single tariff book, speedy clearance of imports, strengthening of post audits, and setting up a special customs surveillance unit.

1999 Article IV consultation (IMF, 1999m)

- Design and announce a medium-term trade reform strategy including plans for tariff reduction and compression, tariffication of quantitative restrictions, and phasing out of export subsidies.
- Make the preshipment inspection system fully operational.

2001 Article IV consultation (IMF, 2002b)

- Develop a plan for moving expeditiously toward a more simplified tariff structure, with a much lower average import tariff and minimal reliance on nontariff barriers.

were overly dependent on preferential access to the European Union (IMF, 1997c, 2002b).

116. The World Bank was also involved in trade issues in Bangladesh during the period and provided substantial support to the government. In 1999, the Bank launched an export diversification technical assistance project aimed, inter alia, at building analytical capacity within the Tariff Commission and at modernizing and automating the customs administration. During 1998–99, FAD also fielded technical assistance missions on revenue reform and tax/customs administration. To address the criticism that trade reforms had moved too fast during the early 1990s, the Bank published a detailed study of the pace and impact of trade liberalization in Bangladesh based on an analysis of formal and informal trade patterns and survey data collected from a large sample of domestic firms (World Bank, 1999). This found that the pace of Bangladesh's trade liberalization was comparable to that of many Asian and Latin American countries, and that trade liberalization had positively affected the manufacturing sector. However, it noted that there still remained a considerable anti-export bias in the economy, and that the ideal trade liberalization agenda was far from complete. The study was discussed at a high-level seminar in Dhaka in September 1999.

117. In June 2003, a PRGF arrangement was approved at the same time as a World Bank Development Support Credit (DSC). It was agreed that the Bank would take the lead in trade reform, while the Fund would focus on providing fiscal advice to create room for further trade liberalization. In contrast to the advice they had given during previous Article IV consultations, Fund staff recommended a "cautious approach to trade reform" in the program and made it clear that the heavy dependence on trade taxes (about 37 percent of revenue) and the need to develop alternative sources of revenue necessitated a "moderate pace" of tariff reduction (IMF, 2003b). Within the PRGF-supported program and the DSC, therefore, the extent of planned trade liberalization was directly tied to prospects for revenue mobilization. During the three-year program period—beyond compensating for tariff-related losses—the program targeted an increase of 1.5 percentage points in the revenue-to-GDP ratio.

118. In line with the division of responsibilities agreed with the World Bank, the PRGF-supported program included very little trade conditionality. Nevertheless, the envisaged trade reforms (which were closely coordinated with the DSC) were included in the memorandum of economic and financial policies and could thus be considered an integral part of the program the IMF was supporting. The trade reforms in the first year of the program involved a rationalization of the tariff structure to a four-tier system with a maximum rate of 30 percent. The number of items subject to quantitative restrictions was almost halved and confined to products that were covered by WTO waivers.[51] It was thought that the reforms would reduce Bangladesh's TRI rating from 8 to 7. With advice from the World Bank (in consultation with the IMF mission and an FAD technical assistance mission on tax and customs administration), the authorities introduced further tariff reforms before the second program review (in July 2004) (Annex Table 13).

119. In July 2004, the PRGF arrangement was augmented through the Fund's newly created TIM. The expiration of MFA textile quotas by January 2005 was expected to lead to a decline in foreign exchange earnings as Bangladesh's exports of ready-made garments met increased competition from countries such as India and China. Bangladesh was the first recipient of funding from the TIM, which the Fund created in April 2004 to help member countries meet balance of payments shortfalls that could result from multilateral trade liberalization such as the elimination of quotas under the ATC. To justify the use of the TIM, staff estimated the magnitude of the anticipated shock, concluding that Bangladesh would likely face significant pressures on the balance of payments, output and employment, though there were scenarios under which Bangladesh would likely be able to hold its market share (IMF, 2004b). The Fund team drew on an in-house study (Mlachila and Yang, 2004) which used the Global Trade Analysis Project (GTAP) model to simulate the effects of the quota phase-out.

120. Banking sector reform was a major structural component of the PRGF-supported program but liberalization of trade in financial services was not the focus. According to Abdelati (2007), foreign banks have been generally welcomed in Bangladesh since the 1990s.[52] However, Bangladesh was not considered an attractive market for foreign banks; a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in 2003 characterized the banking sector as having "one of the highest levels of corruption in the world" (IMF, 2003c). Foreign banks in Bangladesh held a small market share (less

[51] Four items (eggs, chicks, salt, and carton packaging/paper bags) remained subject to quantitative restrictions for balance of payments reasons. In a November 2004 meeting (at which the Fund was represented), the WTO CBR granted Bangladesh until 2007 to submit a timetable for removal of the remaining restrictions (WTO, 2004).

[52] According to WTO (2006a), foreign banks are allowed to open branches (with permission from the central bank); there is no minimum domestic equity requirement; they are free to take deposits from and grant loans to domestic companies and residents and are generally allowed to conduct the same business as local banks; and they have full access to credit from the central bank, local financial markets, deposit insurance, and clearing facilities.

than 5 percent of banking system assets in 2004) and concentrated principally in trade finance (Berezin, 2005; WTO, 2006a). The banking system was dominated by four state-owned ("nationalized") commercial banks that were poorly managed, subjected to directed lending and continued political interference, and basically insolvent. The PRGF-supported program included steps to develop detailed resolution strategies for each state-owned bank (a structural performance criterion) with the eventual goal of their partial or complete privatization.[53] In the second review of the PRGF-supported program (July 2004), the authorities agreed to allow qualified foreign investors to own shares in a privatized bank in excess of the statutory ceiling of 10 percent, on a case-by-case basis (IMF, 2004b).

Assessment

121. The IMF's trade policy advice to Bangladesh during the 1996–2002 surveillance period was in line with the prevailing wisdom. Advice on unilateral trade reform followed the best-practice recommendations of targeting quantitative restrictions as a first priority and aiming for low and relatively uniform tariffs. Staff identified potential weak points (e.g., the concentration of exports, the dependence on preferential access to foreign markets, and the low tax effort) early on and urged the authorities to address them through trade liberalization, export diversification, and tax and customs administration reforms. Staff at times had difficulty obtaining a clear picture of whether and how the restrictiveness of the trade regime had evolved prior to the PRGF-supported program (various staff reports put the TRI at 7, 6, and 8 during 1996–2002, while PDR data had the rating at 8 through the period), but their efforts were backstopped by solid analytical and empirical work from the World Bank.

122. At the operational level, Fund-Bank cooperation during the 2003 PRGF-supported program was highly effective. The conditionality of the PRGF-supported program was closely coordinated with that of the DSC. The division of labor was appropriately clear—the Bank took the lead in trade reform, while the Fund focused on fiscal revenue mobilization—and there was no perceived conflict between the objectives of the two institutions. At both the local level and at headquarters, IMF and World Bank staff reported that cooperation on trade issues in Bangladesh was close and mutually supportive.

123. Substantively, however, tensions between trade reform and revenue mobilization and restructuring came to the fore. By the second program review (July 2004), the tariff structure had been streamlined to three rates, with a top rate of 25 percent, with accompanying reductions in the level and dispersion of supplementary duties and in the number of products subject to quantitative restrictions (IMF, 2004b). According to PDR, Bangladesh's TRI dropped from 7 in 2003 to 6 by the end of the PRGF program.[54] The 2006 WTO trade policy review reported "[s]ignificant progress" in shortening the list of items subject to quantitative restrictions (WTO, 2006a). In its most recent WTO CBR consultation (May 2007), at which the Fund was represented, Bangladesh committed to remove its remaining three import restrictions maintained for balance of payments reasons (quantitative restrictions on salt, chicks, and eggs) by December 2008 (WTO, 2007). On the fiscal revenue side, however, staff regarded the overall increase in the revenue-to-GDP ratio over the PRGF-supported program period—less than half a percentage point—as disappointing. This poor showing was attributed to deficiencies in overall tax design and a slower-than-anticipated pace of administrative reforms—including customs administration improvements to limit revenue losses associated with trade liberalization—that reflected institutional rigidities. In the 2007 Article IV consultation, staff noted that Bangladesh's revenue collection was still "among the lowest in the world" and insufficient to support desired further reductions in tariffs and supplementary duties (IMF, 2007e).

124. The IMF's work on preference erosion in connection with the use of the TIM, though it did not fully assuage fears of a painful post-MFA adjustment, was well done. This episode gave an opportunity to increase understanding of the impact of global trade policy developments. Mlachila and Yang's (2004) results were widely cited in the local and international press.[55] The augmentation of the PRGF under the TIM in July 2004 also received media coverage.[56] Yet shortly after the TIM was approved, in October 2004 Bangladesh joined six other develop-

[53] The reform strategy drew on the recommendations of the FSAP mission, with technical assistance and funding from the World Bank's Enterprise Growth and Bank Modernization Project.

[54] On the World Bank's trade restrictiveness index, Bangladesh ranks 113 out of 125 countries (Davies and Dunn, 2008).

[55] "Bangladesh faces shock when textile quotas end—IMF," *Reuters*, July 15, 2004; "IMF warns of impact on Bangladesh of quota removal," *Global Insight*, July 16, 2004; "Post-MFA tidings for Bangladesh," *Financial Express*, July 19, 2004; "Social upheaval feared when end of import quotas hits Bangladesh," *Financial Times*, July 24, 2004; "The looming revolution," *The Economist*, November 21, 2004; "Fear surrounds end to textile quotas," *South China Morning Post*, December 14, 2004; "The end is nigh," *Economist Intelligence Unit*, December 23, 2004.

[56] "IMF approves $72 million loan disbursement to Bangladesh," *Dow Jones*, July 29, 2004; "IMF approves $72 mln payment to Bangladesh," *Reuters*, July 29, 2004; "World Bank, IMF only ready for case-by-case help to poor textile exporters," *Agence France Presse*, October 22, 2004.

ing countries in an appeal to the WTO. The group of countries sought—unsuccessfully—to delay the ATC deadline until the WTO Secretariat had studied the (country-level) adjustment-related issues and costs resulting from the expiration of MFA quotas and had identified trade-related solutions and adjustment measures that would mitigate the impact of the quota phase-out (WTO, 2005).[57]

125. Although the TIM was well received, it did not contribute substantively to adjustment in Bangladesh's textile and clothing sector. The TIM involved no conditionality beyond that already contained in the PRGF arrangement nor did it include adjustment measures specifically linked to the external trade liberalization shock. In the event, the immediate impact of the ATC quota expiration was minimal and Bangladesh's garment exports grew in the subsequent period. This growth was partly due to the imposition of safeguard quotas on China through 2008 by the United States and the European Union, which provided some temporary breathing space for Bangladesh's garment sector (Moers, 2005; Dunn, 2007). In addition, Bangladesh still benefits from preferential access to its major export markets for garments under the EU's Everything But Arms Initiative, the U.S. Generalized System of Preferences, and the Canadian Market Access Initiative (Dunn, 2007). The evidence to date indicates that Bangladesh has not fully adjusted to the post-MFA world: its exports are still highly concentrated in the garment sector, and longstanding barriers to competitiveness (e.g., generally inadequate infrastructure—especially port infrastructure, low labor skills, and an unattractive business climate) remain unresolved (Dunn, 2007; Davies and Dunn, 2008).

I. Overall Evaluation

126. During 1996-2007, the IMF's involvement in trade policy issues in the seven countries examined went through the full swing of the pendulum. From 1996 until approximately 2001, the Fund was actively involved in a rather wide range of trade policy issues. By far the greatest involvement was in tariff and quota policy and customs administration, but involvement also occurred episodically in subsidies, PTAs, trade in financial services, and state trading monopolies for traded goods. After 2001, the IMF shifted to a generally hands-off mode, at times skirting even trade policy issues with macroeconomic relevance. Fund-supported programs in low-income countries have been increasingly less likely to contain trade-related components. Even in the surveillance of low-income countries for which trade policies are relevant, if not critical, for growth and/or resilience to shocks, missions have been less willing to address trade policy issues. Part of the reason for this change lies in the Fund's streamlining of conditionality and a perception that trade policy is generally not critical to macroeconomic objectives. For low-income countries, particularly in Africa, the introduction of the criterion that the Fund's structural conditions must be macro-critical—exemplified by the softening of the Fund's stance with regard to Mozambique's sugar sector protection in 2000—marked a welcome change in the Fund's approach to trade liberalization, which had frequently gone beyond the IMF's primary areas of interest.

127. In general, the IMF's positions on trade policy reflected a rather broad consensus in the academic and public policy literature on the merits of liberal trade regimes. Indeed, governments for the most part were interested in changing their trade policies broadly in the direction advocated by the IMF, though important differences arose on the pace of change. IMF advice and conditionality tended to press hard for a rapid pace of reform, at times in consonance with governments' preferences, but at other times zooming in on issues even of questionable macroeconomic relevance and pressing countries to unilaterally liberalize faster than their intrinsic commitment supported. Some of these differences arose because governments wished to continue to protect some sectors or industries, others because governments were concerned about fiscal or adjustment costs of rapid change.

128. In many of the cases, staff underestimated the effects of trade liberalization on fiscal revenue. Country authorities often cited revenue concerns as a reason for slowing the pace of tariff reduction. Staff, however, tended to push for speedier trade liberalization in conjunction with tax reforms (such as the introduction of a VAT and a rationalization of tax and tariff exemptions), and for improvements in customs administration to compensate for anticipated revenue losses. In most cases, FAD provided extensive technical assistance in these areas. However, tax and tariff exemptions proved difficult to remove, usually because they were perceived to be important for attracting and retaining foreign investment, and customs administration reforms were lengthy processes that took time to bear fruit, if they ever did. According to Baunsgaard and Keen (2005), low-income countries in general have recovered, at best, no more than about 30 cents of each dollar of trade tax revenue lost from trade liberalization; IMF (2005b) came to a similar pessimistic conclusion.

[57] Earlier in 2004, Bangladesh was one of the first Asian countries to sign the so-called Istanbul declaration seeking a two-year extension of the ATC deadline. The October 2004 appeal to the WTO was opposed by larger exporters such as China, India, and Brazil.

129. Interagency cooperation was not always present on trade policy issues but worked reasonably well when it was. The World Bank was active in all seven case study countries but was not always involved in trade reforms. The Bank took the lead in trade reform in some cases, and worked jointly on trade reform with the Fund team in others. In general, Bank-Fund cooperation worked well when the work was clearly delineated and both teams were in close and constant contact. This was the case in Bangladesh, for example. Of course, the success of such cooperation is also rather dependent on personalities and compatible priorities. When Fund and Bank staff diverged on a particular trade policy issue (such as sugar sector protection in Mozambique), the IMF had either to get involved substantively, so that it was in a position to defend its position to critics, or drop the issue altogether. IMF-WTO cooperation was episodic and generally low-key. The Fund staff's trade policy advice was usually in line with observations in the WTO's trade policy reviews, although for low-income countries, these reviews were not frequent. Where cases of alleged dumping arose, Fund staff appropriately discouraged the use of ad hoc trade measures and pointed the country authorities to the WTO; in doing so, however, staff should have been more careful to understand whether or not low-income countries could follow antidumping procedures that were consistent with WTO rules.

130. The effectiveness of the IMF's involvement in trade policy issues during the first part of the evaluation period was mixed and seems to have depended on several key factors. Typically, favorable outcomes (that is, outcomes where IMF support and analysis seem to have contributed to changes in trade policy that are likely to have increased economic efficiency and growth, or to have better positioned countries to offset the revenue impact of trade liberalization) occurred when the IMF worked closely with the World Bank or itself became substantively invested in the analysis of a specific issue, almost regardless of its nature. Usually, these outcomes occurred when the government was interested in, or at least not inherently resistant to, trade liberalization. Poor outcomes (that is, outcomes where no policy changes occurred, or where changes occurred but were later reversed, or where IMF advice or conditionality prompted serious and high profile objections) usually arose when the IMF's advocacy and pressure exceeded the government's intrinsic commitment to liberalization or when advocacy went beyond the depth of the underlying analytical work and the IMF found itself unable to defend a position on which it had taken a very strong stand.

131. The IMF's general withdrawal from trade policy issues since the early 2000s may have led to its missing, or only belatedly recognizing, some important issues with clear macro relevance. In almost all of the case study countries, a significant trade policy development has been a shift toward PTAs. In some cases, PTAs added complexities to individual members' trade regimes, such as the introduction of supplementary/suspended duties or high common external tariff rates on certain items. Yet membership in a (potential) customs union basically took trade liberalization, especially tariff reform, off the table in IMF programs and also, to some extent, in surveillance discussions with the Fund. Fund staff were noticeably reluctant to be drawn into PTA issues. In some sense this was understandable, as PTAs tend to be driven by political, as well as economic, motives, and staff were unwilling to get involved in bilateral/regional relations. Also, the IMF Board had sent quite mixed signals on what it expected the staff's involvement in PTA issues to be. But staff were also slow to analyze the macroeconomic impact of preferential arrangements, or to form views on the extent to which such arrangements could hinder or facilitate the process of trade liberalization in an individual country. For example, formal EPA negotiations between the European Union and African countries began in 2003–04 but Fund missions only started to analyze their impact in the four African case study countries in 2008, if at all. (It is true, however, that the negotiations were, and still are, evolving, and that some of the countries were receiving advice and technical assistance on the negotiations from other sources under the IF.) Only in one of the case studies (Vietnam) did bilateral and regional trade liberalization form a component of a Fund-supported program; even in this case, staff made no attempt to systematically assess the macroeconomic implications of the PTAs that were incorporated in the program.

132. Some of the IMF's strongest work on trade came in connection with the erosion of trade preferences. Analyzing the macroeconomic impact of trade preference erosion on the most vulnerable low-income countries was a task that staff were well equipped to handle and an area where the IMF could make a unique and constructive contribution to international trade policy discussions. The individual country analyses were carefully done and important for macroeconomic policy and planning: they helped to reassure countries when domestic macroeconomic effects were not projected to be large and to spur the authorities to formulate plans for action when they were. The analyses were also important from a systemic point of view, as they pointed to how broad trends in the advanced countries' trade policies affected smaller players on the global stage.

133. Accurate, timely, and sufficiently informative trade policy indicators are prerequisites for any meaningful involvement by the IMF in trade policy issues. The Fund's TRI had little operational

usefulness. Staff were instructed to incorporate the TRI in all medium-term programs starting in early 1998 (IMF, 1998b) but they had little idea as to what would have been a reasonable change in the index to target over the course of a given program. As a result, projected reductions in TRI ratings were not meaningful and were rarely realized. Compounding the problem in low-income countries was the difficulty in obtaining reliable and up-to-date information on trade policy changes. While other agencies have made great strides over the past several years in compiling cross-country data on trade barriers and trade preferences, large information gaps remain, especially in low-income countries that will be costly to fill. Discontinuing the use of the TRI was right in light of its many shortcomings, but one or more well-grounded summary measures of trade policy would have been useful both for staff (to obtain a clearer idea of the extent of a country's trade restrictiveness or trade distortions relative to other countries, as a basis for dialogue) and for the IMF at large (to be seen to be involved in trade policy issues in an even-handed way).

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Annex. Case Study Countries: Key Trade Measures in IMF-Supported Programs

Annex Table 1. Tanzania: Key Trade Measures in the 1996 ESAF-Supported Program

Tariffs	Export Taxes/ Restrictions	State Trading Monopolies	Customs Administration	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, October 25, 1996 (IMF, 1996j)				
*Harmonize import taxes between the mainland of Tanzania and Zanzibar by end-December 1996. [Structural benchmark]** Reduce the maximum tariff from 40 percent to at most 30 percent by July 1997.	Complete by March 1997 a study of possible new tax measures (directed mainly at the agriculture and mining sectors) to replace the temporary tax on traditional exports introduced in the 1996/97 budget under the CBI initiative.	*Announce that all companies, including the Tanzania Petroleum Development Corporation, will be able to import refined petroleum products. [Prior action]**	*Extend the jurisdiction of the Tanzania Revenue Authority (TRA), including the operations of the preshipment inspection companies, to include Zanzibar. [Prior action]** *Close all owner-operated bonded warehouses except those used for the storage of petroleum, motor vehicles, and production inputs. [Prior action]** *Complete an audit of the bonded warehouses by end-December 1996. [Structural benchmark]** *Establish a monitoring system for bonded warehouses by end-December 1996 prior to computerization of the system in end-March 1997. [Structural benchmark]**	
Memorandum of Economic and Financial Policies, November 19, 1997 (IMF, 1997e)				
Further simplify the tariff structure with a maximum rate of 25 percent at the beginning of 1998/99, following a review of the tariff system to be undertaken with technical assistance. Prepare for the introduction of parallel VAT systems in Zanzibar and mainland Tanzania.		*Fully decontrol petroleum product pricing and importation by June 1998. [Structural benchmark]***	Introduce a new preshipment inspection contract, including provision for the sealing of containers, with effect from January 1998. Implement an action plan for strengthening the Customs Department in light of the comprehensive review of procedures, including as key steps establishing targets for clearance times, implementing the Automated System for Customs Data (ASYCUDA) at the Dar es Salaam port, and producing timely and accurate trade statistics.	
Memorandum of Economic and Financial Policies, January 19, 1999 (IMF, 1999a)				
*Obtain government approval for reform of the import duty and exemptions regime by March 1999. [Structural benchmark]** *Adopt a reform of the tax system, including changes in import duties and exemptions by June 1999. [Structural benchmark]** *Revise duty rates in the 1999/2000 budget in line with Tanzania's undertakings under the CBI. [Condition for completion of mid-term review]**		*Remove controls on petroleum product prices by February 1999*; pending removal of controls, increase price ceilings in line with any increase in import costs when it occurs and refrain from any reduction in price ceilings. [Structural benchmark]^*	*Introduce preshipment inspection for private sector imports to Zanzibar by January 1999. [Structural benchmark]^*	Review the structure and level of tax incentives, such as the differential treatment of investments depending on whether or not they are approved by the Tanzania Investment Centre, as well as the tax treatment of NGOs and the public sector.

Annex Table 1 *(concluded)*

Tariffs	Export Taxes/ Restrictions	State Trading Monopolies	Customs Administration	Trade-Related Subsidies/ Exemptions
Memorandum of Economic and Financial Policies, July 13, 1999 (IMF, 1999h)				
Keep import duty and VAT rates under review, in consultation with the governments of neighboring countries, with a view to achieving greater harmonization. Phase out over time suspended duties on some of Tanzania's imports from its partners in COMESA. Phase out over time the temporary sugar regime including suspended duties on sugar imports from other countries and the assumed dutiable value that is higher than the world price.			Apply the standard preshipment inspection fee to imports coming in through Zanzibar, in view of the latter's failure to extend preshipment inspection to private sector imports. Study the merits of introducing mechanisms for improving coordination of exemption control among the departments of the TRA and of introducing a refund system under which duties are payable upon importation, but refundable to exempt parties.	Establish a new duty drawback system within three months of provision of IMF technical assistance. Begin pro forma recording of customs duties and VAT liabilities of the public sector by July 1999, in preparation for the elimination of the exemption of such imports in future. Review statutory exemptions from customs duty payment. Amend the Import Duty Act to centralize in the Income Tax Department of the TRA the certification of the status of NGOs eligible for exemptions.

Italics denote prior actions, performance criteria, and structural benchmarks.
* indicates commitment was met.
** indicates commitment was delayed or modified subsequently.
^ indicates commitment was not met.
^^ indicates no information on compliance.

Annex Table 2. Tanzania: Key Trade Measures in the 2000 PRGF-Supported Program

Tariffs	Export Taxes/ Restrictions	State Trading Monopolies	Customs Administration	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, March 9, 2000 (IMF, 2000a)				
Eliminate the suspended duty on sugar by July 1, 2002. Review the tariff structure and correct anomalies in the classification of goods in the intermediate bands in the 2000/01 budget. Subject to the performance of domestic revenue sources and progress of negotiations within the frameworks of agreements with regional trading partners (particularly in SADC and EAC), carry out further reductions in the top rate over the 3-year program period.	Consider establishing an antidumping law.	Eliminate the sole remaining export duty (on scrap metal) by July 1, 2000.	*Base minimum dutiable values on international prices (except sugar) by July 2000. [Structural benchmark]** Refrain from imposing minimum dutiable values on any other commodities. Review the existing list on a quarterly basis, with the aim of phasing them out. Eliminate the remissions recently provided on 25 commodities when used as intermediate goods rather than for final consumption by assigning the goods to single rates by the 2001/02 budget.	*Establish a new duty drawback system by March 2000. [Structural benchmark]**
Memorandum of Economic and Financial Policies, July 18, 2000 (IMF, 2000e)				
Under the 2000/01 Finance Bill, unify the rates for a number of the 25 commodities that had been given split rates last year. Unify the rates for the remaining items in the 2001/02 budget. Refrain from adding new items to the existing list.	Request technical assistance from the WTO to introduce a law on antidumping and countervailing measures that is WTO-consistent.		Fully implement the WTO's import valuation methodology by January 2001.	

Annex Table 2 *(concluded)*

Tariffs	Export Taxes/ Restrictions	State Trading Monopolies	Customs Administration	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, February 24, 2001 (IMF, 2001a)				
*Harmonize the split import duty rates for all goods by July 1, 2001. [Structural benchmark]** Review the tariff structure further in the 2001/02 budget with the aim of reducing the number of nonzero bands from the current four to three, and to rationalize the rates on inputs by, inter alia, eliminating all the remaining split rates. Continue to reform the system of trade protection, including through a further reduction of external tariffs in line with regional initiatives under the SADC and the EAC. Begin implementing the tariff reduction schedule agreed within SADC from July 2001.	Have legislation on dumping, subsidies, and countervailing measures in place by June 2002, with assistance from the WTO.		Revise the contract under which TRA receives preshipment inspection services to reflect a new role of preshipment inspection, particularly in training and developing, maintaining, and making available price databases to TRA.	*Eliminate all remaining tax exemptions for the government (except those constituting contractual obligations) by July 1, 2001. [Structural benchmark]***
Memorandum of Economic and Financial Policies, August 31, 2001 (IMF, 2001d)				
Start implementing a program of tariff reduction in the context of the SADC whereby import tariffs on 11 percent of total trade with the member countries will be eliminated effective November 2001. Gradually reduce the top import tariff rate beginning with next year's budget, in harmony with regional partners. Keep under review the justification for suspended duties on sensitive import items.				
Memorandum of Economic and Financial Policies, March 29, 2002 (IMF, 2002a)				
Gradually eliminate the suspended duties (import surcharges) imposed in the budget for 2001/02 on 13 product groups, starting with a significant step in the budget for 2002/03. *Announce a timetable for the elimination of the remaining suspended duties by July 2002. [Performance criterion]** Reduce the top tariff rate from its current level of 25 percent in the framework of the EAC trade protocol expected to be concluded by end-2002.				

Italics denote prior actions, performance criteria, and structural benchmarks.
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^^ indicates no information on compliance.

Annex Table 3. Kenya: Key Trade Measures in the 1996 ESAF-Supported Program

Tariffs	Nontariff Barriers	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, April 12, 1996 (IMF, 1996f)		
Further rationalize the import tax structure, with the objective of achieving a maximum tariff rate of 30 percent, and no more than 4 rates (including zero as one of the rates) by July 1997. Eliminate the discriminatory elements of the supplementary levy on sugar by December 1996. Abolish the specific duties on cereal imports by end-1996. Eliminate the suspended duty on petroleum imports that was introduced in November 1994 to provide temporary protection to the refinery, by October 1996, contingent on the completion of the liquefied petroleum gas import unloading pipeline.	*Abstain from reimposition of direct controls on prices, marketing, and foreign trade (throughout 1996). [Performance criterion]** Establish an appropriate antidumping mechanism with technical assistance from the WTO, to be presented to parliament by end-1996.	Stop granting discretionary import duty exemptions from February 1, 1996.

Italics denote prior actions, performance criteria, and structural benchmarks.
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^^ indicates no information on compliance.

Annex Table 4. Kenya: Key Trade Measures in the 2000 ESAF-Supported Program

Tariffs	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, July 12, 2000 (IMF, 2000d)	
*Complete the development of a tariff reform program by March 31, 2001, with a view to implementing it under the 2001/02 (July–June) budget. [Performance criterion]**	*Prepare by March 31, 2001 a plan for the elimination of major import exemptions awarded to the public sector, with a view to implementing the plan under the 2001/02 budget. [Structural benchmark]^^*

Italics denote prior actions, performance criteria, and structural benchmarks.
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^^ indicates no information on compliance.

Annex Table 5. Mozambique: Key Trade Measures in the 1996 ESAF-Supported Program

Tariffs	Export Taxes/Restrictions	Customs Administration	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, May 30, 1996 (IMF, 1996g)			
Simplify the current tariff structure by reducing the number of rates and their maximum levels by mid-1996.	Gradually eliminate the tax and avoid any quantitative restrictions on exports of unprocessed cashew nuts.	*Sign a contract for the private management of customs by end-June 1996. [Performance criterion]**	*Complete the study of the legislation on tariff exemptions and take measures to substantially curtail them. [Prior action]**
		Combine preshipment inspection with the full reconciliation of duties due and paid to help the strict enforcement of customs laws, starting in March 1996.	
		Further streamline the licensing of exports, ensuring that its use for statistical purposes does not entail an unnecessary burden on exporters.	
		Make efforts to redirect illegal exports of gold and precious stones through normal commercial channels by increasing border control.	
Memorandum of Economic and Financial Policies, June 9, 1997 (IMF, 1997b)			
		*Introduce a standard customs form for clearance of exempted goods by end-June 1997. [Structural benchmark]**	
		*Approve a program for redeploying current customs personnel and recruiting new staff by end-April 1997. [Structural benchmark]**	
Memorandum of Economic and Financial Policies, August 10, 1998 (IMF, 1998e)			
*Lower the top import tariff rate from 35 percent to at least 30 percent by April 30, 1999. [Structural benchmark] **		*Implement the Trade Information Management System customs software in at least four sites by October 1998. [Performance criterion]**	
		Review the role of preshipment inspection in the context of the introduction of the single administrative document for customs clearance planned for October 1, 1998.	
		Prepare laws on setting special tribunals and regulations for resolving disputes concerning customs matters, and submit to the Assembly of the Republic in June 1999.	

Italics denote prior actions, performance criteria, and structural benchmarks.
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Annex Table 6. Mozambique: Key Trade Measures in the 1999 ESAF-Supported Program

Tariffs	Export Taxes/Restrictions	Customs Administration	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, June 10, 1999 (IMF, 1999g)			
*Complete an assessment of the remaining import surcharges (cement, steel plates and tubes, sugar) by September 1999. [Structural benchmark]^* Refrain from adopting new import surcharges or increasing existing general import surcharges. Further reduce the level and dispersion of import tariffs during the period of the new three-year ESAF arrangement. Reduce the top import tariff rate from 30 to 25 percent, effective in January 2002.	Refrain from adopting new export taxes/restrictions or increasing existing export taxes/restrictions.	*Complete computerization of at least ten customs clearance points by September 1999. [Performance criterion]** *Adopt new procedures governing customs warehousing and transit trade by September 1999. [Structural benchmark]** *Complete redeployment of 500 redundant customs personnel December 1999. [Structural benchmark]** *Submit revised customs legislation to the National Assembly (basic customs act; customs code; and law on customs tribunals) by December 1999. [Performance criterion]*** Provide the necessary financial and other support to customs to ensure that the management company completes its scheduled work by end-1999.	*Review the tax and tariff system and adopt a position toward rationalizing the exemptions regimes by March 2000. [Structural benchmark]**
Memorandum of Economic and Financial Policies, March 17, 2000 (IMF, 2000b)			
*Complete a review of sugar sector policy, with a view to determining (i) whether support for the sector is warranted, and (ii) the amount, duration, and form of any such support by August 2000. [Structural benchmark]**		*Attain a target level of customs personnel (1,100 staff) by April 2000. [Structural benchmark]*** *Implement adequate physical controls around the industrial free zones and adopt a mechanism of tax and customs surveillance to prevent leakages, by April 2000. [Structural benchmark]**	*Complete a review of the system of tax and customs exemptions by August 2000. [Performance criterion]***

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Annex Table 7. Ghana: Key Trade Measures in the 1999 ESAF-Supported Program

Tariffs	Export Taxes/Restrictions	State Trading Monopolies	Customs Administration	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, April 14, 1999 (IMF, 1999c)				
*Reduce the top tariff rate to 20 percent by January 1, 2000. [Structural benchmark]** *Complete a comprehensive review of the tariff regime by end-September 1999. [Structural benchmark]** Gradually reduce the average tariff rate over the next three years to less than 10 percent.	*Increase the producer price to 60 percent of the f.o.b. cocoa price for the 1999/2000 crop year by end-June 1999. [Performance criterion]** Increase the producer price by at least 2 percentage points in each of the next two years and reduce the share of the Cocoa Board and the tax on cocoa to allow for increases in the farmers' share of the f.o.b. price. Review surrender requirements once the licensed buying companies (LBCs) begin exporting cocoa.			
Memorandum of Economic and Financial Policies, November 3, 1999 (IMF, 1999k)				
	Accelerate the increase in farmers' share in the f.o.b. price of cocoa starting in 1999/2000 crop season to at least 62 percent in 2000/2001.	Allow LBCs to export at least 30 percent of their cocoa purchases.	*Provide an assessment of the factors that led to the loss of merchandise from bonded warehouses, together with an estimate of the resulting revenue losses, steps to identify and prosecute those responsible, and measures taken to prevent recurrence of such incidents in the future. Indicate the measures to be taken to strengthen customs. [Prior action]**	Monitor exemptions and report them on a quarterly basis by Harmonized System code.
Memorandum of Economic and Financial Policies, June 25, 2000 (IMF, 2000f)				
*Complete a study on Ghana's tariff structure that assesses the prospects to further reduce tariff rates, by end-October 2000. [Structural benchmark]** *Ask parliament to eliminate the special import tax or replace it with antidumping measures if justified according to existing domestic legislation, by end-March 2001. [Structural benchmark]***	Impose an ad valorem tax projected at 17.8 percent on cocoa exports. A producer price will remain in effect whereby farmers will receive an estimated 67 percent of the f.o.b. export price.	*Inform Fund staff of the cocoa policies for the 2000/01 crop, and issue regulations to allow qualified LBCs to export 30 percent of cocoa purchases. [Prior action]**	Tighten controls over bonded warehouses by requiring computerization of inventory, conducting unannounced audits, limiting warehousing time and type of commodities allowed, and requiring breakage reports to be filled with customs not more than 48 hours after the goods reach the warehouse.	Refrain from introducing new tax incentives, particularly those contingent on export and import performance, until the revenue impact of the existing incentives has been assessed. Tighten tariff exemptions by allowing only NGOs specifically exempted by parliament to import goods free of duty.

Annex Table 7 *(concluded)*

Tariffs	Export Taxes/Restrictions	State Trading Monopolies	Customs Administration	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, June 11, 2001 (IMF, 2001c)				
*Submit to parliament those supplementary tax measures requiring parliamentary approval (including a 5 percent import duty on certain items on the mining list and on materials for processing timber). [Prior action]** *Eliminate the special import tax in the 2002 budget effective immediately (end-March 2002). [Performance criterion]** Formulate plans for broader tariff reform by the end of 2001, so that implementation can begin with the 2002 Budget.	*Submit to parliament those supplementary tax measures requiring parliamentary approval (including a 10 percent levy on exports of lumber). [Prior action]**			*Submit to parliament those supplementary tax measures requiring parliamentary approval (including a 1 percent customs processing fee on tariff-exempt imports and a limitation of tariff exemptions on imports by NGOs). [Prior action]**

Italics denote prior actions, performance criteria, and structural benchmarks.
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Annex Table 8. Guyana: Key Trade Measures in the 1994 ESAF-Supported Program

Tariffs	Nontariff Barriers	Export Taxes/ Restrictions	State Trading Monopolies	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, June 30, 1994 (IMF, 1994b)				
*Implement the second phase of the common external tariff reduction by February 1995. [Structural benchmark]***	Review the remaining import prohibitions in the context of changes implemented by other CARICOM member countries.	*Eliminate remaining export taxes by December 1995. [Structural benchmark]**		Cease the issuance and renewal of discretionary waivers of consumption taxes and import duties to eliminate them over time.
Memorandum of Economic and Financial Policies, May 26, 1995 (IMF, 1995b)				
*Implement the second phase of the reduction of the common external tariff by June 1995. [Structural benchmark]**			*Submit to the International Development Association (IDA) the proposed regulatory framework for Guysuco by September 1995. [Structural benchmark]***	
Memorandum of Economic and Financial Policies, March 18, 1996 (IMF, 1996d)				
Observe the CARICOM schedule of tariff reduction and further cut the maximum common external tariff from 25 percent to 20 percent in early 1997.			*Agree with IDA on a regulatory framework for Guysuco by June 1996. [Structural benchmark]***	
Memorandum of Economic and Financial Policies, April 2, 1997 (IMF, 1997a)				
Reduce the maximum import duty from 25 percent to 20 percent in line with CARICOM's common external tariff policy by June 1997. [Performance criterion]**			*Agree with IDA on a regulatory framework for Guysuco by June 1997. [Condition for completion of mid-term review]^* *Establish the regulatory framework for Guysuco by September 1997. [Structural benchmark]^* *Establish the remaining steps for restructuring Guysuco by June 1997. [Structural benchmark]^*	

Italics denote prior actions, performance criteria, and structural benchmarks.
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Annex Table 9. Guyana: Key Trade Measures in the 1998 ESAF-Supported Program

Tariffs	Nontariff Barriers	Export Taxes/ Restrictions	Customs Administration	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, June 16, 1998 (IMF, 1998d)				
		*Revise the sugar levy to make it more transparent. [Prior action]**		*Bring the import regime for inputs to Guysuco in line with other enterprises. [Prior action]**
Memorandum of Economic and Financial Policies, April 28, 1999 (IMF, 1999d)				
*Reduce the maximum import duty from 25 percent to 20 percent. [Prior action]**			Increase the customs valuation exchange rate by 7 percent on April 30, 1999 (estimated yield of 0.7 percent of GDP).	
Memorandum of Economic and Financial Policies, November 1, 2000 (IMF, 2000g)				
	Review trade policies to ensure consistency with CARICOM and WTO requirements.		*Shift to an automatically adjusted market-based custom valuation exchange rate. [Prior action]**	

Italics denote prior actions, performance criteria, and structural benchmarks.
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Annex Table 10. Guyana: Key Trade Measures in the 2002 PRGF-Supported Program

Customs Administration	Trade-Related Subsidies/Exemptions
Memorandum of Economic and Financial Policies, August 30, 2002 (IMF, 2002d)	
*Formally agree to allow technical work to begin on a comprehensive review of the tax system and its administration with a view to designing a reform that would broaden the tax base and increase tax revenue, while taking into account Guyana's commitment under regional trade/WTO arrangements. [Prior action]**	
Memorandum of Economic and Financial Policies, August 22, 2003 (IMF, 2003d)	
	*Amend Section 12 of the Customs Act with a view to eliminating discretionary powers to grant exemptions to commercial undertakings or individuals. [Prior action]** *Enact legislation so that income tax holidays are granted only to new firms that create new employment located in depressed areas or that conduct economic activity in specific fields. [Prior action]**
Memorandum of Economic and Financial Policies, July 7, 2004 (IMF, 2004a)	
Strengthen tax administration to include extension of ASYCUDA to off-site locations and implementation of ASYCUDA++ or equivalent system for the modernization of customs administration.	*Adopt regulations defining guidelines and criteria for the implementation of the Customs Order Act, by end-July 2004. [Performance criterion]** *Review the Customs Duties (Amendment) Order and draft amendments where necessary, by end-November 2004. [Performance criterion]^* Adopt the necessary amendments to the Customs Duties (Amendment) Order and send to parliament by end-Jan 2005. *Publish tax exemptions granted (during September to December 2003) by end-July 2004. [Performance criterion]** Continue to publish tax exemptions annually (including the amounts), by end June each year, in relation to the preceding fiscal year.
Memorandum of Economic and Financial Policies, January 12, 2005 (IMF, 2005a)	
With the support of the Inter-American Development Bank, extend ASYCUDA to off-site locations and implement the ASYCUDA++ or equivalent system for the modernization of customs administration by end-March 2006.	*Undertake a study, with the support of CARTAC, on the economic costs and benefits of the existing exemptions, focusing on how the exemptions affect the critical economic sectors, by end-June 2005. [Performance criterion]*** *Adopt revisions to Customs Duties (Amendment) Order by end-January 2005 [Structural benchmark]** Publish by end-June 2005 tax exemptions granted (including the amounts), specifying the recipients by categories (companies by name), as well as new or revised contracts signed that give rise to exemptions under Section 11 of the Custom Duties (Amendment) Order in relation to the preceding fiscal year.

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Annex Table 11. Vietnam: Key Trade Measures in the 1994 ESAF-Supported Program

Tariffs	Nontariff Barriers	Trade in Services
Memorandum of Economic and Financial Policies, September 22, 1994 (IMF, 1994c)		
*Replace tariffs by excise duties and reduce the maximum import tariff rate to 60 percent by April 1, 1995 [Performance criterion]** Rationalize the import tariff schedule into 6 rates by October 1995.	*Eliminate import permits for at least 5 commodities by April 1, 1995. [Performance criterion]*** *Reduce the coverage of imports requiring an import shipment license by April 1, 1995. [Structural benchmark]*** Lift the import prohibition on cigarettes. Simplify registration procedures for exporters and importers during 1995. Once a commercial law has been promulgated, simplify the registration procedure further with only one administrative step required to fulfill all the conditions necessary to conduct international trade.	
Memorandum of Economic and Financial Policies, June 1, 1995 (IMF, 1995c)		
	*Remove import shipment license requirements for at least half of imports (measured in terms of value, excluding the imports that require import permits) by August 1, 1995. [Prior action for mid-term review]*** *Reduce the number of commodity groups requiring import permits to 5 by April 1, 1996. [Structural benchmark].*** Propose a plan for eliminating the remaining requirements for import permits during the discussions for the second annual ESAF arrangement. Abolish the requirement for import shipment licenses.	
Memorandum of Economic and Financial Policies, December 18, 1995 (IMF, 1996a)		
*Submit to the National Assembly draft legislation incorporating tariff reforms to (i) further reduce the maximum rate of import tariff; (ii) reduce the number of import tariff rates; and (iii) apply excises uniformly to goods whether produced domestically or imported by October 1996. [Structural benchmark]^*	*Remove the requirement for shipment licenses for about half of imports (in value terms, excluding imports that require import permits) in early 1996. [Prior action]** *Phase out half of the remaining import shipment licenses during 1996 [Structural benchmark]* and eliminate the remainder in 1997.* *Reduce the number of commodity groups requiring import permits to a maximum of 5, by July 1996. [Performance criterion]** Agree on a timetable for the removal of the remaining permits at the time of discussions for the midterm review.	Reduce restrictions on local currency business imposed on foreign banks, before June 30, 1996.
Memorandum of Economic and Financial Policies, October 28, 1996 (IMF, 1996l)		
	Eliminate sugar from the list of commodities that require import permits by the end of 1996. Reduce the coverage of import licensing through the issuance of a complete list of consumer goods that require import licenses at the beginning of 1997. Allow all licensed exporters (including private sector enterprises) to export commodities outside of the scope of their license with the exception of certain major products from the beginning of 1997.	*Relax the limit on local currency lending by foreign bank branches. [Prior action]**

Italics denote prior actions, performance criteria, and structural benchmarks.
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Annex Table 12. Vietnam: Key Trade Measures in the 2001 ESAF-Supported Program

Tariffs	Nontariff Barriers	Export Taxes/ Restrictions	Trade-Related Subsidies/Exemptions	Trade in Services
Memorandum of Economic and Financial Policies, March 14, 2001 (IMF, 2001b)				
Reduce AFTA tariffs on the majority of tariff lines of products subject to the tariff reduction roadmap of AFTA, to at most 20 percent by the start of 2003, and further to 0–5 percent by the start of 2006.	*Adopt and announce a program with annual targets for phasing out quantitative restrictions, on a multilateral basis, on 6 items (cement and clinker, remaining steel products, construction white glass, paper, vegetable oil, and granite tiles and ceramic tiles) during 2001–03. [Prior action]** *Free foreign trading rights for business-registered domestic firms, by allowing them to import all kinds of goods except banned and conditional imports. [Prior action]**	Lift restrictions on enterprises permitted to export rice and rice export licensing, and adopt a more liberal regime.	Cease granting any new and phase out all existing ad hoc (case-by-case) exemptions on import tariffs during 2001–03.	Secure for one of the state-owned commercial banks strategic equity participation with a reputable foreign partner by end-2003.
Memorandum of Economic and Financial Policies, November 7, 2001 (IMF, 2001e)				
Implement the 2001 tariff reductions under AFTA.	Replace quantitative restrictions for three items (steel, vegetable oil, and construction glass) with tariffs. Auction at least 25 percent of the garment export quota while continuing to improve the auction process.			
Memorandum of Economic and Financial Policies, June 3, 2002 (IMF, 2002c)				
Effect tariff reductions already announced under the AFTA roadmap.	Adopt a timetable to establish the proper legal framework to implement the USBTA. Remove quantitative restrictions on three out of five remaining items (cement, motorcycles, and passenger vehicles up to nine seats) by end-December 2002. Assess the potential impact of global integration on the most vulnerable sectors, drawing on donor technical assistance.			Prepare regulations to further open to foreign investors areas in the services (including most retail sales and distribution), agribusiness, and fishery sectors, in advance of the timeframes under the USBTA.

Italics denote prior actions, performance criteria, and structural benchmarks.
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Annex Table 13. Bangladesh: Key Trade Measures in the 2003 PRGF-Supported Program

Tariffs	Nontariff Barriers	Customs Administration	Trade in Services
Memorandum of Economic and Financial Policies, June 4, 2003 (IMF, 2003b)			
Rationalize the tariff structure by moving to a four-tier tariff rate in FY04, with a maximum rate of 30 percent. Reduce the effective average tariff rate in tandem with efforts to broaden the customs tax base in order to protect revenue.	Reduce the list of goods subject to control (ban, or with quantitative restrictions) from 134 to around 70.	*Complete revamping the bonded warehouse system, including requiring bank guarantees for all imports going through the system, by end-December 2003. [Structural benchmark]** Continue automation of customs and other modernization measures.	
Memorandum of Economic and Financial Policies, July 8, 2004 (IMF, 2004b)			
*Adopt in the FY05 budget a three-tier customs duties structure with a maximum rate of 25 percent. [Prior action]** Reduce the number of supplementary duty rates from 7 to 3 and the maximum rate to 30 percent.	Further phase out quantitative restrictions for reasons other than environmental, security, and religious, except for poultry, fishing net, and salt, and replace them with appropriate tariff duties. Streamline import licensing requirements to improve the investment climate. Reduce restrictions on the import of textiles.		*Agree on action plans with the managements of Sonali, Janata, and Agrani Banks covering the period to Jun 2006 to operationalize the resolution strategies for each bank, with key benchmarks including timelines for necessary legal changes to eliminate limits on foreign ownership in the banking sector, by end-November 2004. [Performance criterion]***
Memorandum of Economic and Financial Policies, May 26, 2005 (IMF, 2005c)			
	Replace all remaining quantitative restrictions by tariffs by end-June 2005, in the context of DSC III, except those on grounds of health, national security, religion, and environmental protection.	Further strengthen the pre-shipment inspection, customs valuation process, and the post-clearance audit, with World Bank assistance. Continue to monitor the functioning of the bonded warehouse system; make further efforts to ensure that inspectors are well trained.	
Memorandum of Economic and Financial Policies, January 9, 2006 (IMF, 2006b)			
Further reduce average tariffs (including any surcharges) by at least two percentage points in the context of the FY07 budget.	Further reduce the number of regulatory stages involved in the clearance of imports and exports.		

Italics denote prior actions, performance criteria, and structural benchmarks.
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Background Document 5

Trade Conditionality in IMF-Supported Programs in Emerging Market Countries: Five Case Studies

A. Introduction

1. This paper evaluates the IMF's trade conditionality in five emerging market programs during the capital account crises of the late 1990s: Indonesia (1997), Korea (1997), Ukraine (1998), Brazil (1998), and Turkey (1999). These programs, supported by IMF Stand-By Arrangements (SBAs) or the Extended Fund Facility (EFF), were particularly high profile as they exemplified the Fund's response to a new type of balance of payments crisis that involved massive reversals of short-term capital flows and contagion. The arrangements were also high-access, involving hitherto unprecedented loan amounts for the Fund. Brazil, Korea, and Turkey drew on the IMF's new Supplemental Reserve Facility (SRF), which had been created expressedly to provide very short-term financing on a very large scale. Table 1 summarizes the history of IMF arrangements in the five countries.

2. This paper focuses only on the trade policy aspects of these programs. The programs have been evaluated elsewhere—notably in IEO (2003), Stone (2002), IMF (2005a), IMF (2006a), and IMF (2008b)—but not from the trade policy angle. Hence, this paper will cover some familiar ground, but it will also bring a fresh perspective because the five case study countries had very similar trade regimes and trade policy issues before the onset of their crises yet widely differing experiences with trade conditionality under their IMF-supported programs. The evaluation questions addressed are:

- Did the trade conditionality conform to and carry out well a reasonable interpretation of the Fund's mandate? Internal memos and guidance notes set out parameters for the inclusion and design of trade conditionality; key guidelines relevant for this evaluation are listed in Table 2.
- Was the trade conditionality appropriate in scope? In other words, were trade issues identified and analyzed in sufficient detail and included in program conditionality when they were critical to macroeconomic outcomes and vulnerabilities, and omitted when they were not? Such an assessment needs to be balanced against the internal guidelines prevailing at the time (Table 2).
- Was the trade conditionality sufficiently well thought out? Did it adequately reflect country-specific analysis of institutional frameworks, supply capacity, and spillovers within the economy, and was it embedded in a framework for macroeconomic policy and strategies?
- Was the Fund evenhanded and balanced in its application of trade conditionality? Were there systematic factors underlying the decision to include or exclude trade conditionality?
- Was the trade conditionality effective? Were the Fund's views clear, persuasive, and apparently consistent with overall macroeconomic advice and the country's other commitments, such as ongoing/future negotiations with the World Trade Organization (WTO) and regional trade agreements? Did the conditionality help spur debate and develop political consensus for change? Was it implemented, and were the reforms sustained?

B. Indonesia

Trade policy regime and IMF advice before the 1997 program

3. In the late 1990s, Indonesia's trade regime was rated by the IMF as "moderately restrictive." A series of reform packages beginning a decade earlier had sought to shift the economy away from an inward-looking import substitution strategy by reducing tariffs and other trade restrictions and liberalizing investment regulations in some sectors (Box 1). But the liberalization was not complete. In 1997, Indonesia scored 5 on the IMF's 10-point aggregate Trade Restrictiveness Index (TRI), based on a "relatively open" tariff rating of 2 (out of 5) and a "moderate" nontariff barrier rating of 2 (out of 3). The unweighted average tariff rate was 13 percent. About one-fourth of imports were subject to nontariff barriers including quantitative restrictions and

Table 1. Indonesia, Korea, Ukraine, Brazil, and Turkey: History of IMF Arrangements

Type of Arrangement	Date of Arrangement	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Indonesia (date of Fund membership: February 21, 1967)				
SBA	November 5, 1997	August 25, 1998	8,338.24	3,669.12
EFF	August 25, 1998	February 4, 2000	5,383.10	3,797.70
EFF	February 4, 2000	December 31, 2003	3,638.00	3,638.00
Korea (date of Fund membership: August 26, 1955)				
SBA	July 8, 1983	March 31, 1985	575.78	575.78
SBA	July 12, 1985	March 10, 1987	280.00	160.00
SBA	December 4, 1997	December 3, 2000	15,500.00	14,412.50
Of which: SRF	December 18, 1997	December 17, 1998	9,950.00	9,950.00
Ukraine (date of Fund membership: September 3, 1992)				
SBA	April 7, 1995	April 6, 1996	997.30	538.65
SBA	May 10, 1996	February 23, 1997	598.20	598.20
SBA	August 25, 1997	August 24, 1998	398.92	181.33
EFF	September 4, 1998	September 3, 2002	1,919.95	1,193.00
SBA	March 29, 2004	March 28, 2005	411.60	0.00
SBA	November 5, 2008	November 4, 2010	11,000.00	3,000.00
Brazil (date of Fund membership: January 14, 1946)				
SBA	August 23, 1988	February 28, 1990	1,096.00	365.30
SBA	January 29, 1992	August 31, 1993	1,500.00	127.50
SBA	December 2, 1998	September 14, 2001	13,024.80	9,470.75
Of which: SRF	December 2, 1998	December 1, 1999	9,117.36	6,512.40
SBA	September 14, 2001	September 5, 2002	12,144.40	11,385.37
Of which: SRF	September 14, 2001	September 5, 2002	9,950.87	9,950.87
SBA	September 6, 2002	March 31, 2005	27,375.12	17,199.64
Of which: SRF	September 6, 2002	September 5, 2003	7,609.69	7,609.69
Turkey (date of Fund membership: March 11, 1947)				
SBA	April 4, 1984	April 3, 1985	225.00	168.75
SBA	July 8, 1994	March 7, 1996	610.50	460.50
SBA	December 22, 1999	February 4, 2002	15,038.40	11,738.96
Of which: SRF	December 21, 2000	December 20, 2001	5,784.00	5,784.00
SBA	February 4, 2002	February 3, 2005	12,821.20	11,914.00
SBA	May 11, 2005	May 10, 2008	6,662.04	6,662.04

Source: IMF Finance Department.

Table 2. Key IMF Guidance on Trade Conditionality

Date	Guidance	Key Point(s)
November 17, 1994	Concluding Remarks by the Acting Chairman: Conditionality Review—Distilling the Main Messages and Direction for Further Work (IMF, 1994b)	"[F]rom the start, Fund supported programs should give high priority to a coherent set of structural measures, institution building, and removal of distortions that will stimulate supply responses and investment."
November 1, 1995	Reference Note on WTO Consistency (IMF, 1995b)	Fund staff should identify policy measures that are potentially inconsistent with WTO rules at an early stage; encourage the authorities to clarify the issue directly with the WTO; and explore alternative measures with the authorities. Fund program design can (and should) encourage countries to improve economic efficiency by undertaking unilateral trade liberalization beyond their commitments under the WTO, but must avoid "cross conditionality," meaning that "while program conditionality can be applied to trade liberalization, the program cannot require the member to make a binding commitment to the WTO on the new liberalization undertaken in the context of the Fund-supported program."
October 30, 1997	Summing Up by the Acting Chairman: Trade Liberalization in Fund-Supported Programs (IMF, 1997h)	Trade liberalization should be pursued as part of a broad-based adjustment program, i.e., staff should ensure an appropriate overall policy mix and a critical mass of complementary structural measures, including financial sector reform, privatization, and other external reforms. Greater emphasis on clearly defined, quantifiable, and monitorable medium-term policy objectives is crucial for enhancing prospects for success of trade reform. Programs should also emphasize intermediate targets to measure progress and supporting policies, and should be accompanied by an early public announcement of the medium-term targets. Trade liberalization efforts must continue to be undertaken in close cooperation with the World Bank and the WTO.
April 2, 1998	Index of Aggregate Trade Restrictiveness—Operational Implications (IMF, 1998f)	Staff should begin to assess the trade reforms of program countries by including in staff reports on new medium-term (two or more years) adjustment programs the estimated Trade Restrictiveness Index (TRI) at the outset of programs, and after the implementation of program measures.
January 8, 1999	Note on Import Surcharges (IMF, 1999a)	In line with the Fund's mandate, and consistent with WTO principles, the Fund opposes surcharges in the great majority of cases. In the event they are introduced, the surcharge should be uniform across all imports, on a temporary basis, and subject to a pre-announced timetable for elimination.
July 20, 1999	Guidelines on Designing and Implementing Trade Policy Reforms (IMF, 1999f)	Trade reform should first target the least transparent and most restrictive elements of the trade regime, particularly nontariff barriers, export restrictions, and exemptions. Thereafter, emphasis should be placed on attaining low and relatively uniform tariff protection, but commencement of tariff reduction need not wait until the elimination of nontariff barriers is complete. Fund advice should be guided by considerations of efficiency in resource allocation. Thus, trade reform programs will typically need to be more ambitious than is required under the WTO. However, such reforms should not contravene countries' obligations under the WTO. Fund staff should stress that trade reforms need to be accompanied by complementary policies, because of the strong mutual and supporting links between trade policy and macroeconomic and structural policies.
September 18, 2000	Streamlining Structural Conditionality—Interim Guidance Note (IMF, 2000c)	Fund structural conditionality should cover only reforms that are relevant for a program's macroeconomic objectives. The assessment of macro-relevance should be established on a case-by-case basis and made explicit in program documents. Structural reforms that are macro-relevant and critical for the achievement of the program's macroeconomic objectives must be covered by Fund conditionality. Structural reforms that are macro-relevant but not macro-critical and within the Fund's core areas of responsibility may be covered by Fund conditionality. However, the presumption would be that structural performance criteria would not be used in these cases, and that prior actions or structural benchmarks would be used sparingly and would require justification.
September 20, 2001	Concluding Remarks by the Acting Chair: Trade Issues—Role of the Fund (IMF, 2001b)	Any conditionality pertaining to trade measures should be consistent with the guidelines and evolving practice for streamlining conditionality.

Box 1. Indonesia: Trade Liberalization During 1985–96

A series of reform packages beginning in 1985 aimed to shift the Indonesian economy away from a heavy dependence on oil exports and import substitution (Fane, 1996; Feridhanusetyawan and Pangestu, 2003). During 1985–90, tariffs were rationalized and reduced across the board to an unweighted average rate of around 20 percent and some nontariff barriers (such as import licensing and import monopolies) were removed. Other important reforms included transferring customs inspection duties to a private Swiss surveying company, improving the duty drawback scheme for exporters, and relaxing restrictions on foreign direct investment. Reform fatigue set in 1991—a few more nontariff barriers were abolished (e.g., import bans on certain steel products and export bans on copra and palm oil were abolished) but average tariff reduction was minimal. Trade liberalization was reinvigorated in 1994, the year Indonesia hosted the Asia-Pacific Economic Cooperation (APEC) summit and signed the Bogor Declaration to achieve free trade and investment within APEC by 2020. In May 1995, the unweighted average tariff was lowered to 15 percent and a comprehensive program of tariff reductions was announced to lower most tariffs to 0–5 percent by 2003, in line with Indonesia's WTO commitments and the accelerated ASEAN Free Trade Area (AFTA)'s common effective preferential tariff scheme. This was followed by a trade liberalization package in January 1996, with further (relatively small) tariff reductions, reductions in import licensing, and measures to enhance export competitiveness (e.g., extending the duty drawback facility, easing import and export restrictions on foreign-owned exporting firms, and removing a number of export taxes) and another package in June 1996, which lowered the unweighted average tariff rate to 13 percent and included measures to simplify export procedures (e.g., eliminating export inspections and reducing documentation requirements).

Several preferential policies also emerged during the 1990s. Among the most controversial were the establishment in 1990 of a Clove Marketing Board run by one of the President's sons; a 20 percent tariff surcharge on propylene and ethylene imports in 1993 to protect a petrochemical complex owned by another of the President's sons; and preferential tax and duty arrangements for the national car, the Timor, in 1996. But Fane (1996) notes that these interventions were "of less quantitative importance than the very large reductions in trade and investment barriers which [had] occurred since the mid-1980s."

exclusive import rights. There were export taxes and bans on a range of commodities, including palm oil and logs. Production and marketing monopolies and other privileges existed in some industries, notably cement, paper, fertilizer, plywood, steel, and refined oil products. The state agency, Badan Urusan Logistic Nasional (Bulog) controlled five important agricultural commodities—rice, wheat and wheat flour, sugar, soybeans, and garlic—through price controls, production controls, and import and distribution monopolies.

4. Indonesia's national car project came under dispute in the WTO in 1996. The project, launched by President Soeharto in February of that year, gave a three-year exemption from import duties and luxury taxes (averaging 20 percent) to Indonesian companies that manufactured cars locally using an Indonesian brand name and predominantly local parts. Only one company qualified for this privileged tax treatment—the automobile manufacturing company in the Timor Putra National (TPN) group, a holding company created and owned by the President's youngest son. However, the national car, the Timor, was actually produced abroad by a Korean company, Kia Motors, in a joint venture with TPN, and imported duty-free into Indonesia. The special advantages given to TPN and the national car project were widely criticized, especially by competing automobile manufacturing companies. In October 1996, Japan, the European Union, and the United States filed suits with the WTO's Dispute Settlement Body against Indonesia's national car program, claiming that the tax and tariff exemptions were in violation of Indonesia's obligations under various WTO agreements.[1] A dispute settlement panel was established in June 1997.

5. Indonesia's financial system had undergone significant liberalization by the mid-1990s, although restrictions remained on foreign entry. Major reforms over the previous decade and a half had included deregulation of interest rates, reduction in the coverage of directed credit schemes, granting of licenses for new private banks and a decline in the role of the state banks. The 10 foreign banks operating in Indonesia in 1997 obtained their licenses in the late 1960s. Since then, the entry of foreign banks was limited through the requirement either to form joint ventures (with a maximum of 85 percent foreign ownership) or to buy shares of domestic banks

[1] See http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds64_e.htm.

Box 2. Indonesia: Trade and Industrial Liberalization Issues Listed in the 1997 Article IV Staff Report

1. External trade restrictions

- Domestic protection is still high and variable, with an effective rate of protection for the import-competing sector of 28 percent.
- Nontariff barriers affect 23 percent of imports, including quantitative restrictions on certain goods and exclusive import rights.
- Export bans and export taxes affect key products (especially palm oil, rattan, and other agricultural and forestry products) and levies are extensive.

Staff recommendations:

- Lower all tariffs that are above 25 percent.
- Complete WTO and AFTA commitments, including lowering most tariffs to 0 percent or 5 percent and others to 10 percent by 2003.
- Eliminate nontariff barriers especially restrictions on wheat, rice, sugar, and oilseeds.
- Abolish export taxes, licensing requirements, and levies, and simplify administrative procedures.

2. Marketing regulations

- Exclusive licensing rules grant monopoly distribution rights for rice, cloves, soybeans, and flour.
- Forestry concessions are restricted to existing processors. Cartels dominate cement, plywood, and paper sectors.
- Price controls exist for rice, sugar, cement, petroleum products, bus and rail transportation, gas, and electricity.

Staff recommendations:

- Open industries to competition.
- Establish and enforce competition law which prohibits anticompetitive practices, including cartels.
- Eliminate remaining price controls.

3. Foreign investment restrictions

- Six sectors are closed to foreign direct investment including taxi and bus transportation and local shipping, and another 17 sectors are restricted (including milk, saw milling, plywood, and aircraft).

Staff recommendations:

- Liberalize restrictions on foreign direct investment.

on the stock exchange, where the maximum foreign holding was set at 49 percent (Gulde, 1997).

6. The IMF's trade policy advice to Indonesia during 1996–97 emphasized further reduction of all forms of trade protection. During the 1996 and 1997 Article IV consultations, IMF staff urged the Indonesian authorities to eliminate nontariff barriers, lower tariffs, remove export controls, dismantle private and public import and export monopolies in key commodities, and abolish ad hoc tax exemptions and privileges (Box 2) (IMF, 1997c). The IMF argued that eliminating the remaining structural rigidities in the economy was essential for improving productivity, efficiency, and economic governance (IMF, 1997d); it stressed that the existence of monopolies and cartels and the granting of special privileges to individual firms undermined investor confidence. The 1997 Article IV mission also proposed an easing of the regulations that limited the entry of new foreign banks.

7. The IMF mission drew on econometric work by staff suggesting that further trade liberalization would improve Indonesia's medium-term prospects for export growth. A selected issues paper (SIP) for the 1997 Article IV consultation (McDermott, 1997) estimated that trade liberalization measures (specifically, the reduction of import tariffs and export taxes) during 1980–94 accounted for 40 percent of the expansion of Indonesia's manufactured exports over that period.[2] Counterfactual simulations indicated that more trade liberalization would have resulted in even better performance, and that future liberalization would lead to further improvements in export performance. But there was no analysis by staff, or reference to analysis by others, of the costs of specific policies highlighted in the 1997 staff report, such as the import and distribution monopoly in agricultural products and the export restrictions in forestry products. And while a separate SIP (Gulde, 1997) identified concentrated bank ownership as one of the main problems of the Indonesian banking sector, that paper did not include measures to liberalize financial services trade (such as easing the entry of

[2] Trade distortions were proxied by the ratio of import tariff revenue to total imports plus the ratio of export tax revenue to total exports, smoothed to remove cyclical fluctuations; nontariff barriers and export bans were excluded due to data limitations. Based on this measure, trade distortions fell dramatically from around 18 percent in 1970 to around 5 percent in 1996 (McDermott, 1997).

foreign banks) in its proposed agenda for strengthening Indonesia's banking sector.

8. The authorities agreed in principle with the desirability of further trade liberalization but were noncommittal about removing special concessions.[3] Indonesia already had commitments to the WTO and the ASEAN Free Trade Area (AFTA) for further trade liberalization. Under those agreements, most tariffs would be reduced to within the range of 0–10 percent, with an estimated average unweighted tariff rate of 7 percent, by 2003. With regard to the elimination of marketing monopolies and special privileges, the authorities indicated only that those issues "would be addressed in a phased manner"[4] (IMF, 1997c). The authorities did not think it necessary to relax entry requirements for foreign banks, pointing to the large growth in the number of foreign institutions operating in cooperation with local enterprises as evidence that the existing regulations were not a major constraint.

The 1997 SBA-supported program

9. Not long after the conclusion of the 1997 Article IV consultation, Indonesia was severely affected by market contagion in the region. The rupiah, which had been allowed to float in August 1997, came under intense pressure in the wake of the Thai baht crisis, forcing the authorities to raise short-term interest rates to very high levels. The rupiah depreciation and high interest rates created difficulties for the banking and corporate sectors, precipitating a financial crisis. The loss of market confidence surprised the IMF, which had considered Indonesia's macroeconomic policies to be sound.[5] In October 1997, after several weeks of intensive consultations with Fund staff and management, the Indonesian authorities sought, and received, financial support for a three-year program under the SBA. The SBA-supported program was jointly funded by the World Bank and the Asian Development Bank.

10. With no ready explanation for the cause of the crisis, IMF staff homed in on the economy's underlying structural problems. The theory was that these problems, such as banking sector weaknesses, trade distortions, and poor governance, were masked by Indonesia's strong fundamentals before the crisis but came to the fore once the crisis hit. According to the staff, the weak banking system exposed the country to a shift in financial market sentiment; the lack of transparency in decisions affecting the business environment increased uncertainty and adversely affected investor confidence; and long-standing rigidities in the form of domestic trade regulations and import monopolies impeded economic efficiency and competitiveness. Although a few Executive Directors were unconvinced by this theory, the IMF Board endorsed the wide-ranging adjustment program, whose key planks included restructuring the financial sector and eliminating impediments to foreign and domestic trade.[6]

11. From the start, IMF management instructed staff to take a demanding stance on structural measures, including various trade-related policies. Targeted for elimination were import restrictions, various monopolies, and some large national projects linked to the President's family and friends. IMF staff and management were advised by the "Berkeley mafia," a group of U.S.-educated Indonesian economists, that cronyism and corruption ("the family") were at the root of Indonesia's problems and were scaring off much-needed foreign investment. The IMF staff worked closely with the Indonesian economic team, a group of reform-minded ministers who were themselves anxious to deal with some of those problems and wanted the Fund's help to counter opposition from other ministers who favored active industrial policies. The IMF staff were also told to draw on the World Bank, which had a field office and a large presence in Jakarta.

12. Obtaining agreement on a critical mass of structural reforms proved to be the most difficult part of the program negotiations. Once in the field, the IMF mission found it could get little traction in this area with the President. The national car program, Bulog's trading monopoly on food products, the plywood cartel, and strategic industries were particularly contentious issues. The mission was under pressure from IMF headquarters to do more; even though the national car case was concurrently being deliberated at the WTO, the IMF's then Policy Development and Review Department (PDR)

[3] In June 1997, the government announced another trade deregulation package, reducing import tariffs (to an unweighted average of 12 percent), easing the public sector monopoly on raw sugar, cutting the export tax on crude palm oil and its derivatives, and easing customs documentation requirements for exports. In September 1997, import duties on a number of raw materials and intermediate products were reduced and preshipment financing was provided to stimulate exports.

[4] At the Board discussion of the 1997 Article IV consultation, the Indonesian Executive Director quoted from a *Financial Times* editorial of June 13, 1996 which criticized industrial countries (particularly the United States and the European Union) for warning developing countries such as Indonesia (as well as Brazil, China, and Malaysia) against using infant-industry protection to support the development of automobile manufacturing while they themselves engaged in equally egregious policies to protect their own industries (IMF, 1998j).

[5] The summing up of the Board discussion of the 1997 Article IV consultation in July 1997 stated that "the strong fundamentals of the Indonesian economy had helped it to largely avoid the contagion effects from events in the region" (IMF, 1997d).

[6] One Board member likened the program to applying a broad-spectrum antibiotic.

insisted on more immediate action to eliminate the tax exemptions for TPN. The World Bank's Jakarta-based staff also favored adding even more trade conditions to the Fund program as the Bank lacked the resources to develop its own program at the time. After more than two weeks of negotiations, including interventions from the IMF Managing Director, a package of structural measures—substantially less ambitious than the Fund had originally sought—was finally agreed. Table 3 lists the trade policy-related commitments in the government's memorandum of economic and financial policies (MEFP) of October 31, 1997. There were only two upfront measures related to trade: the dismantling of Bulog's trading monopoly in wheat and wheat flour, soybeans, and garlic and the inclusion of chemical, steel/metal, and fishery products in the overall tariff reduction plan (a structural benchmark).[7] Other measures, such as tariff reductions, reductions in export taxes and restrictions, the elimination of the local content program for motor vehicles, and the expansion of the list of foreign direct investment activities open to foreigners, were phased over the three-year program period or longer. With respect to the national car project, the government agreed to implement ahead of schedule the ruling of the WTO dispute panel (expected in mid-1998).

13. When the SBA-supported program faltered within weeks of its seemingly successful launch, IMF staff pinpointed policy slippages in every area and called for further trade reforms to help restore market confidence. While the tariff reductions in chemicals, steel, and fishery products and the liberalization of imports of wheat and wheat flour, soybeans, and garlic were implemented as planned, at the same time the government simultaneously introduced a new export ban on palm oil to alleviate domestic shortages of cooking oil. The IMF Board specified several structural measures that were needed immediately to bring the program back on track, including: ceasing special privileges and protections for private projects and companies, particularly the national airline project; dismantling Bulog's control over domestic distribution and eliminating its import monopoly in sugar; dismantling export cartels, notably for plywood and cloves; and liberalizing foreign investment regulations for banks. Those measures, plus several additional ones, were included in the revised MEFP of January 15, 1998 (Table 3).

14. But the government's commitment to reform was widely questioned. A few days after signing the revised MEFP, the President announced that the national car and airplane projects would continue without state assistance.[8] In February 1998, the government announced that the clove monopoly would be replaced by a "partnership" of the Clove Marketing Board, cooperatives, and clove-cigarette factories that would function in the same way as the original monopoly. In March 1998, the President named as the new trade minister his close friend who ran Apkindo, the plywood export cartel that the IMF wanted dismantled. While Apkindo's formal authority to set prices and output was abolished, the cartel shortly afterwards instituted a new centralized shipping service to enable it to retain de facto control of the sector (IMF, 1998h).

15. Meanwhile, Indonesia's trade flows all but seized up. As the banking system practically ceased operating, foreign banks stopped accepting letters of credit written by Indonesian banks, and firms whose banks had been closed had difficulty finding new banks to service their needs. There were reports of shipments of food into Indonesia being delayed and exporters with confirmed orders being unable to arrange for the working capital credits they needed to import their inputs.[9] The Singapore government proposed a multilateral facility to guarantee trade finance, but the G-7 countries, Indonesia's largest trading partners, preferred to rely on bilateral trade financing deals to help their own exporters.[10]

16. Food prices skyrocketed. Several factors were responsible, including a drought which affected the rice crop; the sharp depreciation of the rupiah which raised the price of food imports; the collapse of the banking system, which made it difficult for food importers to open letters of credit; and the dismantling of Bulog's monopolies on agricultural commodities, which affected the agency's role in food price stabilization and food distribution. Expectations of large increases in food prices led to speculative and panic-driven hoarding, which exacerbated the inflation and led to riots. IMF staff advised the government to reduce tariffs on imported food and eliminate restrictions on inter- and intraprovincial trade. But an

[7] The import monopoly of soybean, garlic, and wheat flour imports was replaced by import tariffs of 10–20 percent on the three commodities, to be reduced to 5 percent in 2003. Bulog retained its distribution monopoly of wheat flour in the domestic market for the next three to five years, and continued to maintain its monopoly on rice and sugar.

[8] "Car, jet projects continue—Soeharto," *Jakarta Post*, January 20, 1998.

[9] See, for example, "Asia exports suffer as cash for raw materials dries up," *Wall Street Journal Asia*, January 22, 1998, and "Cash crisis hits Indonesian food," *Lloyd's List International*, February 10, 1998.

[10] Rather ironically, the Australian Wheat Board accused the United States of using its export credit program to grab market share in Indonesia after the dismantling of Bulog's import monopolies ("Australia blasts U.S. on Indonesia," *Wall Street Journal*, February 6, 1998; "U.S. assures Australia grain trade on export credits," *Reuters*, February 17, 1998).

Table 3. Indonesia: Key Trade Liberalization Measures under the 1997 SBA-Supported Program

Tariffs	Nontariff Barriers	Export Taxes/ Restrictions	State Trading Monopolies	Trade-Related Subsidies	Trade in Services
MEFP, October 31, 1997 (IMF, 1997i)					
Reduce tariffs on most chemical products by 5 percentage points and tariffs on fishery products from 10–20 percent to 5 percent by January 1, 1998.[1] [Structural benchmark] Reduce tariffs on items currently subject to rates of 15–25 percent by 5 percentage points by end-March 1998.[1] [Structural benchmark] Reduce most tariffs for steel/metals beginning January 1, 1999.[1] [Structural benchmark] Reduce tariffs on chemical, steel/metal and fishery products further to 5–10 percent by 2003. Reduce temporary import tariffs on soybeans and dried garlic (20 percent) and wheat flour (10 percent) to 5 percent by 2003.	Phase out the local content program for motor vehicles by 2000. Phase out any remaining quantitative import restrictions and other nontariff barriers that protect domestic production (other than those that may be justified for health, safety, environment and security reasons) over the program period.	Cut export taxes on rattan, leather, cork, ores and waste aluminum products in November 1997. Reduce export taxes and restrictions gradually over the next three years.	Eliminate Bulog's import monopoly over wheat and wheat flour, soybeans, and garlic in November 1997.	Implement ahead of schedule the ruling of the WTO dispute panel with respect to the national car project.	Modify regulations concerning foreign ownership of financial institutions to facilitate entry of international banks and investors into the Indonesian banking system. Simplify and further expand the list of activities open to foreign investors over the next three years.[2] [Progress in this area will be reviewed at the time of the second review.] Study the retail sector with a view to partially opening this sector up to foreign investors.
MEFP, January 15, 1998 (IMF, 1998a)					
Cut tariffs on all food items to a maximum of 5 percent; reduce tariffs on nonfood agricultural products by 5 percentage points by February 1, 1998. Reduce tariffs on nonfood agricultural products to a maximum of 10 percent by 2003.	Abolish local content regulations on dairy products by February 1, 1998. Abolish import restrictions on all new and used ships by February 1, 1998.	Abolish export taxes on leather, cork, ores and waste aluminum products by February 1, 1998. Reduce export taxes on logs, sawn timber, rattan, and minerals to a maximum of 10 percent ad valorem and impose appropriate resource rent taxes in March 1998. Remove the recently imposed ban on palm oil exports and replace it by an export tax not exceeding 20 percent in March 1998. Replace remaining export taxes and levies by resource rent taxes as appropriate; eliminate all other export restrictions over the program period.	Dissolve restrictive marketing arrangements for cement, paper and plywood; allow cement producers to export with only a general exporter's license by February 1, 1998. Limit Bulog's monopoly on rice; take effective action to allow free competition in the sale or distribution of flour and the importation and marketing of sugar by February 1, 1998. Eliminate the Clove Marketing Board by June 30, 1998.	Discontinue special tax, customs, or credit privileges granted to the national car by January 1998. Discontinue budgetary and extrabudgetary support and privileges to Nusantara Aircraft Industry projects by January 1998.	Lift restrictions on branching of foreign banks by February 1, 1998. Remove restrictions on foreign investment in retail trade by March 1998. Remove restrictions on foreign investment in wholesale trade by March 1998. Submit to the parliament a draft law to eliminate restrictions on foreign investment in listed banks by June 30, 1998. Issue a revised and shortened negative list of activities closed to foreign investors by June 30, 1998.

Table 3 (*concluded*)

Tariffs	Nontariff Barriers	Export Taxes/ Restrictions	State Trading Monopolies	Trade-Related Subsidies	Trade in Services
MEFP, April 10, 1998 (IMF, 1998g)					
		Reduce export taxes on logs, sawn timber, rattan, and minerals to: 30 percent by April 22, 1998.[1] [Prior action for logs and sawn timber]; 20 percent by end-December 1998 [Structural performance criterion for logs and sawn timber]; 15 percent by end-December 1999; 10 percent by end-December 2000. Phase in resource rent taxes on logs, sawn timber, rattan, and minerals. Replace quantitative restrictions on palm oil, olein, and stearin with an export tax of no more than 40 percent by April 22, 1998.[1] [Prior action] Review the export tax on palm oil, olein, and stearin regularly for possible reduction based on market prices and the exchange rate, and reduce it to 10 percent by end-December 1999.	Announce dismantling of the joint marketing body for plywood by end-March 1998.[1] [Prior action]		Lift restrictions on foreign investment in wholesale trade by April 22, 1998.[1] [Prior action]

[1] Indicates that the measure was implemented on schedule.
[2] Indicates that the measure was subsequently modified.

internal Fund memorandum acknowledged that the staff had also insisted on the elimination of fuel subsidies and export restrictions on palm oil, which may have exacerbated the problem by raising the price of fuel and cooking oil.

17. The first program review was prolonged and contentious, and the economic and political situation deteriorated even further. The IMF scaled down some of its demands, notably by allowing the government to continue subsidizing food not just through Bulog but also through private sector importers. But it also included a range of prior actions on log export taxes, the plywood monopoly, palm oil export restrictions, and liberalization of wholesale trade (Table 3). Social unrest boiled over in May 1998; widespread rioting and looting severely undermined business confidence, especially within the ethnic Chinese community, and damaged the distribution system. The Soeharto government fell and was replaced by that of B. J. Habibie.

18. When the SBA-supported program was cancelled and replaced with an EFF arrangement in July 1998, the existing trade conditionality was carried over to the new program. The reduction of export taxes on logs and sawn timber to 20 percent was elevated to a performance criterion. Food security issues took on greater importance; as one of the measures to stabilize the rice market, the government eliminated Bulog's last remaining monopoly and allowed private traders to import rice (IMF, 1998q). The focus of trade-related conditionality shifted toward privatization, introducing a competition law and an investment law establishing equal treatment for domestic and foreign investors, and developing mechanisms for regular adjustment of administered food and fuel price increases. The World Bank assumed a leading role in issues related to trade policy and trade financing, privatization, environmental policies, food security, and the social safety net (IMF, 1998q).

19. The 1998 EFF-supported program was followed by another EFF-supported program in January 2000, with further trade policy commitments. The MEFP for the second EFF-supported program included commitments to: establish a three-tier tariff structure (0 percent, 5 percent, and 10 percent) for all goods except alcohol and automobiles by end-2003; eliminate all exemptions from import tariffs (except those that were part of international agreements) and remove all existing nontariff barriers (except those maintained for health and safety reasons) during the program period; review the forestry sector taxation policy in consultation with the World Bank in January 2000, and ensure that the forest resource royalty rate captured at least 60 percent of the economic rent from logs; and eliminate all other export restrictions (e.g., licensing requirements or government approval on logs, coffee, and wood products) by end-2000, with the exception of those needed under the international agreements. At the same time, the program allowed for new transitional import tariffs on rice (a specific tariff to be applied through August 2000) and sugar (a 25 percent import tariff to be phased down over three years) (IMF, 2000a).

Assessment

20. Indonesia's SBA-supported program was one of the prominent IMF arrangements of the late 1990s that led to a rethink of structural conditionality. Critics such as Feldstein (1998) and Radelet and Sachs (1998) argued that the structural reforms were simply a distraction from the financial crisis. Later IEO (2003) concurred, noting that "detailed and extensive structural conditionality, particularly in areas that are not macro-critical, is not helpful to crisis resolution" and that "[t]he crisis should not be used as an opportunity to seek a long agenda of reforms just because leverage is high, irrespective of how justifiable they may be on merits."

21. At the time, however, the existing guidelines were broad enough to include trade liberalization as a normal part of IMF-supported programs (Table 2). PDR had developed the TRI in August 1997 and had started to think about using this in designing and monitoring the trade liberalization components of Fund-supported programs. In November 1997, PDR staff calculated in an internal memo that Indonesia's SBA would take the country's TRI from 5 to 1 within two to three years, but hesitated to publicize the figures, because the methodology had limitations (e.g., it did not incorporate tariff dispersion and exemptions) and because it would draw attention to the relatively weak trade policy content of Thailand's SBA-supported program, which had been signed three months earlier.[11]

22. The trade policy conditionality in Indonesia's SBA-supported program was not well thought-out. Trade liberalization and overall structural reform were seen by IMF staff and management as crucial to reestablishing investor confidence by signaling a clean break with the past. But the staff were clearly out of their depth when it came to designing and negotiating trade conditionality, and the World Bank's (limited, mostly microeconomic) input was not found to be particularly helpful. IMF staff did not present a convincing macroeconomic case for why those particular trade reforms were necessary other than arguing in general terms that the reforms

[11] The memo noted that Thailand's TRI was 6 in 1997 but its SBA program involved no trade liberalization measures; in fact, import tariffs were increased on 12 consumer goods items for revenue reasons.

would increase economic efficiency.[12] In fact, the standard "small country" assumption did not apply to Indonesia's trade in many commodities, and some of Indonesia's trade restrictions were linked to wider problems, such as food security and forestry management, in which the Fund had no mandate and no expertise. For example, Bulog could not be simply wiped out and replaced by competitive private traders—dismantling the complex system of price setting and import and distribution monopolies created side effects that staff did not foresee, such as increased uncertainty and food price volatility. Reducing export restrictions on logs contributed to the deforestation problem, prompting widespread criticism by environmental groups (Barr, 2001; Mainhardt, 2001; Tockman, 2001). Some trade liberalization measures were futile: reducing import tariffs on food was of little help when firms could not obtain trade credit to import food and the distribution network had been wrecked.

23. Some of the trade policy conditionality came close to overstepping the IMF's boundaries. The WTO's dispute settlement panel had already started to decide the case brought by Japan, the United States, and the European Union against the national car project, but the IMF would not wait for the outcome. By insisting that Indonesia implement ahead of schedule the ruling of the WTO dispute panel, the Fund essentially prejudged the panel's decision and overrode the compliance period that was allowed under WTO rules (typically around 15 months). In addition, commitments made under the Fund-supported program to liberalize trade in financial services, such as lifting restrictions on branching of foreign banks and on foreign investment in listed banks, were bound as part of Indonesia's commitments under the General Agreement on Trade in Services (GATS) (IMF, 1998a), whereas IMF guidelines had explicitly stated that the Fund could not require a borrowing country to make a binding commitment to the WTO on trade liberalization that was undertaken in the context of a Fund-supported program (Table 2).

24. In the end, the trade policy conditionality was not very effective. By the IMF's measure, Indonesia's TRI fell from 5 to 4 in 1998 with no change thereafter. The improvement was entirely due to tariff reductions—the (unweighted) average tariff was reduced from 13 percent to 9.5 percent in 1998 and, in line with Indonesia's commitments to the WTO and AFTA, gradually down to 7 percent in 2003. The success of the other trade measures was mixed; Khatri (2004) noted that the sweeping "regime change" initiated by the SBA program resulted in less predictability for businesses, and some of the reforms were subsequently reversed. The outcomes of some of the more prominent trade policy commitments are discussed below:

- *The national car*. In January 1998, the government discontinued all special tax, customs, and credit privileges granted to the national car (IMF, 1998g). In July 1998, the WTO panel ruled that the local content requirements and special privileges were in violation of Indonesia's WTO commitments.[13] Production of the Timor car ceased shortly afterwards. Kia Motors formally withdrew from the joint venture in 1999. TPN was taken over by the Indonesian Bank Restructuring Agency. In early 2000, the Indonesian government reimposed the ban on luxury vehicle imports and negotiated with Kia to revive the national car project, but the agreement with Kia fell apart in 2001 in a dispute over tax incentives (Hale, 2001). The government remains embroiled in a lawsuit with TPN's owners over the sale of the company's assets.[14]
- *Bulog's soybean, wheat, and sugar monopolies*. The government dismantled Bulog's trading monopoly in soybeans, garlic, and wheat flour in January 1998 and eliminated Bulog's trading monopoly in sugar and sole distribution rights in wheat flour in June/July 1998; both steps were taken a couple of months later than indicated in the MEFPs (IMF, 1997i, 1998a). However, there was little additional competition as private sector participation in those activities was inhibited by (exchange rate) subsidies that were granted only to Bulog (IMF, 1998j). The government extended Bulog's subsidies to all market participants, also a couple of months later than indicated in the MEFP (IMF, 1998g). However, the subsidized commodities were promptly re-exported for a profit, causing the government to impose export bans in July 1998 to ensure adequate domestic supplies (IMF, 1998n). In September 1998, the subsidies on sugar, wheat, and soybeans were abolished together with their import duties, and

[12] IMF staff and management justified some of the reforms as necessary to correct misgovernance—an argument that was probably valid but should not have been expected to win over the President ("RI's macroeconomy affected by graft, monopoly," *Jakarta Post*, November 12, 1997).

[13] The panel found, inter alia, that Indonesia had acted inconsistently with Article 2 of the Trade-Related Investment Measures Agreement and Articles I and III:2 of the GATT 1994, and recommended that the Dispute Settlement Body request Indonesia to bring its measures into conformity with its obligations under the WTO Agreement. See http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds54_e.htm.

[14] "Suharto's son sues Indonesian minister over car case," *Reuters*, August 12, 2008.

Bulog's imports of those commodities ceased (IMF, 1998n). The export bans were lifted in May 1999.[15] As noted earlier, in early 2000, the government—with the Fund's approval—reimposed a (transitional) 25 percent tariff on sugar imports to protect the domestic industry (IMF, 2000a). The following year, the government—without the Fund's approval—limited the number of sugar importers to four state-owned plantations; as none of the four had the experience or the funding to import sugar, the task fell back to Bulog.[16] In 2003, Bulog was transformed into a semi-profit-oriented state-owned company with an undefined but potentially wide-ranging role.[17]

- *Export taxes/restrictions on palm oil*. The government banned the export of all crude palm oil products in January 1998 in an effort to stabilize the domestic price of cooking oil, but agreed to replace the ban with an export tax of not more than 20 percent after March 1998 (IMF, 1998a). However, the move was postponed in the face of soaring international prices for crude palm oil and its derivatives. In April 1998, the commitment was revised to an export tax of no more than 40 percent, to be reduced to 10 percent by end-1999 (IMF, 1998g). The export tax was raised to 60 percent in July 1998. The high export tax did not result in lower prices for cooking oil—with the depreciated rupiah, exports were still more profitable than domestic sales—forcing the government to control the distribution of the commodity through Bulog. Only when international crude palm oil prices began a downward trend was the export tax cut—to 40 percent in February 1999, 30 percent in June 1999, and 10 percent in July 1999.
- *Export taxes/restrictions on logs*. The government initially committed to reduce export taxes on logs and sawn timber to 10 percent (from 200 percent) and impose appropriate resource rent taxes by March 1998 (IMF, 1998a). This was subsequently revised to a more gradual timetable of export tax reductions: to 30 percent by mid-April, 1998, 20 percent by end-1998, 15 percent by end-1999, and 10 percent by end-2000 (IMF, 1998g). The reductions were implemented on schedule except for the second one (a performance criterion under the 1998 EFF-supported program), which was delayed by three months. Log exports increased. Environmentalists complained that the export tax reduction encouraged illegal logging and the domestic wood-processing industry complained of a shortage of raw materials. In response, the government imposed a temporary ban on log exports in October 2001, and made the ban permanent in June 2002 (Resosudarmo and Yusuf, 2006).

25. The IMF missed the opportunity to take a proactive role in coordinating trade finance during the financial crisis. IMF management was unwilling to work with the Singaporeans and others to come up with a multilateral solution and was unresponsive to the entreaties of the WTO Director-General to do more to resolve the problem of trade finance.[18] Given that the IMF was, by that time, being widely blamed for exacerbating the financial crisis, a visible effort to take the lead in coordinating trade finance would have gone some way toward rehabilitating its public image.

C. Korea

Trade policy regime and IMF advice before the 1997 program

26. In the late 1990s, Korea's trade regime was rated by the IMF as "moderately restrictive." A series of import liberalization programs beginning in the early 1980s had eliminated virtually all nontariff barriers on manufactured imports and lowered tariff rates on manufactured imports to industrial-country levels. In 1997, Korea's aggregate score on the TRI was 4, based on an "open" rating of 1 (the lowest) in the tariff category and a "moderate" rating of 2 (out of 3) in the nontariff barrier category. The unweighted average tariff rate was about 9 percent, tariff dispersion was relatively low (other than for some agricultural products), and the use of tariff exemptions was limited and transparent. However, so-called adjustment tariffs (supplementary duties) of up to 100 percent were imposed on various products (e.g., agricultural and fishery products, clothing, footwear, and toys) to protect domestic producers; the list of products was determined annually and ranged from 38 to 68 items. There were some nontariff barriers in the agricultural sector, such as state import monopolies for certain agricultural products, import quotas on rice, and restrictive import licensing for beef and cattle (WTO, 1996a).

[15] "Government lifts export ban," *Jakarta Post*, May 3, 1999.

[16] "Government policies support unfair competition," *Jakarta Post*, June 13, 2003.

[17] "Bulog changes status to semi profit-oriented firm," *Jakarta Post*, January 14, 2003.

[18] See Box 8 in Background Document 2.

Box 3. Korea: OECD Accession and Financial Services Liberalization

Korea's 1996 accession to the OECD was contingent upon its acceptance of the following rules affecting trade in financial services: (i) the Code of Liberalization of Capital Movements, which requires OECD members to remove specific restrictions on capital flows including foreign direct investment in financial services and foreign portfolio investment; (ii) the Code of Liberalization of Current Invisibles Operations, which requires OECD members to remove specific restrictions on cross-border trade in financial services; and (iii) the OECD Declaration on International Investment and Multinational Enterprises, which provides for national treatment principles for foreign-owned enterprises.

Reservations to both codes and exceptions to the national treatment principles are permitted. According to Dobson and Jacquet (1998), Korea availed itself of the opportunity to exercise this option, accepting only 69 percent of the codes on financial liberalization (compared to the OECD average of 89 percent), although it committed to phase out many of its reservations and exceptions by 2000.

In September 1996, the Korean government announced that it would phase in the following reforms to liberalize the flow of foreign portfolio investment and foreign direct investment in financial services: foreign banks and securities firms from OECD countries would be permitted to establish subsidiaries in Korea by 1998; foreign investors from OECD countries would be allowed to establish and hold 100 percent ownership of any type of financial institution by December 1998; foreign investment consulting firms from OECD countries would be able to offer their services without establishing a commercial presence in Korea by 1999; and aggregate foreign investment ceilings for investors from OECD countries would be phased out by 2000 (Dobson and Jacquet, 1998).

27. Foreign access to Korean markets was more restricted for services than for manufactures. In the mid-1990s, the share of industries eligible for foreign direct investment was around 85 percent for services compared to 98 percent for manufacturing. The finance and business services, transport, and communications industries were among the least accessible to foreign participation (WTO, 1996a). In the early 1990s, Korea had undertaken reforms to liberalize financial services trade—easing restrictions on foreign bank entry; granting foreign securities firms (limited) access to the domestic market; deregulating overseas bond issuance and foreign borrowing by financial institutions and corporations (which remained subject to government approval); and liberalizing trade-related short-term financing. But the policy stance was characterized as a "lukewarm and partial opening" (Hwang, Shin, and Yoo, 2003). Cross-border trade was not allowed in the banking sector.[19] A five-year reform program starting in 1993 that sought to enhance the efficiency of the financial sector reduced the degree and scope of government intervention in the sector.[20] As part of the reform program, the scope of financial activities allowed for foreign banks was broadened to include local branch establishment, and regulations governing the operations of foreign securities firms were eased (Hirschhofer, 1995; Hwang, Shin, and Yoo, 2003). In 1996, Korea made further commitments to liberalize financial services trade as part of its accession to the Organization for Economic Cooperation and Development (OECD) (Box 3).

28. The IMF's trade policy advice to Korea during 1995–96 focused mainly on further liberalizing imports. An SIP prepared for the 1995 Article IV consultations (Tzanninis, 1995) highlighted a number of issues that had created frictions in Korea's bilateral trade relations: the import diversification program, restrictions on trade in financial services, and nontariff barriers for agricultural imports and automobiles. In the 1996 Article IV consultation, IMF staff encouraged the authorities to speed up their plans to reduce the number of items covered by the import diversification program and to abolish the program as soon as possible (IMF, 1996e) (Box 4). But staff did not analyze the impact of the import diversification program or the expected effect of its elimination.

29. There was much discussion of the pace of capital account liberalization and domestic financial sector reform. The authorities favored a grad-

[19] Limited cross-border trade was allowed under the Foreign Exchange Management Act as part of permitted capital transactions (Hwang, Shin, and Yoo, 20003).

[20] Interest rates were deregulated; government intervention in credit allocation by financial institutions (through policy loans, mandatory lending ratios, and credit controls) was scaled back; and measures were introduced to enhance the autonomy of bank management, ease restrictions on financial institutions' business activities, and improve bank supervision. The program also entailed a significant—although not complete—liberalization of capital controls (Hirschhofer, 1995).

Box 4. Korea: The Import Diversification Program

The import diversification program was created in the late 1970s to correct Korea's large and persistent bilateral trade imbalances by diversifying the sources of imports of designated items. The program basically sought to replace imports from Japan—a country with which Korea had a substantial trade deficit as well as a difficult historical and political relationship—with imports from other countries. The number of products targeted for diversification reached more than 900 by 1981 before being gradually reduced to 258 in 1993. The Japanese government had repeatedly requested that the program be repealed, as it violated Korea's obligations under the General Agreement on Tariffs and Trade (GATT). However, Japan never brought a formal complaint to the GATT dispute settlement system, preferring instead to rely on political and diplomatic channels to resolve the issue (Ahn, 2004).

In 1994, the Korean government agreed to reduce the product coverage by half over the next five years. Subsequently, with its accession to the OECD in 1996, Korea agreed to eliminate the import diversification program by the end of 1999.

ual approach because they were concerned about the impact that financial sector deregulation would have on macroeconomic stability in general, and on the exchange rate in particular. IMF staff supported the authorities' gradual approach, arguing inter alia that it would "provide adequate time for the further strengthening of the domestic financial sector in advance of increased competition with foreign financial institutions" (Adams, 1996).[21] But a number of Executive Directors argued that rapid and complete capital account liberalization would be beneficial to Korea and that there was some urgency to carrying out the liberalization and deregulation that the government had already committed to implement (IMF, 1996f).

The 1997 SBA-supported program

30. In November 1997, Korea requested IMF assistance to overcome a financial crisis.[22] Overinvestment and weakening export prices had driven an unprecedented number of highly leveraged conglomerates (*chaebols*) into bankruptcy, and this, together with a steep decline in stock prices, had severely weakened the financial system, leading to downgrades by international credit rating agencies and a sharp tightening in the availability of external finance. IMF staff noted that "[w]hile the contagion effects of developments in Southeast Asia were a contributing factor, the magnitude and speed of the deterioration owed much to the fundamental weaknesses in Korea's financial and corporate sectors," notably a lack of commercial orientation in financial institutions and lax prudential supervision (IMF, 1997j).

31. IMF staff diagnosed the cause of the crisis as a collapse in market confidence due to concerns about the soundness of the financial system, mounting short-term external debt, and dwindling reserves. Accordingly, the centerpiece of the three-year SBA-supported program was a comprehensive plan to restructure the financial sector, including opening it to foreign investment to promote competition and efficiency. The MEFP of December 3, 1997 included prior actions and commitments to accelerate foreign entry into the domestic financial sector through the establishment of foreign bank subsidiaries and brokerage houses, participation by foreign financial institutions in mergers and acquisitions of domestic financial institutions, and purchases by foreign banks of equity in domestic banks (IMF, 1997k). These measures were grouped under capital account liberalization measures.

32. Trade liberalization measures were also considered necessary. Immediately after Korea's request for assistance, PDR began looking into trade reform measures that could be included in the program. An internal PDR memo suggested that it would be reasonable for the program to move Korea to a TRI rating of 1 over the two- to three-year program period (the same target as for Indonesia); it listed possible prior actions, first-year reforms, and medium-term

[21] Fund staff constructed different medium-term adjustment scenarios under alternative assumptions about the pace and scope of capital account opening. The sensitivity analysis suggested that a somewhat faster pace of capital account liberalization would imply somewhat larger current account deficits in the near term that could be comfortably financed but could reduce the ability of the economy to respond to unfavorable external developments, such as an unexpected deterioration in the terms of trade. A much faster pace of capital account liberalization would risk complicating short-run macroeconomic management and could place significant upward pressure on the exchange rate (Adams, 1996).

[22] At that time, Korea's last IMF arrangement was an SBA-supported program that ended in March 1987 (Table 1). A staff team visited Korea during October 1997 to conduct the 1997 Article IV consultation discussions, but the economic situation deteriorated significantly shortly afterwards and the consultation was continued into 1998.

Table 4. Korea: Key Trade Liberalization Measures under the 1997 SBA-Supported Program

Tariffs	Nontariff Barriers	Trade-Related Subsidies	Trade in Services
MEFP, December 3, 1997 (IMF, 1997k)			
Set a timetable at the time of the first full review to eliminate the import diversification program in line with WTO commitments.	Set a timetable at the time of the first full review to eliminate restrictive import licensing in line with WTO commitments. Take steps to streamline and improve the transparency of the import certification procedures.	Set a timetable at the time of the first full review to eliminate trade-related subsidies in line with WTO commitments.	Announce plans to propose to the first session of the National Assembly immediately after the elections an amendment of the related laws to allow foreign financial institutions to participate in mergers and acquisitions of domestic financial institutions in a friendly manner and on equal principle. For merchant banks, foreign participation will be allowed up to 100 percent.[1] [Prior action] Effective immediately, allow foreign banks to purchase equity in domestic banks without restriction, provided that the acquisitions contribute to the efficiency and soundness of the banking sector.[1] [Prior action] Allow foreign financial institutions to establish bank subsidiaries and brokerage houses by mid-1998.
MEFP, December 24, 1997 (IMF, 1997m)			
Phase out the import diversification program (covering 113 items) (committed to the WTO by end-1999): liberalize 25 items by December 30, 1997; liberalize an additional 40 items by July 1998; liberalize an additional 32 items by December 1998; liberalize the remaining items by June 1999. Reduce the number of items subject to adjustment tariffs from 62 to 38 by January 1, 1998.[1]	Harmonize import certification procedures with WTO standards and strengthen their implementation.	Submit to the National Assembly a bill to abolish three trade-related subsidies, and abolish one subsidy administratively at the time of National Assembly approval, expected in March 1998 (committed to the WTO by end-1998).	Announce the binding of financial services liberalization agreed with the OECD as part of commitments to the WTO in January 1998. Issue clear guidelines governing foreign investment in domestic financial institutions by January 20, 1998. Allow foreign banks and brokerage houses to establish subsidiaries by March 31, 1998.
MEFP, February 7, 1998 (IMF, 1998d)			
	Review existing import certification procedures and present a plan to streamline them and bring them in line with international practice by August 15, 1998.	Review all existing subsidy programs and their economic rationale. Present a proposal for rationalizing existing subsidy programs by November 15, 1998.	Issue a presidential decree following passage of the Banking Act (in December 1997) to provide transparent guidelines governing foreign investment in domestic financial institutions by February 28, 1998. Allow foreign banks and brokerage houses to establish subsidiaries by March 31, 1998.[1] [Structural performance criterion]

Table 4 *(concluded)*

Tariffs	Nontariff Barriers	Trade-Related Subsidies	Trade in Services
MEFP, May 2, 1998 (IMF, 1998i)			
			Permit foreigners to engage in securities dealings, insurance, leasing, and other property-related businesses by April 1, 1998.
			Submit legislation to abolish regulations that prohibit foreigners from becoming bank managers by June 30, 1998.
			Submit legislation to abolish restrictions on foreign ownership of land and real estate properties on the basis of national treatment by June 30, 1998.
			Increase the permitted equity ownership by foreigners of Korean telephone service providers from 33 percent to 49 percent by January 1, 1999.
MEFP, July 24, 1998 (IMF, 1998m)			
			Increase foreign ownership ceilings on publishing of newspapers (to up to 33 percent) and publishing of periodicals (to up to 50 percent) by January 1, 1999.
			Permit foreigners to engage in deep sea foreign freight transport by August 1, 1999.
MEFP, March 10, 1999 (IMF, 1999b)			
			Submit a revised financial services offer to the WTO consistent with OECD commitments by January 19, 1999.

[1] Indicates that the measure was implemented on schedule.

program targets for trade liberalization, including elimination of nontariff barriers, trade-related subsidies, and restrictions on foreign investment, as well as reduction of agricultural import tariffs. The December 3 MEFP included commitments to begin eliminating trade-related subsidies, restrictive import licensing, and the import diversification program, and to streamline and improve the transparency of the import certification procedures (IMF, 1997k). Table 4 lists the trade policy-related commitments in this MEFP.

33. The initial program failed to restore confidence and was quickly replaced by a strengthened one with more financing and more structural conditions, including on trade. Days after the initial program announcement, uncertain political support and damaging leaked information about Korea's reserves and short-term debt had led to an increase in financial turmoil. In response, the Korean authorities worked with the IMF (and the World Bank) to strengthen their economic program.[23] IMF staff formed an interdepartmental working group to come up with detailed, concrete, and time-bound trade reform measures that could help to reinforce the structural component of the program. The revised program—announced on December 24, 1997, in conjunction with an additional disbursement from the SRF—featured more specific measures to open the economy, including: reducing the number of items subject to adjustment tariffs; announcing that Korea would bind (as a WTO commitment) the financial services trade liberalization it had agreed with the OECD; abolishing four trade-related subsidies some nine months ahead of its WTO commitment; and phasing out the import diversification program six months ahead of its OECD/WTO commitment (Table 4).

34. Further trade liberalization measures—covering services in particular—were added in subsequent program reviews. The requirement to allow foreign banks and brokerage houses to establish subsidiaries by end-March 1998 was made a structural performance criterion at the first quarterly review in February 1998. The first quarterly review also included measures to open securities dealing, insurance, leasing, and other property-related business to foreigners. The second quarterly review (in May 1998) added measures to open telephone services and the third quarterly review (in July 1998) added measures to open deep sea freight transport and newspaper and periodical publishing to foreign ownership (Table 4).

35. The United States pushed for tough conditionality on trade. While IMF staff were negotiating the program with the Korean authorities, U.S. computer chip, steel, and automobile companies—some of which had initiated complaints against allegedly unfair trade practices by Korea—vigorously lobbied their government to attach trade conditions to the IMF program.[24] The Korean media observed that a U.S. Treasury official stayed at the same hotel as the IMF mission team and attended their meetings. The Korean finance minister himself speculated that the United States and Japan must have requested certain conditions to open Korea's goods and financial markets.[25] The U.S. administration continued to pressure the IMF on trade conditionality even after the revised program was approved. In January 1998, the U.S. Trade Representative (USTR)'s Office sent, via the U.S. Executive Director, a detailed list of trade policy measures proposed for the program, including measures to liberalize trade in goods (e.g., lowering tariff and nontariff barriers in specific goods, especially automotive imports and agricultural imports) and services (financial services and telecommunications services in particular), and measures to limit government interference in commercial lending decisions affecting the semiconductor, automobile, steel, shipbuilding, and agricultural sectors.[26] According to IMF staff, several such communications were received during the course of the program. At a congressional hearing in March 1998, the USTR testified that her office and other government agencies were actively monitoring Korea's (and Indonesia's) compliance with the Fund's trade-related commitments.[27] The U.S. Omnibus Appropriations Act signed in October 1998 tied additional U.S. funding for the IMF to several conditions including the requirement that IMF borrowing countries be made to liberalize trade.

36. The IMF justified its inclusion of trade conditionality in the Korean (and Indonesian) programs as necessary and appropriate. At a press conference in December 1997, the First Deputy Managing Director

[23] Korea graduated from World Bank borrowing in 1994, but as part of the international assistance package in response to the financial crisis, the Bank provided structural adjustment loans in 1997 and 1998 to support reforms in financial sector restructuring, corporate sector restructuring, and labor market reform.

[24] "Micron opposes bailout of South Korea by IMF," *Wall Street Journal*, December 3, 1997; "U.S. firms want say on Korea bailout," *Journal of Commerce*, December 3, 1997.

[25] "U.S. hand seen in South Korean IMF negotiations," *Reuters News*, December 5, 1997.

[26] In October 2002, the European Union filed a WTO dispute against Korea, alleging that "corporate restructuring subsidies" (in the form of debt forgiveness, debt and interest relief, and debt-equity swaps) provided through government-owned and -controlled banks to certain Korean shipbuilding companies were inconsistent with Korea's obligations under the Safeguards and Countervailing Measures Agreement. See Box 6 in Background Document 2.

[27] Statement of Ambassador Charlene Barshevsky, USTR, Testimony before the Subcommittee on Trade of the House Committee on Ways and Means, Hearing on Asia Trade Issues, February 24, 1998.

(FDMD) acknowledged that the U.S.'s views "naturally count[ed] for a lot in the IMF Board" but denied that the trade-related bilateral issues "had any particular role" (IMF, 1997l). In a March 1998 speech, the FDMD said:

> The Fund promotes international trade directly, by encouraging trade liberalization, both through surveillance and in its lending programs with member countries. It has always done so, and the purposes of the Fund require it to continue to do so. It is therefore a surprise that our Asian programs are criticized for including conditionality on trade liberalization measures. (Fischer, 1998)

In response to Feldstein's (1998) criticism that the Asian crisis programs (especially Korea's) included excessive structural conditionality, the FDMD said it was not clear why Feldstein considered trade liberalization an unnecessary interference with the proper jurisdiction of a sovereign government whilst banking sector reform was not, or why extensive structural conditionality was "acceptable" in Fund-supported programs in the transition economies but not in Asia (Fischer, 1998).

Assessment

37. The relatively extensive trade conditionality in Korea's SBA-supported program was out of proportion to the initial restrictiveness of Korea's trade policy regime. At a general level, the program was modeled after the Indonesian SBA, where a commitment to structural reforms was considered necessary to restore market confidence. But while it is reasonable to argue that weaknesses in the financial and corporate sectors contributed to the Korean crisis, there is no indication that trade restrictions had any effect on market confidence. Prior to the crisis, trade restrictions barely featured in the IMF's dialogue with Korea; the only trade restriction that IMF surveillance missions had highlighted regularly was the import diversification program. Fund staff had to scramble to learn more about Korea's trade policies—adjustment tariffs, trade-related subsidies, and import certification procedures—as the program was being negotiated. They had scant information, for example, about the nature of the four trade-related subsidies that were to be removed, let alone any indication of how economically meaningful those subsidies were.[28] Unlike in Indonesia, the World Bank did not help on the trade front. However, the collaboration with the Korean authorities was much smoother than in Indonesia and the measures were more straightforward—many simply involved accelerating the timetable of commitments that had already been made to the OECD and/or the WTO.

38. No meaningful or concrete effort was made to justify the trade liberalization measures as macrocritical. It is hard to see why a bilateral trade issue like the import diversification program (that was already scheduled to be dismantled) would be relevant for resolving the financial crisis. One could also question the need to liberalize financial services trade during a financial crisis that had been caused in part by lax prudential supervision—surely the preferred sequencing would have been to strengthen prudential supervision first and then liberalize, rather than do both simultaneously. In general, while the trade liberalization measures were likely to have been desirable for Korea's medium-term growth, the reasons for including such measures in a program explicitly addressing an immediate crisis were not made clear. The same conclusion was reached in IEO (2003).

39. The underlying reason for the trade liberalization measures was mainly political. IMF staff interviewed for this evaluation were candid in their admission that the trade conditions were inserted to please certain shareholders, particularly the U.S. and Japanese governments, so that they would in turn persuade their commercial banks to roll over Korea's external debt.[29] The U.S. Treasury was clearly not shy with its suggestions for trade conditionality, but for any given trade condition included in the program it is impossible to determine whether the impetus came from within or outside the Fund.[30]

40. This may have damaged the IMF's credibility. With no convincing economic reason for the inclusion of trade conditionality in the program, and given the U.S. government's overt efforts to put pressure on the Fund, Koreans (and others) concluded that the trade measures were included at the request of the Fund's major shareholders in return for their financial support.[31] The IMF did not manage to convince the public of its independent judgment, "tarnishing

[28] A Fund memo identified the subsidies as: (i) the microcomputer assistance program; (ii) the export losses program; (iii) the development market program; and (iv) the investment market program. The first program was characterized as a subsidized loan; the other three were "related to tax exemptions in one form or other."

[29] See IEO (2003) on the developments leading up to the decision to urge a coordinated rollover on creditor banks, and the outcome of the rollover.

[30] IEO (2003) noted the active engagement of the United States in the Korean program but allowed that this was understandable to a certain extent, given the importance of U.S. bilateral support in resolving the crisis. The evaluation found no evidence that the specific policy measures mentioned were included "solely because large IMF shareholder governments demanded them."

[31] See for example "Koreans fume at alleged U.S. and Japanese intervention in IMF deal," *Associated Press*, December 4, 1997 and "IMF bailouts subject Korea Inc. to U.S.," *Korea Herald*, March 3, 1998. Kapur (1998) stated that: "According to fund sources, conditions such as the one asking Korea to speed up the opening of its automobile and financial sectors reflected pressures from major shareholders (Japan and the United States)." Stiglitz (2001) characterized the trade conditionality in Korea's SBA as "a crude political power play," and noted that the Fund's effectiveness was "weak-

the technocratic reputation that is essential to the credibility of its prescriptions" (Kapur, 1998). The events may have also inadvertently hurt the image of others—there is no evidence, for example, that the Japanese government sought to use its influence on the Fund the way the U.S. government did, but it was widely assumed to have tried.

41. The trade conditionality also came close to crossing into WTO territory. Korea had already committed at the WTO to undertake a number of the trade measures that featured in the IMF-supported program, such as phasing out trade-related subsidies and the import diversification program. By agreeing to remove those trade restrictions earlier than scheduled, Korea sacrificed some adjustment time, although IMF staff broke no rules in making those requests and the sacrifice was small (six to nine months). But the IMF contravened its own guidelines on "cross-conditionality" when it required that Korea (like Indonesia before it) bind its financial services liberalization at the WTO (Table 2).

42. Overall, the trade conditionality was effective in opening the Korean economy a little earlier than planned, though by the IMF's own measure it was not a success. The import diversification program was eliminated, four trade-related subsidies were abolished, and the number of items subject to adjustment tariffs was reduced (Table 4). Instead of declining, Korea's overall TRI remained at 4, then actually rose to 5 (reflecting an increase in the unweighted average tariff) in 2000. Korea continues to levy adjustment tariffs of 11–57 percent on various products to protect domestic industries from import surges; the authorities claim that these adjustment tariffs are within Korea's WTO bindings (WTO, 2008).

43. The financial services liberalization measures (not measured by the TRI) were generally hailed, but they were not without controversy. The reforms—including allowing foreign banks and securities firms to establish domestic subsidiaries, allowing up to 100 percent foreign ownership of Korean financial institutions, and allowing foreign nationals to become directors of Korean banks—were characterized by the WTO (2000) as a "remarkable opening of the [financial] services sector." Fund staff reckoned that foreign capital was instrumental in the restructuring and stabilization of the Korean banking system: foreign private-equity funds acquired three failed banks, restructured them, and sold their stakes to Citigroup and Standard Chartered (Semblat, 2006). By 2005, foreign banks' share of assets in the Korean banking system stood at 21 percent, compared with 4 percent in 1997. The Koreans were less enthusiastic. The foreign private-equity funds were criticized for making hefty profits from their sales of stakes in Korean banks. According to a 2005 Bank of Korea study, the foreign firms were focused on short-term capital gains and not the long-term development of Korea's financial sector (Kang and Kim, 2005).[32] In early 2005, Korea's Financial Supervisory Commission issued guidelines to limit the share of seats occupied by foreign directors on commercial bank boards to 50 percent, but fell short of making this a legal requirement, after meeting strong opposition from the government and a threat by the European Union to take the issue to the WTO.[33] In 2006, the potential sale by a U.S.-based private equity fund of its stake in a Korean bank was delayed by an investigation into legal issues that many observers saw as a barometer for Korea's attitude toward foreign investors.[34]

ened...by the growing perception that its policies [were] dominated by the political interests of the U.S. Treasury."

D. Ukraine

Trade policy regime and IMF advice before the 1998 program

44. In the late 1990s, Ukraine's trade regime was rated by the IMF as "moderately restrictive." After some initial progress in establishing a liberal import and export regime during 1994–95, Ukraine's trade policy drifted toward protectionism in 1996–98 (Box 5). In 1998, Ukraine's aggregate TRI was 5, based on a "relatively open" tariff rating of 2—the unweighted average tariff was 12.7 percent—and a "moderate" nontariff barrier rating of 2. There were import quotas on agricultural goods and an import ban on used cars (Box 5).[35] Exports of livestock and hides were subject to export taxes of 30–75 percent (IMF, 1997e) and exports of sunflower seeds were subject to export deposits and indicative export prices.[36]

45. Trade in services was hampered by uneven privatization and deregulation efforts and a generally difficult environment for private sector activity and

[32] The report noted that foreign financial institutions helped raise the overall standard of Korea's financial services sector by introducing advanced banking practices and new products. Hence, it argued that selling the banks to foreign financial institutions rather than foreign private equity funds would have been more beneficial to the development of the country's banking sector.

[33] "Top regulator reaffirms bank board guidelines," *Korea Times*, February 23, 2005; "Korea defends EU criticism of financial policy," *Korea Times*, April 5, 2005; "Seoul to abandon board rule for foreign banks," *Financial Times*, April 11, 2005.

[34] "Korean court clears KEB, frees up Lone Star for stake sale," *Euro Week*, November 27, 2008.

[35] "Avtozaz signs Daewoo pact," *Financial Times*, March 4, 1998.

[36] "Ukraine to regulate sunseed exports," *Reuters*, July 31, 1998.

Box 5. Ukraine: Trade Liberalization During 1994–98

When Ukraine joined the IMF in 1992, much of its trade still took place through intergovernmental agreements that specified quantities of goods to be traded and were implemented through quotas and state orders. The (new) Ukrainian government adopted a relatively liberal import regime with modest tariffs of 0 percent to 10 percent for most imports and no significant nontariff barriers, but controlled exports tightly using a complex array of quotas, licensing requirements, and border taxes. In 1993, the government introduced a system of "state contracts" whereby it purchased exportable goods at domestic prices, sold them abroad through international trading organizations, and deposited the foreign exchange proceeds directly into its own accounts (IMF, 1993).

In 1994 and 1995, under programs supported by the Fund's Systemic Transformation Facility and an SBA, the government substantially liberalized the export regime. Export duties were eliminated, export quotas were abolished, and the system of state contracts for exports was dismantled (IMF, 1997e).

However, there was a movement toward protectionism during 1996–98. Import tariffs were raised on hundreds of products (including agricultural goods, television and radio sets, domestic appliances, and toys) and quotas were introduced on agricultural imports. In order to stimulate the automobile industry—specifically, a joint venture between Korea's Daewoo and Avtozaz, Ukraine's largest car-maker—the government, at Daewoo's urging, provided tax and tariff breaks (subject to local content requirements) and banned imports of used cars five years or older in April 1998. A presidential decree signed in July 1998 required exports of sunflower seeds to be backed by a 100 percent cash advance deposit in an authorized bank and re-established indicative export prices for sunflower seeds.

foreign direct investment. Thousands of large- and medium-scale enterprises in sectors including energy, transportation, and communications were placed on a "negative privatization list." The banking sector, in contrast, was mostly privatized by 1998, although it was still at a relatively early stage of development and an effective regulatory system was only gradually being created. Since independence, many private banks had been established in an environment characterized by low entry costs (no minimum statutory capital requirements initially) and limited banking supervision. Despite the large number of banks, Ukraine's banking system was small by international standards and confidence in the banking system was low. This partly reflected the legacy of the centrally planned system but also the period of hyperinflation that Ukraine had experienced shortly after independence (IMF, 1999c). There was some resistance to foreign banks: total foreign capital participation in the equity ownership of the Ukrainian banking system was capped at 15 percent, foreign bank branches were banned (though wholly-owned subsidiaries were allowed), and minimum capital requirements were higher for foreign banks than for domestic banks. By most accounts these restrictions were not really binding, however; according to IMF (1999c) by mid-1998 there were some 28 banks with foreign capital participation (including eight with 100 percent foreign ownership, up from two in mid-1996); those banks mostly focused on corporate financing and were not engaged in retail banking.

46. Ukraine applied to join the WTO in November 1993 but had made little headway in its accession negotiations. The limited progress was due to the slow pace of market and trade reform: Ukraine ranked near the bottom of the transition league tables updated annually by the European Bank for Reconstruction and Development and its trade policies came under strong criticism from the European Union, the United States, Japan, and Canada.[37] In 1994, Ukraine signed a partnership and cooperation agreement with the European Union. The agreement, which entered into force in March 1998, was designed to bring Ukraine into line with the legal framework of the single European market and the WTO system and also provided for the establishment of a free trade area further down the road. One of the first actions the European Union took under the agreement was to initiate formal dispute consultations with Ukraine over the tax breaks and other privileges granted to the country's automobile industry.

47. The IMF used program conditionality to liberalize Ukraine's (goods) trade regime. Ukraine had three SBAs during 1995–98: April 1995–April 1996; May 1996–February 1997; and August 1997–August 1998. All three programs featured trade liberalization commitments, including in the form of prior actions and structural benchmarks (Box 6). One of the main

[37] "Doubts cast over Ukraine's fitness for WTO," *Financial Times*, June 11, 1998.

Box 6. Ukraine: Key Trade Conditionality in the 1995, 1996, and 1997 SBA-Supported Programs

1995 SBA-Supported Program
MEFP, March 3, 1995 (IMF, 1995a)

- Eliminate all remaining export quotas and licenses other than on grain and goods subject to voluntary export restraints (VERs) under international agreements. (Prior action)
- Abolish quotas and licenses on grain exports by end-June 1995. (Structural benchmark)
- Remove the government's authority to delay or prohibit exports (other than for health and security reasons and to implement international agreements) under the scheme for registering export contracts. (Prior action)
- Eliminate the system of state orders and state contracts (including for foreign trade purposes), other than to meet the government's own needs, narrowly defined. (Prior action)
- Refrain from adopting any new legislation that directly or indirectly poses obstacles to exports. Continue to avoid resort to quantitative restrictions.
- Complete the privatization of at least 1,000 medium and large enterprises, including agricultural distribution, storage, and transportation companies, by end-June, 1995. Identify a list of at least 100 enterprises in which substantial blocks of shares are to be available, at auction, for foreign participation. (Structural benchmark)

1996 SBA-Supported Program
MEFP, April 22, 1996 (IMF, 1996b)

- Complete the privatization of at least 70 percent of shares of at least 2,000 medium and large enterprises, including in agricultural distribution, storage, and transportation, by end-July 1996. (Structural benchmark)
- Refrain from adopting any new legislation that directly or indirectly poses obstacles to exports.

1997 SBA-Supported Program
MEFP, August 6, 1997 (IMF, 1997f)

- Abolish all export duties except on live animals and cow hides. (Prior action)
- Abolish the system of indicative prices for exports, with the exception of live animals, cow hides, and goods subject to VERs and actual antidumping actions. (Prior action)
- Liberalize the Special Export Regime so that registration of exports is an automatic process and for statistical purposes only. (Prior action)
- Abolish the export surrender requirement. (Prior action)
- Reduce the maximum import tariff rate to 30 percent, with possible exceptions covering less than 1 percent of total imports. (Prior action)
- Reduce the number of distinct tariff rates to 6 by end-December 1997.
- Reduce the number of commodity positions (at the 4-digit level) subject to combined ad valorem and specific import tariffs to no more than 80. (Prior action) Phase out the remaining mixed tariffs, reducing them by one-third by end-March 1998 and by another one-third by end-June 1998. (Structural benchmark)
- Harmonize the remaining excise taxes on domestic and foreign production by end-March, 1998. (Structural benchmark)
- Continue to ensure that certification rules and procedures for imports are WTO compliant and nondiscriminatory.
- Allow foreigners to buy seats at the commodity exchanges. (Prior action)
- Simplify the licensing procedures for foreign commercial banks and expedite applications in process to allow them greater access to the Ukrainian market.
- Submit to parliament a new customs code consistent with international standards. (Prior action)
- Screen customs procedures and documentation, improve control over goods in transit, and improve the coordination of customs collection with the State Tax Administration.

objectives of the 1995 SBA was to strengthen export performance; in concluding the 1995 Article IV consultation, Executive Directors "urged the authorities to remove all remaining export restrictions, especially to abolish the system of indicative export prices, to eliminate uncertainties about prevailing legislation, and to fully liberalize grain marketing" (IMF, 1996a). The export liberalization conditions were largely met, though not without delays. During the 1997 Article IV consultation, the staff team commended the authorities for maintaining "generally liberal trade policies" and resisting protectionist pressures (IMF, 1997f) but several Directors "underscored the need for a stronger commitment by the authorities to trade liberalization" (IMF, 1997g). At the same time, in the 1997 SBA the scope of trade conditionality was broadened to include import tariff reduction, liberalization of trade in financial services, and improvements in customs administration.

48. IMF missions did not directly address the liberalization of trade in services. However, they consistently stressed broader behind-the-border issues such as privatization, de-monopolization, reducing government intervention in the economy, and improving the business climate. In the negotiations for the 1997 SBA program, IMF staff underscored the need to improve the overall health of the banking system. The authorities responded that they intended to take several steps to improve banking supervision and regulation, to deal with problem banks, and to increase the efficiency of the banking system, including simplifying the licensing procedures for foreign commercial banks and expediting the applications in process to allow them greater access to the Ukrainian market (IMF, 1997f).

The 1998 EFF-supported program

49. The 1997 SBA-supported program went off-track after the first review as government finances spun out of control. To finance the growing budget deficit, the government had borrowed heavily through the Treasury bill market, which attracted domestic and nonresident participants, and had even been able to issue foreign currency bonds in international capital markets. But in the wake of the financial crises in Asia, which subsequently spread to Latin America and Russia, Ukraine's external financing prospects dried up. The government had to resort to the central bank to finance its budget deficit and debt service payments, which in turn put pressure on the exchange rate.[38]

50. The IMF Board approved a three-year EFF arrangement in August 1998, just as the financial crisis broke out. IMF staff and the Ukrainian authorities had earlier discussed an EFF-supported program to succeed the 1996 SBA-supported program, but a lack of parliamentary support for key adjustment measures in the proposed EFF-supported program—including a reluctance to commit not to intensify import restrictions—resulted in agreement on a one-year SBA-supported program instead, in 1997. IMF staff still believed that a medium-term program was needed to correct Ukraine's institutional shortcomings and put it on a sustainable growth path, and the discussions for an EFF-supported program were revived when a new parliament was formed after the 1998 elections (Stone, 2002). When the financial situation deteriorated in the wake of adverse developments in Russia (only days before the IMF Board meeting to discuss the program request), the EFF arrangement was adjusted to reflect short-term stabilization needs as well as medium-term structural reforms (IMF, 2005c). Staff (and the Board) were concerned about the risks to the program from the financial crisis but decided to push ahead with the EFF-supported program rather than lose the opportunity to seal the "long-awaited adjustment package" (IMF, 1998p).

51. The EFF-supported program envisaged fundamental structural reforms, but trade liberalization was not heavily emphasized. The structural reforms were mainly aimed at reducing the government's role in the economy and promoting private sector development, improving governance, and reforming the agricultural and energy sectors. Trade liberalization was included among the structural reforms but was not their main focus.[39] The authorities reduced tariffs and tariff exemptions as prior actions for the program. The staff considered Ukraine's trade regime to be already "relatively liberal and open" based on its TRI rating of 5 out of 10, and did not anticipate a reduction in the rating as a result of the trade liberalization measures outlined in the program (IMF, 1998o). This view was not challenged by PDR or by the Board (although the USTR did express her dissatisfaction to the Fund and the WTO over the relatively low level of trade conditionality in the Ukraine program compared to the earlier Asian programs). Table 5 summarizes the main trade-related conditions in the EFF-supported program. Included among the structural measures was a commitment to reduce barriers to the entry of foreign banks by simplifying licensing procedures and by lifting the limit of 15 percent on total foreign capital participation in the equity ownership of the Ukrainian banking system.

52. Serious budgetary slippages delayed the completion of the first program review; in response, the authorities resorted to an import surcharge to help keep the fiscal program on track. The IMF mission considered the imposition of the (uniform 2 percent) import surcharge in May 1999 "regrettable" but "unavoidable" given the difficult fiscal situation and the difficulties in implementing corrective structural revenue reforms.[40] Staff urged the authorities

[38] Ukraine's hryvnia, which was introduced in 1996, was pegged to the U.S. dollar within a narrow band.

[39] The World Bank was also actively involved in Ukraine, mainly in sectoral projects such as public sector reform, agricultural sector reform, energy sector reform, financial sector reform, and privatization (IMF, 1998p). There is little evidence of Bank-Fund collaboration on trade policy issues.

[40] During the first program review in January/February 1999, the mission learnt that despite the commitment to reduce tax exemptions, the zero-rating of VAT on electricity, imported gas, and coal had been extended for 1999 and a tax moratorium on agriculture had been imposed. The authorities explained that they had little choice due to strained relations between the government and parliament.

Table 5. Ukraine: Key Trade Liberalization Measures under the 1998 EFF-Supported Program

Tariffs	Nontariff Barriers	Export Taxes/Restrictions	Customs Administration	Trade-Related Subsidies	Trade in Services
MEFP, August 11, 1998 (IMF, 1998o)					
Reduce the average import tariff (using 1996 weights, excluding energy products) to no more than 7.5 percent (January 1998 level).[1] [Prior action] Adopt a resolution limiting the frequency of import tariff adjustments to no more than twice a year for the rest of 1998 and 1999, and to no more than once a year thereafter.[1] [Prior action] Reduce the number of commodity positions (at the 4-digit level) subject to mixed specific/ad valorem import tariffs to no more than 25 by December 31, 1998.[1] [Structural performance criterion] Limit exceptions to the maximum tariff of 30 percent to items covering no more than 0.8 percent of total imports by July 1, 1998. Reduce the maximum tariff to 25 percent (with a few exceptions covering less than 0.8 percent of total imports) and reduce the (unweighted) average import tariff to no more than 13.3 percent by December 31, 1999. Reduce the maximum tariff to 20 percent (with a few exceptions covering less than 0.5 percent of total imports) and reduce the average import tariff to no more than 10 percent by December 31, 2000.	Ensure that any import protection measure which could become necessary to prevent injury to domestic producers is price-based, precisely defined, temporary, and nondiscriminatory and introduced only after appropriate procedures consistent with WTO rules are followed. Further harmonize Ukrainian legislative and normative acts with international and European ones, and conclude and implement agreements on mutual recognition of conformity assessments (certification) in order to remove obstacles to trade in line with WTO principles. Continue ensuring the nondiscriminatory character of certification procedures. Continue the free import of gas throughout the program period.	Introduce payment of market interest on advance deposits on exports of sunflower seeds.[1] [Prior action] Eliminate remaining export duties on animal skins and hides by November 15, 1998. Eliminate the advance export deposit requirement on sunflower seeds by December 31, 1998. Refrain from introducing any new restrictions on exports throughout the program period.	Impose reporting requirements on importers of gas on volume and value of gas imports and payments by July 1, 1998. Adopt a new customs code that is consistent with international standards by December 1998. Improve customs administration, including the following measures: (i) consult with the World Customs Organization or other appropriate agency to develop a valuation database on import prices by December 1998; (ii) create specialized units for post clearance review of tariff classification and valuation by June 1999; (iii) implement the valuation database covering 60 percent of imports and phase out the use of indicative values by June 2000.	Eliminate import tariff exemptions with the exception of those on imports directly related to Chernobyl programs, humanitarian assistance, bilateral and multilateral technical assistance programs, and no more than five special foreign investment projects.[1] [Prior action] Refrain from granting any new import tariff exemptions throughout the program period.	Reduce barriers to the entry of foreign banks, including by increasing flexibility of the limit of 15 percent on total foreign capital participation in the equity ownership of the Ukrainian banking system by June 30, 1998.

Table 5 *(continued)*

Tariffs	Nontariff Barriers	Export Taxes/Restrictions	Customs Administration	Trade-Related Subsidies	Trade in Services
MEFP, May 20, 1999 (IMF, 1999e)					
Implement a temporary, uniform, nondiscriminatory, 2 percent import surcharge in a manner that would yield additional revenues of Hrv 300 million for the remainder of 1999.[1] [Prior action] Eliminate the import surcharge by end-December 1999.		Remove the export duty on hides and skins by end-December 1999.			
MEFP, August 26, 1999 (IMF, 1999g)					
		Veto the law introducing export duties on sunflower seeds.[2] [Prior action]			
MEFP, December 5, 2000 (IMF, 2000e)					
		Reduce the export tax on sunflower seeds to 10 percent by December 31, 2000.[2] [Structural benchmark]		Complete a review of the free economic zones (FEZs) and special investment regimes (SIRS) by April 30, 2001.[1] [Structural benchmark] Establish a timetable for the phasing out of exemptions in the FEZs and SIRS on the basis of the review by June 2001.	

Table 5 *(concluded)*

Tariffs	Nontariff Barriers	Export Taxes/Restrictions	Customs Administration	Trade-Related Subsidies	Trade in Services
MEFP, August 31, 2001 (IMF, 2001a)					
Unify fully the excise treatment of imports and domestically produced goods by January 2002.	Enact laws on standardization and certification and accreditation of certification agencies (to reduce technical obstacles to foreign trade).[1] [Prior action] Enact Law on the Customs Tariff; introduce the new harmonized tariff system.[1] [Prior action] Approve laws on copyright and allied rights, on inventions, and on the enforcement of responsibility for violation of intellectual property.[1] [Prior action] Simplify documentation requirements for domestic and external trade in grains and reduce registration fees at the exchanges; abolish the requirement to register domestic grain transactions; and suspend the mandatory declaration of grain stocks.[1] [Prior action]		Enact the Customs code by January 2002.	Adhere to the moratorium on establishment of new FEZs, including spot zones.	

[1] Indicates that the measure was implemented on schedule.
[2] Indicates that the measure was not implemented.

to remove the surcharge by end-1999 and replace it with other revenue measures such as eliminating tax exemptions and zero-rating the value-added tax (VAT) on electricity, imported gas and coal. The IMF agreed to augment the EFF arrangement in view of the deterioration in Ukraine's external environment.

53. At the same time, the government began to consider imposing an export duty on sunflower seeds to boost budget revenues and assist domestic vegetable oil producers. There was vigorous domestic lobbying both for the tax (by oilseed crushers) and against it (by oilseed growers and traders). IMF staff strongly opposed the measure, arguing that it would harm Ukraine's export performance and would violate the commitment not to introduce new restrictions on exports during the program period.[41] In July 1999, the parliament went ahead and approved a 30 percent export tax on sunflower seeds but the move was vetoed by the President; the tax was subsequently lowered to 23 percent and signed into law in September 1999. Fund staff criticized the export tax as being "among the worst possible means of raising budgetary revenues."[42]

54. The program went off-track shortly afterwards and was suspended for more than a year. Besides the sunflower seed export tax, many more serious problems—including nonobservance of quantitative and structural performance criteria, insufficient progress on structural reforms, and an incident involving misreporting of the central bank's international reserves—contributed to the derailment of the program (IMF, 2005c). IMF staff had several discussions with the Ukrainian authorities to try to bring the program back on track, but eliminating the export tax was one of the conditions to which the authorities would not agree. By September 2000, the mission team was ready to drop the demand, but Fund management and other departments argued that that could weaken the program conditionality by too much. When the Fund re-engaged and completed the fourth review in December 2000, the compromise was to reduce the export tax on sunflower seeds to 10 percent by the end of the year as a structural benchmark (Table 5). But the program went off-track again, and only one more (delayed) review was completed after that (IMF, 2001a).

55. After the EFF arrangement expired in 2002, Ukraine had one more IMF-supported program during the evaluation period but no more trade conditionality. After 2001, the focus of Ukraine's trade (and broader structural) reforms shifted to WTO accession and the Fund provided encouragement for this goal in every Article IV consultation. In early 2004, Ukraine requested, and the Fund approved, a twelve-month precautionary program under the SBA aimed at promoting economic growth and helping to lay the foundations for membership in the WTO and eventually the European Union. The specific reforms needed for WTO accession were left to the World Bank to monitor under its Programmatic Adjustment Loan program (IMF, 2004a).

56. One of the conditions for WTO membership was to allow foreign banks to open branches in Ukraine. The central bank, government, and parliament wrestled over this issue from 2002 to 2006; the central bank (backed by the President) submitted proposals to change the legislation several times during this period but parliament rejected the proposals each time. IMF staff largely stayed out of this issue. A Financial Sector Assessment Program (FSAP) mission in 2003 simply noted that foreign bank involvement in Ukraine had been modest, particularly compared with that in other transition countries (IMF, 2003a). During this time, IMF staff increasingly drew attention to the rapid credit growth that was taking place in Ukraine and the risks that it posed for banking sector stability. The staff implicitly endorsed the idea of greater foreign bank entry, reasoning that this would increase competition and efficiency and improve risk management practices (IMF, 2005b, 2006c). An SIP for the 2004 Article IV consultation (Schaechter, 2004) argued that the relatively low degree of foreign ownership in Ukraine's banking sector raised concerns that the credit boom could be unsustainable. As foreign interest in Ukraine's banking sector grew, a follow-up SIP to the 2003 FSAP (Ong, Schaechter, and Sologub, 2005) made some recommendations for improving banking regulation and supervision, including raising the minimum capital adequacy ratio in the short term and preparing a contingency plan for crisis management in the medium term. It was not until 2008, when foreign participation in the banking system became "significant," that staff sounded the alarm about the need to develop better cross-border supervisory arrangements: the 2008 update for the FSAP called for "[u]rgent action … to strengthen consolidated supervision and supervisory cooperation," including closer and more effective cooperation with home country supervisors, and noted that the growing importance of foreign-owned banks increased the risk of spillovers from foreign bank failures on to Ukrainian subsidiaries, and had to be considered in Ukraine's contingency planning (IMF, 2008a).

[41] "Ukraine to discuss sunseed exports limits with IMF," *Reuters*, April 27, 1999; "Ukraine in talks with IMF on sunseed export duty," *Reuters*, May 20, 1999; "IMF counsels Ukraine against sunseed export duty," *Reuters*, June 3, 1999; "Negotiations continuing with IMF on export duty for sunflower," *Ukrainian News*, June 15, 1999.

[42] "IMF slams Ukraine's planned sunseed export duty," *Reuters*, September 21, 1999.

Assessment

57. Given that the primary focus of Ukraine's EFF-supported program was on growth-enhancing structural reforms, the inclusion of trade conditionality was entirely appropriate. Critics have characterized the program as "[a]n extreme example of the proliferation of conditions" (Stone, 2008) and the Fund itself acknowledged that the program became known for "excessive structural activism" (IMF, 2005c). But the EFF-supported program was designed first and foremost as a medium-term adjustment program to address structural obstacles to growth rather than as a short-term program to overcome a financial crisis, so the emphasis on structural conditionality was justifiable. Certainly, trade reforms were macro-relevant for the Ukrainian economy in 1998, given its poor transition record and disappointing growth performance and in light of its aspirations to join the WTO.

58. Yet the IMF focused much less on trade liberalization in Ukraine than it did in some of the Asian crisis programs. IMF staff considered Ukraine's TRI of 5 to be acceptable and not in urgent need of reduction, when barely a year earlier Indonesia and Korea, with similar ratings, were seen to require significant trade reforms. The IMF was not swayed by the USTR's call for more trade conditionality. The Avtozaz-Daewoo deal had echoes of Indonesia's national car project, yet the IMF was silent on this issue.[43] Interviews with the staff revealed that trade liberalization was low on their list of priorities in Ukraine, being crowded out by more pressing structural issues such as privatization, agricultural reform, and tax reforms.

59. The IMF was prepared to be flexible on trade policy issues. The IMF endorsed the introduction of a temporary import surcharge during the program, even though PDR had argued forcefully against such measures in a guidance note issued to staff earlier in the year (Table 2). But trade policy was not the only area in which the Fund was prepared to cut corners in Ukraine. Ukraine was a "difficult counterpart" highly resistant to trade and other structural reforms yet partly because of "major shareholder pressure" the Fund repeatedly bent over backwards to stay involved in the hopes of "tipping the balance toward reformers." (IMF, 2005c.) Interviews with the staff reinforced Stone's (2002) observation that the Fund "repeatedly bent the rules in Ukraine's favor" because "the G-7 [had] made it clear that it expected the IMF to reach some pragmatic accommodation with the recalcitrant Ukrainian authorities."

60. The most significant and controversial trade condition—the removal of the export tax on sunflower seeds—was not sufficiently analyzed. IMF staff relied on the standard textbook arguments without examining the structure of the sunflower seed market or quantifying their analysis. They noted that Ukraine was one of the world's largest producers and exporters of sunflower seeds and that the tax would impose a "significant" deadweight cost, but they did not estimate the optimum tax or the deadweight cost, and hence could not make a compelling case that reducing the tax was critical for achieving key program objectives (IMF, 2005c). They argued that "the tax was emblematic of the ability of powerful groups (in this case, domestic oilseed crushing plants) to bend the rules of the game to their advantage at the expense of weaker groups (in this case, growers of sunflower seeds)" (IMF, 2005c). But in fact there were large (foreign) and small (domestic) interests on both sides of the issue: the Ukrainian Grain Association, which opposed the tax, included among its members large American and European oilseed trading companies that provided financial support to the oilseed growers.[44] And staff were largely ignorant of the actual implementation of the tax, notably, the extent to which it was avoided or evaded. In interviews for this evaluation, staff confirmed that no analysis was done on the sunflower seed export tax issue because none was considered necessary, either (according to some staff) because the issue was relatively insignificant and had simply been blown out of proportion, or (according to others) because the standard textbook arguments were considered to be unassailable.

61. The IMF was effective in generating an active debate in Ukraine on the pros and cons of the export tax, even if it was unsuccessful in eliminating the tax on its terms. A Factiva search turned up numerous media reports on the issue between 1998 to 2001, including both assenting and dissenting views within and outside the government. In the event, the structural benchmark to cut the export tax to 10 percent by end-2000 was not met; in June 2001, the tax was reduced to 17 percent instead of 10 percent and "the sunflower seed issue was quietly dropped from the [Fund's] agenda" (IMF, 2005c). In July 2005, as a precondition for WTO accession, parliament adopted legislation to lower the export tax by one percentage point per year upon WTO membership until it reached 10 percent (IMF, 2005c). In December 2008, a gov-

[43] Fund staff did argue strongly against the tax incentives in free economic zones but did not manage to convince the Ukrainian authorities.

[44] Cargill subsequently opened a huge sunflower seed processing plant in Donetsk oblast in April 2000 ("Cargill set to shake up Ukraine sunseed market," *Reuters*, April 6, 2000).

ernment proposal to abolish the (14 percent) export tax was once again rejected by the parliament.[45]

62. The IMF may have been successful in reducing import tariffs (eventually) although it is not certain that the tariff cuts will stick. Ukraine's TRI rating fell from 5 to 4 in 2002 when its unweighted average tariff dropped from 12.7 percent to 7 percent. But in December 2008, the parliament voted to impose an additional temporary duty on all imports to address balance of payments difficulties.[46]

63. Ukraine further opened its banking sector though the IMF did not push very hard on this issue. The 15 percent limit on the capital that could be owned by foreign banks was eliminated in 1999 (IMF, 1999c). The central bank announced a uniform minimum statutory capital requirement of €5 million for newly formed banks, in line with international standards, in 2005 (Ong, Schaechter, and Sologub, 2005). In November 2006, parliament finally passed the bill allowing foreign banks to establish branches in Ukraine. In May 2008, Ukraine acceded to the WTO. Six months later, after the economy and the banking system were hit hard by a sharp decline in steel prices and a reversal of capital flows, Ukraine requested, and the Board approved, a two-year SBA-supported program. IMF staff estimated a banking capitalization need of at least 8 percent of GDP; most of the large institutions, including foreign banks, were expected to be able to raise capital on their own but could apply for public recapitalization funds if needed. The authorities began to strengthen the monitoring of banks, including via enhanced cross-border supervisory cooperation (IMF, 2008c).

E. Brazil

Trade policy regime and IMF advice before the 1998 program

64. In the late 1990s, Brazil's trade regime was rated by the IMF as "moderately restrictive." Despite a significant trade liberalization program in the early 1990s and the adoption of the common external tariff regime of the Common Market of the South (MERCOSUR) in 1995, import tariffs remained high and the dispersion of rates gave rise

[45] "Ukraine lawmakers reject scrapping sunflower seeds export tax," *Dow Jones Newswires*, December 24, 2008.

[46] "Ukrainian president worried IMF might cancel loans due to increase of import duties," *Kyiv Post*, December 24, 2008. The import duty was subsequently restricted to two goods (cars and refrigerators) but thus far has not been implemented.

Box 7. Brazil: Trade Liberalization During 1990–98

Brazil undertook a significant program of trade reforms during 1990–93: it abolished all quantitative import controls and most export controls; eliminated the list of prohibited imports; allowed automatic access to import licenses; suspended external financing requirements for imports; removed most direct export subsidies, fiscal incentives for exporters, and import tariff exemptions; eliminated export taxes and the system of minimum export prices; and implemented a multi-year tariff reduction program (IMF, 1994a). In 1991, Brazil ratified the treaty of MERCOSUR to create a common market with Argentina, Paraguay, and Uruguay from January 1, 1995. The agreement stipulated a common external tariff structure ranging from 0 to 20 percent on about 85 percent of all traded goods from January 1, 1995; most of the remaining 15 percent of goods (classified as national exceptions, capital goods, or computer goods) were to be brought in line with the common external tariff rates by 2001, and all of them by 2006. Tariffs on intra-MERCOSUR trade were generally prohibited, but each member was allowed to maintain tariffs for approved items (until January 1, 1999 for Argentina and Brazil and January 1, 2000 for Paraguay and Uruguay) (IMF, 1995c).

Brazil started implementing the MERCOSUR tariff reduction program in September 1994, earlier than required by the agreement. But whereas the trade liberalization of the early 1990s had a limited impact on import flows because of the depreciation of the cruzeiro and depressed domestic demand, the subsequent expansion of the economy and appreciation of the new currency, the real, in late 1994 produced trade deficits that contributed to a protectionist backlash. In response, the government raised tariffs on a range of consumer goods imports in March 1995; tariffs on intermediate inputs were reduced at the same time, hence, the overall effect was to increase the average nominal and effective rates of protection, particularly for automobiles (IMF, 1997b). Some of the tariff increases were rolled back in 1996, but in that same year, quotas were introduced on imports of certain categories of textiles and a provisional "safeguard" tariff of 70 percent was used to protect the toy industry (IMF, 1997a).

In November 1997, in response to the economic crisis created by the turmoil in world financial markets and after consulting with its MERCOSUR neighbors, Brazil implemented an across-the-board increase on all tariff items (inside and outside the common external tariff), raising the ceiling from 20 to 23 percent (USTR, 1998).

to high rates of effective protection in some sectors, notably automobiles and computers.[47] Several retrograde steps were taken in 1995–97, including sector-specific and across-the-board tariff increases (Box 7). In 1998, Brazil's aggregate TRI was 5 out of 10, with a "relatively open" tariff rating of 2 (based on an unweighted average tariff of 14.6 percent) and a "moderate" nontariff barrier rating of 2. Nontariff barriers included quotas on automobile imports (Box 8) and import licensing for certain products (USTR, 1998). Export restrictions applied to sugar and ethyl alcohol (to ensure sufficient domestic supply), raw hides and skins, and sawn timber. Various export incentives were in place including tax and duty exemptions/reductions for inputs to export industries, export performance requirements, and export finance programs. The Programa de Financiamento às Exportações (Proex), established in 1991 and operated by the central bank, provided postshipment export financing through either direct loans or interest rate equalization, whereby the government paid the difference between the interest charged and the cost of raising funds (WTO, 1996b).

65. Foreign participation in key service activities had historically been restricted, but was gradually being liberalized. Foreign participation in the banking sector was limited under Brazil's constitution: the number of foreign bank branches was fixed and the establishment of new branches and bank subsidiaries of foreign banking institutions was prohibited. But exceptions were permitted on the basis of obligations under international agreements, reciprocity, or national interest, and in practice, the government had allowed substantial foreign entry and expansion to occur since 1995 (U.S. Treasury, 1998). By the beginning of 1998, foreign banks accounted for 21 percent of total banking system assets (IMF, 1998c). Efforts were also underway to liberalize foreign investment in other service sectors: constitutional amendments were passed in 1995 to facilitate the participation

[47] The "information law" protected the computer sector with a nominal tariff of up to 50 percent (IMF, 1998c).

Box 8. Brazil: Automobile Sector Policies

The automobile sector in Brazil has traditionally been highly protected. After a brief attempt to open the sector to foreign competition in the early 1990s, the Brazilian government reverted to protectionist policies in 1995, raising import tariffs from 20 percent to 70 percent and (re-)imposing import quotas (WTO, 1996b). Brazil justified the quotas to the WTO as being necessary for balance of payments reasons. However, the Fund testified at the WTO Committee on Balance-of-Payments Restrictions (CBR) in October 1995 that Brazil's international reserves had "risen to high levels" and that its resort to quotas on car imports was "of particularly serious concern because of the distortionary nature of the restrictions" (WTO, 1995). The CBR agreed with the Fund and told Brazil to remove the quotas.

Brazil replaced the import quotas with a new "car industry regime" that halved the tariff to 35 percent for vehicles imported by foreign automakers operating in Brazil but kept it at 70 percent for vehicles manufactured by foreign automakers with no Brazilian operations. The new rules also required cars assembled in Brazil to have at least 60 percent of their component parts manufactured domestically (or within MERCOSUR).[1] In July 1996, Japan filed a complaint at the WTO, charging that the preferential tariffs favored U.S. and European automakers who had extensive operations in Brazil and discriminated against Japanese automakers who did not.[2] Brazil then designed a tariff quota system, allowing 50,000 cars from Japan, Korea, and the European Union to enter at the 35 percent tariff rate over the next 12 months.[3] In August 1996, the United States filed complaints at the WTO against the tariff quota system and the local content requirement of Brazil's car industry regime, and in May 1997, the European Union also filed a complaint at the WTO.[4] Brazil settled the WTO disputes out of court. Japan and the European Union dropped their complaints in August 1997 after Brazil extended the tariff quotas for another year and lowered the in-quota and out-of-quota tariff rates.[5] The United States dropped its complaint in March 1998 after Brazil agreed to accelerate its plans to phase out the trade-distorting investment requirements.[6]

[1] "Brazil sets new rules for car industry," *Financial Times*, December 28, 1995.
[2] http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds51_e.htm.
[3] "Brazil seeks to silence car dispute foes," *Reuters*, August 21, 1996.
[4] http:// www.wto.org/english/tratop_e/dispu_e/cases_e/ds52_e.htm; http:// www.wto.org/english/tratop_e/dispu_e/cases_e/ds65_e.htm; http:// www.wto.org/english/tratop_e/dispu_e/cases_e/ds81_e.htm.
[5] "Brazil to renew car import quotas, cut tariffs," *Reuters*, August 20, 1997.
[6] "U.S. to end probe after reaching auto deal with Brazil," *Reuters*, March 16, 1998.

of private and/or foreign companies in areas of the economy from which they were barred previously, notably shipping, telecommunications, and natural gas distribution through pipelines (IMF, 1995c).

66. Brazil was (and is) a frequent user of the WTO's contingency measures; it was also on the receiving end of WTO complaints. According to the WTO, Brazil initiated 52 antidumping investigations between 1995 and 1998, making it the seventh largest user of WTO contingency measures during that period.[48] In June 1996, Brazil used its new safeguards legislation to provide protection to its toy industry (IMF, 1997a). In the same month, Canada filed a WTO dispute against Brazil regarding Proex's interest rate equalization scheme. Canada argued that the scheme provided financial terms that were more advantageous than purchasers of Brazil's Embraer aircraft would have obtained from commercial lenders or from export credit agencies had they purchased from other countries, and that hence it constituted an export subsidy that unfairly affected Canada's own aircraft manufacturer, Bombadier, and violated WTO rules. A dispute settlement panel was established in July 1998.[49] Complaints were also lodged against Brazil's automobile sector policies by Japan, the European Union, and the United States during 1996–97, but those were settled out of court (Box 8).

67. The IMF's trade policy advice to Brazil during this period focused on the need to reverse the slide into protectionism evidenced in 1995–96 and to seek a faster pace of trade liberalization than envisaged under MERCOSUR. In the 1996 and 1997 Article IV consultations, the IMF noted that Brazil's import tariffs remained relatively high and urged the authorities to bring the rates down and, more generally, to develop a medium-term agenda of purposeful and additional trade liberalization (IMF, 1997a, 1998b). The IMF Managing Director echoed the same message in an interview with the local media.[50] These calls reflected those being made at the time by other multilateral organizations (e.g., WTO, 1996b). Interviews with the IMF mission teams from this period revealed that they did not use the TRI as an assessment tool in Brazil's case, arguing that it was too "blunt" given the complexities of the Brazilian trade policy regime; instead the missions tended to rely on their own information about Brazil's trade regime, supplemented by the WTO's 1996 trade policy review. Staff reports and background documents for the 1995, 1996, and 1997 Article IV consultations described—sometimes in great detail—changes in the level and dispersion of Brazil's tariff structure, developments in MERCOSUR, and Brazil's export promotion policies, but the reports were purely descriptive; they provided no analysis to support the staff's views.

68. The IMF was particularly critical of Brazil's automobile sector policies. In the 1996 and 1997 Article IV consultations, IMF staff highlighted the "considerable protection" that the high tariffs and local content and export performance requirements afforded the automobile sector, pointing out that although those policies had resulted in a large expansion of automobile trade in the region, the trade had come at a "significant cost" to MERCOSUR customers (IMF, 1997a, 1998b). Several IMF Directors called for a reduction in the protection provided to the automobile sector (IMF, 1998e).

69. IMF staff were divided on how to approach the Proex issue. PDR was concerned that the Proex scheme could constitute an export subsidy in contravention to the WTO Subsidies Agreement, and urged the mission to raise the issue with the Brazilian authorities and advise them to consult with the WTO. But the mission team agreed with the authorities that the Proex subsidies—at less than 0.1 percent of GDP—were insignificant and that their elimination was unlikely to have a major beneficial impact on the fiscal accounts or the balance of payments. The mission thus simply noted that credit provided under export prefinancing facilities "should be granted at market rates" (IMF, 1997a) and did not look any further into the issue.

The 1998 SBA-supported program

70. Brazil's macroeconomic situation deteriorated dramatically in the wake of the Russian crisis in August 1998. The real had come under significant pressure in the last quarter of 1997 as the Asian crisis spread to other emerging markets and the international financial environment worsened, but confidence had recovered rapidly thanks to a prompt monetary and fiscal response by the government. However, as external pressures eased, so did the fiscal stance. The deterioration in the public finances and persistent external current account deficits left Brazil vulnerable to contagion from the Russian crisis in August 1998. In November 1998, the government requested support from the IMF in the form of a three-year SBA-supported program.[51] This program marked the beginning of a succession of IMF programs until 2005.

[48] http://www.wto.org/english/tratop_e/adp_e/adp_e.htm.

[49] http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds46_e.htm.

[50] "IMF chief blasts Brazil on trade," *Reuters*, January 27, 1997.

[51] IMF support was to be complemented by support from the World Bank and the Inter-American Development Bank; by bilateral loans through the Bank for International Settlements from the United States, Canada, the European Union, Switzerland, and Norway; and by a bilateral loan from Japan.

71. The 1998 SBA-supported program focused mainly on fiscal adjustment policies; trade policy did not feature in the program.[52] The November 13, 1998 MEFP contained one vague paragraph on trade policy, in which the government committed to "continue the policy of trade liberalization" through regional integration (MERCOSUR), to "aim to increase trade with countries outside the region," and not to impose trade restrictions that were inconsistent with its WTO commitments or for balance of payments reasons. The government stood firm on its export promotion policies, allowing only that they would be "in line with WTO regulations" (IMF, 1998r). The IMF mission pointed to the recent introduction of protectionist nontariff barriers such as stiffer measurement and quality standards, flat import fees, and nonautomatic licensing for selected imports, but accepted the authorities' argument that those measures would not appreciably affect imports.

72. PDR's Trade Policy Division was concerned about the absence of trade conditionality but its objections were overruled. Though the Trade Policy Division staff pointed out that Brazil's resort to protectionism in response to the Asian crisis was setting a bad example for the region, the MEFP only subjected Brazil to the minimum standards of WTO disciplines, which left room for increased protectionist measures and were inconsistent with the IMF's internal guidelines on trade policy reform. No trade conditionality was added in subsequent program reviews.

73. Canada (unsuccessfully) pushed for the IMF to address the issue of export subsidies. The Canadian Executive Director argued that Brazil's export subsidies were an inefficient and trade-distorting use of public resources and urged the Fund to address the issue, specifically in the context of possible new conditionality attached to the SBA. In April 1999, the WTO dispute settlement panel found Brazil's export subsidies to be in violation of the Subsidies Agreement, but Brazil immediately appealed the decision. In their discussions with IMF staff, the Canadian authorities argued that the 1997 Indonesia program had provided a precedent for the Fund to make the provision of financial support conditional on the implementation of WTO rulings. The staff, however, declined to use the leverage provided by the SBA to pressure the Brazilian authorities to respond to the WTO ruling.[53]

74. The IMF did not use the program to open Brazil's financial sector or to bind its financial sector commitments under the GATS. Brazil participated in the 1997 WTO negotiations on financial services, but did not ratify its commitments or take the necessary steps to make them binding under the GATS. Financial sector reform was not a major issue in the SBA which included only two structural benchmarks aimed at further enhancing the regulatory framework and supervision of the banking system (IMF, 1998r). Interviews with the staff indicated that for much of the period under evaluation they were focused more on crisis resolution issues than on the potential for opening the financial services sector. Some staff members did not consider financial services trade to be an issue of concern for Brazil while others said they were aware of the relatively restrictive nature of trade in financial services but did not pursue the issue because management and the authorities were not supportive.

75. The IMF did not include any trade conditionality in its subsequent lending arrangements with Brazil. However, the Fund continued, in the context of Article IV consultations, to call for reductions in trade barriers, at first in the form of unilateral tariff reductions, then—after the authorities explained that that they dealt with trade policy issues only in a reciprocal setting—more generally "on a bilateral, regional, and multilateral basis" (e.g., IMF, 2000d, 2001c). PDR on several occasions highlighted concerns over Brazil's entry barriers to foreign services providers (including financial institutions) but the missions did not take up this issue in program or surveillance discussions. An SIP for the 2001 Article IV consultation (Belaisch, 2002) argued that it was not a lack of foreign competition but rather the oligopolistic market structure of the banking system that explained the relatively limited depth and efficiency of bank intermediation in Brazil compared with other countries.[54]

[52] The World Bank provided support for social protection, social security reform, administrative reform, and banking reform, but not trade reform.

[53] In August 1999, the WTO's appellate body upheld all the findings of the panel, but Brazil refused to comply with the decision. The case went to arbitration and Canada was authorized to take appropriate countermeasures against Brazil. In 2001, Canada decided to introduce export subsidies of its own to help Bombardier compete with Embraer. Brazil immediately filed a countersuit at the WTO. In 2002, the dispute panel ruled that Canada's subsidies violated the Subsidies Agreement; the case also went to arbitration and Brazil was authorized to take countermeasures against Canada (http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds222_e.htm).

[54] Belaisch (2002) noted that foreign banks had gained substantial market share in Brazil since the mid-1990s by acquiring domestic banks (greenfield investment by foreign banks is not allowed). By mid-2001, more than half of the top 50 banks had some foreign participation in their capital, in most cases with controlling-interest business. Yet the increased foreign participation had not dramatically changed the efficiency or intensity of competition in the Brazilian banking system. Similar observations were made in Carvalho (2002) and McKinsey Global Institute (2003).

Assessment

76. The absence of trade conditionality in the 1998 SBA-supported program (and subsequent programs) is striking when viewed against the IMF's trade policy advice to Brazil prior to the program. In the years before the program, the IMF had consistently highlighted Brazil's still-restrictive trade regime as an impediment to productivity growth. To be sure, trade conditionality would not have been critical for restoring macroeconomic stability under the Fund-supported program, but this was not the only criterion in use at the time: a year earlier, the IMF Board had called for trade liberalization to play an increasingly important role in Fund-supported medium-term adjustment programs and the guidelines on "WTO-consistency" instructed staff to program faster and deeper trade reforms than would have been required by WTO commitments (Table 2). Yet the staff did not elicit from the Brazilian authorities anything beyond an assurance not to impose trade restrictions that were inconsistent with their WTO commitments.[55] Staff ignored the guidelines that required them to assess trade reforms by reporting the TRI at the outset of the program and the estimated index after the implementation of program measures. There is no indication that the staff used the TRI at all and no indication that anyone noticed.

77. The absence of trade conditionality is striking also when viewed against the global environment during that period. The IMF's May 1999 *World Economic Outlook* highlighted "a worrisome increase in pressures for protection in Latin America" in the wake of the Asian and Russian crises—notably, an increase in trade tensions within MERCOSUR between Argentina and Brazil (IMF, 1999d). The size and importance of its economy meant that Brazil's problems could have had a significant regional impact. In view of such concerns, the IMF should have pressed for a stronger commitment from the government not to engage in further protection, even if the protection was allowed under WTO rules. Fortunately, Brazil did not intensify its trade restrictions and the 3 percent increase in MERCOSUR's common external tariff was removed by end-2000 as planned.

78. The absence of trade conditionality for Brazil stands in stark contrast to other large programs in emerging market countries during that period.[56] Many of the same policies that the IMF insisted be reformed or abolished in Indonesia, Korea, and Ukraine—e.g., preferential policies in the automobile sector, export taxes on key commodities, and restrictions on foreign bank entry—went unmentioned in Brazil's SBA-supported program(s). In retrospect, this was the right choice as those policies were not particularly critical for resolving the problems at hand in Brazil. But it raises the question of the IMF's evenhandedness since the same policies were, arguably, not particularly macro-critical in Indonesia, Korea, and Ukraine either. Was the Fund playing it safe in Brazil after being criticized for excessive structural conditionality in the earlier programs? The timing suggests otherwise: the Fund's initiative to streamline structural conditionality started only in 2000 (Table 2) and in fact, Ukraine's EFF-supported program, signed just three months before Brazil's, was "a leading example of excessive structural activism" (IMF, 2005c).

79. The staff's decision not to press for the elimination of Proex subsidies was entirely appropriate but appeared arbitrary after the unfortunate precedent set in Indonesia's 1997 SBA-supported program. The staff argued—correctly—that the Fund should not appear to use the leverage provided by the program to put pressure on one party in a bilateral trade dispute that the WTO was adjudicating. But Canada was not wrong to point out that the same argument did not seem to apply in the case of Indonesia's national car dispute. The only difference was that Indonesia had four WTO complaints against its national car (from Japan, the European Union, and the United States) whereas Brazil—having successfully settled its automobile disputes with the same three trading partners just before the program started—only had Canada's complaint against its export subsidies. The Fund's decision thus seemed to suggest that some major shareholders were more major than others.[57]

80. The staff's light touch vis-à-vis trade in financial services was also broadly appropriate given the lack of compelling evidence linking restrictions to performance in that sector. In the program context, certainly, the Fund would not have been justified in pushing for stronger commitments to open financial services trade, and staff were right not to consider doing so. In surveillance discussions, however, IMF missions could have engaged the authorities on the pros and cons of improving the contestability of Brazilian banking by introducing greater clarity

[55] IEO (2003) suggested that slightly more ambitious structural conditionality would likely have reduced Brazil's vulnerability to external shocks; this finding was echoed in the Fund's own ex post assessment of Brazil's programs (IMF, 2006a), although neither study mentioned trade policy specifically.

[56] IEO (2003) also contrasted the limited structural conditionality in Brazil's 1998 SBA with the broad structural conditionality found in the East Asian programs the previous year.

[57] Brazil's trade policies did not appear to be of major concern to the United States during that time. The United States had a large trade surplus vis-à-vis Brazil and its exports were not significantly affected by Brazil's intensification of trade restrictions during 1996–97.

Box 9. Turkey: The Turkey-EU Customs Union

Turkey completed the 22-year transition to a full customs union with the European Union on January 1, 1996. The customs union covers only manufactured goods and processed agricultural products; services and traditional agricultural products are excluded. With the entry into effect of the customs union, Turkey eliminated customs duties and charges on manufactured goods imported from the European Union and European Free Trade Association countries, and adopted the EU's common external tariff rates for most imports of industrial goods from third countries. In June 1996, Turkey notified the WTO of its intention to eliminate all trade restrictions that had been maintained on balance of payments grounds (mainly tariffs in excess of bound rates) as of January 1, 1997. Turkey also harmonized much of its legislation with that of the European Union in the areas of customs provision, duty concessions, officially supported export credits, competition policy, state aid, intellectual property rights, standards, and sanitary and phytosanitary measures. In order to avoid trade diversion, Turkey undertook to align itself with the EU's preferential trade agreements with third countries within a period of five years (IMF, 1996c).

While the customs union resulted in an overall liberalization of Turkey's trade, it also introduced some new trade restrictions. For example, Turkey had to adopt the EU's textile and clothing regime and impose quotas on imports from developing countries. It also introduced tariff-quotas on some agricultural and processed agricultural products in the framework of some of its recently signed free-trade agreements (WTO, 1998).

and security in market access conditions for foreign financial institutions (World Bank, 2004).

F. Turkey

Trade policy regime and IMF advice before the 1999 program

81. In the late 1990s, Turkey's trade regime was rated by the IMF as "moderately restrictive." Turkey liberalized its trade regime—historically highly protective—when it formed a customs union with the European Union in 1996 (Box 9). Manufactured goods tariffs were pared down to EU levels, but agricultural tariffs remained very high as the customs union did not cover agriculture and services. In the Uruguay Round, Turkey undertook to reduce its agricultural export subsidies but did not make any commitments to cut financial support to its agricultural producers. In 1999, Turkey's score on the aggregate TRI was 5 out of 10, with a "relatively open" tariff rating of 2 (based on an unweighted average tariff of 13.7 percent) and a "moderate" nontariff barrier rating of 2, reflecting policies such as import quotas on textiles and clothing; import licensing on certain telecommunications equipment, machinery, motor vehicles, chemicals, and other goods; and a state import monopoly for alcohol. Export taxes and export bans existed on several broad categories of products (WTO, 1998).

82. Turkey's service sectors were very slowly beginning to open up. Most of them were dominated by large state-owned enterprises/monopolies, e.g., Turk Telekom (telecommunications) and Ziraat and Halk Banks (banking). Although Turkey liberalized its financial sector, including foreign entry, in the 1980s, foreign banks played only a very small role in the financial system (IMF, 1996c).

83. The IMF was very supportive of the Turkey-EU customs union. Fund staff listed numerous potential benefits that could be expected as a result of the customs union, such as: lower prices of imported products for industries that relied on imported raw materials and investment goods; efficiency improvements brought about by increased competition with EU producers; no more EU quotas on Turkish textile and clothing exports; improved market access to third countries with whom the European Union had preferential trade agreements; and technology transfer from an increased flow of foreign direct investment (IMF, 1996c). The staff noted that the impact of the customs union on the Turkish economy would depend on "complementary policies … to keep the fiscal deficit from rising as a result of the loss of tariff revenues." Directors welcomed the implementation of the customs union, noting that it "opened major growth opportunities for the country" (IMF, 1996d). Once the customs union was in place, the Fund essentially stopped paying attention to trade policy issues in Turkey.

84. IMF staff did advise Turkey to cut agricultural subsidies, but from the viewpoint of improving the fiscal position rather than liberalizing trade. In June 1998, the IMF agreed to an 18-month Staff-Monitored Program (SMP) to lower Turkey's inflation to the single digits over three years.[58] The

[58] During the 1990s, the monetization of large and growing fiscal deficits had led to average annual inflation of almost 80 percent.

linchpin of the disinflation effort was to be a sustained fiscal consolidation. In this context, IMF staff observed that agricultural subsidies weighed heavily on the budget and that agricultural tariff protection was excessive; they advised the authorities to reduce agricultural support prices closer to international levels and to eliminate input subsidies and subsidized credit to the agricultural sector (IMF, 1998l; Orsmond, 1998). The SMP included commitments to limit agricultural support price increases in 1999 to targeted, rather than past, inflation rates and to gradually eliminate the interest rate subsidy on agricultural credits (IMF, 1998k).

The 1999 SBA-supported program

85. In December 1999, the Turkish government requested a three-year SBA-supported program in support of its new disinflation and fiscal adjustment program. The framework of the SMP had proven too weak to stop the deterioration in the fiscal accounts: in the absence of major structural reforms, fiscal policy had quickly turned expansionary in the face of weakening economic activity (compounded by the knock-on effects of the Russian crisis on Turkish exports), the announcement of early elections, and the devastation wrought by the August 1999 Marmara earthquake. As a result, the new government that took office in mid-1999 had to contend with recession, high real interest rates, and rapidly rising public debt. The objective of the 1999 SBA-supported program was to bring Turkey's unsustainable public sector debt dynamics and high inflation under control by breaking inflationary expectations once and for all; this was to be accomplished through a strong fiscal adjustment and a preannounced crawling peg exchange rate anchor (IMF, 1999h).

86. The 1999 SBA-supported program had a wide-ranging structural reform agenda that did not include trade reforms per se but did include trade-related reforms in agriculture. As in the SMP, the primary goal of these reforms was to improve the fiscal situation. In the area of agricultural reform, the program included measures to: reduce the spread between the support price and the projected world market price for cereals and adjust the import tariff so that the tariff-inclusive import price would be above the support price in 2000–01; discontinue unofficial government support to industrial crops by granting full autonomy to agricultural sales cooperatives and their unions (a structural benchmark for the completion of the first review);[59] and phase out the credit subsidy to farmers (also a structural benchmark). Fund staff estimated the primary fiscal cost of the various agricultural policies to be around 2 percent of GNP (Moalla-Fetini, 1999). Agricultural reform issues were subsequently picked up by the World Bank under an Economic Reform Loan that was approved in May 2000 (IMF, 2000b).

87. No trade conditionality was introduced in Turkey's subsequent SBA-supported programs (2002–05 and 2005–08), although IMF staff addressed trade policy issues sporadically during 2002–07. In the staff reports for the 2002 and 2005 SBA-supported programs, Fund staff stated that trade policy conditionality was not included because Turkey's trade regime was "only moderately restrictive" (IMF, 2002a, 2005a). During the discussions for the 2005 SBA-supported program, the staff recommended lowering agricultural tariffs and rethinking any agricultural reforms that would move the system from direct income support back to more distortionary production subsidies, but they did not include these issues in program conditionality because agricultural reforms were being handled by the World Bank (IMF, 2005a). In the 2002 and 2004 Article IV consultations, the staff called attention to Turkey's high agricultural tariffs and "overuse" of antidumping measures (IMF, 2002b, 2004b)—the same points that were highlighted in the WTO's 2003 trade policy review of Turkey (WTO, 2003).[60]

88. One trade-related issue that emerged in the mid-2000s was the expiration of international textile and clothing quotas in January 2005. Fund staff noted that the elimination of quotas under the WTO's Agreement on Textiles and Clothing (ATC) would pose a significant challenge to Turkish exporters—particularly in the EU market where Turkey's textile and clothing exports were protected by quotas on exports from competitors such as China, India, and Pakistan; they estimated that the export loss could cut GNP growth by 0.3–0.4 percent in 2005. Turkey would also need to remove its own quotas on textile and clothing imports when the ATC expired (IMF, 2004b). The authorities had been mulling a cut in the VAT for textile products since 2004, well before the expiration of the ATC. Aside from providing relief to domestic textile and clothing producers, the proposed cut in the VAT was ostensibly aimed at reducing tax evasion. Fund staff argued strongly against this move, noting that the standard 18 percent VAT rate in Turkey was not high by international standards, that cutting the VAT rate at a time

Prior to the 1998 SMP, Turkey had an SBA-supported program from July 1994 to September 1996 (Table 1).

[59] Agricultural sales cooperatives and their unions were authorized to undertake support purchases of industrial crops on behalf of the government. They typically purchased commodities directly from farmers, undertook primary processing and packaging, and resold the commodities to final users (Orsmond, 1998).

[60] The coverage of trade policy developments in the 2004 Article IV staff report drew on WTO (2003).

of strong domestic demand and a widening current account deficit was risky, and that ad hoc rate cuts for specific sectors ran counter to best practice and undermined policy credibility (IMF, 2005a).[61] In the MEFP for the 2005 SBA-supported program, the government committed not to change VAT rates or coverage during the program period (excluding previously agreed rate reductions for health care, education services, and certain food items, in line with EU directives) (IMF, 2005a).

Assessment

89. The level of trade conditionality in the 1999 SBA-supported program was commensurate with the IMF staff coverage of trade policy prior to the program. The staff report for the 1999 SBA-supported program request did not mention Turkey's TRI or explain why trade reforms were omitted from the three-year adjustment program. (In the 2002 and 2005 SBA-supported program requests, the staff explained that Turkey's trade regime was only moderately restrictive.[62]) It was clear at the time that Turkey's macroeconomic problems in 1999 could be traced to a large and unwieldy public sector, fiscal indiscipline, and monetary accommodation. IMF staff had been aware of this and Fund surveillance had always paid special attention to those issues. The 1999 SBA-supported program focused its structural conditionality on areas that impinged upon the fiscal sector. Trade policy was not considered to be one of those areas; it had simply not been on the Fund's radar screen in the years prior to the program.

90. The IMF may have missed the opportunity to include tariff reduction in the overhaul of agricultural support policies. The agricultural reform policies that were outlined in the December 1999 MEFP and subsequently elaborated and implemented with the help of the World Bank aimed to reduce the burden of support on the economy and move Turkey's agricultural policies closer to those of the European Union by replacing the potentially more production-distorting measures with a less distortionary direct support system. But the reforms did not address the relatively high tariff protection in agriculture—even though IMF staff had identified this as a key component of Turkey's agricultural support policies (Orsmond, 1998; Moalla-Fetini, 1999) and the WTO had criticized it as "a tax not just on consumer welfare but also implicitly on manufacturing and services that compete[d] with agriculture for production factors" (WTO, 1998). According to the WTO, Turkey's simple average applied most-favored-nation tariff rate for agricultural products was 28.3 percent in 2007 (WTO, 2007b)—higher than the European Union's, at 18.6 percent (WTO, 2007a).

91. In subsequent programs, the IMF proved ineffective in persuading the authorities not to yield to protectionist pressures arising from the expiration of ATC quotas. IMF staff gave sound advice against selective VAT cuts—their arguments were eminently sensible. However, the authorities were not totally convinced, as evidenced by their discussions with Fund staff and management and by their public statements.[63] In January 2005, Turkey imposed import quotas on a number of textile products from China, taking advantage of the textiles-specific safeguards clause written into China's WTO accession protocol. In March 2006, the Turkish authorities went ahead and cut the VAT rate to 8 percent on textile products. IMF staff reiterated their objections and came up with further (sensible) arguments against the VAT cut, that is, that targeted tax reductions ran counter to program commitments to simplify the tax structure and would invite calls from other sectors for similar treatment (IMF, 2006b).[64] But there is no indication that the staff discussed alternative options with the authorities, such as program augmentation under the Trade Integration Mechanism; staff interviewed pointed out that Turkey's loan was already in the very high brackets and that besides, they were not in favor of policies that would delay Turkey's adjustment to the post-ATC environment. In the event, the authorities (again) agreed to avoid introducing any further rate reductions (IMF, 2006b) but (again) reneged when they cut the VAT rate to 8 percent for the tourism sector in 2007.[65]

G. Overall Evaluation

92. In the cases studied there was no obvious correlation between trade conditionality and initial trade restrictiveness. All five countries restricted their trade to similar extents prior to their IMF-supported programs, as measured by the Fund's own TRI as well as other assessments (Table 6). But the amount of trade conditionality in the five programs differed significantly: Indonesia had a relatively large number

[61] The FDMD discussed the VAT cut at length with the Turkish finance minister during a meeting in Washington in April 2004.

[62] The staff reported Turkey's TRI (5) in 2002 but not in 2005 after the Board decided against publishing the TRI in staff reports.

[63] "Turk minister sees positive developments with IMF," *Reuters*, February 19, 2004; "Finance ministry working to cut VAT on textiles," *Turkish Daily News*, April 16, 2005. In his conversation with the IMF FDMD in April 2004, the Turkish finance minister said that the VAT cut had been put aside only temporarily for the seventh review of the (2002) SBA-supported program.

[64] See also "IMF criticizes Turkey's VAT rate cut on textiles," *Reuters*, March 9, 2006.

[65] "Turkish VAT cuts not contrary to IMF accord," *Reuters*, May 25, 2007.

Table 6. Indonesia, Korea, Ukraine, Brazil, and Turkey: Trade Restrictiveness

	Aggregate TRI (1 to 10)	Tariff Rating (1 to 5)	Unweighted Average Tariff Rate (Percent)	NTB Rating (1 to 3)
Indonesia (1997)	5	2	13.0	2
	(No WTO TPR before the program.)			
Korea (1997)	4	1	9.0	2
	"Agriculture and significant services sectors have remained largely insulated from international competition, creating economic distortions at home and political frictions abroad." (WTO, 1996a.)			
Ukraine (1998)	5	2	12.7	2
	(No WTO TPR before the program.)			
Brazil (1998)	5	2	14.6	2
	"[F]requent tariff adjustments give an appearance of uncertainty to the trade and investment régime. A series of potentially trade distorting measures taken since 1995 stand in sharp contrast to Brazil's general record of reform.... Greater co-ordination, transparency and a more measured response to requests for assistance from specific sectors would help Brazil translate its stated commitment to free trade into actions more clearly consistent with its development needs and with a stronger multilateral trade system." (WTO, 1996b.)			
Turkey (1999)	5	2	13.7	2
	"[T]he current trend of increasing support in [the agricultural] sector is contrary to the liberalization seen elsewhere in the economy. This sectoral imbalance could be a tax not just on consumer welfare but also implicitly on manufacturing and services that compete with agriculture for production factors." (WTO, 1998).			

of trade conditions, Korea and Ukraine had some, Brazil and Turkey none.

93. There was no obvious correlation between trade conditionality and the Fund's coverage of trade issues prior to the program. Preprogram coverage of trade policy issues was minimal in Korea and Turkey—indicating a perceived low degree of macro-relevance—yet one of these countries had substantial trade conditionality while the other had none. On the other hand, the Fund argued strongly and consistently for further trade liberalization in Indonesia and Brazil yet only applied trade conditionality in Indonesia and not Brazil. In all cases, the Fund's preprogram coverage of trade policy issues tended to be superficial, being limited mostly to reporting but not analyzing policy changes. Thus when trade conditionality was included in a program, Fund staff were often unable to explain why those policies were targeted, let alone to quantify their macroeconomic effects.

94. There was no obvious correlation between trade conditionality and the financial crises that necessitated the programs. Each of the five programs was introduced to address a capital account crisis and loss of market confidence, although each of the crises had a different proximate cause and different structural issues identified as its root causes. In Indonesia, the program focus was on financial sector weaknesses and governance, in Korea on financial and corporate sector weaknesses, and in Brazil, Turkey, and Ukraine, on the public finances. None of these crises had anything to do with trade. The closest that trade reforms came to meeting the macro-criticality criterion for the Fund's structural conditionality was in the case of Indonesia, where many of the trade liberalization measures (e.g., dismantling import monopolies) were also seen as measures to improve governance.

95. Because trade reforms were not crucial (except arguably in the case of Indonesia), Fund staff had some leeway in choosing whether or not to include them in the structural adjustment package. As these were high-profile (and in most cases high-access) programs, political considerations were often the deciding factor.[66] This was most obvious in the case of Korea, where the Fund inserted trade conditionality to win U.S. and Japanese support, and Ukraine, where the Fund capitulated on trade (and other) issues in order to accommodate the G-7. The international, and often highly political, nature of trade policy made it more likely to be taken up by Fund members—trading partners/competitors of the program country—hoping to exploit the leverage provided by the Fund program. Fund management and staff picked through the lobbying on a case-by-case basis; their decisions were inevitably arbitrary.

[66] A background paper for the IEO's 2008 evaluation of IMF governance made the same observation: "Although formal procedures are in place to safeguard staff autonomy, shareholders are able to exercise substantial informal influence over the content of conditionality that is not subject to scrutiny, as in the cases of Indonesia and Korea" (Stone, 2007).

96. In some cases, trade conditionality was included for symbolic purposes. Prime examples were the abolition of the national car and import monopolies in Indonesia and the elimination of the sunflower-seed export tax in Ukraine. According to senior Fund staff, in cases where wide-ranging structural reforms were necessary, the Fund often had to be pragmatic and focus only on select well-known policies. Although these policies and the Fund conditionality directed at them captured a great deal of media attention, they were not subject to rigorous—or indeed, any—analysis because their deleterious effects were thought to be obvious and staff resources were considered to be better used elsewhere.

97. Rules and guidelines were sometimes disregarded. PDR's request for staff reports to assess trade reforms in medium-term programs was ignored half the time: only Ukraine's 1998 request for an EFF-supported program and Turkey's 2002 request for an SBA-supported program incorporated the requisite information. The guidelines on "WTO-consistency" also seemed to be taken lightly: the Fund insisted that Indonesia and Korea bind their financial services liberalization in the GATS, despite admonitions to avoid such "cross-conditionality" (Table 2). In 2002, the definition of "cross-conditionality" in Fund guidelines shifted toward a situation "under which the use of the Fund's resources would be directly subjected to the rules or decisions of other organizations" (IMF, 2002c).

98. Interagency cooperation was less good than it could have been. Only in Indonesia was the World Bank active in trade policy issues, but the Bank's credibility there was close to zero as it was perceived as a supporter of the Soeharto government. In the other case study countries, the World Bank's focus was elsewhere: in Korea, on financial sector reform, corporate restructuring, and social sector reforms; in Ukraine, on public sector reform, agricultural sector reform, energy sector reform, financial sector reform, and privatization; in Brazil, on social protection, social security reforms, and state-level administrative reforms; and in Turkey, on banking and public sector reforms, social support, and agricultural reform. Cooperation with the WTO was also imperfect. WTO trade policy reviews were referred to only in staff reports for Brazil and Turkey, but only after 2000; they were not used in designing Fund programs. The Fund was slow to share its documents with the WTO Secretariat in the early days of the Asian crises, but this glitch was quickly resolved. More seriously, the Fund overstepped its boundaries in Indonesia's national car case when it anticipated the judgment of the WTO dispute panel and overrode the panel's decision on the implementation period.

99. The trade conditionality was somewhat, but not totally, effective. Some of the trade reforms were sustained; most of these were reforms bound by commitments to the WTO and/or other organizations such as the OECD (e.g., financial services liberalization measures in Indonesia and Korea and elimination of the import diversification program and trade-related subsidies in Korea) or by commitments in existing or potential preferential trade agreements (e.g., tariff reduction in Indonesia and reform of agricultural support policies in Turkey). Some of the trade conditions—the symbolic ones especially—stirred up an active policy debate in the program country even if they were ultimately not implemented as planned. Some of the trade reforms were subsequently reversed: these tended to be measures that were not carefully thought through at the outset (e.g., the elimination of Bulog's monopolies and log export taxes in Indonesia) and measures that could be undone without violating WTO or other commitments (e.g., tariff increases within WTO bound rates in Ukraine).

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Background Document

6

IMF Surveillance of Trade Policies: General Observations and Case Studies of Advanced Countries

A. Introduction

1. This paper starts with a brief description of IMF surveillance of trade policies in all members and then reviews more closely surveillance of trade policies in three advanced countries. Trade policy issues featured regularly in IMF bilateral surveillance even though they were typically not at the center of the Fund's macroeconomic concerns.[1] The main objectives of the Fund's advice were to improve allocative efficiency, to investigate systemic or domestic macroeconomic effects of trade policy changes, and to call attention to negative spillover effects. In the three advanced countries examined in more depth, barriers to trade, taken together, were relatively low, and the focus of surveillance—on agricultural protection, use of countervailing duties and antidumping remedies permitted within the World Trade Organization (WTO) framework, preferential trade agreements (PTAs), and, to a lesser extent, trade in financial services—was appropriately selective.

2. The paper is organized as follows. The next section provides general indicators of the coverage and depth of IMF trade policy surveillance in 1996–2007 in countries that had a surveillance-only relationship with the IMF as well as those that also had lending arrangements. The following section examines the content of IMF advice on trade policy for the United States, Japan, and Norway. The United States and Japan were selected for close review because they represent the members of the Quad (Canada, the European Union, Japan, and the United States) where IMF advice on trade policy was most active (United States) and least active (Japan) during the evaluation period. Norway was selected because it provides an example of surveillance of a smaller advanced country where agricultural trade distortions were very large and PTAs were numerous. The final section summarizes findings.

B. Coverage and Depth of Surveillance of Trade Policies

3. Surveillance of trade policies reached across income groups, including countries that had lending arrangements with the IMF and those that did not. The case studies presented in the previous background documents examine IMF involvement in countries with borrowing arrangements. There, conditionality figured prominently, though program commitments were agreed against the backdrop of work done in connection with periodic surveillance exercises—which continued, though less frequently, during the lending arrangement. For this short comprehensive overview, we present snapshots (drawn from the full IMF membership) of the beginning of the evaluation period (1996) and toward the end (2006).

4. Broadly, surveillance in 1996 covered trade policies in some 60 percent of countries in all income groups (Figure 1). In each income group, the focus was on conventional trade policies (tariffs, quotas, subsidies, and contingent protection remedies). Fewer than 10 percent of the consultations covered one or more of the three other broad groups of trade policy issues—trade in services, PTAs, and preference erosion. In the mid-1990s, the background documents tended to include general descriptions of trade policy changes that had taken place in the preceding year; hence most of the advice on conventional trade policy issues, regardless of the country's income level, was based on some explicit staff background work.[2]

[1] Bilateral surveillance occurred through annual Article IV consultations, reports on which described the staff's exchange of views with the authorities, provided staff views, and served as the basis for the Executive Board's consideration of the country's macroeconomic policies and outlook. As background to Article IV consultations, staff prepared more in-depth analytical pieces—selected issues papers—on issues of specific interest.

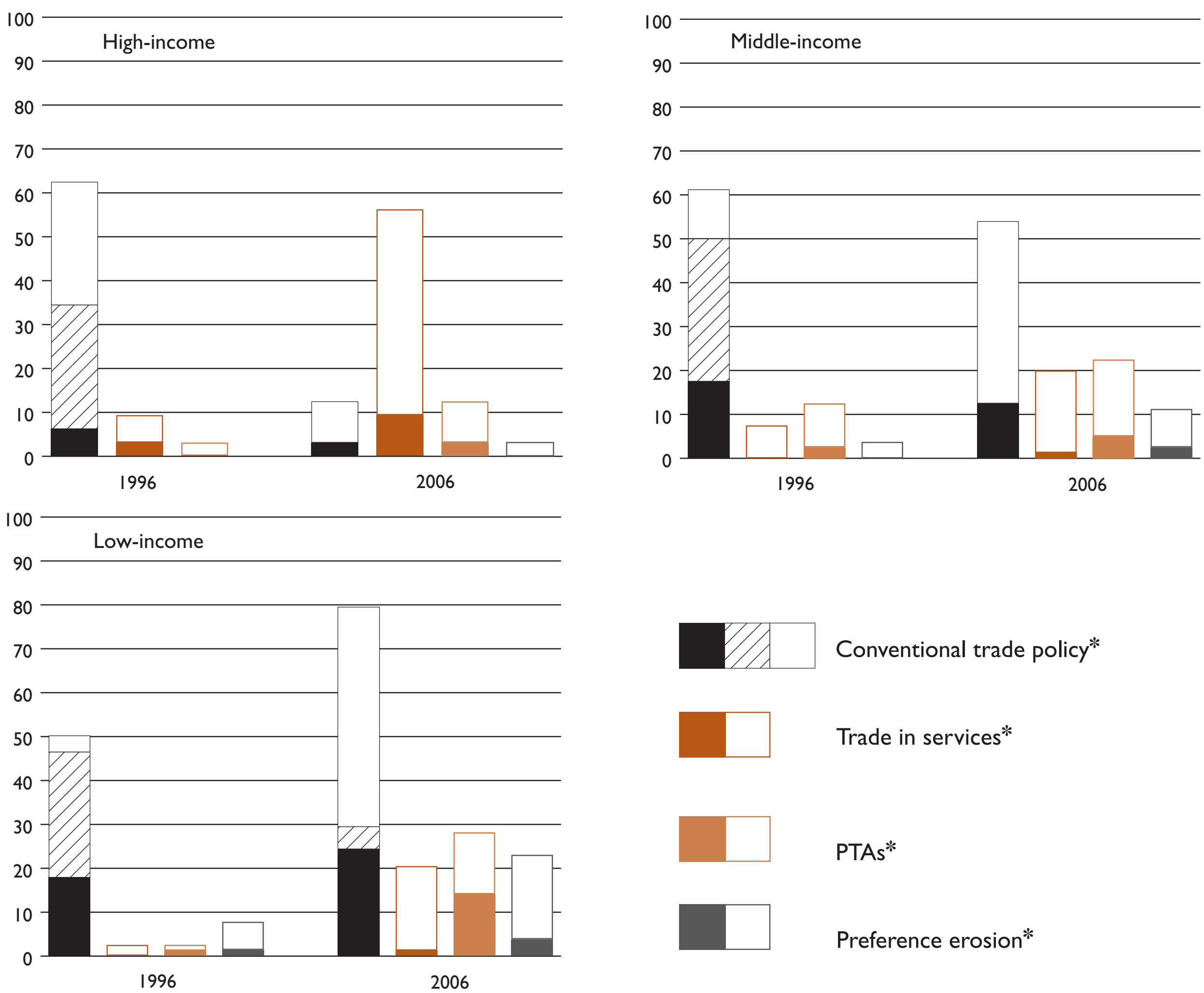
[2] In the 1970s and 1980s, most Article IV consultation documents included rather long descriptions of major policy issues, including trade policy. Gradually, during the 1990s, these were replaced by more analytical work on specific issues selected as the most important aspects of the IMF's advice to the country in that year. This meant that, starting in the mid- to late-1990s, trade policy was no longer automatically covered in background documents and could

5. By 2006, the pattern of coverage had changed significantly. For high-income countries in particular, the focus had moved sharply away from conventional trade policies: in fewer than 10 percent of high-income countries did Article IV consultations provide advice on these policies. A large shift had occurred toward issues of trade in services (especially trade in financial services among European countries) and, to a lesser extent, PTA issues. Far less of the advice was now backed by explicit analysis shown in staff papers; this pattern reflected a shift away from broadly descriptive background documents toward narrower, more analytically focused background papers that touched on trade policies less frequently. In middle- and low-income countries, the Fund's attention to conventional trade policy issues had remained broadly stable, though the share of advice that was backed by explicit analysis

even be excluded from any in-depth analytical examination for many years running.

Figure 1. Staff Views on Trade Policy in Bilateral and Currency Union Surveillance by Income Group, 1996, 2006

(Percent of all consultations in indicated year)



*Dark portion indicates views backed by obvious staff analysis or other in-depth analysis; patterned portion indicates views backed only by descriptive material in background documents; white portion indicates views with no obvious analytical or descriptive backing.

Source: IEO. Data reflect an examination of the surveillance documents for all IMF members (as well as currency unions and territories) in the years indicated and classification in terms of whether trade policy issues were covered and the depth of the analysis shown in staff work backing positions in staff reports. Annex I of the main report describes the classification system.

or description had dropped. Attention to other issues had risen. In both these income groups in 2006, some 10–30 percent of countries received advice on trade in services, PTAs, and preference erosion.

6. These trends are both reassuring and troubling. They are reassuring in that they broadly reflected the changes that took place in the trade policy landscape after the Uruguay Round. Tariffs fell during this period. In high-income countries, the average most-favored-nation (MFN) tariff fell to about 5 percent by 2006; and in low-income countries, the average tariff also fell sharply—indeed by more than that in high-income countries in absolute terms—but nonetheless its level in 2006 was twice as high as the high-income countries' average tariff had been in 1996 (Table 1). The issue of concern, however, is that the depth of explicit analysis underlying the IMF's trade policy advice fell across both middle- and low-income groups and across all issues.

C. Trade Policy Surveillance in Three Advanced Countries

United States

Initial conditions

7. The United States, a key advocate of multilateral trade liberalization with low overall measures of trade barriers yet significant pockets of protection, presented challenges for surveillance. In the mid-1990s, its tariff protection in the industrial sector was low; the simple average MFN tariff rate was 4.8 per-

Table 1. Degree of Trade Restrictiveness for Selected Advanced Countries

	1996[1]			2001			2007		
1. IMF TRI[2]	NTB	Tariff	Overall	NTB	Tariff	Overall	NTB	Tariff	Overall
Japan	2	1	4	2	1	4	2	1	4
Norway	2	4	7	2	1	4	2	1	4
United States	2	1	4	2	1	4	2	1	4
2. World Bank OTRI[3]	Mfg	Agri.	All	Mfg.	Agri.	All	Mfg.	Agri.	All
Japan	..	..	..	6.1	69.8	17.3	5.9	53.0	11.5
Norway	..	..	..	2.4	35.9	5.0	0.9	39.1	4.8
United States	..	..	..	9.4	27.2	10.5	6.2	19.9	7.0
High-income countries[4]	..	..	..	6.0	48.2	9.6	5.4	47.6	9.2
Low-income countries[4]	..	..	..	19.8	34.8	22.3	17.1	33.2	19.2
3. MFN Tariff (percent)[5]	Mfg.	Agri.	All	Mfg.	Agri.	All	Mfg.	Agri.	All
Japan	4.3	18.3	6.2	2.7	22.2	5.3	2.6	22.3	5.2
Norway[6]	5.9	12.6	5.3	2.1	9.2	2.6	0.6	37.6	6.7
United States	4.8	5.2	4.8	3.8	5.6	4.0	3.2	5.5	3.5
High-income countries	6.6	24.1	8.9	5.3	17.5	6.9	4.9	16.7	6.4
Low-income countries	23.0	25.3	23.3	13.9	17.8	14.4	11.6	15.9	12.1
4. OECD PSE (percent)[7]									
Japan	58			59			45		
Norway	67			68			53		
United States	14			23			10		
OECD	30			31			23		

Sources: IMF; World Bank, World Trade Indicators 2008; and OECD, Producer and Consumer Support Estimates: 1986–2007 Database.

[1] Figures for IMF TRI are for 1997.

[2] The Trade Restrictiveness Index (TRI) is a 10-point-scale (10 = most restrictive, 1 = most open).

[3] The Overall Trade Restrictiveness Index (OTRI) is a weighted sum of tariffs and ad valorem equivalents of nontariff measures at the tariff-line level. Weights are a function of import shares, elasticities of import demand at the tariff-line level, and aggregate levels of protection at the tariff-line level. See http://go.worldbank.org/C5VQJIV3H0.

[4] Based on World Bank income grouping standards as of July 2007; low (53 countries), lower middle (56 countries), upper middle (41 countries), and high (60 countries).

[5] Simple average applied MFN tariff.

[6] The 2007 agricultural tariff figure reflects a 2000 percent tariff on flour that was imposed beginning in 2002.

[7] The Producer Support Estimate (PSE) is an indicator of the annual monetary value of gross transfers from consumers and taxpayers to support agricultural producers, measured at farm gate level, arising from policy measures, regardless of their nature, objectives or impacts on farm production or income. The percentage PSE is the ratio of the PSE to the value of total farm production (at farm gate prices), plus budgetary support. See http://www.oecd.org/document/59/0,3343,en_2649_33797_39551355_1_1_1_1,00.html.

cent in 1996, and commitments under the Uruguay Round saw this fall to about 4 percent in 1999. However, nontariff protection in agriculture was substantial—mainly through quotas and other nontariff barriers to imports of sugar, fruits and vegetables, beef, dairy products, tobacco, and cotton among other commodities, along with price supports in a broad array of products. In textiles and apparel, the United States maintained a high level of nontariff protection, which through Uruguay Round agreements was to be dismantled by end-2004. Domestic protectionist pressures resulted in resort to contingent trade remedies. Despite strong support for, and activism in, multilateral trade negotiations, the United States actively pursued PTAs in the region and further afield (including preferential access to U.S. markets for some developing countries).

Main issues covered and policy advice

8. During the evaluation period, the IMF took positions on most trade policies that were widely regarded, including outside the IMF, as the key issues for U.S. policy. Most of the issues that were picked up were covered over two to three consultation cycles, but rarely for longer. Seldom was the reason for the discontinuation of attention to such issues (i.e., whether the issue was resolved or overtaken by other events) explained in subsequent staff reports. This pattern creates the impression of some arbitrariness in the selection of trade policy issues that were covered. Examples, described in more detail below, are the coverage of responses to protectionist pressures through domestic remedies versus through the WTO dispute settlement process (which peaked in the late 1990s) and of agriculture protection (which peaked in 2001–02). Some themes—the U.S. role in the Doha Round and domestic pressures for protectionism—were pressed, though with declining urgency, throughout the evaluation period. The IMF mission team to the United States in most years during the evaluation period included a staff member with trade policy expertise from the Trade Policy Division of the IMF's then Policy Development and Review Department (PDR).

9. The United States' approach to PTAs was a continuing theme in surveillance of the U.S. economy. This topic is covered in an accompanying background paper for this evaluation on the IMF's handling of PTA issues more broadly (de Melo, 2009) and will not be covered in depth here. Staff handling of PTA issues vis-à-vis the U.S. economy was quite consistent over the years. U.S. officials stated their intention to pursue liberalization aggressively through multilateral, regional, and bilateral agreements. For the most part, the tone of staff positions on PTAs was cautionary, urging the United States to pay close attention to ensuring that PTAs followed best practice vis-à-vis coverage of trade, rules of origin, preference erosion, and simultaneous pursuit of multilateral liberalization (IMF, 2001b, 2003d, 2004c, 2005d, 2006c). That said, in-depth work on the North American Free Trade Agreement (NAFTA) and PTAs more generally in 2003 calculated that gains from U.S. PTAs were considerable (Kose, 2003; Hilaire, 2003). Perhaps reflecting this evidence and the general perception that U.S. PTAs were as well constructed as those of any other major country, IMF staff tended to take a somewhat softer line on PTAs in the United States than in the European Union.

10. The Fund's attention to trade issues had fallen off sharply by the last few years of the evaluation period. After 2004, consultation documents included no in-depth work on trade policy issues, and coverage of the issues in reports on discussions with the authorities, staff appraisals, and Executive Board summings up were minimal and pro forma. Though few new trade policy issues (that is, ones that had not been examined in depth during the preceding three to four years) arose that were significant from a macroeconomic perspective, some critical issues—notably, the 2007–08 Farm Bill negotiations—that should have been covered were not.

11. The reduction in attention to trade policy reflected a number of influences. Although PDR rather consistently pressed for taking more and stronger positions on trade policy, particularly on PTAs and protectionist pressures, area department staff felt strong pressure to prioritize other issues (particularly financial sector issues) and given that their reports had to fit within prescribed word limits they decided that attention to trade issues should be scaled back. Also staff indicated in interviews that on a couple of occasions, IMF management requested less attention be paid to trade issues, and staff responded accordingly.

Agricultural protection

12. Article IV missions delved into agriculture issues around the time of the 2002 Farm Security and Rural Investment Act. Major farm bills that, inter alia, set the parameters for government support of agricultural activities, are considered and enacted every six years in the United States. These points present windows of opportunity for the IMF to address agriculture policy issues of macroeconomic and systemic relevance. However, staff coverage of the generally pivotal debates and actions surrounding these bills was highly uneven. Although the Federal Agriculture Improvement and Reform Act (FAIR) of 1996 marked a significant new and more market-oriented approach to government intervention in support of agriculture, it received no staff analysis

in Article IV consultations until 2001. Then, coinciding with the debate on and passage of the 2002 Farm Bill, agriculture protection was addressed in selected issues papers (SIPs) for the 2001 and 2002 Article IV consultations (MacDonagh-Dumler, 2001; MacDonagh-Dumler, Yang, and Bannister, 2002). Strong positions were taken in staff reports in both years against what staff saw as a retreat from the commendable objectives of the FAIR (IMF, 2001b and 2002e). Thereafter, coverage of the issue ceased, and the issue received no attention at the time of the 2007–08 Farm Bill discussions, when staff did not seize the opportunity to urge the authorities to move back toward the approach introduced in 1996 (IMF, 2007d).

13. The work undertaken in the 2001 and 2002 consultations is a good example of the capacity of the IMF, using limited resources, to take strong, well-substantiated positions on an issue that had systemic implications. SIPs by Fund staff in both years (MacDonagh-Dumler, 2001; MacDonagh-Dumler, Yang, and Bannister, 2002) laid out complex issues simply and for the most part clearly. Most of their characterization of effects of policy choices was derivative, interpreting the substantial analytical work done in the Organization for Economic Cooperation and Development (OECD), Economic Research Service of the U.S. Department of Agriculture, U.S. Congressional Budget Office, and research institutes. MacDonagh-Dumler, Yang, and Bannister (2002) produced simulations of effects of various subsidy reduction scenarios (in the United States and other Quad countries) on welfare in agricultural exporting countries.[3] The paper also compared agricultural tariffs and subsidies in the United States with those in other large trading countries. This put U.S. policies in a global perspective, producing an evenhanded approach.

14. The substantive work in these SIPs produced several observations on effects of the Farm Bills and provided analytically sound backing for strong views expressed in the 2001 and 2002 staff reports. The 2001 analysis (MacDonagh-Dumler, 2001) reviewed the degree to which the 1996 FAIR had shifted the government's approach from farm price support to income support as a transitional program to reducing overall farm support (IMF, 2001b). It reached several conclusions: the policy shift had not been implemented as planned due to "emergency" support to farmers and deficiency payments that were made when world prices fell in the late 1990s; after falling at one of the fastest rates in the world during 1980–96, U.S. subsidies to farmers doubled during 1996–99; these policies had helped to lower world prices for certain commodities; and U.S. farm payments went disproportionately to farmers with high gross sales. These conclusions laid the groundwork for the IMF to make a preemptive call—prior to the passage of the 2002 Farm Bill—for returning to the original goals of the FAIR and for resisting pressures for extending support to a wider range of products (IMF, 2001b).

15. Building from this position, the 2002 consultation assessed and criticized the outcome embodied in the 2002 Farm Security and Rural Investment Act (2002 Farm Bill). The staff report (IMF, 2002e), backed by analysis in MacDonagh-Dumler, Yang, and Bannister (2002), quantified the increase in subsidies (through a tariff-equivalent analysis) and the effects on the welfare of agricultural exporters. It strongly criticized the 2002 Bill for undermining the approach introduced in the 1996 FAIR and maintaining and augmenting policies that reduced the sensitivity of U.S. producers to market forces. In balanced recommendations for future efforts to turn back these features, the reports stated (though they did not quantify) that such a reversal would have important effects on domestic farm balance sheets that would need to be offset (through income support) as envisaged in the FAIR.

16. This work for bilateral surveillance was buttressed by a complementary analysis in the September 2002 *World Economic Outlook* (*WEO*) on the effects of the advanced countries' agriculture policies on low-income countries. The approach in the *WEO* analysis (IMF, 2002c) was similar to that for the U.S. consultation, but was broadened to include welfare effects of highly protectionist agricultural policies pursued by other advanced countries (the European Union, Iceland, Japan, Korea, Norway, and Switzerland). This analysis helped to put U.S. policies in perspective and placed the overall message on the systemic effects of protectionist agricultural policies on a larger stage than bilateral surveillance could provide.

17. IMF Executive Board support for the robust messages coming out of the 2001–02 staff reports was muted. During the evaluation period, the Board frequently urged the United States to reduce barriers to agriculture imports, though it typically couched these admonitions in the context of broad support for liberal trade policies. However, in the years (2001–02) when staff had placed special attention on agriculture issues, Board summings up either did not explicitly address the issue (IMF, 2001a), or approached it only with a light touch—"Directors urged the authorities to give priority in three policy areas—namely, disciplined fiscal policies; reforms of corporate governance and accounting; and strengthened leadership

[3] These simulations used the computable general equilibrium model of the Global Trade Analysis Program, a program run by a consortium of researchers worldwide, of which the World Bank and WTO are members.

in trade and agricultural policies" (IMF, 2002b).[4] In view of the staff effort to address the issue substantively, this was a missed opportunity for the Board to take a stand on an important issue.

Resisting and handling protectionist pressures

18. U.S. commitment to liberal trade conditions was strongly challenged during the evaluation period. The aftermath of the Asia crisis saw a substantial appreciation of the dollar against the currencies of several rapidly industrializing emerging market countries followed by a sharp slowdown in U.S. growth in 2000–02. Prior to and during these developments, the IMF persistently called attention to the costs of actual protectionist measures and the risks of succumbing to protectionist pressures. Staff supported this position with occasional in-depth work, which had three broad strands.

- During 1995–96, background papers for the staff reports (Leidy, 1995; IMF, 1996d) detailed each U.S. petition for protection that resulted in a dispute settlement request to the WTO or a domestically adjudicated trade remedy. This explicit reporting on individual cases (e.g., 14 were recorded in IMF (1996d)) was as effective a way to name and shame as the IMF could undertake. The process stopped in 1997, after which staff reports simply admonished the authorities to avoid, to the extent possible, resorting to even WTO-consistent trade remedies. In interviews with the evaluation team, staff said that detailed IMF attention to trade remedies had been discontinued because of the absence of such reporting in countries other than the United States and because the WTO began to publicize these developments.
- In 1996, staff examined the link between domestic economic developments (civilian unemployment rate and industrial capacity utilization) and petitions for protection through antidumping/countervailing duties (IMF, 1996e). They found a robust relationship even when controlling for other explanatory variables. This pointed to the likelihood of substantial ebbs and flows in protectionist pressure, well within the limitations posed by WTO rules.
- Staff preemptively cautioned against and later criticized safeguard tariffs that the United States imposed on steel imports in 2002 (IMF, 2002e). In 2001, as the U.S. debate on the proposal occurred, the staff report took a strong opposing position (IMF, 2001b). The 2002 staff report included calculations of the domestic and international welfare losses from the safeguard tariff—calculations that broadly affirmed estimates by other prominent researchers (IMF, 2002e). It also pointed out that retaliatory actions by other countries substantially increased the calculated welfare losses.

Each of these strands was appropriate. The treatment of trade remedies reflected a good adjustment to the WTO's activities (though an explanation in subsequent staff reports of why the treatment was changed would have been appropriate), while macroeconomic foundations of protectionism and the effects of the steel tariffs were issues on which the IMF voice was useful.

19. Throughout the evaluation period, surveillance addressed other issues surrounding the handling of protectionist pressures in the United States. Early in the period, a key issue was whether, and how fully, the United States would shift the handling of domestic producers' requests for trade remedies to the WTO dispute settlement process, away from domestic provisions (Sections 201 and 301 of the 1974 Trade Act).[5] During 1996–99, staff reports, supported by brief but clear wording in Board summings up, urged the government to work through the dispute settlement process and to work with the WTO to strengthen any aspects of the process that were regarded as weak (IMF, 1996a, 1996b, 1997c, 1997d, 1998c, 1998d, 1999b, 1999c). By 2000, the issue was dropped from staff reports despite the fact that U.S. use of domestic antidumping remedies rose through 2001.

20. At least until 2002, staff kept under review alternative approaches that the IMF could use to discourage U.S. responses to protectionist pressures. Two episodes stand out. In 2001–02, PDR pressed successfully to shift the IMF's approach from a presumption of wrongdoing to one of questioning the methodology used to evaluate antidumping and countervailing duty requests. Accordingly, in 2001–02, staff reports (and the 2001 summing up) urged the United States to change the administration of antidumping and countervailing duty procedures to provide import protection only when foreign producers were found to be engaged in anticompeti-

[4] Of course, the opening sentence of most summings up—affirming the Executive Board's support for the thrust of the staff appraisal—was indirect support for the staff's work on trade policy. But more telling of the Board's emphasis were the direct expressions of support in the later paragraphs of the summings up.

[5] Section 201 of the 1974 Trade Act implements Article XIX (the Safeguards Clause) of the General Agreement on Tariffs and Trade. It allows protection, on a nondiscriminatory (MFN) basis, to a domestic industry found to be seriously injured by imports. Section 301, as amended, may be applied to enforce U.S. rights under bilateral and multilateral trade agreements and to respond to unreasonable, unjustifiable, or discriminatory foreign government practices that burden or restrict U.S. trade.

tive behavior and to reduce the degree of discretion allowed in findings of injury to domestic producers (IMF, 2001a, 2001b, 2002e). This, they argued, would be consistent with the antitrust thrust of the underlying motivation for appropriate protection. More recently, staff reports pressed for greater support for workers displaced by imports. The United States responded that its current provisions were adequate (IMF, 2007d). Apart from this new attention to the adequacy of provisions for displaced workers, admonitions against protectionist policies became substantially shorter, less specific to particular episodes, and more pro forma after 2003.

U.S. positions in the Doha Round

21. One consistent theme in staff reports beginning in 2001 was encouragement for the United States to play a leadership role in the Doha Round. Acting on guidance from the Executive Board, staff discussed with the U.S. authorities (at a general level) U.S. views on, and aspirations for, the Doha Round. Staff consistently pressed for a more ambitious agenda for liberalizing protection of the U.S. agricultural sector as a means of moving the Round ahead and ensuring the strongest possible outcome. Board summings up conveyed this message quite explicitly most years (IMF, 2005c, 2006b, 2007b).

Market access

22. Staff reports during 2000–02 explicitly encouraged the U.S. authorities to broaden duty-free market access for least-developed countries (IMF, 2001b, 2002e). No background work was undertaken to support this position directly, though there was implicitly a substantial overlap between this issue and the work in 2001–02 on agriculture. After 2002, market access was generally not taken up explicitly, though indirectly it was reflected in general admonitions to liberalize trade conditions, especially in agriculture.

Other issues

23. A number of bilateral trade issues were addressed in staff reports; not all of them justified receiving attention on macroeconomic grounds. At the most relevant end of the spectrum, an SIP in 2004 (Alexandraki, 2004) addressed domestic and systemic implications of the rapid increase in China-U.S. trade. It concluded, on the basis of a constant market share analysis, that China's increased exports to the United States had largely displaced exports from other suppliers outside the United States, with rather little effect on the U.S. manufacturing sector. On the basis of more heuristic evidence, it concluded also that U.S. exports had benefited from greater access to the Chinese market. Nevertheless, the report noted that China had been on the receiving end of U.S. contingent protection measures, and the number of these was detailed in the background paper. This finding supported a gently worded cautionary note in which the Fund urged the authorities to avoid a defensive recourse to trade remedy actions (IMF, 2004c). There was no explicit uptake in the Board summing up.

24. At the least obviously relevant end of the spectrum of bilateral trade issues addressed was the Cuban Liberty and Democratic Solidarity Act. Mentioned in the Board summing up for the 1996 consultation (IMF, 1996b), the issue was explicitly addressed only in the 1997 staff report (IMF, 1997c). The macroeconomic or systemic relevance of this high-profile dispute between the United States and European Union, and therefore the merits of its inclusion in the 1996 Board summing up, was not obvious.

25. Staff reports did not systematically address any issues pertaining to trade in services, including financial services. Though staff appraisals and Board summings up called on the United States to play a leadership role in services trade liberalization (particularly after the United States withdrew from the financial services agreement under the General Agreement on Trade in Services in 1995), no in-depth work was done, and staff reports and Board summings up made no more than occasional, rather general statements on the issue. However (in an interesting departure from the more common line in bilateral surveillance in other countries), the 2003 staff report (IMF, 2003d) questioned whether the investment provisions in PTAs involving the United States could leave the partner countries in those PTAs too vulnerable to surges in capital inflows.

Interlocutors and effectiveness

26. Staff teams met with several senior officials involved with U.S. trade policy, and the quality of the dialogue varied. One meeting that stands out was that between the IMF Managing Director and the U.S. Treasury Secretary at the end of the 2002 Article IV consultation, when the Managing Director pointed critically to the adverse effects of the 2002 Farm Bill on developing countries. This was the year when the IMF had done substantial in-depth work on agriculture protection and taken a strong stand against the Farm Bill. According to the mission's minutes, the Secretary regretted the passage of the bill and encouraged the IMF to continue to support lower trade barriers. More generally, however, an obvious difficulty in staff discussions with the Office of the U.S. Trade Representative (USTR) arose from differences in approach to trade policy issues—the

IMF addressing them from an economic perspective and the USTR more from a legal perspective.

27. USTR and Treasury officials with whom the evaluation team spoke felt that IMF missions had provided added value on trade issues. Given the highly complex and multifaceted process through which trade policies are formulated in the United States, a direct effect of the IMF's advice would never be obvious. That said, USTR staff wrote a memo to the Treasury Department detailing the IMF's positions after each Article IV report was published, and these memos show that they generally thought that the IMF's work on trade policies in the United States and other countries was important in focusing attention on costs of protection and benefits of more open trade.

28. Looking ahead, officials from both the USTR's Office and the U.S. Treasury appear to feel that a strong presence of the IMF on trade issues would be important. From interviews with the evaluation team, four particular observations stand out.

- "The world would be a very dangerous place" if the IMF were to permanently reduce its attention to trade policy issues. When the new U.S. administration reexamines trade policy in 2009–10, this will be a very fertile opportunity for the IMF to discuss trade policy with the United States.
- The IMF needs to bring concrete analysis to meetings for discussion. U.S. officials commented that too often IMF staff did analysis after the fact or did not bring analysis with them to the consultation discussions.
- Far more useful than either broad-brush advocacy for trade liberalization or a critical appraisal of some detailed aspects of trade policy would be analytical work on the macroeconomic effects of trade policy initiatives. Officials pointed to IMF work on preference erosion and PTAs as embodying the IMF's best contributions. They also felt that the *WEO* was an effective platform for the IMF to address trade policy issues.
- Presentations of IMF work on trade policy issues should be strengthened so that they would reach lay as well as technical audiences. Officials felt that the IMF could make stronger contributions by presenting to broad audiences thought-provoking material on why certain policies were good or flawed.

29. Press coverage of IMF positions on trade policy for the United States was minimal. The evaluation team could find only one press report on IMF views on trade policy—following the 2002 consultation when the IMF's position on agriculture protection was prominent.[6] Three factors seem to lie behind this lack of coverage. First, trade policy was rarely a headline issue in U.S. Article IV consultations, and press coverage of the consultations themselves was usually limited. Second, with no press conference after consultations, scope was limited for directing media attention to IMF views on trade policy. Third, since 2004, IMF positions on trade policy have been minimal and certainly not concrete enough to make for good press coverage.

30. In contrast, press coverage of the 2002 *WEO* analysis on the effects of U.S. agriculture protection on developing countries received press coverage in several locations globally. Even a quick search of the media turned up seven citations from that period that characterized the IMF's position reasonably accurately. This suggests that if one criterion for effectiveness is contributing to the public debate, *WEO* (or likely also *Regional Economic Outlook*) coverage of trade issues may be relatively effective.

Japan

Initial conditions

31. Like the United States, Japan maintained a broadly open trade regime outside of agriculture. In the mid-1990s, Japan's average industrial MFN tariff was about 6 percent and over the evaluation period it fell to just over 5 percent. Measures of protection in agriculture, however, exceed those of the United States and the European Union, making Japan the most protectionist among the Quad countries in agriculture. The OECD's producer support estimate (PSE) put agriculture subsidies at over half of total farm income in 1996 and, due to some reforms during the evaluation period, at 45 percent of farm income in 2007. In the Uruguay Round, Japan committed to convert to tariffs all its nontariff barriers except for those on rice.[7] Though Japan was a strong supporter of trade liberalization through the Doha Round, it too became quite active in negotiating PTAs during the evaluation period, though generally somewhat later than the United States.

Main issues covered and policy advice

32. During the first half of the evaluation period, IMF attention to Japan's trade policy was scant. Staff involved explained to the evaluation team that

[6] "IMF says U.S. trade deficits threaten global growth," *Bloomberg Report*, June 25, 2002, includes a sentence on the IMF's position on the 2002 Farm Bill.

[7] Rice was exempted from tariffication for a six-year grace period from 1995 to 2000. Japan agreed, under the Uruguay Round Agreement on Agriculture, to minimum amounts of rice imports beginning in 1995 (increasing thereafter), and, in 1999, it effectively converted the special treatment of rice to an import tariff.

with few new commitments by Japan to trade policy changes after those embodied in the Uruguay Round and with major issues at stake in the real and financial sectors in the ongoing crisis, trade policy was not viewed as a priority for surveillance. Nevertheless, in two of those years, staff made effective use of OECD and WTO reports to motivate their positions (though at a relatively shallow level).

33. Starting in 2001, coverage of trade policy issues in Article IV consultations picked up. That said, during this relatively active period, only two background pieces were included in SIPs—one on agricultural policies (Nagaoka, 2002) and one of a more general, descriptive nature (Nagaoka, 2001)—and in 2006, trade policy was not mentioned in the staff appraisal or Executive Board summing up (IMF, 2006a, 2006d). Some consideration was given to Japan's growing interest in PTAs (the subject of a short annex in the 2007 staff report (IMF, 2007c)), but PTAs generally received less attention than in consultations with the United States. Still, as in the United States, staff appraisals pressed for MFN liberalization alongside the proliferation of PTAs. An economist with trade policy expertise from PDR's Trade Policy Division joined the mission teams in 2004–06.

Agriculture protection

34. In almost every consultation with Japan, staff discussed with the authorities the high protection of a wide range of agricultural products. The message that resulted reasonably consistently in staff appraisals (though only intermittently in Board summings up) was critical of the complexity and level of agricultural protection (IMF, 2002a, 2005b). During the late 1990s when staff attention was primarily on crisis-related issues, the language was typically general. As attention started to swing back toward trade issues in about 2001, the approach became somewhat more pointed: a recurring theme was the efficiency and productivity gains that a more open agriculture sector would make possible. This emphasis was consistent with the broader effort by staff—with occasional explicit backing from the Board—to advocate structural reform, deregulation, and liberalization to raise Japan's growth.

35. For much of the evaluation period, staff advocacy for agriculture liberalization was not backed by in-depth staff work. In 2005, an SIP (McDonald, 2005) addressed agriculture protection directly and provided the basis for subsequent positions in staff reports. This study was an effective amalgamation of simulations and other empirical work by several researchers inside and outside the IMF. The paper clearly reviewed the parameters of Japan's agriculture protection and then reported the effects of various multilateral agricultural liberalization scenarios on prices and volumes of agriculture imports to Japan, welfare in Japan, and value added in the Japanese agriculture sector. The work also drew on the 2002 *WEO* study on the effects of agriculture on developing countries (IMF, 2002c). As in surveillance on the United States, staff did not establish an explicit link between agriculture protection (a substantial portion of which was in the form of subsidies) and fiscal costs.

36. On at least one occasion, staff discussed with the authorities the main objective behind agriculture protection—food security. Staff acknowledged the authorities' concern but took the position that a better way to achieve food security would be to raise Japanese efficiency in food production, rather than to protect farmers (IMF, 2003c, 2004b). While this dialogue was useful, it would likely have been more effective if staff had provided even a simple numerical exercise to demonstrate the feasibility of the approach they suggested.

37. In contrast to the experience in the United States during the peak of staff interest in agriculture policy in 2001–02, the 2005 Executive Board summing up strongly supported the staff work**.** The summing up pointed to large potential benefits of liberalization given the agricultural sector's current low efficiency and used the opportunity to press for trade liberalization (IMF, 2005b).

38. The IMF's attention to agriculture dropped off rather sharply after 2005. Neither staff appraisals nor Board summings up mentioned agriculture policy during 2006–07. Insofar as the 2005 SIP had established a good basis for taking positions on agriculture protection for the next several years, this seems to have been a missed opportunity for continuity.

Resisting and handling protectionist pressures

39. By comparison with the United States, pressures for new protectionist measures were generally subdued in Japan during the evaluation period. In the first two years of the period, any new measures were detailed in the background paper to the staff report. Japan's bilateral relations with the United States and the European Union also figured prominently in these background papers (IMF, 1996c, 1997b). Though the issues generally did not spill over into the staff report, the detailed nature of the many issues reported clearly went beyond the macroeconomic concerns of the IMF. It was appropriate that this coverage ended early in the evaluation period, particularly as regular trade policy reviews by the WTO Secretariat more than amply covered such issues.

40. In contrast to surveillance in the United States, staff reports did not place much emphasis on using WTO dispute settlement procedures when protec-

tionist pressures did arise. This difference is quite reasonable insofar as Japan was not even among the top 20 users of antidumping initiations during 1995 to 2008, while the United States was ranked as the second most frequent user. Early in the period, staff only mentioned that progress had been made in resolving bilateral trade issues through active use of the WTO dispute settlement procedures (IMF, 1997a, 1998a). Later in 2002, however, staff called attention to instances of the use of safeguards (IMF, 2002d). In the first, Japan imposed safeguard protection on several agricultural commodities, but allowed these measures to expire shortly afterwards. In the second, Japan retaliated against the use of safeguards for steel in the United States. Staff reported the situation, but did not comment. The Board did not specifically take positions on the handling of requests for protection in Japan. It is unclear why staff took such low-key approaches.

41. Market access for developing countries was the issue on which the Executive Board most persistently pressed for Japan (IMF, 2002a, 2003b, 2004a). Staff did no in-depth work on this issue for the consultation per se, though of course they were able to draw on the work done on agriculture more generally in the 2002 *WEO* (IMF, 2002c). Still the result was a very general appeal for better terms of market access for developing countries rather than an attempt to give fresh perspectives on the problem every few years.

Japanese positions in the Doha Round

42. Just as for the United States, in 2001, staff began standard, though very brief, commentary on Japan's position in the Doha Round. As instructed by the Executive Board, these updates were direct reflections of the authorities' views, though the tone of reports was quite encouraging of Japan stepping up to a leadership role. The Executive Board also offered its explicit encouragement for such a role most years after 2000 (IMF, 2002a, 2003b, 2004a, 2007a).

Other issues

43. A few staff reports discussed issues of trade in financial services. Early in the evaluation period, an issue vis-à-vis the United States involved liberalization of Japan's insurance sector. Staff described the problem but did not take a position or involve themselves in the dispute (IMF, 1997a). In 2006, staff looked into overseas activities of Japanese banks (and included a box on the subject in the staff report (IMF, 2006d)). Both issues were noteworthy for their factual reporting with little in the way of a staff view on the questions.

Interlocutors and effectiveness

44. Both staff and the authorities saw the IMF's involvement in trade policies in Japan as quite limited, particularly when no in-depth work had been prepared before the mission. Routinely, IMF staff spoke to officials from the Ministry of Finance, the Economic Planning Agency, and the Ministry of Trade and Industry during the consultations. During the early part of the evaluation period, discussions were rather pro forma and uneventful, though in later years staff felt they had had quite good exchanges of views on PTAs and agriculture. From the Japanese side, the exchange of views was also seen as interesting, though Japanese officials explained to the evaluation team that several factors limited the IMF's effectiveness on trade (as well as on other issues): similarities of messages from many international institutions meant that new perspectives were infrequent; political considerations figured strongly in all policies, but particularly on trade issues where most actions were taken in negotiations; the Foreign Ministry was involved in trade policy formulation but did not meet with the IMF mission; and for most IMF missions, issues besides trade dominated the discussion.

45. The authorities suggested to the evaluation team that couching IMF advice on trade issues in the context of fiscal policy might make it more compelling. Specifically because agricultural subsidies were a key issue for Japan but were intensely political, greater traction might have been gained by examining the effects of subsidies on the fiscal position. More generally, the authorities felt that bringing fresh perspectives on the case against agriculture subsidies could be effective. However, in contrast to the U.S. authorities, who felt that the IMF's involvement in trade policy was crucial, Japanese authorities interviewed for this evaluation seemed to feel that trade policy was not an essential part of the Article IV consultation.

Norway

Initial conditions

46. Norway's trade regime during the evaluation period was characterized by very low protection of the industrial sector and very high protection of the small agricultural sector. Only a few agricultural product groups are produced domestically, yet farms received on average more than 60 percent of their income from budget support. In contrast, agreements in the Uruguay Round saw Norway's MFN industrial tariffs fall from an average of about 6 percent in the mid-1990s to less than 3 percent by 2001. Liberalization also occurred under the auspices of the European Economic Area; liberalization of trade in

services (including financial) was a particular focus there. Norway is also a member of the European Free Trade Association (EFTA), and primarily through EFTA, it participates in 17 PTAs.

Main issues covered and policy advice

47. By far the dominant trade issue in Norway's Article IV discussions was agricultural subsidies. Through 2005, the issue was raised each year in discussions, reported in the staff report, and mentioned explicitly in the Executive Board summing up. However, there was no in-depth staff analysis of the issue at any time during the evaluation period. And though the OECD pursued this issue in some depth in its regular series, *Agricultural Policies in OECD Countries*, no explicit references were made to that work or to WTO trade policy reviews. The 2002 *WEO* analysis of the effect of agriculture policies of advanced countries on developing countries (IMF, 2002c) explicitly included Norway (singled out along with Iceland and Switzerland as among the small advanced countries with exceptionally high agriculture protection). After 2005, the agricultural subsidy issue was not raised again in either the staff report or Board summing up.

48. The approach to the agriculture issue was, on the whole, similar across the years. Staff pointed clearly to the salient characteristics of the situation: at more than 50 percent of farm income, Norway's farm subsidies were at the top end of the industrial country spectrum; because Norway was a small producer on the global scale, the adverse effects were not systemic, but rather caused deadweight losses to consumers; whatever the aims of agriculture protection, they could be achieved with less distorting policies. The budgetary cost of subsidies (in 2001, 1.4 percent of GDP against a tax burden of 43 percent of GDP) was not a central issue in the staff's discussion of agricultural subsidies. In the dialogue, the authorities repeatedly made the point that subsidies served domestic nontrade objectives (support to sparsely populated parts of the country and food security) and that much of Norwegian agricultural production competes with European producers, rather than producers in developing countries. Therefore, agriculture policy did not contradict Norway's generous aid policy, as some critics claimed.

49. Other issues—specifically Norway's approach to the Doha Round and trade in services—were raised occasionally. Particularly during the consideration of Stage Three of the European Monetary Union in the late1990s, staff reports addressed the need for steps (especially liberalizing conditions for bank mergers and improving supervision) to help domestic banks compete when European competition increased (IMF, 1998b, 1999a). After 2001, staff also reported on the authorities' position in, and ambitions for, the Doha Round (IMF, 2003a, 2005a).

50. A surprising omission from the menu of issues raised with Norway was its abundant participation in PTAs. Though most of these agreements were organized through EFTA, and were therefore not the result of strictly domestic policy decisions, and though the PTAs typically embodied best practice with respect to regional cumulation of rules of origin, their sheer number suggests that the IMF should have analyzed their implications for Norway's economy.

Interlocutors and effectiveness

51. Trade issues did not form a central part of the Article IV discussions with Norway nor in turn of Executive Board discussions. The authorities with whom the evaluation team spoke felt that IMF advice had little effect on Norway's trade policies and that IMF staff expertise lay in issues other than trade policy—particularly in light of what they viewed as the very complicated nature of trade policy in Norway. That said, they felt that the IMF might be able to contribute more to the debate on trade policy if specific work were brought to the table on the effects of Norway's trade policies on its own macroeconomy or on developing countries. They were not specific about what such approaches might entail. The authorities to whom the evaluation team spoke did not however feel that the IMF should ignore trade policy issues. They felt that silence from the IMF on these issues would be taken as an indication of greater tolerance more generally for trade protection.

D. Findings

52. The IMF's surveillance in the United States until 2004 and, to a lesser extent, in Japan speaks to a reasonably strong attention to trade policy issues and willingness, for the most part, to take strong positions on trade issues in advanced countries. While this does not erase concerns about the asymmetry between IMF conditionality and surveillance in terms of forcefulness, it does ease concerns about whether the IMF *in surveillance* pressed on advanced countries to the same extent as it did on developing countries. Indeed, in advanced countries as in developing countries, the IMF urged countries to go beyond their WTO agreements in liberalizing trade policies.

53. Direct effects in terms of obvious changes in trade policies as a result of IMF surveillance are not obvious. As some country officials pointed out, however, the record on this score probably does not differ much from that in other areas of the IMF's involvement. That said, in two of the three countries examined, country officials felt that the discussions

had added some value and that IMF attention to trade policies should not be discontinued in their own countries or in other countries.

54. IMF advice on trade policy was often not seen as bringing a new perspective to trade policy issues. Typically, it did not depart from widely held views on best practice and often IMF staff brought no in-depth background analysis to the table. This suggests the need for some recalibration of the IMF's approach to trade policy in surveillance-only countries:

- Particularly in view of tight constraints on word counts in staff reports, attention to some of the more routine trade policy issues (such as countries' negotiating positions in the Doha Round) might best be omitted from staff reports, except when the authorities have made truly noteworthy points.
- At the same time, occasional in-depth attention to a key trade policy issue (for example, every three to four years) would establish the basis for strong IMF positions that are more likely to garner attention and influence the policy debate than is yearly more superficial attention.
- Such work should aim explicitly to draw micro-macro linkages, including between trade policies and fiscal balances—an area where the cases reviewed in this paper were rather thin.
- Analysis of trade policy in the *WEO* seems to have attracted better press coverage than that in bilateral surveillance. More attention in multilateral surveillance exercises to trade policy issues with implications for the global macroeconomic outlook and stability would have strong synergies with country-specific involvement in trade policies.

55. The coverage of trade policy issues in the countries examined generally encompassed the right issues from the IMF's perspective. That said, PTAs in Norway and trade in services issues more generally appear to have been underrepresented in Article IV consultations relative to their likely importance for macroeconomic outcomes.

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Statement by the Managing Director

Staff Response

The Acting Chair's Summing Up

Statement by the Managing Director on the Independent Evaluation Office Evaluation of IMF Involvement in International Trade Policy Issues

Executive Board Meeting
June 8, 2009

1. The Independent Evaluation Office (IEO) is to be congratulated for a thorough and insightful report into the IMF's involvement in international trade policy issues. I consider that the report provides a balanced assessment of the strengths and weaknesses of the Fund's involvement and I welcome the IEO's constructive recommendations.

2. I am encouraged by the IEO's generally positive assessment of the Fund's work in this area. In particular, I welcome the IEO's positive findings on: the appropriateness of conditionality on trade liberalization; the effectiveness of institutional cooperation; and that on some important trade issues, bilateral surveillance has provided excellent analysis and a strong voice for changing policies that harmed global stability. I am also pleased that the IEO's efforts to assess the IMF's overall effectiveness in this area has put the IMF in a fairly favorable light. This can be seen both through the IEO's detailed survey results, as well as their supporting analytical work.

3. As the report rightly emphasizes, the IMF's involvement in trade policy has evolved since 1997. Certainly the success in opening trade regimes globally has made some reduction in staff resources for trade both possible and desirable, but this report provides an excellent opportunity to discuss future priorities, and the role the IMF should play in trade policy issues going forward. Given the demands on the Fund we must seek to prioritize trade work while remaining broadly within the existing resource envelope for trade. In light of this, I agree in particular with the IEO's focus on financial services and preferential trade agreements, and the need to ensure due attention to farm and other systemically-important trade policies in major countries.

4. The accompanying staff statement provides a detailed response to the report's findings and recommendations. I look forward to the Board's reflections on the report, which will provide the opportunity to draw out further the implications for the Fund's policies and procedures.

Staff Response to Independent Evaluation Office Evaluation of IMF Involvement in International Trade Policy Issues

Executive Board Meeting
June 8, 2009

Key Points

- We welcome the IEO's perspective on the role of trade in the Fund, including the recognition that trade policies can strongly influence macroeconomic stability. Staff agree on the need to prioritize trade work, while remaining within the existing resource envelope.
- We agree with the focus on financial services and preferential trade agreements, and the need to ensure due attention to farm and other systemically-important trade policies in major countries.
- Staff agree that the Fund needs to have some dedicated expertise on trade issues, though not a stand-alone division on trade policy.

1. This IEO Evaluation presents a useful assessment of the Fund's involvement in trade policy and provides constructive ideas for its future evolution. The Fund's overall mission requires that it address certain aspects of trade policy, including those that significantly influence external stability, yet we must be mindful of overall constraints. In this context, we see the recommendations as useful in contributing to a discussion on priorities for trade work within the Fund, rather than expanding that work.

2. Resources devoted to trade have declined. The Evaluation could, however, have conveyed more clearly that success in opening trade regimes globally made a reduction in staff resources for trade desirable. Nevertheless, as international economic integration has deepened the macro-critical trade issues facing staff have also tended to change, and there is a need to develop guidance for new issues such as preferential trade agreements (PTAs) and financial services.

Comments on IEO Recommendations

3. *Board guidance*. Periodic Board guidance on trade policies would help to define the parameters of trade work in ways that best support the Fund's broader mission. We agree that such discussions should be more focused than the 1994 Comprehensive Trade Paper. In line with the cycle for other policy reviews, this could be done at five-year intervals.

4. *Trade policy in Fund-supported programs*. Members experiencing balance of payments needs can face protectionist pressures, and an advisory role may be appropriate during Fund-supported programs. Guided by Article I(v), the emphasis should be on avoiding the resort to trade restrictive measures: trade liberalization should be promoted actively only where judged necessary for program objectives. Staff considers that cross-country monitoring of trade finance developments, including through close contact with market participants and trade finance experts in other institutions, is normally adequate, although additional attention to trade finance is appropriate in periods of financial market stress, such as the current crisis.

5. *Surveillance: PTAs*. There is scope for additional guidance to staff on the role and approach of the IMF in PTAs. This should not expand the mandate by involving staff in detailed assessments of individual PTAs. Rather, considering the Fund's broader objectives and aware of the work done in other multilateral organizations, the guidance should identify particular aspects of PTAs such as fiscal effects and the impact on investment flows in which the Fund's broader mission implies an interest.

6. *Surveillance over trade policies: trade in financial services*. Considering the importance of financial services trade in financial stability, there is also scope for guidance on the IMF role and the modalities for staff work. This role might appropriately stress the links between trade in financial services; the (international and domestic) regulatory environ-

ment, including of the WTO; and capital account liberalization. It may be important to develop in a very few staff the appropriate specialized expertise.

7. *Trade policy in multilateral and regional surveillance*. We agree that there should be occasional trade-policy-related pieces in existing surveillance vehicles such as the *WEO* and *REOs*, to place these issues in a regional and global context. Like the IEO, we see potential economies of scale in orienting these pieces toward helping IMF staff teams sharpen views on trade issues of macroeconomic significance. This could also help to meet the IEO's objectives regarding outreach and the balance of trade policy issues across the Fund membership.

8. *Trade policy advice across the Fund membership*. The IEO's recommendation here lines up well with existing guidance following the Review of Fund Work on Trade (SM/05/47). On that occasion, "Directors considered that it would be useful to extend the staff's analysis of spillover effects of the trade policies of key industrial countries to cover also the trade policies of larger middle-income countries…." (BUFF/05/45). In the event, the anticipated extension of trade policy spillovers to a few larger middle-income countries has not occurred. The diminished frequency and depth of coverage in key industrial countries has reflected shorter and more focused staff reports, uncertainty as to when a "spillover" warrants attention, and, more recently, a decline in overall staff resources and the urgency of crisis-related work. Staff agree that more consistent attention be given to the regional and global effects of trade policies in systemically important countries. For the relatively few countries concerned, in most cases trade policy spillovers could be addressed at two to three year intervals. To use staff and travel resources most efficiently, we would explore carrying out much of this work in Geneva, where all large members have mid- and high-level trade officials, with area department staff following up with capital-based officials.

9. *Outreach*. Staff supports the objectives of this set of recommendations. We agree particularly with the way in which the IEO elaborates the recommendation in the context of PTAs. Addressing other IEO recommendations (such as on board guidance and multilateral and regional surveillance vehicles) would in staff's view go far toward enhancing outreach, and greater selectivity and clearer priorities in trade work would facilitate also greater outreach in the selected areas. Exploring alternative modalities for trade work may allow for doing this work roughly within the existing envelope of trade-policy-related resources.

10. *Expertise and organization*. We agree that a certain level of expertise on trade policy is needed inside the Fund, particularly as the focus shifts from conventional trade policies to newer, more complex areas. However, given the larger division size following the Fund's recent refocusing, this may not be best achieved in a stand-alone division. Regardless of the division structure, we believe that implementing other IEO recommendations would provide needed exposure to this work and help to draw and sustain the required expertise. Staff would be open to exploring other modalities if these could improve the quality and efficiency of our trade work.

11. Data on trade policies are important, but information on trade policies need not come exclusively from the Bretton Woods institutions. The quality and accessibility of trade policy information from the WTO and other institutions has greatly improved over the last two decades. Also, compiling data has often considerable resource costs. As the Evaluation notes, the World Bank has had considerable difficulty in keeping its Trade Restrictiveness Index (TRI) up to date even with its much larger resource envelope, and we doubt that Fund staff could do much to expedite the TRI.

12. Staff share the IEO's view that institutional cooperation has been generally effective, particularly at the informal level and among management teams. Much of the informal cooperation with the WTO involved the Office in Geneva, and with its closure in November 2008 staff are mindful of the need to sustain the frequency and quality of institutional cooperation. Occasional regular or formal meetings on trade with counterparts in other multilateral economic institutions may have important benefits. Such meetings might be most effective at staff levels and be used to set an agenda for and follow up on practical issues of common importance to the institutions.

Appendix: Country-Specific Comments and Factual Corrections

Country-specific comments

Japan

Paragraph 37 argues that Article IV consultations with Japan after 2005 have not included background papers on the issue of PTAs. We would emphasize, however, that staff's 2007 report on Japan makes the point (page 26, paras. 32 and 34) that to enhance the benefits of PTAs, Japan's network of bilateral EPAs should work effectively on a regional basis, such as through regional cumulation of origin and low and secure MFN tariffs, and recommended a reduction in agricultural protection. To provide supporting detail, staff included an annex (page 37) specifically on issues regarding Japan's economic partnership agreements.

Indonesia

Paragraph 32 of the report notes that "*without obvious indications that trade reforms were critical to addressing the causes of the capital account crises in these countries, political pressures on IMF management from trade partners/competitors appeared to play a role.*" Staff would emphasize, however, that in the background study on Indonesia, the IEO clearly lays out the case for trade reform in the Indonesia program as being "essential for improving productivity, efficiency, and economic governance" (para. 6).

Vietnam

Paragraph 111 of the background document suggests that the liberalization of financial services in Vietnam increased risks and created instability in the banking sector. Staff would qualify this with three points. First, foreign banks continue to have only a limited presence in Vietnam, mainly operating as bank branches, with three foreign-owned subsidiaries having only recently started to operate. Second, as noted in the 2008 Article IV consultation, "*some joint-stock banks (JSBs) have benefited from investment and knowledge transfer by major foreign banks in recent years*." Finally, the statement in the background document that "*The liberalization of foreign entry into the banking sector in 2007 brought a flood of domestic and foreign applications for banking . . . concerned about the possible impact on banking soundness, the central bank tightened the criteria for granting new licenses in August 2008*" is misleading. In fact, most of the applications for banking licenses were from domestic entities, while rapid credit growth was fueled by massive capital inflows. The central bank's response—tightening the licensing criteria—was not aimed at foreign banks, but rather at domestic banks, in particular the conversion of rural banks to urban JSBs as well as attempts by state-owned enterprises to establish their own banks.

Turkey

Paragraph 32 uses the example of Turkey to support the claim of uneven treatment on trade policy conditionality. It should be emphasized, however, that the Turkish economy at the end of the 1990s was burdened with many inefficiencies, and program conditionality in 1999 focused on fiscal sustainability—which was at the core of Turkey's history of macroeconomic instability—and those issues most related to it. Furthermore, it is important to note that the World Bank took the lead on agriculture and trade issues at that time.

Tanzania

Regarding paragraph 22 of Background Document 4 staff would emphasize that since 2007 wide-ranging customs reform initiatives have been implemented, including the East African Community customs union protocols and common external tariff; improved trade facilitation; automation; and integration of customs administration and destination inspection processes.

Factual corrections

In Background Document 2, the extent to which the WTO is required to consult the Fund on issues within Fund jurisdiction, including under Article XV of GATT, is somewhat misleading. Specifically, the role assigned to the Fund by the WTO Agreements is more dispositive than suggested in paragraphs 4 and 8 of Background Document 2. GATT Article XV provides that the WTO "*shall accept* (emphasis added) the determination of the Fund as to whether action by a [member] in exchange matters is in accordance with the Articles of Agreement of the IMF." In this regard, contrary to what is suggested in paragraph 4 of Background Document 2, the WTO is *required* to, not "expected" to, defer to the Fund's findings on the consistency of a member's action in exchange matters with the Articles of Agreement. Similarly, in paragraph 8 of Background Document 2, a panel is *clearly required* to receive and treat as authoritative the Fund's findings on the consistency of a member's actions with the Articles of Agreement.

The main report contains several incorrect statements concerning the new policy on structural conditionality. In particular, paragraph 15 incorrectly states that the IMF is retreating from structural conditionality. Rather, the IMF is changing the modalities for monitoring progress in the area of structural reform in a review-based framework.

The main report and Background Document 1 draw a distinction between a "*passive*" and an "*active*" role in the surveillance of trade policy issues. Staff would like to clarify that the Fund has not viewed its surveillance mandate in a manner that distinguishes a passive and an active role.

Paragraph 43 of the main report argues that "*a serious impediment to focused work on trade in financial services is the virtual absence of measures of the degree of restrictiveness of countries' financial services sectors.*" We do not disagree, but it's worthwhile noting that the IMF's *Annual Report on Exchange Arrangements and Exchange Restrictions*

(AREAER) database does include useful information on three modes of trade in financial services, namely: purchase abroad; cross-border provision of services; and commercial presence.

The report does not mention the IMF's cooperation with a number of other relevant bodies, including, for example, the World Customs Organization (WCO).

The reference for the *Review of Fund Work on Trade,* SM/05/47 (Washington: International Monetary Fund) is incorrect in Background Document 1.

Paragraph 6 of Background Document 2 states that, according to the Reference Note on WTO-Consistency, Fund staff could not, in the context of a comprehensive tax reform, ask a country to increase some tariffs above their WTO bindings. This statement appears to go further than the Reference Note, which stated that Fund staff should explore alternatives with authorities for not increasing tariffs above their WTO bindings and that, if this is unavoidable, the staff should advise the authorities to consult with the WTO under the relevant provisions to seek the requisite waiver.

Paragraph 17 of Background Document 2 incorrectly mixes staff policy advice on surcharges with the Fund's institutional role in WTO BPC consultations. On the latter, the WTO Agreements do not call on the Fund for trade policy advice.

In paragraph 32 and Box 10 of Background Document 2, the discussion misses the key practical benefit of the TIM, the deviation feature (under which augmentation decisions can be expedited). In Box 10, the "*policy adjustment endorsed by the staff*" seems to refer to the TIM qualifying event. That qualifying event was not CAFTA-DR, but the WTO ATC.

Paragraph 15 of Background Document 3 is somewhat outdated as it does not reflect the Board's more recent discussion of revenue replacement issues in 2005, in the context of FAD's background paper on dealing with the revenue consequences of trade liberalization.

Paragraph 128 of Background Document 4 referencing the Baunsgaard-Keen paper should be qualified. As other later work has stressed, country experience has varied widely, and some low-income countries have a good revenue replacement performance.

The Acting Chair's Summing Up
IEO Evaluation of IMF Involvement in Trade Policy Issues

Executive Board Meeting
June 8, 2009

Executive Directors welcomed the Independent Evaluation Office's (IEO) insightful Evaluation of the IMF's involvement in international trade policy issues, which has provided a valuable opportunity to take stock of achievements and identify ways to further enhance effectiveness in this important area. Directors considered that the report provides a balanced assessment of the Fund's involvement and welcomed its constructive recommendations. They broadly agreed with the IEO that the Fund has an important role to play on broad trade policy issues and their implications for external stability, but highlighted the Fund's resource constraints. Many Directors also observed that trade policy issues are only peripheral to the core competency of the Fund, and viewed engagement as being best served through cooperation with the WTO. Against this background, Directors agreed that the Evaluation gives useful impetus to discussions on what should be the priorities for trade work within the Fund's existing resource envelope going forward. Directors welcomed the report's comprehensive coverage of trade policy issues, although some felt that the interaction between exchange rate and trade policies could have been usefully included.

Noting that trade policies can strongly influence macroeconomic stability, Directors agreed with the IEO that the Fund must play an active role in calling attention to systemic and macroeconomic implications of trade policy developments. Surveillance should discuss macro-critical trade policy issues, for all countries, while ensuring evenhandedness in trade policy advice. In this context, most Directors also saw scope for multilateral surveillance to pay greater attention to the global effects of trade policies in systemically important countries. The Fund's role in assessing the revenue implications of trade liberalization was also noted. However, given resource constraints, Directors emphasized that greater attention to the key trade policy issues in surveillance will require effective prioritization.

Most Directors welcomed the scaling back of conditionality on trade policy in Fund programs. They suggested that trade-related conditionality should continue to be macro-critical and take into account country-specific circumstances, as in other policy areas. Directors underscored that, guided by the Fund's Article I, the emphasis should be on avoiding the resort to trade restricting measures. Trade liberalization should be promoted actively where necessary for program objectives. Some Directors concurred with the IEO recommendation for a strong advisory role for the Fund in this context.

Most Directors supported the IEO's recommendation on the need for periodic Board review of guidance on trade policies, which would help to define the parameters of trade work in ways that best support the Fund's broader mission. Directors agreed that such discussions should be more focused than the 1994 Comprehensive Trade Paper and, in line with the cycle for other policy reviews, might be done at five-year intervals. In particular, they noted the benefits from guidance on the approach to trade in financial services that stresses the links between trade in financial services, the regulatory environment, and capital account liberalization. A few Directors also saw a role for Fund advice in the area of financial protectionism. Most Directors considered it advisable to establish guidance on the approach to Preferential Trade Agreements (PTAs) where there are issues of spillovers or significant macroeconomic effects.

Directors agreed that attention should be given to the regional and global effects of trade and trade-related policies (in this context, a number of Directors mentioned agriculture) in systemically-important economies when such issues are relevant, given their important external spillovers. They also agreed that trade policy should be addressed periodically in multilateral and regional surveillance vehicles, such as the *World Economic Outlook*, *Regional Economic Outlooks*, and, on financing issues, the *Global Financial Stability Report*.

Some Directors supported the Evaluation's emphasis on enhancing outreach. Directors underscored that outreach on trade issues should follow the same principles as Fund policy recommendations on other macro-critical structural policies.

Directors agreed with the IEO Evaluation on the need for a critical mass of trade policy expertise within the Fund. Most, however, did not consider that this required re-introducing a separate Trade Policy Division, while recognizing that this matter would have to be decided by management. Directors concurred with the IEO on the importance of up-to-date summary trade policy information within the Fund, but encouraged staff to examine efficient alternative approaches to securing and internally disseminating this information. They also encouraged reliance on data provided by the WTO and the World Bank.

Directors welcomed the IEO's finding that institutional cooperation with the WTO and the World Bank on trade has evolved and should be strengthened further, and agreed that occasional meetings on trade with counterparts in other multilateral economic institutions would—if focused and well-designed—bring important benefits. Directors suggested that such meetings might be most effective at staff levels and be used to set an agenda for and follow up on practical issues of common importance to the institutions.

Directors looked forward to consideration of management's implementation plan of the Board-endorsed recommendations later in 2009.