INTERNATIONAL MONETARY FUND

Review of Fund Work on Trade

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In Consultation with Other Departments

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EXECUTIVE SUMMARY AND RECOMMENDATIONS

The Fund has responded to a number of recent challenges facing its members by stepping up its work on trade. The Fund's trade agenda has been shaped by both Executive Board guidance and demands on missions. The present report assesses the Fund's priorities in the trade area, takes stock of its work, and reviews the Fund's collaboration and division of labor with other institutions. It is organized around three broad themes.

Under the first theme, the report examines the trade-related challenges facing Fund members and the associated Fund messages. The Fund has consistently advocated open trade regimes as a means to improve economic efficiency, combat rent-seeking and corruption, promote income growth, and, as a result, provide a firm basis for poverty-reduction efforts. This message is grounded in economic theory and supported by the recent empirical literature on trade and growth. While the message applies to members at all income levels, there are differences in emphasis:

- **The Fund's trade advice to developed countries has focused on global policy spillovers.** Market access restrictions and trade-distorting subsidies in sectors such as agriculture and labor-intensive manufactures are costly for the countries themselves and at cross-purposes to the international community's development efforts.
- **In many developing countries the Fund's focus has been on the unfinished liberalization agenda.** The Fund has advised developing countries to seize the opportunities that open trade policies afford to promote development objectives, and to avoid conditioning liberalization on the policies of other countries.
- **The Fund has encouraged members to proceed with trade reforms despite possible short-term adjustment costs.** It has directed its resources to helping countries address balance of payments vulnerabilities and fiscal challenges related to trade reform in order to create the conditions for successful adjustment.

The Fund has also pressed for an ambitious Doha Round and urged members to ensure that free trade initiatives are consistent with the multilateral system. Success in the Doha Round requires developed country leadership and the readiness of developing countries to take on both the rights and obligations of the multilateral system. Regional trade preferences cannot substitute for an open multilateral system. Their proliferation may pose serious risks, and they will need to be designed carefully.

The report concludes that these messages remain valid for the period ahead. Members continue to face challenges as the WTO moves towards a Doha Round settlement and its implementation, progress on the MDGs becomes increasingly pressing, and preferential trade arrangements continue to multiply while their regulatory content deepens. At the same time, low-income countries should be encouraged to integrate trade strategies more fully into PRSPs—given trade's position at the core of any viable development strategy. The Fund could also highlight the benefits of reforms in services trade as much as it has for merchandise trade.

Under the second theme, the report describes how the Fund has carried out its work on trade and assesses the scope for improvement. The report reviews recent work by modality and notes that:

- **The Fund has stepped up its surveillance of trade-related issues in the past three years**, especially with regard to policy spillovers from high-income countries, trade-related macro vulnerabilities, and regional trade initiatives. The Fund is helping to lay the groundwork for mainstreaming trade in PRSPs through its participation in the Integrated Framework.
- **The use of trade-related conditionality under Fund-supported programs has declined sharply, while program work is beginning to focus on trade vulnerabilities** (with the Trade Integration Mechanism (TIM)). There has been a drastic shift in the content of conditionality from trade policy measures towards trade administration.
- **Fund staff has also undertaken a significant amount of trade-related research, technical assistance and communication.** While regional integration issues were most prominent among research topics, technical assistance has focused on addressing budgetary aspects of trade reform and on customs modernization. Trade-related communication has become considerably more forceful, most visibly through management speeches, letters, and communiqués in support of the Doha Round.

Trade coverage through the different modalities appears largely adequate, but the report recommends some fine-tuning:

- **Scope remains for a more selective discussion of trade policies in bilateral surveillance**—while the discussion could be strengthened in some cases, it could be dropped in others. The report offers suggestions that might assist the coverage decision.
- **Efforts to mainstream trade policies in PRSPs could receive further impetus under the forthcoming review of the medium-term orientation of PRSPs.**
- **The Fund could consider combining its dialogue on trade policies at the bilateral level more systematically with discussions at the regional level.** As the proliferation of regional integration arrangements leads to a pooling of trade policy and administrative prerogatives, the current approach to Fund bilateral surveillance in this area may become less effective.
- **The dialogue on global spillovers of policies might be extended to the larger middle-income countries**, whose trade policy decisions (principally on market access) have a rapidly growing impact on the export prospects of other countries.
- **Services trade warrants increased emphasis in surveillance.** Coverage of services trade will be facilitated as information, which has traditionally been scarce in this area, is beginning to improve.
- **The sharp decline in trade-related conditionality should be assessed within the context of the broader review of implementation of the 2002 Conditionality Guidelines.** In particular, it raises questions about the appropriate scope of conditions for

reforms that may be key for longer term program objectives, but whose immediate criticality may be difficult to establish.

Under the third theme, the report reviews the Fund's collaboration on trade issues with other agencies and assesses whether the division of labor is appropriate. The two multilateral agencies with which the Fund collaborates most closely on trade are the World Bank and the World Trade Organization. The three institutions have a number of complementary strengths. Technical level collaboration has been smooth, and in recent years there have also been several joint initiatives at management level.

The scope for division of labor among the three agencies should not be overestimated. Each has its own mandate and capabilities. While all three foster the progressive liberalization of trade in goods and services, the Fund focuses on the overall policy framework, the Bank on development and sectoral issues, and the WTO on a rule-based approach to liberalization and transparency.

- **There can be overlap between the Fund and the Bank in trade-related surveillance and research**. But the Bank cannot substitute for the Fund's assessments where these are required under Article IV surveillance or other Fund policies. And, while not eliminating it, differences in the frequency, country coverage and focus of each institution's trade dialogue and analysis often reduce overlap in practice. In trade-related program support, the two institutions have a history of cooperation.

- **With the WTO, there is less risk of duplication because of fundamental differences in the nature of the Fund's and the WTO's work**. The WTO is a member-driven organization. While trade policy reviews (TPRs) at the WTO have become more analytical over time, the WTO Secretariat nonetheless operates within much narrower confines in this respect than does the Fund staff in its preparation of Staff Reports, and the Secretariat focuses uniquely on the impact of trade policies on trade. And TPRs do not substitute for the obligations of the Fund and members to engage in trade-related surveillance under Article IV, as appropriate.

- **The evolving trade agenda will require occasional reassessments and fine-tuning of the relationship among the three institutions.** In emerging areas such as regional trade arrangements, there remains scope for better informing the Fund's work by drawing on the considerable expertise of the Bank, the WTO and other agencies. In certain other areas, especially financial services trade, there may in future be a need to define more clearly the relationship between the Fund and the WTO, as market access and regulatory commitments under multilateral trade agreements gain in substance.

I. Introduction

1. **The Fund has occasionally reviewed aspects of its work on trade, with the latest review focused on trade-related conditionality in Fund-supported programs.**[1] The Fund's commitment to the success of the Doha Round of multilateral trade negotiations, its engagement in low-income countries, and trade-related macroeconomic challenges facing the membership have led the Fund, in recent years, to step up its involvement in trade issues. This argues in favor of a more comprehensive approach to the review at the present time.

2. **The Fund's mandate on trade is grounded in its Articles and its general policies.**[2] In a general sense, the Fund's work on trade matters is consistent with the purpose of the Fund expressed in Article I (ii), "to facilitate the expansion and balanced growth of world trade." Specific responsibilities derive from the surveillance mandate under Article IV and from the requirement, under Article V, that Fund financial support be consistent with its purposes. Trade policies fall under the surveillance mandate when they have fiscal impact or are a sign of exchange rate inadequacy. As expressed recently in the Executive Board discussion in the context of the *2004 Biennial Surveillance Review*, trade policies are also covered by Article IV where they have an important influence on a country's stability and growth prospects.[3] Similarly, in accordance with the *Conditionality Guidelines* of 2002, trade policy measures not only can but should be covered by conditionality in a Fund-supported program when the measures are of critical importance for achieving the goals of the member's program or for monitoring the program. Part of the task of this paper, in Section III, is to provide more detailed operational content to these policies as they apply to trade issues. In so doing, it focuses on trade-related surveillance and program work, but also describes the work in other areas, including research, technical assistance and outreach and communication.

3. **Against this background, the Fund has focused on trade issues either directly, as part of its core macroeconomic agenda, or because trade policy significantly influenced the environment for that agenda.**[4] Some aspects of the Fund's trade work aim at promoting

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[1] *Trade Policy Conditionality in Fund-Supported Programs* (SM/01/60, Supplement 3, 2/16/2001); Robert Sharer and others, *Trade Liberalization in IMF-Supported Programs*, World Economic and Financial Surveys (Washington, DC: International Monetary Fund, 1998); Margaret Kelly and others, *Issues and Developments in International Trade Policy*, World Economic and Financial Surveys (Washington, DC: International Monetaryf Fund, 1992); and Margaret Kelly and others, *Issues and Developments in International Trade Policy*, IMF Occasional Paper No. 63 (Washington, International Monetary Fund, 1988).

[2] Annex 1 discusses legal aspects of the Fund's trade-related surveillance and program work.

[3] *The Chairman's Summing Up, Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision* (SUR/04/80, August 2, 2004).

[4] For Board guidance on trade-related priorities, see *Concluding Remarks by the Acting Chair, Trade Issues—Role of the Fund* (BUFF/01/143, September 20, 2001) and *Concluding Remarks by the Acting Chair, Market Access for Developing Country Exports—Selected Issues* (BUFF/02/165, September 18, 2002).

economic stability and growth. Trade regimes that are distortionary or allow excessive discretion create a poor environment for economic performance, external viability, aid effectiveness, and good governance. Conversely, and as explored in a background paper, trade reforms are crucial ingredients of growth strategies and can be instrumental for the success of reforms in other areas—such as locking in regulatory reforms through external commitments, strengthening market disciplines on enterprises and banks, or reducing the scope for corruption. In addition to the balance of payments effects of trade policies and of the global trade policy environment, there are other links between trade and the macroeconomic framework. Thus, trade policies may affect government revenue and, under the growing rubric of services trade, financial sector stability.

4. **While trade policy is covering an increasingly wide array of topics, the focus of the Fund's work has reflected its own macroeconomic perspective.** The evolution of the trade negotiations agenda under the GATT/WTO illustrates the widening of the "trade policy" concept. Early GATT rounds were primarily concerned with tariffs and nontariff barriers (NTBs) for trade in industrial products, while more recent rounds have also covered agriculture, textiles and services, and added or deepened the coverage of a broad range of "behind-the-border" regulatory issues,[5] associated capacity building and (more loosely) infrastructure. The Fund's responsibility for global and macro-linkages requires that it take a particular perspective in addressing these issues—broadly speaking, encompassing a large segment of the trade policy spectrum but concentrating on the link with the wider economic context.

5. **In carrying out its responsibilities, the Fund cooperates with and draws on the work of other institutions.** In particular, the Fund, the World Bank, and the WTO share common objectives in the trade area, and—while carefully respecting each institutions' mandate—there is a need to ensure policy coherence and a sensible division of labor. The review highlights notable differences in the approaches and competencies of the three institutions, which can limit opportunities for relying on each others' work, but also a considerable amount of fruitful interaction.

6. **In sum, this paper sets out to answer three sets of questions**: First, what are the challenges facing the membership in the trade area (Section II)? Second, how did the Fund carry out its work on trade, was it consistent with the Fund's policies on surveillance and program support, and is there scope for adjustments to better fit the challenges (Section III)? Third, how does the Fund collaborate on trade with other agencies, and is the division of labor appropriate (Section IV)? The paper does *not* review the quality of the Fund's analysis and advice in the trade area for individual countries, nor its economic or social impact, given the resource costs of such a study. These questions are raised in Section V along with a request for Executive Board guidance on follow-up work. A discussion of resource

[5] Thus, the negotiating agenda under the Doha Round and certain recent bilateral trade agreements cover "behind-the-border" measures such as subsidies, investment policies, intellectual property rights, government procurement, competition policy, services regulation, and other areas.

implications of the proposals in the paper follows in Section VI, and issues for discussion in Section VII.

7. **Three companion papers probe more deeply into some of the issues raised and are frequently cross-referenced.**[6] One describes trends and patterns in the Fund's trade conditionality, while another assesses the fiscal implications of trade reforms. The third companion paper reviews the pros and cons of the Fund's Trade Restrictiveness Index (TRI) and discusses ways to address its shortcomings, which relate mainly to the crude qualitative measure used for non-tariff barriers. Alternative indicators tend to impose exacting data requirements, which are not easily met by many Fund member countries. Against this background, and while efforts will continue to be made to refine the TRI or calculate parallel indicators, the TRI remains a useful tool to identify where more in-depth analysis of trade policy reform needs is appropriate. This is the way in which the TRI is employed in the present report.

II. Trade Policy Challenges Facing the Membership

8. **A number of challenges are shaping the Fund's work in the trade area**. These are briefly discussed in this section, dividing them into the reform agendas at the unilateral, multilateral, and regional levels for conceptual clarity.

A. Tackling Restrictive Trade Regimes

9. **Despite significant gains in trade liberalization over past decades there is a sizable "unfinished agenda."** Table 1 provides a perspective on how trade regimes for merchandise trade have evolved between 1997 and 2004, as measured by regional averages as well as for the ten most restrictive economies in each region. The Fund's advice in this area is premised on the voluminous theoretical and empirical literature in support of trade liberalization, which suggests that trade restrictions result in the misallocation of resources, constrain private sector- and export-led growth, and can lead to entrenched corruption and poor governance. And while the direct link between trade and the income of the poor continues to be debated, to the extent that trade reform promotes growth, it can make important contributions to poverty reduction.[7] Political economy or fiscal revenue considerations can, of course, dictate temporary deviations from standard advice (as set out in Annex II), and Fund missions have tended to be sensitive to such constraints.

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[6] *Trade Conditionality in Fund-Supported Programs 1990-2004* (SM/05/57, Supplement 1); *Review of the IMF's Trade Restrictiveness Index (SM/05/57)*, and *Dealing with the Revenue Consequences of Trade Reforms* (SM/05/57, Supplement 2).

[7] For a recent review of the literature, see Berg, A. and A. Krueger, 2003, "Trade, Growth and Poverty: A Selective Survey," IMF Working Paper 03/30 (Washington: International Monetary Fund).

Table 1. Trade Restrictiveness Index (TRI) Ratings and Average Tariffs by Region[1]

	1997				2004			
	Simple Average Tariff (in percent)		**TRI Rating**[2]		**Simple Average Tariff (in percent)**		**TRI Rating**[2]	
	All countries	*Ten most restrictive*	*All countries*	*Ten most restrictive*	*All countries*	*Ten most restrictive*	*All countries*	*Ten most restrictive*
AFR	22	*32*	5.9	*9.1*	17	*26*	4.2	*6.8*
APD	14	*26*	4.9	*7.3*	11	*21*	4.1	*6.6*
EUR	11	*16*	4.2	*5.8*	7	*11*	3.8	*4.7*
MCD	17	*30*	5.4	*8.8*	12	*23*	4.0	*7.0*
WHD	13	*18*	4.6	*6.2*	12	*18*	4.1	*5.5*

Source: Trade Policy Information Database.
[1] The first columns under each heading represent totals for the region as a whole; the second (in italics) represents the average for the ten countries with the most restrictive regimes in each region.
[2] The TRI, which is a synthetic index of both tariff and NTBs, rates countries on a scale of 1 to 10, with 10 the most restrictive. For a description, see the companion paper, *Review of the IMF's Trade Restrictiveness Index*, SM/05/57. See also paragraph 7 above.

10. **Given the diversity of the Fund's membership, tackling impediments to trade entails differences in emphasis for different groups.**[8] As shown in Table 1, while trade barriers have declined across regions, they remain high in a subset of countries which thus face the challenge of broad-ranging trade reforms. In countries with more open overall trade regimes, challenges tend to be more issue-specific. Key measures might include moving toward relatively low and uniform tariffs, limiting exemptions, and eliminating NTBs to trade and restrictions on exports. Developing countries are often concerned about the implications of tariff reforms for government revenues. Designing a trade liberalization strategy that avoids government revenue losses can be a challenge, as many countries have few other tax instruments to rely on.[9] For the large trading nations, in addition to the cost to themselves of restricting trade, the spillovers of their policies on the global trading system—and especially on poorer countries—can matter greatly and should help inform the reform agenda. Although WTO negotiations will, if successful, curtail some of the more distortionary subsidies, peak tariffs and tariff escalation, policies with significant third-country impact are bound to remain prominent (including contingent forms of protection, such as safeguard and antidumping action).

11. **In many low-income countries, PRSPs should represent a focal point for policy and assistance towards growth and external sustainability, yet few contain a coherent strategy for trade.** This is unfortunate, not least since the participatory nature of PRSPs could allow the authorities to develop public support for trade reforms and facilitate their implementation by linking policy actions with budgetary resources and donor support. The

[8] See also Annex II for the trade policy guidance issued to Fund staff.

[9] A companion paper provides a detailed analysis and a fresh look at policy options (*Dealing with the Revenue Consequences of Trade Reforms* (SM/05/57, Supplement 2).

trade content of PRSPs shows a shift in countries' trade-related priorities toward trade facilitation and regional and global integration strategies. However, the discussion often appears incomplete. For instance, as shown in Table 2, PRSPs in several of the countries with moderately restrictive trade regimes do not discuss reforms to tariffs or NTBs (and where they do, they often lack substance). Policy coherence in some PRSPs seems tenuous, as they simultaneously advocate export-promotion and import-substitution policies. The discussion of integration strategies tends to lack specifics and practical measures. And there is little analysis of the poverty implications of trade policies, or of their link to growth.[10]

Table 2. Trade Policy Content of PRSPs as of End-2004
(38 countries covered)

Nature of Trade Regime[1]	Number of Countries	Discussion of trade policy regime[2]
Liberal	24	9
Moderately restrictive	11	5
Restrictive	3	3

[1]Trade restrictiveness index 1-4 liberal, 5-6 moderately restrictive, 7-10 restrictive
[2]Excludes discussion of trade facilitation and bilateral/regional integration.

12. **An increasingly prominent part of the trade policy debate is the liberalization of international trade in services.** Restrictions on services trade are not reflected in Table 1, and indeed, there has been a dearth of readily available information in this area. Yet, services are an increasingly important component of world trade, and many services are meshed closely with the production and trade of merchandise. Their availability, cost and quality can be key determinants of competitiveness. Available estimates suggest that the tariff-equivalent of protection in services sectors can be high (Table 3). The liberalization of services trade has tended to proceed on a unilateral basis, but since the 1990s, services have also become a subject of multilateral and regional trade negotiations.[11]

13. **The challenge of addressing restrictive trade policies unilaterally is likely to retain much of its relevance—across all income groups**. Commitments on most-favored-nation (MFN) tariffs in the Doha Round may set the stage for certain reductions in applied tariffs. But the combination of special and differential treatment clauses and large gaps between bound and applied rates is likely to limit the impact on most developing countries,

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[10] An exception is the PRSP for Cambodia, which stresses the need for carefully sequencing the reduction of import tariffs for rice to minimize potential welfare losses by producers.

[11] Commitments in these negotiations (mostly regarding MFN and national treatment) cover cross-border provision, provision through foreign subsidiaries, consumption abroad and temporary movement of persons.

and liberalization outside the WTO framework will remain a key driver of openness, including for services.[12]

Table 3. Estimates of the Impact of Protection in Various Services Sectors

Foreign providers in:	Direct Impact on Service Price of Trade and Regulatory Restrictions (in percent)				
	OECD	Brazil	Russia	Thailand	Average Developing Countries
Banking	3	18	7	11	3
Distribution services	3	2	4	6	2
Electricity supply	12	16	17	11	14
Telecommunications	6	4	7	19	31
Maritime transport	2	9	11	4	5
Professional services	6	9	3	4	6

Source: OECD (2004), based on simulations with the GTAP model.

B. The Multilateral Reform Agenda

14. **The WTO's Doha Development Agenda (DDA) was established in December 2001, with a broad mandate to liberalize trade.** The Doha Round was tasked with opening markets effectively across the whole spectrum of tradable goods and services, to strengthen the rules of the multilateral trading system, and to address the concerns of developing countries, including capacity-building needs. A suitably ambitious Doha Round is expected to boost global incomes and growth—as have previous rounds under the GATT—and integrate poorer developing countries more deeply with the global economy.[13] Systemically, it would help to further entrench the principles of multilateralism.

15. **The success of the Doha Round is clearly not yet assured.** While a framework for negotiating modalities was agreed in August 2004, pro-Doha lobbies in key industrial countries remain weak, and a segment of the developing world is fundamentally unconvinced of the benefits of multilateral liberalization. Time, however, is running short. The year 2007 is considered by many to represent the ultimate deadline for the Round since the U.S. administration may find it hard to renew its negotiating authority under the Trade Promotion Act. The international community's declared fight on poverty is a further cause for urgency. There is a close correspondence between key items on the Doha agenda and some of the Millennium Development Goals (MDGs), which set, inter alia, operational objectives for

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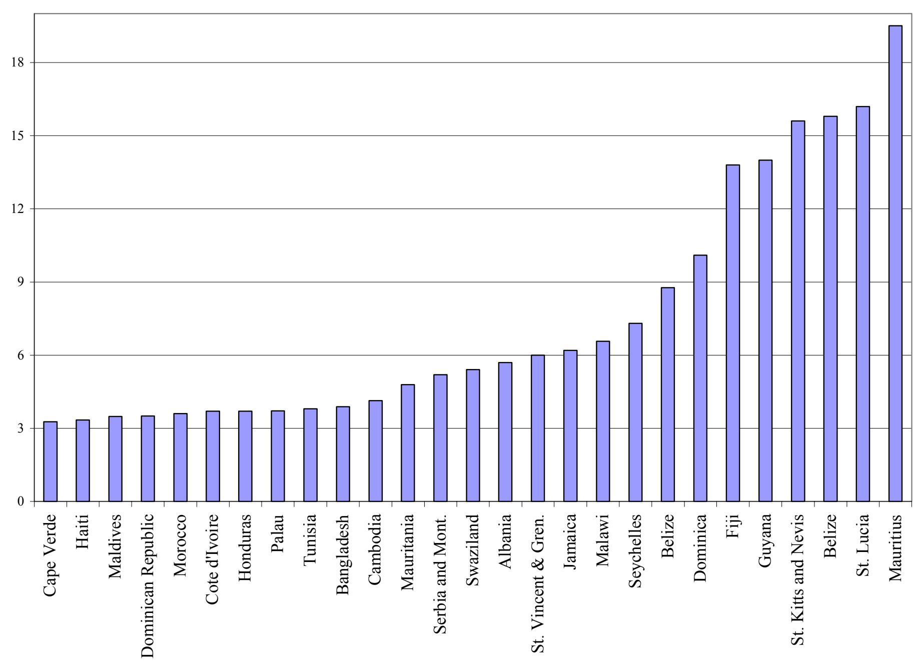
[12] According to Martin and Ng (2004), average tariffs in developing countries were reduced from 33.7 percent in 1983 to 13.6 percent in 2003. For their sample of large developing countries, 27 percent of the 18.6 percentage point decline in MFN tariffs over this period was caused by the Uruguay Round, while 73 percent was due to other sources, such as autonomous decisions to liberalize or participation in World Bank/IMF-supported adjustment programs. (See W. Martin and F. Ng., "Sources of Tariff Reductions," background paper to the *Global Economic Prospects 2005* (Washington, DC: World Bank, 2004).

[13] World Bank, *Global Economic Prospects 2005* (Washington, DC: The World Bank, 2004).

industrial country trade liberalization, as part of a global partnership aimed at eradicating extreme poverty and promoting sustainable development. The implementation of trade-related MDG targets has so far been hampered by slow progress in the multilateral trade negotiations.

16. **While promising considerable benefits overall, the Doha Round has raised concerns among some developing countries that their balance of payments might suffer in the short term.** The typically narrow export base and heavy reliance on a few key commodities make developing countries particularly vulnerable to changes in the trade policies of their partner countries. Three types of concerns have been prominent in recent years: the erosion of market access preferences as a result of MFN liberalization; the impact of the phasing-out of textiles quotas in early 2005; and changes in the food terms of trade following a reduction in farm subsidies. Figure 1 provides a perspective on preference erosion, whose effects are concentrated on a small number of countries. The end of textiles quotas is potentially quite disruptive for countries whose export markets were sheltered by the quotas from more competitive suppliers (although textiles producers in some countries have, over recent months, demonstrated the ability to adjust to the new circumstances). And world market prices for certain agricultural commodities may rise as a result of trade reforms, increasing the bills of net food importers.

Figure 1. Percent Change in Average Export Unit Values Following a 40 Percent Cut in Preference Margins
(in percent of exports in 2001; export supply elasticity = 1)



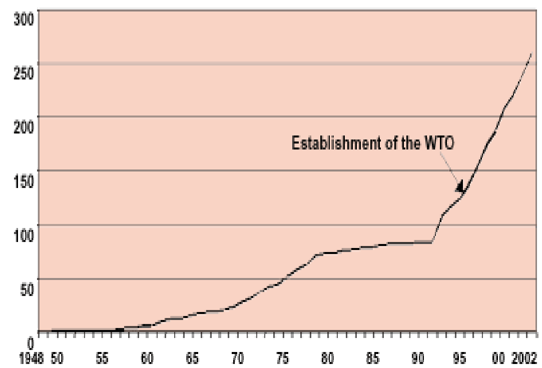
Sources: Alexandraki and Lankes, IMF Working Paper:WP/04/169. Subramanian, paper for WTO: WT/TF/COH/14.

C. Regional Integration Initiatives

17. **Regional trade arrangements, in the form of both multi-country and bilateral trade arrangements, have proliferated in recent years.** As of November, 2004, 150 RTAs had been notified to the GATT/WTO and were in force, with 100 entering into force since January 1, 1995 when the WTO was established (Figure 2, which also includes inactive RTAs).[14] The nature of these arrangements varies greatly, and many—including recent North-South agreements—have gone beyond the standard template for free trade agreements in earlier decades by including provisions on services, investment, labor and environment regulations, and cooperation in domestic policies.

Figure 2. Evolution of Regional Trade Agreements, 1948–2002

(Number of RTAs notified to GATT/WTO)



Source: WTO Secretariat.

18. **The proliferation of RTAs reflects their growing acceptance by countries in virtually every income group.** Proponents present a variety of arguments in favor of RTAs, including trade creation, the prospect of deeper economic integration through "WTO-plus" commitments, and political and security considerations that do not lend themselves easily to cost-benefit assessments on purely economic grounds. Furthermore, as the number of RTAs grows, countries fear being left on a weaker competitive footing if they do not themselves enter into such agreements.

19. **Nonetheless, most of the economics profession has been skeptical.** Trade preferences for regional partners can lead to intra-regional trade replacing less efficient national production (trade creation), but also to the replacement of more competitive imports from third countries (trade diversion). Trade diversion can easily dominate, such as when MFN barriers are high. Empirical studies cast doubt on whether RTAs improve global welfare. Figure 3, which compares the potential benefits under a particular scenario from one recent study, illustrates how outcomes under multilateral and preferential liberalization can differ significantly. Most RTAs contain numerous exemptions for sensitive products; restrictive rules of origin and competing standards in overlapping agreements raise transaction costs; their negotiation absorbs administrative capacity that is scarce in poor

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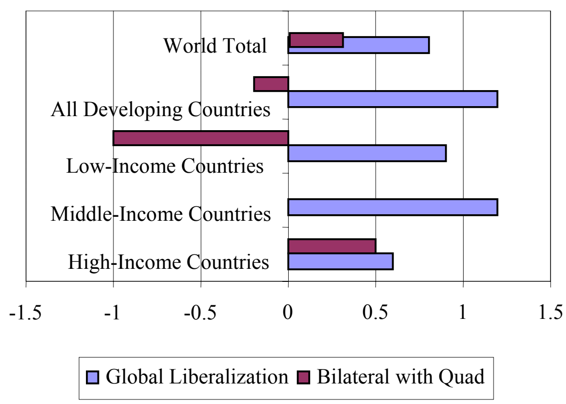
[14] More than 250 RTAs have been notified to the GATT/WTO, but many of them are not effectively in force, or have been superseded by redesigned agreements by the same signatories. However, there are also many RTAs that are operational but are not yet notified. It is estimated that the number of operational RTAs may well reach 300 by the end of 2005.

Figure 3. Bilateral Agreements vs. Global Trade Reform
(Percent change in real incomes in 2015 compared to baseline)



Source: World Bank, *Global Economic Prospects 2005*.

Note: Results are from general equilibrium simulations with the GTAP model. The darker bars represent real income changes in the respective region in a situation in which all countries agree bilateral preferential trade terms with the Quad countries (Canada, EU, Japan, and the United States), while the lighter bars report results for multilateral (global) liberalization. Note that the value for bilateral agreements with middle-income countries is zero.

countries and competes with the Doha Round; and certain non-trade aspects of RTAs are of dubious value for developing countries. Above all, RTAs could lower support for multilateral liberalization by making traders comfortable with the *status quo*.

20. **Since new RTAs are likely to be agreed, their design is critically important.** WTO rules require that countries forming an RTA not raise trade barriers against outside countries, and that the RTA eliminate internal trade barriers on "substantially all trade." These rules, however, have proven to be too vague to be effectively enforced, and as yet relatively little attention has been given to strengthening them. A practical issue is how to maximize the potential benefits of RTAs while limiting potential costs. Best practices in the design of RTAs have recently been reviewed by the World Bank in its *Global Economic Prospects 2005*.

III. Modalities of Fund Work on Trade

21. **Recent years have seen a decline in the number of trade-related program conditions under Fund-supported programs, but an upswing in aspects of trade-related surveillance, research, and other activities.** This reflects the more liberal trade policies of the membership and efforts to streamline Fund conditionality, as well as the emergence of a variety of developments in the world trading system to which the Fund has endeavored to respond. Among organizational developments was the creation of a unit in the Research Department in 2003 to examine issues related to trade and trade policy. In reviewing the breadth of Fund work on trade, this section focuses on surveillance and program work, but also touches on research, technical assistance, and communications (in boxes 2, 3 and 5).

A. Surveillance

General policy

22. **The Fund's policy on trade-related surveillance has been most recently reviewed by the Executive Board in the context of the 2004 Biennial Surveillance Review.**[15 16] Directors reiterated that, beyond the core issues in surveillance, the selection of topics in it should be based on macroeconomic relevance. Directors also called for the inclusion in Article IV consultations for systemically important countries, of conditions and policies affecting the global or regional economic outlook. Specifically, they encouraged a more *"selective coverage of trade matters, focused on issues that have an important influence on stability and growth prospects."*

23. **Within this framework, there remains a need for judgment in selecting particular trade policy issues for discussion.** Drawing on the identification of trade issues in Section II, Table 4 sets out key considerations in operationalizing this framework. One could, of course, attempt to create more mechanical rules based on numerical benchmarks; however, that would reduce often diverse circumstances to a single dimension and limit the necessary room for judgment. Still, numerical benchmarks can provide helpful markers, for instance in judging whether the trade policy environment is so distorted as to warrant a deeper analysis and discussion in the staff report, or whether a country should be considered to be "vulnerable" to external trade policy shocks.

24. **Apart from deciding *whether* to cover particular trade matters in surveillance, the question arises at *what level*—bilateral, regional or multilateral—to cover them.** As in other policy areas, a dialogue on regional and global issues is important where the cross-country experience can inform policy recommendations, or institutions at the regional or global level influence the policy development in individual countries. In addition, governments have, in the context of customs and economic unions, decided to pool sovereignty over certain trade and regulatory policy decisions. It would be logical to conduct a policy dialogue at the level where the relevant trade decisions are taken.

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[15] See *The Chairman's Summing Up, Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision* (SUR/04/80, August 2, 2004). Earlier guidance is contained in *Concluding Remarks by the Acting Chair, Trade Issues—Role of the Fund* (BUFF/01/143, September 20, 2001) and *Concluding Remarks by the Acting Chair, Market Access for Developing Country Exports—Selected Issues* (BUFF/02/165, September 18, 2002).

[16] The legal underpinnings of Fund surveillance and conditionality with respect to trade issues are explained in more detail in Annex I.

Table 4. Coverage of Trade Issues in Article IV Staff Reports—Considerations

Trade issue	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.
Spill-over 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.[17]
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).

Bilateral surveillance

25. **One way to assess the coverage of trade issues in bilateral surveillance is to examine whether it has been consistent with the macrorelevance criteria.** For purposes of this review, Article IV staff reports issued in 2004 were assessed for the adequacy of trade content. The judgment of "adequacy" was based on the list of considerations set out in Table 4. This portion of the review assessed: (i) whether coverage of a particular trade area was warranted, and (ii) whether a particular trade area was indeed covered in the report. Regarding the coverage of reforms to the merchandise trade regime, coverage was judged "adequate" either if staff reports highlighted reform needs for countries with a restrictive trade regime, or if they did not discuss trade reforms in countries with open trade regimes. Conversely, coverage may be considered "excessive" if trade policy was discussed for countries with relatively open trade regimes without providing a justification from a broader

[17] The criteria the staff have 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 SM/04/63.

economic perspective, or "insufficient" if it was not discussed but should have been in view of the distortionary trade regime.[18] Equivalent criteria were applied to other trade issues. Results are reported in Table 5.

Table 5. Coverage of Trade Issues in Recent Article IV Staff Reports

	Coverage Warranted[1]		Coverage Unnecessary[1]	
	Covered	Not Covered	Covered	Not Covered
	(in percent of reports reviewed)			
Reform of trade regime	**48.6**	**10.3**	**15.0**	**26.2**
High income countries	30.0	0.0	20.0	50.0
Middle income countries	50.0	20.8	6.3	22.9
Low income countries	65.5	3.4	24.1	6.9
Multilateral & regional agenda	**40.8**	**12.2**	**7.0**	**39.9**
High income countries	48.3	10.0	16.7	25.0
Middle income countries	41.7	10.4	3.1	44.8
Low income countries	31.6	17.5	3.5	47.4
Macro vulnerability	**9.0**	**14.0**	**0.6**	**76.0**
High income countries	0.0	11.1	1.1	87.8
Middle income countries	11.9	17.5	0.7	69.9
Low income countries	13.8	11.5	0.0	74.7

Source: Based on review of 108 Article IV staff reports issued in 2004.

[1] Based on considerations in Table 4.

26. **While this approach reveals some basic patterns, it is a coarse filter.** Since it represents an *ex post* application of informal considerations for selectivity, the results cannot be taken to represent an assessment of Fund policy implementation. More importantly, the review offers no insight into the *quality* of the trade discussions in staff reports. A particular analysis might be wrong in substance but could still be judged "adequate" in terms of the criteria of the present review. The content of Fund advice in Article IV staff reports is briefly summarized in Box 1, and Annex II presents existing staff guidance in this area.

27. **This document review indicates that, in around three-quarters of the cases, trade issues were adequately covered in Article IV staff reports.** Nevertheless, it also reveals distinct patterns in coverage across country groups, and scope to fine-tune coverage to achieve still greater selectivity. The considerations set out in Table 4 could be helpful in this regard for country missions. The results are consistent with the 2004 Biennial Surveillance Review but offer additional perspectives.

[18] The presumption was that for countries with a rating of 5 or higher on the Fund's TRI there should be a substantive discussion of reform needs for the merchandise trade regime, whereas for countries with a rating equal to or lower than 4, such a discussion would have to be specifically motivated with reference to growth or stability objectives, or spillover effects. 64 countries rated 5 or higher at the end of 2004.

Box 1. Bilateral Surveillance Themes by Income Group

The Fund's surveillance of trade issues has emphasized different topics, but certain themes emerge within income groups.

In **high-income countries**, the emphasis has been on promoting market access for developing country exports and addressing trade-distorting practices that have a systemic impact—less often on the costs of such policies for these countries themselves. A review of Article IV staff reports and selected issues (SI) papers shows that during 2000-04 the scope of the trade policy coverage in consultations with Quad countries (Canada, EU, Japan, and United States) widened progressively, and there was a growing focus on the global impact of these policies. Staff reports for the United States and the Euro Area, and to a lesser extent Canada and Japan, reviewed aspects of their negotiating positions in the Doha Round and provided a critical assessment of the impact of their agricultural policies on developing countries. During 2002-04 seven SI papers for the Quad examined trade issues, most prominently the impact of Quad trade policies on third countries—there had been no SI papers on trade in 2000. This trend was confirmed by the 2004 Biennial Surveillance Review (BSR), although the BSR also noted a less focused approach to non-Quad industrial countries.

Fund surveillance and policy advice for **middle-income countries** covered a broad spectrum of issues, reflecting the diversity of the group. Middle-income countries have generally more restrictive trade regimes than high-income countries. The remaining agenda for reforms of the merchandise trade regime was the most common element in surveillance of this group. Surveillance reports for the Islamic Republic of Iran, Seychelles, and Syria, for example, provided broad ranging suggestions for trade policy reform—reflecting their relatively restrictive trade regimes. For Mauritius and South Africa—with somewhat less restrictive trade regimes—there was a tighter focus on tariff reform and the elimination of exemptions. For other countries with moderately restrictive or relatively open trade regimes, Fund advice centered on a range of remaining impediments, including import surcharges, and measures related to trade facilitation. Surveillance of trade-related vulnerabilities was another common element in the middle-income group (textiles in Turkey, sugar in Mauritius and Fiji).

For **low-income countries**, surveillance has concentrated on the agenda for reform of the merchandise trade regime and the institutional infrastructure for trade. For countries with restrictive trade regimes, surveillance and advice focused on the reduction/rationalization of tariffs (Burkina Faso and Ethiopia). To a lesser extent, Fund advice has also touched on the need to remove or rationalize NTBs (Pakistan and Zambia). As with other country groups, advice has also come in the context of regional trade liberalization (Burkina Faso, Cameroon, Guinea, Ghana, and Tanzania). Key recommendations have focused on trade facilitation measures (customs reform), strengthening governance, and increasing institutional capacity (Albania, Cameroon, Georgia, and Mali).

28. The share of reporting judged to be adequate ranged from 70 to 80 percent for the **coverage of merchandise trade regimes and related reform needs**. In the remaining cases the coverage of trade issues was out of line with the presumptive macrorelevance of the problems. While for high-income countries the percentage of reporting was not "adequate" in only around 20 percent of cases, it was very significant—almost 40 percent—if measured as a proportion of cases in which these reforms received coverage in staff reports. The proportion for low-income countries was similar. In virtually all these cases, the judgment of the review was that the discussion did not meet the macro-relevance test and should have been dropped. For middle-income countries, in turn, the most prominent problem was the converse—in 30 percent of cases in which reforms should have been covered, they were not.

While *excessive* coverage would seem generally to be a question of differences in approach that might be addressed through common standards and criteria, *insufficient* coverage also reflects a preponderance of more immediate vulnerabilities (in the face of document size limits and resource constraints), and the absence of specialized knowledge and information that may be required to engage with country authorities in any depth. Steps that might help in tackling the latter problem could include selected training activities, and intensifying the knowledge transfer from other institutions, in particular the World Bank (see Section IV).

29. Coverage of other trade issues was generally appropriate, with overall margins of "adequacy" higher than for reforms of the merchandise trade regime. Nevertheless, across income groups, **trade-related vulnerabilities** (both fiscal and balance of payments) were frequently not covered when they might have been, especially in light of the expiry of textiles quotas and potential tariff revenue losses from regional trade arrangements in countries heavily dependent on such revenue.[19] Since these vulnerabilities are linked to processes of liberalization that are underway or forthcoming, their importance for the Fund is set to rise over the coming period. Again, some of the problem may be due to insufficient information and skills, and existing internal training and dissemination activities—including seminars and country-specific analytical support—should continue.

30. While limited to the "Quad" countries (see Box 1), the discussion of **policy spillovers** seemed largely adequate. A separate review of trends over the period 2000–04 suggests that the coverage of trade issues in general, and specifically of the "spillover effects" of Quad policies, had strengthened considerably, in both staff reports and selected issues papers—the spillover perspective was still unusual at the start of that period.[20] Reporting on the authorities' positions and key initiatives in the Doha Round was also appropriate for this group of countries. At the same time, there was no discussion of policy spillovers for large developing countries, and coverage of positions taken in multilateral talks was often thin. Yet, the trade policies of several non-OECD countries, such as Brazil, China, South Africa and Russia, can matter greatly either globally or for neighboring countries. The analysis of the systemic impact of trade policies could thus be expanded to cover a broader range of countries.

[19] The expiry of textiles quotas was covered in discussions with 28 countries, including 11 expected to be highly vulnerable to this event.

[20] See Box 6, "Global Impact of the Trade Policies of the Quad" in *Biennial Review of the Implementation of the Fund's Surveillance and of the 1997 Surveillance Decision—Content of Surveillance* (SM/04/212, Sup. 2, July 2, 2004).

31. **Attention to *trade* restrictions or reforms in services was virtually absent throughout.**[21] Service sector reform generally has attracted attention in the Fund's work, but not *trade* in services per se.[22] There are two reasons why the Fund may need to consider this issue more systematically. First, because of the economic distortions associated with restrictive trade regimes in services, as discussed above. And second, because of a growing overlap between services trade negotiations and traditional areas of Fund advice. For example, services trade negotiations can influence the pace and sequencing of financial sector liberalization and thus financial vulnerability (through market access and other measures), shape standards of regulatory transparency, and influence capital account regimes (e.g., transfers associated with cross-border provision of financial services or foreign establishment). The weak coverage in this area may be largely due to the dearth of available information on services restrictions and their economic impact. Similarly, services trade negotiations tend to be opaque and the bottom line in terms of liberalization frequently hard to assess. Both of these problems also made it difficult during the review to judge whether there should have been coverage in individual cases. Nevertheless, work on services trade is intensifying, especially at the OECD and the World Bank, and the information is likely to improve. This, together with improved dissemination, should support appropriate attention to the issue in Fund surveillance going forward.

Trade coverage in low-income countries—the Integrated Framework

32. **The provision of trade diagnostics and advice in the LICs has also followed an additional track, separate from the Article IV process.** The Fund has coordinated its trade policy work in LICs with other international partners, in a joint effort to promote the mainstreaming of trade in poverty reduction strategies and trade-related capacity building. At the core of this agenda has been the Fund's involvement in the Integrated Framework (IF). Substantive Fund input into the IF process has been principally through the Diagnostic Trade Integration Studies (DTIS). The DTIS, prepared for LDCs under the leadership of the World Bank, include macroeconomic sections usually contributed by Fund staff, as well as detailed reviews of the trade environment that set out priority policies and projects for the authorities and donors. As of end-2004, some 14 DTIS had been finalized since 2002, and 14 more were

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[21] Since 1980, services exports have grown more rapidly than merchandise exports and now amount to about US$1.5 trillion annually, or one-fifth of total world exports. See A. Lehmann, N. Tamirisa, and J. Wieczorek, "International Trade in Services: Implications for the IMF," IMF Policy Discussion Paper 03/6 (Washington, DC: International Monetary Fund, 2003).

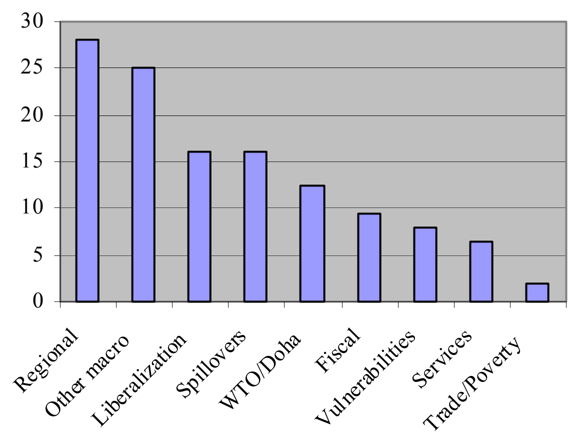
[22] However, financial sector surveillance—notably through FSAPs—and technical assistance often addresses such trade-related issues as the international competitiveness of a country's financial sector in advance of opening (cf. Kazakhstan FSAP update); cross-border cooperation in regulation and supervision, which is important for welfare-enhancing trade in banking services (cf. work on European financial integration and on OFCs); and the effects of capital account liberalization. The Fund has done extensive work over the years on the sequencing of financial sector liberalization, which would be more explicitly linked to developments in trade negotiations.

Box 2. Fund Research on Trade

The Fund has conducted a considerable amount of research on trade issues over the past three years, and taken organizational steps to provide added structure to this effort.

Many departments throughout the Fund conduct trade-related research. Figure 4 describes the topical focus of Fund research on trade issues during 2002–04, covering a total of 64 Occasional Papers, Working Papers, and other published research (representing 8.4 percent of all OPs and WPs published during that period). These papers were grouped in accordance with the trade-related challenges highlighted in Section II (along with an "other macro" category). Almost 60 percent of the papers addressed trade issues in the context of specific country cases, among which countries in Africa and Asia were most prominent. The greatest concentration of research—28 percent of all papers—was on issues related to regional trade integration. At the other end of the spectrum, only one paper during that period looked specifically at the trade and poverty nexus, and four analyzed services trade.

Figure 4. Fund Research on Trade, by Topic
(percent of research papers 2002-04, papers can be in more than one category)



Organizationally, the most notable recent development in this area was the establishment, in July 2003, of a trade research unit within the Research Department. The unit was launched to promote a strategic approach to research on trade issues, as well as to provide analytical support to Fund surveillance and program design. The unit organized a research conference on recent developments in trade research in October 2004 and, in addition to shorter papers, has undertaken two large projects: a study of the effects of exchange rate volatility on trade flows (OP235), which was transmitted to the WTO, and a study on international outsourcing of services.

in the pipeline.[23] By design, the IF and PRSP processes are closely integrated at the national level, and the DTIS, which are discussed at participatory national workshops, provide an opportunity to help "mainstream" trade policy into poverty reduction strategies. Overall, this is a relatively low-resource activity for the Fund which exploits nicely the complementary strengths of the Bretton Woods, UN institutions, and the WTO, and which is firmly rooted in a participatory and country-owned philosophy of development.

[23] Staff are building an internal reference database—extracting diagnostics and policy priorities from the DTIS—which will help in assessing the trade content of PRSPs for Joint Staff Advisory Notes (JSAN), and more broadly inform Fund trade-related work in LICs.

33. In practice, however, and despite progress, a recent review of the IF process concluded that national ownership and the link to PRSPs remain tenuous.[24] This was evident from the discussion in Section II (Table 2). An important part of the explanation is that the DTIS are relatively new—the first ones were finalized at the end of 2001, and most are less than two years old—and PRSP production follows its own cycle. Future PRSPs may better reflect the results of the IF. Furthermore, non-LDC low-income countries are not covered by the IF. Internally, the IF continues to struggle with capacity bottlenecks, in-country coordination and, especially, donor follow-up. More consistent flagging of trade reform needs in Joint Staff Assessment Notes (JSANs) would be helpful, but of course it is a matter for countries to decide whether to include such policies in their PRSPs. The low visibility accorded to trade in past PRSPs should be seen in the light of the broader weaknesses in the medium-term orientation of PRSPs, an issue that will be examined in the 2005 PRSP Review.[25]

Regional perspective

34. **The Fund's regional dialogue on trade issues is less extensive than at the bilateral level, but has gained some momentum in recent years.** The focus of this work has been RTAs and other regional integration initiatives. Regular consultations with regional trade bodies on the basis of staff reports to the Board have been undertaken with CEMAC and WAEMU (periodically since 1998), the European Union (annually since 2000), and CARICOM (since 2004). While focused on currency issues, these have also covered regional trade policies. The EU consultations take place formally under Article IV of the Fund's Articles of Agreement, and a similar approach is envisaged for CEMAC and WAEMU.[26] In addition to these direct consultations, however, the examination of trade issues at the regional level has taken a number of other forms, reflecting some experimentation on the part of staff. During 2004 alone, trade and related issues have been central in three regional workshops with officials, other initiatives at the regional level (such as CIS-7 and Central Asian Regional Economic Cooperation), and the Sub-Saharan African and Middle East and North Africa Regional Economic Outlooks.

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[24] World Trade Organization, "Final Report of the Evaluation of the Integrated Framework," WT/IFSC/6, Rev. 2, November 26, 2003 (Geneva).

[25] Fund staff are also engaged in a joint effort with selected donors, the OECD DAC Secretariat, the World Bank and UN agencies, to develop implementation-oriented regional workshops with trade and development officials in developing countries aimed at supporting the "mainstreaming" of trade in PRSPs. A first workshop was hosted by the U.K. DFID in London in December 2003.

[26] A formal approach to Euro Area surveillance was first proposed in 1998 (*EMU and Fund Surveillance* (SM/98/215, August 26, 1998). The initial emphasis was on monetary and exchange developments, but trade first received individual focus in 2000 (see *Monetary and Exchange Rate Policies of the Euro Area*, SM/00/212, Sup. 2, October 13, 2000).

Table 6. Existing and Planned Customs Unions and Economic Communities

	Number of Members	Average Tariff
Andean Community (ANCOM)	5	11.2
Caribbean Community and Common Market (CARICOM)	15	15.2
Central African Economic and Monetary Community (CEMAC)	6	19.5
Common Market for Eastern and Southern Africa (COMESA)	20	17.2
East African Community (EAC)	3	19.6
Eurasian Economic Community (EAEC)	5	8.7
European Union (EU)	25	6.5
Gulf Cooperation Council (GCC)	6	5.0
Southern African Customs Union (SACU)	5	11.4
Southern African Development Community (SADC)	14	14.3
Southern Cone Common Market (Mercosur)	4	10.6
West African Economic and Monetary Union (WAEMU)	8	14.6

Sources: Article IV staff reports and staff estimates.

35. **Conducting a review of each RTA from a regional perspective would not be needed and clearly beyond the Fund's capabilities, but would be a necessary supplement to bilateral discussions with members in cases where trade-policy decision-making is transferred to the regional level.** Apart from the European Union, CEMAC and WAEMU, this transfer has occurred or is scheduled to begin in the Andean Community, CARICOM, East African Community, Gulf Cooperation Council, Mercosur, and SACU, as well as plans for COMESA, SADC, and the Eurasian Economic Community, to varying degrees. Once all these agreements are fully implemented, they will cover a total of over 100 countries (Table 6). Depending on the extent to which these institutions replace decision-making at the national level, this constellation could create a large "blind spot" in surveillance in some regions with fairly restrictive trade regimes, or whose impact on international trade and clout in global trade negotiations has been growing. As a first step in exploring modalities for addressing this concern, a practical, low-cost, approach could be for the staff to consult routinely with the secretariat of the regional trade initiative on the occasion of an Article IV mission to the country in which the secretariat is located. At the same time, judgment will need to be exercised at the bilateral level on whether coverage of trade policies could be deemphasized, taking into account the nature of decision-making at the center and the engagement of individual members in trade policy formulation.

36. **Regionalism is, of course, a much broader phenomenon and the Fund may have to form a view on RTAs—or aspects of RTAs—well before they are negotiated.** As has been typical of the Fund's advice in the past, the primary emphasis should naturally remain on the merits of multilateral trade liberalization, as the economics in support of such an approach are far more compelling than those in favor of RTAs. Existing staff guidance on trade policy, including RTAs, is summarized in Annex II. Nevertheless, given the increasingly central role that RTAs are playing in many countries' development strategies, the Fund should be prepared to help members assess the potential costs and benefits of these arrangements in areas of Fund expertise, such as fiscal implications, and provisions on investment and financial services. The Fund may also want to encourage a set of "best

practices" for RTAs—including comprehensive coverage, a transparent approach to rules and standards, and an outward orientation entailing a reduction in the common external tariffs. A Board seminar is scheduled for the Spring of 2005 to review the Fund's approach toward RTAs.

Multilateral "Surveillance"

37. **Fund surveillance of trade issues at the multilateral level has taken two main forms**. **First, the *World Economic Outlook* (*WEO*).** Trade topics covered in the *WEO* have touched on a broad segment of the global trade agenda in recent years (Table 7). These include issues surrounding the WTO's Doha Round, the impact on the global economy of China's emergence as a trade power, and an analysis of the relationship between trade and financial integration.

Table 7. Recent Coverage of Trade Issues in the *WEO*

Topic	*WEO* Edition
Critics of a New Trade Round	October 2001
How Do Industrial Country Agricultural Policies Affect Developing Countries?	September 2002
The Gravity Model of International Trade	September 2002
Vertical Specialization in the Global Economy	September 2002
Trade and Growth	September 2002
Trade and Financial Integration	September 2002
China's Emergence and its Impact on the Global Economy	April 2004
Quantifying the International Impact of China's WTO Accession?	April 2004
Risks to the Multilateral Trading System	April 2004

Source: *World Economic Outlook,* various issues.

38. **The second focus at the multilateral level has been work in support of the WTO's Doha Round.** Starting during the run-up to the Doha Ministerial of the WTO in late 2001, the Fund developed a range of activities in support of the Round (overview in Box 3). At the surveillance level,[27] these have included Board and Board Committee reviews of the issues at stake, and research papers on core IMF issues prepared for the WTO at the request of its Secretariat. Throughout this work, the Fund has underlined the importance and the benefits for its members of a timely and ambitious Doha Round agreement.

39. **It is hard to define a standard against which to assess the appropriateness of the Fund's work in this area.** The engagement in support of multilateral trade reforms represents a strategic choice by the Fund, and the ultimate test of this strategy is the continuing support for it by the Fund's governing bodies. Nevertheless, work at the

[27] Other activities include a communications strategy and the design of a financing policy aimed at mitigating certain concerns about the Round (Trade Integration Mechanism).

multilateral level can also crucially complement bilateral surveillance where trade policies have joint and systemic effects, such as in agriculture.

Box 3. Fund Support of the Doha Round and other Trade-Related Communication

The Doha Round of multilateral trade negotiations, initiated in 2001, has prompted a substantial amount of activity on the part of the Fund:

- Management has used its voice on several occasions to support the Doha Development Agenda (DDA). Fund and Bank management issued joint press communiqués and an op-ed article highlighting the development benefits of an ambitious round ahead of the 2003 OECD ministerial (together with the Secretary General of the OECD) and in the run-up to the WTO's September 2003 meeting in Cancún. This was followed by a joint letter to heads of state of member countries, urging progress in the round, a range of speeches from Management on the benefits from multilateral trade liberalization, and the unprecedented participation of the Managing Director and Deputy Managing Directors at three WTO General Council meetings during 2003–04.
- Staff have prepared several surveillance and research papers in support of critical aspects of the Round. Most notable have been staff work on issues related to market access for developing country exports (SM/01/137, and SM/02/280), and reports updating the Board on the status of the Round and implications for the IMF (EB/CWTO/02/1, SM/02/225, SM/03/120, SM/03/312, EB/CWTO/03/6, EB/CWTO/04/1). Research prepared at the request of the WTO has included analyses of balance of payments safeguards; export subsidies; the financing of losses from preference erosion; fiscal aspects of tariff reform; and a major study of exchange rate volatility and trade. Several op-ed pieces have been published in the press, as well as more substantive work in support of the Round in the *WEO*, *Finance & Development,* and the *IMF Survey*.

The Fund's governing bodies have been equally vocal. The IMFC repeatedly urged WTO members to move swiftly on the DDA and agree to an ambitious outcome. The Executive Board Committee on Liaison with the WTO (CWTO) has been more active in the past two years than at any time before—meeting six times since the beginning of the DDA process in late 2001.

The Fund also made operational contributions to the DDA, in particular the TIM, in recognition of the needs of those countries concerned about the potential adjustment costs of multilateral trade liberalization (see Section III.B.). The introduction of the TIM was accompanied by an outreach strategy, including a press conference, fact sheet, presentation at a public symposium, and an article in IMF Survey. Bangladesh, and recently the Dominican Republic, have made use of this mechanism.

Beyond support for the DDA, there has been a concerted effort in the past three years by management to emphasize the sound economic rationale for free trade, which has raised the Fund's profile in this area. Speeches have focused on a range of issues, notably the systemic impact of industrial country agricultural policies, the potential for trade to help address poverty reduction, and the general case for free trade.[1] The Fund has also developed a dialogue with civil society organizations, especially on market access policies and agricultural subsidies.

[1] See, in particular, "Willful Ignorance: The Struggle to Convince the Free Trade Skeptics," speech by Anne O. Krueger to the Graduate Institute of International Studies, Geneva, May 18, 2004; and "Trade, Jobs, and Growth: Why You Can't Have One Without the Others," speech by Anne O. Krueger to the Reuters Trade, Globalization and Outsourcing Conference, New York, June 15, 2004.

B. Fund-Supported Programs

40. **Trade policy has been a frequent component of Fund-supported programs and, more recently, concerns over the balance of payments impacts of certain trade policy changes have motivated the introduction of the Trade Integration Mechanism (TIM).** Trends in trade-related program conditionality under Fund-supported programs since 1990 are reviewed in a companion paper (see *Review of Trade Conditionality in Fund-Supported Programs*, SM/05/57 Supplement 1) and this section provides only a summary of the results. Similarly, the TIM was only recently approved by the Board and the implementation experience is still short. This paper limits itself to the brief description in Box 4.

41. **Trade-related conditionality is governed by the general policies on the use of Fund resources.**[28] It is therefore subject to the standards set forth in the Guidelines on Conditionality, and in particular the requirement that the measure covered by conditionality should be of critical importance for achieving the goals of the member's program or for monitoring the program.[29] Given the structural nature of many trade policies, one would expect this standard to be more often met in medium-term programs with a growth orientation than in short-term stabilization programs. Nevertheless, trade instruments can also be critical in pursuing fiscal and governance objectives (e.g., by tackling duty exemptions and customs administration).

Box 4. Trade Integration Mechanism

The most recent development with regard to trade policy under Fund-supported programs is the approval of the TIM in April 2004 (SM/04/63 & Supp. 1). Although the core of the Fund's mandate involves support for orderly external adjustment in the face of shocks, the TIM provides added assurances and represents the first explicit attempt to help members adjust to shocks that emanate from the process of multilateral trade liberalization. The TIM was designed to help mitigate the stated concerns (by many developing countries) that implementation of WTO agreements might give rise to temporary balance of payments shortfalls—through the erosion of tariff preferences, adverse changes in the terms of trade of net food importers, or the expiration of quotas under the WTO's Agreement on Textiles and Clothing (ATC). Bangladesh became the first member to obtain support in accordance with the TIM in July 2004, followed by the Dominican Republic in January 2005.

42. **What constitutes a trade measure of "critical importance" for achieving the goals of a program varies with circumstances.** One key consideration is, of course, the degree to which the existing trade policies distort economic decisions, as reflected, e.g., in the extent to which a country has a relatively open or restrictive trade regime. In practice, the share of programs with tariff or NTB-related conditionality for countries that rated "5" or more restrictive on the Fund's TRI was significantly higher than in countries rating "4" or

[28] The legal basis for the use of trade-related conditionality is discussed in Annex 1.

[29] "Guidelines on Conditionality," Dec. No. 12864-(02/102), Sept. 25, 2002; see paragraphs 7(a) and 7(b).

better (Table 8).[30] However, while a review of empirical studies of the link between trade liberalization and growth (the program goal that would be most often associated with trade reforms) offers a preponderance of evidence in support of a positive relationship, it yields no "threshold" levels of trade restrictiveness that might guide a decision on whether specific trade reforms are "critical" for program objectives. Furthermore, individual measures that do not show up in broader indices may be sufficiently disruptive—to growth, stability or governance objectives—as to warrant being tackled under a program. As in the surveillance case, the inclusion of trade measures among the structural conditions under Fund-supported programs should be judged on a case-by-case basis.[31]

43. **A companion paper contains a review of patterns and trends in the nature and design of Fund-supported trade reform during 1990–2004.** The review describes trade conditions across countries and programs, the types of trade reform advocated, and the implementation rate of such reforms for a sample of 34 member countries that had Fund-supported programs (Stand-By Arrangements, or arrangements under the EFF and PRGF) during this period. Consistent with earlier studies, the implementation track record of Fund trade conditionality was very good.

Table 8. Incidence of Conditionality on Tariffs and NTBs in Fund Programs[1]

	1990-2000		2001-04	
	Programs had tariff or NTB conditions		Programs had tariff or NTB conditions	
	Yes	No	Yes	No
Countries/periods Rating 5 or worse on TRI	75%	25%	27%	73%
Countries/periods Rating 4 or better on TRI	50%	50%	20%	80%

[1] Sample of 138 programs for 34 countries reviewed in companion paper: *Review of Trade Condiitonality in Fund-Supported Programs, forthcoming.*

44. **Perhaps the most striking finding was the changes in trade-related conditionality over time**. The incidence of trade-related conditionality increased from 55 percent of programs with at least one condition in the pre-1995 period to 70 percent in 1998–2000, and

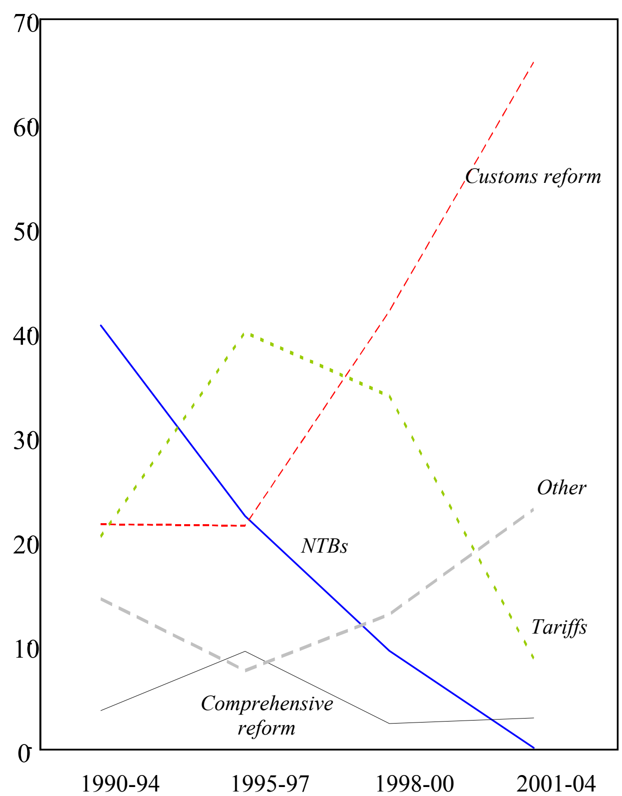
[30] It should be noted, however, that the TRI is not a measure of economic distortion (i.e., an outcome) but only a synthetic way to describe the restrictive measures themselves. This and other aspects of the TRI are reviewed in the companion paper *Review of the IMF's Trade Restrictiveness Index (SM/05/57)*.

[31] Further questions relate to the *quality* of program design, such as the choice, sequencing and phasing of measures. These are not reviewed in this report. However, see Section V on issues proposed for further analysis.

then fell to 46 percent during 2001–04.[32] The recent decline is consistent with the results for growth-oriented conditionality more generally reported in the *Review of the 2002 Conditionality Guidelines* (SM/05/81). Although the review does not specifically control for the quality and "intensity" of conditions, the data give no indication that these have systematically changed over time.

45. **At the same time, the nature of trade-related measures shifted radically, from an initial main focus on NTBs, to tariff reforms, and more recently to reforms of customs administrations** (Figure 5). As a result, while more than 60 percent of program conditions in the mid-1990s related to the traditional instruments of trade policy (tariffs and NTBs), only 10 percent—of a smaller total—did so after 2001. Customs measures were driven as often by fiscal as by trade reform considerations—where made explicit, revenue was an important motive in 53 percent of cases over the 1990-2004 period, economic efficiency and streamlining in 58 percent, and governance in 22 percent of cases.

Figure 5. Trade Conditionality, by Measure
(1990–2004, in percent of total)



46. **These trends are associated with three developments which are hard to disentangle.** First, trade liberalization in the 1990s, including in the context of Fund-supported programs, led to more open and transparent trade regimes in many developing countries, and the focus shifted toward "second generation" administrative and institutional reforms. Second, the trends reflect the clear articulation of the "critical importance" test under the Conditionality Guidelines of 2002 (preliminary guidelines on streamlining structural conditionality had been issued two years earlier). Table 8 provides some support for this proposition: even controlling for whether trade regimes were relatively open or restrictive, the incidence of tariff and NTB conditionality declined sharply during 2001–2004 compared with the period 1990-2000. A program in a country with a restrictive

[32] Across program type, trade conditionality in Stand-By Arrangement- and EFF-supported programs rose through 1997 but declined thereafter. Trade conditionality in SAF/ESAF/PRGF-supported programs rose though 2000 but almost halved in 2001–04.

Box 5. Trade-Related Technical Assistance and Institution-Building

The principal source of the Fund's trade-related technical assistance is the Fiscal Affairs Department (FAD), which provides assistance on customs administration modernization and tariff policy reform. The Fund's TA is demand driven. TA on customs administration has shifted toward a focus on "strategic" TA, providing the overall framework for reform and continuing oversight, whilst leaving more detailed aspects for other donors to support. Trade policy TA, in contrast, usually takes the form of "one-off" missions (which also commonly have a wider tax focus than trade policy alone).[1] At the multilateral level, the August 2004 WTO agreement on a set of negotiating frameworks and modalities for the Doha Round contained a call on the Fund and other international agencies to provide technical assistance for trade facilitation (including for customs and other institutions). Several agencies, including the Fund, subsequently took stock of existing projects and capacities and formed an information network aimed at enabling an efficient response as specific needs for assistance take shape.

Table 9 provides an overview of TA in the areas noted above—delivered through either a mission from headquarters or an expert assignment.[2] Around one-third of the missions had a significant tariff policy component. Overall, FAD has seen a modest increase in trade-related TA mission work in recent years. Not shown in Table 9 is the provision of advice through the recently-established regional technical assistance centers (TACs). The extent of this work varies widely across the TACs.

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[1] The extent to which countries have, in practice, managed to compensate for reduced trade tax revenue by strengthening domestic tax collections has varied, as discussed in the companion paper, *Dealing with the Revenue Consequences of Trade Reforms* (SM/05/57, Supplement 2). Note that the quality of trade statistics can be an important factor in revenue collection.

[2] The typical headquarters mission has three members, and visits the country for two weeks. Expert assignments may be long-term (six months or more), short-term (resident for less than six months), or peripatetic.

Table 9. FAD Trade-related TA

	2000		2001		2002		2003		2004*	
	Missions	Expert months	Missions	Expert months	Missions	Expert months	Missions	Expert months	Missions	Expert months
Africa (Sub-Saharan)	10	21	10	13	4	16	8	19	11*	13*
Asia and Pacific	5	10	3	18	6	15	9	22	7*	17*
Europe	1	-	1	-	6	-	-	-	-	-
Middle East/ North Africa	5	14	5	12	12	7	7	6	8*	5*
Western Hemi-sphere	4	1	5	8	5	20	2	12	4*	9*
Total	26	44	24	51	33	58	26	59	31*	45*

Source: Fiscal Affairs Department.
Note. A mission is defined as use of resources corresponding to at least one person working full time with trade tax policy and/or customs administration over a period of at least five days.
*2004 numbers are preliminary (annualized numbers based on actual data for 2004 Q1-Q3).

regime was three times more likely than one in a more open economy to contain such conditions during 1990–2000, than in 2001–2004. However, a third factor may have been at play as well, namely the Doha Round negotiations begun in 2001, and may have made governments reluctant to commit to unilateral liberalization.[33]

47. **The sharp drop in traditional trade policy conditionality raises the question whether the scope for trade policy reforms that are critical for longer-term program objectives might have been curtailed.** As part of a broader package of policy and institutional reforms, the impact of trade reforms on stability and growth over time can certainly be critical, although the particulars will vary with country circumstances. However, despite the strong evidence linking open trade and growth generally, it can be difficult to establish this link for specific measures, and over particular time-frames. Perhaps more fundamentally, as trade reforms may not be perceived as time-sensitive nor particularly urgent, they are liable to be screened out of the "critical list" (especially if the implicit time-frame for achieving critical goals is understood to be the duration of the arrangement). The parallel *Review of the 2002 Conditionality Guidelines* discusses this issue in a broader context.

IV. Collaboration with the WTO and the World Bank

48. **The Fund undertakes formal and informal cooperation towards its aims in the trade area, and with the World Bank and WTO, has committed to achieving greater coherence in global economic policymaking.** This commitment is carried out through staff collaboration, arrangements for institutional consultations, attendance by each other's staff at relevant meetings, and exchange of documents and information. An increased emphasis on coherence since the start of the Doha Round has fostered a close working relationship between the managements of the Fund and the WTO. In an unprecedented move, the Managing Director and the President of the World Bank addressed the WTO General Council in May 2003, and again in October 2004, to lay out an agenda of support for the Doha Development Agenda. The First Deputy Managing Director addressed the General Council in May 2004, specifically to introduce the Trade Integration Mechanism (TIM). In turn, the Director-General of the WTO was invited to address several meetings of the IMFC in 2002–04. The Bank had similar high-level exchanges.

49. **While the three institutions share common objectives in the trade area, there are notable differences in their approaches and competences.** Through efforts in their respective areas, the three agencies foster the progressive liberalization of trade in goods and services. However, within this broad agenda, the Fund focuses in general terms on the overall

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[33] This statistical exercise does not establish whether, as a result of these developments, the level of trade-related conditionality today is appropriate. That would require a case study approach. More broadly, the statistical trends yield no insight into the quality of trade reforms under Fund-supported programs. See "Issues for Further Consideration" in Section V.

economic policy framework, the Bank on development and sectoral issues, and the WTO on legal commitments. At the same time, the delivery vehicles of the three agencies differ (Table 10). This section discusss the division of labor between the three institutions and the nature of (and basis for) the Fund's collaboration with each.

Table 10. Vehicles of IMF, World Bank, and WTO Trade Policy Advice

	IMF	World Bank	WTO
International architecture for trade	Article VIII Standards and Codes (financial services, jointly with Bank)	Standards and Codes (financial services, jointly with Fund)	Negotiating machinery Dispute resolution Accession process
Surveillance	Article IV Staff Reports Selected Issues Papers *World Economic Outlook*	Economic and Sector Work (ESW) Country Assistance Strategies Diagnostic Trade Integration Studies *Global Economic Prospects*	Trade Policy Reviews World Trade Report Background papers
Program support	Stand-by Arrangement/EFF/ PRGF Trade Integration Mechanism	Adjustment lending Trade facilitation lending Infrastructure for trade	No lending or advisory capacity
Technical Assistance	Tax and tariff reform Customs reform	Capacity building (WBI) Customs reform Regional trade agreements	Capacity building workshops
Research	Research clustered around trade-macro linkages	Broad research agenda with focus on sectors, micro-linkages and institutions	Research emphasis on market access issues

A. IMF and World Bank

50. **The respective roles of the Bank and the Fund are governed principally by their mandates and guided by understandings in various joint reports.** The 1989 "Concordat" between the Managing Director and the World Bank President guides the work of the staffs. It provides specific guidance on the division of activities between the institutions based on an approach of primary responsibilities.[34] While identifying trade and structural reform as among the Bank's "*primary responsibilities*," the Concordat stated that each institution "*must be allowed to explore their legitimate concerns with regard to macroeconomic and structural issues*," albeit relying as much as possible on analysis and monitoring of the other institution

[34] *Bank-Fund Collaboration in Assisting Member Countries* (SM/89/54, Rev. 1, March 31, 1989).

with the primary responsibility.[35] Procedures for collaboration have been improved over the years, as reflected in periodic Board reports on Fund/Bank Collaboration; in particular, trade policy was identified as an area of overlapping responsibility in a 1998 joint report following the Asian crisis and external evaluation of the ESAF.[36]

51. **While the Fund's primary focus has been on the impact of the trading system on external viability and growth, the Bank has both a broader development perspective and sector-specific expertise.** The Bank's trade strategy currently envisages engagement at three levels:

- First, helping to catalyze a **Doha Round** outcome that promotes developing country growth and poverty reduction to the maximum extent. In this area, joint Bank-Fund initiatives have been particularly prominent, including communication by the managements of the two institutions and a joint paper on market access.[37] On sectoral aspects of the negotiations, especially agriculture, the regulatory agenda and global outcomes, the Fund has drawn extensively on the Bank's expertise.
- Second, helping developing countries **integrate pro-poor trade policies** into their national development strategies, placing special emphasis on countries' ability to seize opportunities from trade reform, on capacity building, and on tackling social and sectoral adjustment issues. The Bank has taken the lead in preparing diagnostic trade integration studies under the IF, with the Fund providing inputs in its areas of expertise (e.g., fiscal policies and competitiveness).
- Third, helping to shape the growing **agenda on regionalism** and providing members policy advice in this area. The Bank has developed a broad intellectual leadership on this issue, while the Fund has specialist expertise on certain aspects (such as the fiscal, transfers, currency and general macro dimensions). There is thus considerable scope to draw on each other's work which can be further exploited in future.

52. **Although the general principles of division of labor between the Bank and the Fund are broadly clear, the distinctions cannot always be maintained in operational practice.** As in other areas, in meeting surveillance and UFR needs outside its core expertise, the Fund seeks to draw on the Bank's work, but of course the Fund cannot expect "on-demand delivery" and specific inputs are thus not always perfectly synchronized. The review reveals the following patterns in the division of labor at the operational level:

- The Bank often takes the lead on trade reform in cases where there are complex and detailed reforms or industry- and sector-specific trade policies in which the Bank has

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[35] *Bank/Fund Collaboration on Public Expenditures Issues* (SM/03/73, Feb. 19, 2003), para. 4.

[36] *Report of the Managing Director and the President on Bank-Fund Collaboration* (SM/98/228, Rev. 1, Sept. 25, 1998).

[37] *Market Access for Developing Country Exports—Selected Issues* (SM/02/280, Rev. 1, September 26, 2002).

recognized expertise, for example, telecommunications, transportation, energy, and agriculture.

- The Fund would take the lead when the Bank's operations do not address trade policy, or when the Fund is providing technical assistance on the reform and administration of trade and other taxes. A closer look at the trade component in Fund program work during the 1990s reveals frequent interaction between the Bank and the Fund in the field (see *Review of Trade Conditionality in Fund-Supported Programs*, SM/05/57, Supplement 1). The two institutions' advice on trade tends to be consistent—cases of reported disagreement are rare.
- The Bank's operational reach is geographically more limited than the Fund's. For a broad swath of the membership—including developed countries but also many developing countries that have graduated from Bank lending—the Bank has no vehicle for policy dialogue that is comparable to the Fund's surveillance function. As a result, there is less scope for the Fund to draw on the Bank's work.

53. **The scope for improvement in the two institutions' collaboration in the trade area lies less in tackling avoidable duplication—there is little—and more in the Fund's drawing to the extent possible on the Bank's expertise.** Even though both the Bank (e.g., in its Country Assistance Strategy (CAS)) and the Fund (in its Article IV consultation) might be reviewing the trade policies of a particular country, the Fund would not be in a position to simply drop this review as long as its surveillance mandate and existing policies require it. Similar considerations apply in program work.[38] But it is obviously desirable that the Bank's (often more detailed) analyses inform the work of the Fund. While relatively straightforward in the CAS example, there is also considerable cross-country or informal knowledge that is less easily accessible. One approach being explored is to promote more systematic interaction between Bank regional trade coordinators and Fund mission teams.

B. IMF and WTO

54. **The WTO creates and enforces a rules-based system for the conduct of trade relations among its members.** The WTO is a member-driven organization: it acts at the initiative of members, for example, in determining trade policies through multilateral trade negotiations, the dispute settlement mechanism, or the accession process. Through the "binding" of negotiated tariff concessions and the enforcement of agreed rules, the WTO improves security and predictability of market access in world trade. While there are various fora for discussion of members' trade policies, these meetings do not provide authority to determine whether a member's policies are consistent with its obligations. Rather, obligations in particular cases are enforced through a dispute settlement process that is triggered by an aggrieved member and resolved under the WTO dispute settlement mechanism, which permits trade sanctions for breaches of WTO obligations.

[38] There may be more duplication in research, but most research is individually authored.

55. **WTO commitments determine maximum amounts of protection, not optimal levels from the point of view of economic efficiency.** Furthermore, certain aspects of trade policy with significant structural and macroeconomic implications are not subject to firm disciplines. Such areas include export taxes, state trading monopolies, tariff dispersion, and tariff exemptions. Thus, members can, and often do, go beyond their commitments—autonomously or under Fund/Bank supported programs, outside the framework of the WTO. Indeed, the issue of appropriate "credit" in trade negotiations for autonomous liberalization has been discussed in the context of the Doha Round.

Box 6. Day-to-Day Collaboration Between the IMF and the WTO

Apart from the institutional relationship, the IMF and the WTO consult routinely at the technical level. As set out in the IMF/WTO Cooperation Agreement,[39] cooperation has included reciprocal observership at certain Committee meetings, invited staff statements, document exchange and input into a range of reports at both institutions—for example, detailed comments on 45 WTO Trade Policy Reviews during 2002–04.

The Fund's Office in Geneva (EUOGE) is at the forefront of the Fund's working relations with the WTO. Consistent with the Cooperation Agreement, EUOGE represents the Fund in the WTO 's Committee on Balance of Payments Restrictions. It also participates, as an observer, in WTO surveillance of its members' trade policies through TPRs, and monitors country accession negotiations. Finally, it attends meetings of WTO committees and working groups of interest to the Fund, with a focus on those overlapping with the Fund's areas of responsibility, such as trade and development; trade, debt and finance; and financial services. The effectiveness of Fund/WTO cooperation could be further enhanced if Fund observership in the negotiating bodies created in Doha were confirmed.

56. **While the WTO reviews trade policy generally through Trade Policy Reviews (TPRs), such reviews cannot replace members' obligations under Article IV surveillance.** The objectives of the TPRs—periodic reviews of members' trade policies—are three-fold: to increase transparency and understanding of countries' trade policies and practices, through regular monitoring; to improve the quality of public and intergovernmental debate on trade issues; and to enable a multilateral assessment of the effects of policies on the world trading system. While for the Quad countries, TPRs take place on a biennial cycle, the periodicity is four or six years in most cases, so that their focus lies on medium to long-term trade policy changes rather than on the short-term economic adjustment process. Country-level TPRs are conducted on the basis of two documents, one prepared by the authorities of the member country concerned and the other by the WTO Secretariat, and involve a peer review process during which other WTO members' advice and concerns can be

[39] *Agreement Between the International Monetary Fund and the World Trade Organization*, Dec. No. 11381-(96/105), Nov. 25, 1996, *Selected Decisions and Selected Documents of the International Monetary Fund,* 28th Issue, December 31, 2003, p. 823.

registered. The WTO Secretariat document has become increasingly analytical as the Secretariat has gained experience and won greater leeway from WTO members in providing objective advice and analysis. The WTO Secretariat nonetheless operates within much narrower confines in this respect than does the Fund staff in its preparation of Staff Reports, and the Secretariat focuses uniquely on the impact of trade policies on trade. And, while the WTO TPRs are a valuable input into the Fund's activities, the Fund remains responsible for integrating such information into its overall economic analysis and assessment where required under surveillance and warranted under other policies.

57. **Various provisions in the WTO agreements and the Fund's Articles direct the organizations to work together and address overlapping jurisdiction to avoid conflicting rights and obligations of common members under international law.** The delineation of the WTO's and the Fund's jurisdictions over trade and exchange measures, respectively, is discussed in the Annex. Article X of the Fund's Articles instructs the Fund to cooperate with other international organizations in related fields. The GATT and the WTO Agreements provide that the WTO shall consult the Fund and accept its determinations in specified areas.[40] Apart from jurisdictional issues,[41] this requirement also extends to the Fund's expertise in balance of payments matters—the WTO's charter directs it to ask the Fund to determine the adequacy of a member's reserves and the vulnerability of its external position in assessing whether the member is properly imposing restrictions for balance of payments reasons that are otherwise inconsistent with WTO obligations. The Fund's Executive Board must approve both jurisdictional and balance of payments determinations communicated to the WTO (see also Box 6).

58. **Other aspects of the WTO Agreements overlap with key areas of the Fund's work outside its jurisdiction under Article VIII.** Besides its provisions on current payments and transfers, the General Agreement on Trade in Services (GATS) regulates certain capital movements associated with specific commitments. Fund Article IV consultation discussions necessarily consider the effects of capital flows as they are increasingly important means of allocating savings, promoting growth and facilitating balance of payments adjustment. The GATS also includes market access commitments in financial services, a core area for the Fund. Fund staff have shared experiences under FSAP reviews with the WTO Secretariat and membership.[42] As commitments under GATS provisions deepen through successive negotiating rounds, consideration could be given to enhanced collaboration, such as research on developing country issues, and possibly the more

[40] See, for example, WTO Charter, Article III.5; GATT Articles XV, XII, and XVIII; and GATS Articles XI, XII, and XXVI.

[41] The delineation of the WTO's and the Fund's jurisdictions over trade and exchange measures, respectively, is discussed in Annex I. For a more detailed discussion, see *The Relationship of the World Trade Organization with the Fund – Legal Aspects*, SM/94/303, Dec. 20, 1994; D. Siegel, *Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements*, AJIL, Vol. 96, No. 3, p. 561, July 2002.

[42] A Fund seminar on the FSAP program was held at the WTO in Geneva in June 2002.

detailed articulation of the relationship of the two institutions' responsibilities in financial services generally.

V. ISSUES FOR FURTHER CONSIDERATION

59. **There are important questions relating to the Fund's work on trade which this report has not addressed.** Given the considerable resource costs that would be involved in such an exercise, it has not examined whether the Fund's advice—and the models on which it may have been based—was appropriate, nor drawn any operational lessons. Neither have recent reviews of Fund trade policy conditionality (in 1994, 1998, and 2001) addressed questions relating to the impact and the appropriate design of trade reforms, except with regard to the fiscal revenue implications of tariff reductions.

60. **There are several reasons why it might be worth addressing these questions.** Most importantly, of course, such a study would help determine whether the Fund is providing the best advice, in the program and surveillance context. In addition, it would increase the credibility of the Fund's public advocacy of openness to trade as a key component of a strategy for growth and poverty reduction in developing countries, and support the Fund in its interaction with civil society in the globalization debate, in which Fund-supported trade reforms have always played a disproportionate role. Box 7 sets out some of the criticisms that have been directed at Fund trade policy prescriptions in recent years.

Box 7. Criticisms of Trade-Related Advice by the Fund

"IMF-supported liberalization is too fast. Successful globalizers are not radical liberalizers."

"Fund-supported programs ignore the impact of trade liberalization on vulnerable sections of the population and do not include appropriate social safety nets."

"Trade liberalization in Fund-supported programs ignores market imperfections in domestic and world markets."

"Trade conditionality is driven by the agenda of developed country shareholders in the IMF and is not critical to the objectives of the program."

"Requiring countries to liberalize unilaterally robs them of bargaining power in the multilateral negotiations. The IMF typically does not have arrangements with developed countries and is unable to influence their policies in a similar manner."

"The Fund is too soft on tariffs and non-tariff barriers in industrial countries."

"When developed countries liberalize, their governments are sensitive to the needs of various groups in the population. When the IMF requires a developing country to liberalize, the government is unable to address these needs."

61. **Effectively addressing such questions would require in-depth case studies focused on questions of impact and reform design.** Such studies are bound to draw significant attention since this is a contentious area. In order to deliver a credible product, it would be necessary to contract recognized outside expertise to help design and supervise the

preparation of the case studies and draft a summary report. The World Bank's independent evaluation office is conducting its own review of Bank trade work, which is expected to be completed in mid-2005, and any links would need to be carefully examined. The Bank's study might yield useful input for any follow-up work by the Fund, and to the extent possible, the Fund would collaborate closely with the Bank.

VI. Resource Implications

62. Most of the recommendations in this report are derived from a careful reading of existing policy, especially in the surveillance area. While some aim to raise the level of attention to specific issues compared with the existing practice (services trade, spillover effects of policies in middle-income countries), others would primarily affect the *way* that the Fund approaches trade issues, not the volume (selectivity in surveillance). Still others are unlikely to have noticeable resource implications beyond current levels (trade in PRSPs). Stepped-up consultation with regional institutions could potentially impose additional costs in a certain number of cases. However, preparation of selected issues and other papers on regional trade arrangements has been quite common, and it is not obvious that a more formal approach to regional surveillance would require *net* additional resources. Refining policy on regional trade agreements (planned Board seminar), possible training needs, and efforts to further improve information dissemination may have start-up costs in functional departments but are unlikely to have resource implications over time. The net resource effect of these different proposals is expected to be small and, where temporarily significant, captured within existing planning/budget envelopes.

63. A more significant cost would be attached to the proposal to conduct an additional study of the impact and design of trade policy in Fund-supported programs, as detailed above. The cost of this project is estimated to be around US$400,000 which would have to be resourced from the FY2006 budget (including an estimate of staff employed in the preparation of case studies), plus half a staff-year of in-house supervision and coordination costs.

VII. Issues for Discussion

64. Do Directors agree that the current agenda of trade issues covered by the Fund is appropriate? In view of overall resource constraints, which aspects of this work do Directors view as the most important?

65. Do Directors agree with the recommendation to devote greater attention in Fund surveillance to trade in services, and to spillovers of the trade policies of large developing countries? Do they agree that, in certain cases, surveillance of trade issues might be best conducted at the regional level? Are there areas which Directors would propose to deemphasize?

66. Do Directors concur with staff that the current approach toward Fund collaboration with other international institutions—principally the World Bank and theWTO—is both

appropriate and effective, though the staff could further step up efforts to ensure it is making full use of the information and analyses generated by the other institutions?

67. Do Directors agree that the general policy on selectivity in trade coverage, as set out in the context of the *2004 Biennial Surveillance Review*, can be made more specific by drawing on the considerations in Section III of this report? Do they agree that, while such considerations can provide markers, the coverage decision will ultimately have to rely on the judgment of missions on a case-by-case basis?

68. Do Directors agree that there remains further scope for encouraging better integration of trade reforms in PRSPs (drawing on the work prepared in the context of the Integrated Framework, where available), and that the Fund and other agencies can assist low-income countries on this issue as part of the policy dialogue with the authorities, as well as in Joint Staff Assessment Notes (JSAN)?

69. Trade-related conditionality under Fund-supported programs has declined very significantly during 2001-04, partly driven by the streamlining of structural conditionality under the 2002 *Conditionality Guidelines*. Do Directors view this trend as appropriate?

70. Do Directors consider that it would be desirable to conduct a study, based on country cases, of the impact and design of the trade policy reforms recommended by the Fund, with a view to drawing lessons for future policy advice and increasing the credibility of the Fund's public advocacy of openness to trade?

71. A companion paper reviews the Fund's Trade Restrictiveness Index (TRI). Do Directors agree that the TRI—notwithstanding its shortcomings, and while parallel efforts are made to improve it—remains a useful input into Fund mission discussions? Do they concur with the proposal to avoid quoting the index for individual countries in staff reports, but to preserve the TRI's original purpose of helping to inform the staff's dialogue with the authorities?

Selected Legal Aspects of the Fund's Mandate on Trade[1]

1. In addition to creating the Fund and the World Bank, participants in the Bretton Woods Conference of July 1944 envisaged a third international organization that would liberalize trade. This organization was not created, but the General Agreement on Tariffs and Trade (GATT) was adopted in 1947 and World Trade Organization (WTO) was established in 1995. As explained below, although a division of responsibilities between the Fund and the WTO remains, it does not preclude overlaps. Indeed, trade matters have an important role in key areas of Fund activities based on various provisions of the Articles and policies adopted by the Executive Board, including surveillance and conditionality. Moreover, to the extent that such activities have the effect of liberalizing trade they are consistent with one of the stated purposes of the Fund, which is to "facilitate the expansion and balanced growth of international trade...." (Article 1(ii)).[2]

Respective Jurisdictions over Exchange and Trade Measures

2. The obligation of members to refrain from imposing exchange or trade restrictions is the subject of the jurisdiction of the Fund and the WTO, respectively. Non-compliance with the applicable rules is a violation of an international obligation and can give rise to legal action. This legal principle applies similarly to the Fund's Articles and the WTO Agreements, although the way obligations are enforced differs in the two organizations.[3] The legal aspects of the jurisdictional relationship between the two organizations are complex; a few key points are highlighted here for their implications on the work of the Fund.[4]

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[1]The main author of this Appendix is Ms. D. Siegel (LEG).

[2]The term "facilitates" denotes the effect on the growth of international trade that results indirectly from the work of the Fund. As stated by former General Counsel Sir Joseph Gold: "The nuance of the word 'facilitates' in [Article IV] and of the word 'facilitate' in Article I expresses the idea of encouraging or easing and not controlling." Gold, *Some Legal Aspects of the IMF's Activities in Relation to International Trade,* Oster. Z. Offentl. Recht Und Volkerrecht Vol. 36, pp. 157–217, 1986 at 159.

[3]Under the Fund's Articles, the Executive Board determines compliance with members' obligations under the Articles. A noncomplying member may be subject to sanctions under Article XXVI, ranging from ineligibility to use Fund resources to suspension of voting rights and, eventually, compulsory withdrawal. In contrast, the WTO does not itself impose sanctions. Rather, it is the aggrieved member that initiates the dispute resolution procedure and may eventually pursue remedies in the form of countermeasures. This approach reflects the reciprocal nature of the trade concessions that characterized the GATT. The WTO as an organization facilitates the implementation of the agreements in various ways, including providing the mechanism for formal dispute resolution if a complaint is brought by an aggrieved member. *The World Trade Organization—Institutional Aspects,* SM/94/304, Dec. 20, 1994.

[4]See *The Relationship of the World Trade Organization with the Fund—Legal Aspects*, SM/94/303, Dec. 20, 1994; D. Siegel, *Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements*, AJIL, Vol. 96, No. 3, p. 561, July 2002.

3. As a general rule, Article VIII, Section 2(a) of the Fund's Articles prohibits members from imposing restrictions on the making of payments and transfers for current international transactions without prior approval.[5] Members are not permitted to restrict a resident from making a current "payment" to a non-resident and, in circumstances where this payment is made within the country of the resident, the member may not restrict the non-resident from "transferring" the proceeds of this payment from that country. Article XXX(d) defines payments for current transactions setting forth a non-exclusive list that includes, for example, trade in both goods and services, normal short-term banking and credit facilities, interest on loans and net income from other investments, and other transactions that may be viewed in other contexts as "capital" (i.e., payments of moderate amount for amortization of loans and for depreciation of direct investments).

4. The Fund's jurisdiction is limited, however, to the payments and transfers related to the current transaction; the underlying transaction is treated as a "trade" measure outside of the scope of Article VIII, although liberalizing the payment has the effect of facilitating this transaction. In 1960, the Executive Board evaluated options for defining exchange restrictions and adopted a test based on "whether it involves a direct governmental limitation on the availability or use of exchange as such."[6] This definition applies a technical criterion that looks at the measure's specific relation to the member's exchange system rather than the economic purpose or effect. It was recognized that reliance on this criterion would mean that a country could introduce trade restrictions for purely balance-of-payments purposes without being subject to the Fund's jurisdiction. The Executive Board contemplated, however, that consideration of the measure's effect or the authorities' motivation would necessarily involve evaluation of the member's trade polices and thus would fail to establish an objective rule and a clear method for distinguishing the jurisdiction of the Fund from the scope of the GATT.[7]

5. The WTO Agreements cover a range of matters governing trade in goods and services. Compliance with obligations is not regulated via an approval policy as in the Fund; although waivers are legally possible, they are relatively rare. While there are various fora for discussion of members' trade policies, these meetings do not provide authority to determine whether a member's trade policies are consistent with its obligations. Rather, obligations in particular cases are enforced through a dispute settlement process among members that is essentially adjudicatory in that it is triggered by an aggrieved member and resolved by a panel of independent adjudicators under the aegis of the WTO. An extensive body of

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[5] A limited exception applies for restrictions existing when the country joined the Fund (Article XIV). A special approval procedure exists for restrictions imposed for national security reasons. Dec. No. 144-(52/51), Aug. 14, 1952, *Selected Decisions,* 28th Issue, p. 503.

[6] Dec. No. 1034-(60/27), June 1, 1960, *Selected Decisions,* 28th Issue, p. 509.

[7] *Legal Aspects of Article VIII and Article XIV,* SM/59/73. Nov. 18, 1959.

jurisprudence has developed reflecting a sophisticated analysis that is not necessarily driven by the form of the measure, but could take into account the effect of the measure.

6. This delineation of jurisdiction as between the Fund and the WTO does not necessarily separate the functions of the two institutions in this area. One reason is that the different approaches just described could lead to different characterizations of the same measure. Additionally, some measures have both exchange and trade attributes, including import licenses that are based on a foreign currency budget. Moreover, certain provisions in the WTO Agreements specifically cover current payments and transfers. For example, the General Agreement on Trade in Services (GATS) explicitly covers the payments and transfers for services that are the subject of "specific commitments" to allow market access by foreign service providers.[8]

7. In light of the above, various provisions in the WTO Agreements and the Fund's Articles require the WTO and the Fund to work together to address overlapping jurisdiction and to avoid imposing conflicting obligations upon a common membership. If a restriction under the GATS involves an exchange measure, for instance, the GATS' balance-of-payments safeguard requires that the measures imposed thereunder be consistent with the Fund's Articles.[9] More generally, the GATT provides that the WTO shall consult the Fund on specified matters concerning Fund jurisdiction, as well as on assessments of balance of payments, and requires the WTO to accept the Fund's determinations in these areas.[10] On the Fund side, Article X of the Fund's Articles instructs the Fund to cooperate with other international organizations in related fields, and under the Fund/WTO Cooperation Agreement, the Fund has agreed to cooperate in the areas of requested consultations.[11] For example, with regard to exchange measures that are within the jurisdiction of the Fund, the Fund provides determinations on whether the measure is consistent with the Fund's Articles.[12] Also, as discussed in the main paper, other aspects of the WTO Agreements overlap with key areas of the Fund's work outside its jurisdiction under Article VIII, such as financial services. Application of the balance-of-payments safeguard, in particular, may have implications for members' need to access Fund financing.[13]

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[8]GATS, Article XI.

[9]GATS, Article XII:2(b). See also, *Legal Aspects of Capital Movements Under an Amendment of the Articles—Relationship with Articles XI and XII of the GATS,* SM/97/209, Aug. 19, 1997; *Multilateral, Regional and Bilateral Agreements and Initiatives in Capital Account Liberalization*, EBS/97/02, Feb. 14, 1997.

[10]See, e.g., WTO charter, Article III.5; GATT Articles XV, XII, and XVIII; and GATS Articles XI, XII, XXVI.

[11]*Agreement Between the International Monetary Fund and the World Trade Organization*, Dec. No. 11381-(96/105), Nov. 25, 1996, *Selected Decisions,* 28th Issue, p. 823.

[12]Dominican Republic—Request by WTO Dispute Settlement Panel, EBD/04/68, 6/22/04.

[13]S. Hagan, *Transfer of Funds,* UN Doc. UNCTAD/ITE/ITT/23, UN Sales No. E.00.II.D.38. of Int. and Comp. Law, Vol. 10, No. 2 (2004).

Surveillance

8. Article IV of the Fund's Articles governs surveillance, which is mandatory for the Fund and for members. The Fund conducts consultation discussions with members pursuant to Section 3 of that Article requiring the Fund to (i) oversee the international monetary system to ensure its effective operation, and (ii) oversee members' compliance with the obligations specified under Section 1. While Section 1(i) and (ii) address economic and financial policies, the latter two paragraphs of Section 1 focus specifically on exchange and exchange rate policies.[14] In Biennial Surveillance Reviews in 2000 and 2002, the Executive Board discussed the obligations of Section 1 in terms of "core" and "non-core" areas of "surveillance" (SUR/00/32, 3/2/00 and SUR/02/42, April, 10, 2002). Additionally, in practice, consultation discussions with members have evolved to include a range of issues that fall outside the obligations under Article IV and, therefore, do not form a part of "surveillance" within the meaning of Article IV.

9. Trade issues fall within the various aspects of these consultation discussions as follows. First, in the 2000 Biennial Surveillance Review, the Executive Board identified the "core" areas that are to be covered in all Article IV consultations as consisting of exchange rate policies and their consistency with macroeconomic policies, financial sector issues, the balance of payments and capital account flows and stocks, and related cross-country themes. While there is no obligation to liberalize trade per se, the core areas of surveillance include trade matters if the measures represent a sign of exchange rate inadequacy, including the existence of trade restrictions for balance-of-payments reasons.[15]

10. Second, "non-core" issues are also covered by Article IV when they relate to the obligations under Section 1 concerning the conduct of economic and financial policies (paragraphs (i) and (ii)). This is the case when they involve trade subsides with fiscal impact or have a direct and sizeable influence on macroeconomic development of the member that is the subject of the surveillance discussions. In the 2002 Biennial Surveillance Review, the Executive Board acknowledged further that structural and institutional policies have an impact on macroeconomic conditions. With respect to trade, for example, it was noted that "coverage of trade policies is critical in countries where serious trade distortions hamper macroeconomic prospects…." (SUR/02/42, April, 10, 2002, ¶ 9) As expressed recently in the Executive Board discussion in the context of the 2004 Biennial Surveillance Review, trade

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[14]The legal aspects of surveillance under Article IV were recently discussed in "*Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision—Modalities of Surveillance*," SM/04/212, Supp. I, Appendix I.

[15]Such restrictions might indicate the need for "special consultations" with the member. *Surveillance Over Exchange Rate Policies,* Principles of Fund Surveillance over Exchange Rate Policies, ¶ 2(iii), Dec. No. 5392-(77/63), April 29, 1997, as amended, *Selected Decisions,* 28th Issue, p. 12.

policies are also covered by Article IV where they have an important influence on a country's stability and growth prospects (SUR/04/80, Aug. 2, 2004).

11. Third, discussion of other non-core topics, including certain aspects of trade policy that fall outside the scope of Article IV *obligations*, may be referred to as "policy advice."[16] The Fund may include areas of "policy advice" in consultation discussions because they are important in the economic policy discussions between the Fund and the member.[17] For example, the Board has called for the inclusion in consultation discussions of trade policies which, although they may not have an adverse impact on the member's own economy, may have global or regional implications, i.e., "where trade policies in the major industrial countries affect market access for developing countries, or where trade policies have a significant impact on countries in that region." (SUR/02/42, April, 10, 2002, ¶ 9) Since policy advice is voluntary for members, they have no obligation to pursue specific policies in this area or to provide information that is relevant only for purposes of such policy advice.

Conditionality

12. The principal legal basis in the Articles for conditionality is Article V, Section 3, which sets forth the basic conditions for members' access to the Fund's general resources. First, the Fund's resources may only be used to resolve balance-of-payments difficulties, in accordance with the provisions of the Articles, which include the purposes set forth in Article I. Article I(v) states that the Fund's resources are to be provided "to give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity." Second, the availability of Fund resources must be "subject to adequate safeguards"; that is, the Fund must be of the view that the member will be in a position to repay the Fund within the relatively short period specified in the Articles

13. The above considerations necessitate that Fund conditionality embrace policy measures that may be taken in the trade area. For example, a member that follows trade policies that are "destructive of national or international prosperity" is more likely to aggravate economic maladjustments than to correct them; such policies may also increase the likelihood that the use by such member of Fund resources will not be temporary. Indeed, these principles are the basis for the Fund's decision to include

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[16]See *Role of the Fund in Governance Issues, Guidance Note, Statement by the General Counsel,* BUFF/97/75, July 23, 1977.

[17]Article XII, Section 8 of the Fund's Articles permits the Fund, at any time, "to communicate its views informally to any member on any matter arising" under the Articles. This is consistent with the Fund's purposes, in particular, as stated in Article I(i) "to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems."

in every stand-by and extended arrangement the performance criterion to avoid imposing import restrictions for balance-of-payments reasons. This "standard" performance criterion does not cover restrictions that may be imposed for other reasons, such as to protect local industries.

14. Given the increased recognition of the structural impact of trade restrictions, practice has evolved to include other performance criteria addressing existing trade policy measures, such as arbitrary tariff exemptions or other import subsidies that impact fiscal revenue or the business environment more generally. The choice to include these reforms in Fund arrangements is governed by the general standards for conditionality set forth in the Guidelines on Conditionality; key aspects of this policy include that the measure be of critical importance for achieving the goals of the member's program or for monitoring the program.[18] Because of the focus on the economic consequences of the intended reform, its technical character as an exchange or trade measure is not the determinant of conditionality (as it is under Fund jurisdiction over exchange measures discussed below). On the contrary, program design should take into account the equivalent economic effect of exchange and trade policy. For example, if an objective of the program concerns exchange rate policy, conditionality may need to take into account whether the arrival at a realistic rate of exchange through a flexible exchange rate policy could be frustrated by resort to a restrictive trade policy.[19]

15. The Fund takes care in designing trade-related conditionality to ensure that the measures are not inconsistent with WTO rights and obligations. At the same time, however, trade measures should only be incorporated into Fund-supported programs because they are considered necessary for the program's success. They should not be incorporated for the purpose of enforcing obligations under another international treaty or to expand the scope of commitments under another international agreement (e.g., binding commitments under the WTO Agreements). Such an approach would not only result in the Fund exceeding the authority conferred upon it under the Articles, but the burden would fall unevenly on users of Fund resources.

[18] Guidelines on Conditionality, Dec. No. 12864-(02/102), Sept. 25, 2002, *Selected Decisions,* 28th Issue, ¶s 7(a) & (b), p. 235–36.

[19] Gold, *The Stand-by Arrangements of the International Monetary Fund,* 1970, p. 144.

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Staff Guidelines on Trade Policy Advice

Fund policy advice in the trade area was drawn together in a set of operational guidelines in 1999:

- **Reform should first target the least transparent and most restrictive elements**, particularly NTBs.[62]
- **The pace of reform should be tailored to individual country circumstances**, including the initial degree of restrictiveness, administrative capacity, and likely short-term adjustment costs.
- **Quantitative restrictions (QRs) should be replaced by temporary tariffs**, which should not exceed tariff equivalents of the QRs or WTO bindings.[63] Export restrictions should be replaced by policies addressing the intended objectives (such as encouraging domestic processing or stemming illegal exports) directly.
- **Tariff reform should aim at a simple, transparent regime, with low uniform statutory (and applied) rates**, ideally between 5 and 10 percent. Import surcharges should be avoided as a means to address revenue shortfalls or balance of payments problems, though they might be appropriate temporarily.
- **Customs classification and valuation procedures should be transparent**, and standards and regulations should not discriminate against imports.
- **Trade reform should be accompanied by complementary macroeconomic and other policies**. There are strong links between trade reform, an appropriate level for the real exchange rate, and a liberal exchange system. There are also strong links between trade reform and fiscal policy.
- **Some actions (such as safety nets and fiscal reforms) may be needed** to offset the costs of trade reform, such as a transient increase in sectoral unemployment, or a loss of trade-related revenue.

Regarding participation in regional agreements:

- **Most-favored-nation (MFN) based liberalization is preferable**, but the Fund does not advise against regional trade arrangements (RTAs). Regional trade arrangements should, however, be made consistent with WTO obligations.

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[62] Nontariff barriers include QRs, trade monopolies, restrictive foreign exchange practices that affect trade, quality controls, and customs procedures that act as trade restrictions.

[63] Binding a tariff at the WTO establishes the maximum tariff which can be applied on imports from other WTO members.

- **Liberalization should apply to virtually all trade between RTA members, and include a program of multilateral liberalization.** The aim must be for RTAs to lock in reforms while facilitating progress toward nondiscriminatory multilateral liberalization.
- **Fund advice should not support policies contravening a country's WTO obligations**. At the same time, there should be no cross-conditionality; implementation of WTO agreements should not be made subject to Fund conditionality.
- **The RTAs should be liberal, transparent**, and have clear and consistent rules of origin.