

INTERNATIONAL MONETARY FUND

Reference Note on Trade Policy, Preferential Trade Agreements, and WTO Consistency¹

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September 30, 2010

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¹ This note provides a description of the existing framework. Interpretations of the treaties offered in the note are staff's own and may differ from those of the World Trade Organization or governing bodies of, or parties to, preferential trade agreements.

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I. BACKGROUND AND INFORMATION SOURCES

1. **This Reference Note introduces guidance on preferential trade agreements (PTAs).** In so doing, it responds to the request by the Executive Board in the context of the Independent Evaluation Office (IEO) *Evaluation of IMF Involvement in Trade Policy Issues*.² Section II provides context for the Fund's work on trade policy, drawing upon the 2009 IEO *Evaluation*, the 2005 *Review of Fund Work on Trade*, and the discussion of the Executive Board on these occasions. Section III reflects issues presented in *Preferential Trade Agreements—Issues for the Fund*, discussed at an informal Board seminar in December 2006.³

2. **The remainder of the paper consolidates and updates existing guidance in other trade-related areas, in accordance with the Fund's mandate and applicable Fund policies.** This fulfils an intention expressed in the *Management Implementation Plan* for Board-endorsed recommendations of the IEO Evaluation. Section IV discusses Fund guidance on trade policy reforms. To support policy coherence and help staff to avoid advising Fund member governments in a manner inconsistent with a government's obligations to the World Trade Organization (WTO), Section V summarizes WTO rules relevant to Fund operations. Section VI covers the IMF's role in the WTO Committee on Balance of Payments Restrictions (the BPC).

3. **Information sources available to Fund staff that are useful in trade policy work include the following:**

- SPR is re-vamping the existing Trade Policy Information Database (TPID). The TPID will emphasize information available from other sources and present this information in a manner that facilitates cross-country comparisons. (This note will be updated with additional information as the TPID is developed further.)
- The WTO's annual Tariff Profiles provide summary information on the tariff regime for most countries. This information includes average applied tariff rates and WTO bound (ceiling) rates,⁴ presented according to broad categories. (See www.wto.org)
- The WTO's periodic Trade Policy Reviews (TPRs) provide detailed information on the trade regimes of individual WTO member countries. The TPR is prepared on a two, four, or six year schedule depending on the country's relative importance in global trade. (See www.wto.org)

² IMF IEO An IEO Evaluation of IMF Involvement in International Trade Policy Issues, May 2009. A reference note concerning trade in financial services is being made available separately.

³ The treatment of trade policy should continue to be informed by current guidance in surveillance and conditionality.

⁴ Bound rates are generally determined in the course of membership negotiations or in the course of subsequent global trade rounds. Applied rates can (and often do) fall below bound rates.

- The WTO's Regional Trade Agreement Information System (RTA-IS) provides some information on those RTAs that have been officially notified to the WTO. (See www.wto.org) A database maintained at Dartmouth University, with World Bank support, (www.dartmouth.edu/~tradedb/trade_database.html) includes PTA texts and in-depth information in a format that facilitates comparisons. The website www.bilaterals.org includes PTA articles and the full text of many agreements.
- Two major sources focus on trade-related policy measures implemented since the beginning of the global financial crisis. The WTO Secretariat has prepared periodic reports, sometimes in collaboration with the OECD and UNCTAD. The most recent of these is available on www.wto.org as "Report to the TPRB from the Director-General on Trade-Related Developments" (WT/TPR/OV/W/3, 6/11/10). Separately, Global Trade Alert (www.globaltradealert.org), supported by the World Bank, reports a broader set of measures (including those under consideration or in the pipeline), provides comparator reports in an easily accessible manner, and provides occasional analysis.

II. THE CONTEXT FOR FUND ADVICE ON TRADE POLICY

4. **In discussing the 2009 IEO *Evaluation*, Executive Directors noted that trade policies can strongly influence macroeconomic stability and emphasized that the Fund "must play an active role in calling attention to systemic and macroeconomic implications of trade policy developments".** They called for greater emphasis in multilateral surveillance on the global effects of trade policies in systemically important countries and, for all countries, for bilateral surveillance to tackle macro-critical trade policy issues, while ensuring evenhandedness in advice. They also stressed that staff work on trade policy should remain selective, and should be consistent with the work of other multilateral organizations, principally the WTO.

5. **Directors welcomed the earlier scaling back of trade policy conditionality, in line with streamlined Fund conditionality and gradual improvements in the trade regimes of many countries.** Regarding Fund-supported programs, Directors distinguished new trade liberalization measures, on the one hand, from backsliding on past reforms. Guided by the Fund's Article I, avoiding the resort to trade-restricting measures should be emphasized.⁵ Trade liberalization should be promoted actively where necessary for program objectives.

6. **Guidance from the Board in the context of the IEO *Evaluation* broadly complemented that from the 2005 *Review of Fund Work on Trade*.** That *Review* examined, among other broad issues, the trade-related challenges facing Fund members and the associated Fund messages. In addition to the consideration of

⁵ As stated in Article I(v), the purpose of Fund financing is: "To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments *without resorting to measures destructive of national or international prosperity*" (emphasis added).

macroeconomic stability, the Fund has consistently advocated open trade regimes to combat rent seeking, enhance economic efficiency, promote economic growth, and reduce poverty. While the message applies to members at all income levels, there are differences in emphasis: (i) the Fund's trade advice to developed countries has focused on global policy spillovers; (ii) in many developing countries the Fund's focus has been on the unfinished liberalization agenda; and (iii) the pace of trade reform may need to consider short-term adjustment costs, but reforms must not be put off indefinitely. The Fund has also pressed for ambitious multilateral (WTO) negotiations, including the present Doha Round.

III. PREFERENTIAL TRADE AGREEMENTS (PTAs)

7. **The Fund is neither a critic nor an enthusiast of PTAs.** Countries wishing to “go further” can sometimes do so more quickly through PTAs. But with their inherently discriminatory nature comes a splintering of the multilateral trade system. Staff will not normally have either the resources or expertise to engage in detailed discussions or to advise on the appropriateness of individual PTAs. Nonetheless: (i) PTAs have important systemic implications for the functioning of the global trade system and for trade relations in certain regions, which can require periodic attention by Fund staff, such as in regional and multilateral surveillance, and in the Fund's communications; and (ii) while individual PTAs have both benefits and costs, certain approaches to PTAs increase the benefits and reduce costs; the Fund can advocate these principles.

8. **PTAs represent a departure from the non-discrimination principle underlying the multilateral trading system.** The post-war economic order erected in the 1940s established nondiscrimination as the norm in international economic relations, in both trade and financial relations. The choice of a multilateral trading system with the “most favored nation” (MFN) (non-discrimination) principle at its core reflected a desire to buffer trade from other policy areas and to insulate small, less powerful countries from undue influence of larger ones. WTO rules allow an exception to the non-discrimination principle under certain conditions; however—despite important recent advances toward greater transparency—oversight of WTO rules on PTAs has proven weak. In part as a result, in the past two decades the number of PTAs has risen sharply and they now cover a third to half of global trade. The scope of PTAs has also broadened, to include trade in financial and other services, investment flows, and other rules.

Box 1. Some Concepts Regarding Preferential Trade Arrangements

The economics literature has often used somewhat different definitions of regional trade arrangements. Here, the term Preferential Trade Agreement (PTA) is used to refer to an agreement between two or more countries to apply lower trade policy barriers to goods and services imported from the members than to those imported from third countries. A Free Trade Area (FTA) is a PTA for which barriers on trade between members are reduced or eliminated, and the term usually suggests other policy measures in addition to discriminatory trade preferences. FTA members may elect to impose a common external tariff (CET) for each product; a CET may be imposed with or without the continued use of internal customs controls. A Customs Union (CU) is an FTA with a CET, in which internal customs controls have been eliminated, so that goods imported from third countries may circulate freely throughout the territory of the customs union. A common market, the deepest form of integration, allows the free movement of productive factors (labor and capital) as well as products (goods and services).

9. **Although discriminatory trade preferences may raise or reduce global economic welfare, much of the recent debate over PTAs concerns their effects on excluded countries and whether they undermine the multilateral trading system.** From this perspective, it is important to distinguish *preferential* (discriminatory) policies from the many other elements of cooperation (such as customs administration, standards, and transport and infrastructure) that frequently accompany PTAs in regional initiatives. Unlike preferential (discriminatory) policies, these other elements often carry benign or positive effects on non-participants as well as participants. To the extent these other elements are nondiscriminatory, they are rarely controversial and do not generally raise issues for Fund staff.

A. PTAs and Fund Surveillance

10. **Work on PTAs should reflect established principles of surveillance and be undertaken selectively.** The discussion in this section applies where such work is appropriate under the Fund's surveillance policies.

11. **When covered under bilateral surveillance, staff should acknowledge that PTAs can bring both benefits and costs.** The Fund is neither a PTA critic nor enthusiast, but to help foster a well functioning international trading system, staff may encourage transparency and communicate principles of PTA design that best serve the interests of individual members and of the multilateral system. The Fund also advises on managing fiscal and other consequences of PTAs.

- Especially when PTAs include systemically important countries, discussions on existing or planned PTAs should highlight—and country reports should acknowledge—potentially adverse impact of preferences on non-participants. Reports should contrast areas of potential gains with the possible costs to the parties themselves and third countries, and to the global trading system.
- Discussions should also highlight the benefits of designing PTAs in ways that minimize the distortions to the multilateral trading system and increase the benefits (while reducing the costs) to the parties themselves.

- PTAs should be accompanied by a complementary commitment to prompt and deep reductions of trade barriers on an MFN (nondiscriminatory) basis, so as to reduce the potential trade-diverting effect of a PTA; this is particularly important if existing MFN trade barriers against non-PTA partners are high.
- PTA rules of origin (RoO) should be liberal and transparent. The RoO define whether a good is eligible for duty-free treatment, based on whether it has sufficiently “originated” in the partner country. With restrictive RoO, the use of intermediate inputs from third countries disqualifies a shipment from duty-free treatment in the PTA partner country, exacerbating the bias of the PTA against third countries. The result is a non-transparent form of protection that is not evident in a country’s tariff code.⁶
- Cumulation provisions in PTAs should be broad-based, with “diagonal” rather than “bilateral” cumulation. Multiple PTAs for a single country add a new dimension to RoO—that of “cumulation.” Suppose a single country, X, has PTAs with two other countries, Y and Z. Under *bilateral cumulation* of rules of origin, inputs that Y imports from Z do not count in meeting the RoO for Y when it exports to X. This fragmented “hub and spoke” system—with X as the hub and Y and Z as spokes—discourages trade between Y and Z. Alternatively, under *diagonal cumulation*, inputs that Y imports from Z help Y to meet the RoO when it exports to X. When RoO are otherwise restrictive, bilateral cumulation exacerbates the effects of this restrictiveness.⁷
- PTAs should ideally be open to new members on essentially the same terms agreed by existing members. This allows third countries that are not parties to

⁶ Depending on the type of specification of RoO, some fairly simple questions may shed light on their restrictiveness. For example, many RoO are based on whether domestic processing transforms an imported intermediate input from one tariff classification at the time of import to another tariff classification at the time of export. In this type of specification, a rule that confers origin as a result of a change in the detailed six-digit product classification is relatively easy to meet and thus less restrictive than a rule that confers origin only if processing results in a change in the broad two-digit product classification. Many other RoO are based on value-added thresholds. A rule that confers origin based on a minimum 20 percent domestic value added would be relatively easy to meet and thus less restrictive than a rule of origin requiring 50 percent domestic value added. These two types of RoO (change in tariff classification and value-added threshold) are quite transparent; however, in many cases RoO are specified with much greater complexity and according to more ad hoc considerations. (See http://www.wto.org/english/tratop_e/roi_e/roi_e.htm for recent WTO documents on RoO.)

⁷ In Europe, bilateral cumulation (with the EU at the center) stunted the early integration of the central European countries. With the transition to the Pan-European Cumulation System (PECS), however, the EU opened its European PTAs to diagonal cumulation—allowing (even before Hungary’s EU membership), for example, a Hungarian producer to use Norwegian inputs in production intended for preferential entry into the EU. In Richard Baldwin’s now famous description, the PECS “tamed the European spaghetti bowl,” thus “multilateralizing” the tangle of FTAs in Europe.” Cumulation provisions are critical in regions with many and/or overlapping PTAs, such as in East Asia and Africa. In the unilateral preferences that developed countries often extend to developing and least-developed countries (such as Generalized System of Preferences (GSP) schemes, the EU’s Everything but Arms program, and the United States’ African Growth and Opportunity Act (AGOA) program), cumulation provisions influence South-South trade.

a PTA and may therefore suffer a disadvantage the opportunity to overcome that disadvantage, should they choose to pursue membership.

12. In external communications and in regional and multilateral surveillance, the Fund can bring useful perspectives on PTAs.

- Particularly while multilateral trade negotiations are ongoing, the Fund can highlight the need for caution in embarking on new PTAs and call on members to reflect individually and collectively on ways to guard against the potentially adverse effects on the multilateral trade system of a proliferation of PTAs.
- In this context, Fund communications can support strengthened multilateral rules on PTAs and their transparency. Enhanced WTO provisions are a healthy start, but more can be done to clarify and strengthen multilateral PTA rules. The aim should not be to discourage the use of PTAs, but rather to help shape their evolution in the most positive manner.
- Vocal Fund support for MFN-based reforms (whether through the Doha Round or unilaterally) can strengthen the multilateral trade system, while also setting the best environment for PTAs. Fund communications and surveillance could explicitly acknowledge that the spread of PTAs strengthens the case for further MFN-based reforms. An ambitious conclusion to the Doha Round of multilateral trade negotiations would be a key step.
- The Fund can also highlight the systemic implications of RoO. Although often cast aside as too complex and technical, RoO are in reality a key feature that determines whether a PTA is complementary to multilateralism. Without becoming bogged in details, the Fund can advocate healthy principles of liberal, transparent RoO and broad cumulation provisions, as discussed above. Simplifying and coordinating rules of origin across PTAs can help to “multilateralize” regionalism.

13. Fund staff may on occasion be called on to deal with other aspects of PTAs, such as revenue consequences and provisions concerning services.

Regarding revenue considerations:

- PTAs present revenue issues similar to those of MFN trade reforms. The revenue impact will depend on the share of imports sourced from PTA partners and could be much less than with MFN liberalization, although the extension of preferences to a partner that accounts for a large share of imports may result in significant revenue losses. (Partly for this reason, under the EU’s Economic Partnership Agreements, developing country partners will retain tariffs on imports of many goods from the EU, and those tariffs that are to be eliminated by the developing country partner will be phased out gradually).
- The diversion of trade from dutiable to non-dutiable (PTA partner) sources will exacerbate the revenue impact of a PTA.
- With PTAs in place, MFN tariff reductions will have smaller revenue effects than otherwise. In the presence of PTAs, MFN tariff reductions (i) do not

directly affect duties collected on imports from PTA partners, and (ii) by reducing PTA preference margins, partly unwind the adverse trade diversion effect, thus working to enhance revenue (although the overall revenue effect of MFN tariff reforms in the presence of existing PTAs would in many cases still be negative).

14. **Issues related to financial services trade are of particular relevance for the Fund.** As with the WTO General Agreement on Trade in Services (GATS), PTAs in services may contain obligations regarding related banking, insurance, and associated capital transactions. These issues are addressed in the companion Reference Note on Trade in Financial Services.

B. Surveillance Modalities

15. **Where selectivity criteria suggest a need for Fund bilateral surveillance to cover PTAs, staff may exercise this surveillance in a variety of ways.** The area departments involved are best placed to select the approach, which should then be oriented toward such considerations as the scope for MFN-based reforms (including, in the case of customs unions, through the common external tariff) and PTA RoO.

16. **The typical approach is for teams to consider selected PTAs (or a set of PTA-related issues that may run across individual agreements) in the Article IV consultation discussions, with appropriate coverage in the relevant staff report.** This provides flexibility to country teams to determine whether a particular PTA or issue warrants coverage. Increasingly, teams may want to step back from examining individual PTAs in favor of examining cross-cutting PTA issues that the country faces. Obviously, information sharing and coordination across country teams is important for staff efficiency and consistency of messages.

17. **With PTAs proliferating and deepening, trade policy competency often lies beyond the national authorities.** Effective surveillance can require elements of a regional approach. Consultations with regional bodies are already common, such as with the Central African Monetary and Economic Community, the West African Economic and Monetary Union, the European Union (Euro Area reports) and CARICOM. It may be worthwhile supplementing discussions with one member with discussions with regional bodies, including trade officials.

IV. TRADE POLICY REFORMS

18. **Many Fund members have found trade reforms a key component of broader medium-term programs that emphasize structural reform.**⁸ With progressive reform, trade policy has become less prominent in Fund policy advice and

⁸ Fund research has found trade liberalization among the few reform areas that generate particularly large effects on per capita income growth. See, for example, “Structural Reforms and Economic Performance in Advanced and Developing Countries” at <http://www.imf.org/external/pubs/cat/longres.cfm?sk=22594.0>.

in Fund-supported programs. This section guides staff on designing effective trade reforms and assessing progress in trade liberalization for occasions when attention to trade reform is appropriate.

A. Objectives, Scope, Sequencing, and Pace of Trade Reform

Objectives

19. **The Fund encourages members to maintain liberal trade regimes in order to promote efficient resource allocation, enhance growth, and contribute to economic stability.** Liberal trade policies also improve transparency and promote good governance by reducing rent-seeking and administrative discretion. Indeed, broadly open trade systems promote trade and attract long-term investment. Complex, opaque trade rules and regulations—particularly those that entail discretion and favorable treatment to select groups of producers and consumers—are inimical to good governance.

20. **Fund advice to countries embarking on a program of trade reform should encompass three important aspects of such programs.** First, it should draw on the emerging consensus regarding the appropriate scope, sequencing, and pace of trade reform, while at the same time being tailored to individual country circumstances. The design of trade reforms will have to consider countries' PTAs, without compromising multilateral liberalization objectives. Secondly, Fund advice should be guided by considerations of efficiency in resource allocation. Thus, trade reform programs will typically need to be more ambitious than is required under the WTO. However, such reforms should not contravene countries' obligations under the WTO agreements. Finally, Fund staff should stress that trade reform be accompanied by complementary policies, because of the strong mutual links between trade policy and macroeconomic and structural policies. In this regard, staff should note particularly the need for an exchange rate regime and exchange rate level appropriate to the country, and—where revenue is a key concern—to strengthen broad-based consumption taxes early in the reform process.

Scope

21. **Trade liberalization should target the progressive elimination of policies that discriminate between domestic and foreign products.** In practice, liberalizing trade means eliminating NTBs such as quotas, bans and restrictive licensing, and other administrative arrangements; the progressive lowering of maximum and average tariffs; reducing tariff dispersion through fewer tariff bands (preferably a single relatively low uniform rate); removing export restrictions; eliminating tax exemptions and discriminatory tax treatment; and eliminating trade-related subsidies, state trading monopolies, and other discretionary administrative actions. Where appropriate, countries should also be encouraged to address domestic controls, restrictive business practices, or domestic market structures that foster anticompetitive practices that could negate the benefits of trade liberalization.

Sequencing

22. **The trade reform should first target the least transparent and most restrictive elements of the trade regime, particularly NTBs, export restrictions, and discriminatory or discretionary tariff exemptions.** Thereafter, emphasis should be on attaining low and relatively uniform tariff protection. However, tariff rate reductions need not wait until the elimination of NTBs is complete. Such a sequence of trade reform is also appropriate on the grounds that an increase in revenues associated with the tariffification of NTBs will buy time to improve tax administration and diversify the revenue base.

The Pace of Trade Reform

23. **The pace of trade reform should be tailored to circumstances, including initial restrictiveness, administrative capacity, and any short term adjustment costs.** The experience of successful reformers that have liberalized from a highly restrictive to an open trade regime over about seven years is instructive. Where the scope of reform is less far-reaching and the degree of commitment is higher, trade reforms can be completed in shorter periods. For most, a one-step removal of all restrictions is infeasible and a phased reduction should be considered. Care should be taken not to bunch the most sensitive items toward the end of the phasing period, as this could lead to backtracking on commitment. Too hesitant reforms may send the wrong signals to the private sector, whereas decisive initial action and a preannounced timetable for further reforms signal commitment provide credibility, and attract investment. Thus, staff should strive for balanced or frontloaded trade liberalization measures and seek an appropriately ambitious reform program that can be implemented within the program period.

Quantitative Restrictions and Other NTBs

24. **Quantitative restrictions (QR) and other NTBs should be eliminated early to aid transparency and reduce the discretion that fosters lobbying and corruption.**

- QRs that are protectionist can be converted to equivalent tariffs at rates not exceeding their WTO bindings. The tariffs should be phased down in the context of overall tariff reform according to defined, monitorable targets and a preannounced timetable.
- Licenses required for record keeping should be granted automatically and quickly so as not to impede trade. National trade authorities can refer to specific WTO provisions regarding automatic import licensing.
- Customs classification and valuation procedures should be uniform, transparent and fair. Valuation should be based on the transactions value, with exceptions only if the transaction value does not exist or has been distorted.⁹

⁹ Developing countries continue to face difficulties in implementing this rule, due to wide-spread administrative shortcomings.

(In this situation, alternatives are specified in the WTO Agreement on the Implementation of GATT Article VII).

- Trading monopolies should be discontinued by abolishing the legislation that grants them exclusive rights to trade in particular commodities. The focus should be on exclusivity of rights rather than on ownership.
- Standards and regulations should apply to imports and domestic goods in a non discriminatory manner, to ensure that the measures are not used for protection.

Exemptions

25. **Discretionary and other tariff exemptions should be largely eliminated.** Circumstances under which exemptions are granted should be in law and publicized, and allow minimal or no discretion.

Export Restrictions

26. **Export restrictions should be replaced by domestic policies that address the intended objectives, and a definitive timetable set for the elimination of the restrictions.**¹⁰

- If export taxes are levied to achieve fiscal objectives, these should be replaced by domestic taxes that do not discriminate against trade.
- Where export restrictions are maintained to enforce nonmarket prices for domestically produced goods (as was the case in transition economies), the transition to market prices should be strongly encouraged early in the reform process.¹¹
- If the restrictions reflect environmental concerns, staff should encourage the adoption of measures that directly limit harvesting/extraction, for example by auctioning permits, without restricting the final disposal of the legally harvested/extracted product. In many such cases, international agreements are in place.

¹⁰ Countries generally maintain export restrictions to encourage domestic processing industries; stem illegal exports; address environmental concerns; enforce labor standards; meet fiscal objectives; or to enforce domestic processes to meet social objectives. Often these measures do not achieve the intended objectives but instead accentuate illegal activities, create incentives for lobbying, and induce resource misallocation.

¹¹ Note that WTO rules discipline (albeit lightly) the use of export restrictions, but not export taxes (although the latter are to be imposed on a nondiscriminatory basis). However, some recently acceded WTO members have undertaken specific obligations regarding their use of export restrictions and export taxes.

27. **In special instances, export taxes may be used temporarily to absorb windfall gains from exceptional movements in world commodity prices.** For countries that subsidize exported goods, export taxes can offset domestic subsidies to avoid countervailing duties by importing countries. Assurances are needed to prevent the taxes from becoming permanent.

Export Subsidies

28. **The use of export subsidies is strongly discouraged.** Export subsidies are also prohibited under WTO rules, with limited exceptions for certain developing countries¹² and for certain agricultural products (the latter are expected to be eliminated with the completion of the Doha Round).

Tariff Reform

29. **The tariff reform program should generally seek to attain a tariff system that is simple, transparent, and has low uniform applied tariff rates.** Therefore:

- Ideally, tariff rates should be reduced according to a clearly specified timetable. The experience of successful reformers shows that, even starting from a restrictive trade regime, it is possible within 2–3 years to reduce maximum tariff rates to some 20–25 percent and subsequently further to 15 percent or less; to reduce average applied tariff rates to about 15 percent initially and to about 10 percent or less in the subsequent stages; and to reduce the number of tariff bands to 3–4.
- Specific and other non ad valorem tariff rates should be converted to ad valorem rates to improve the transparency and efficiency of the tariff system.
- “Paratariffs” or “other duties and charges” (ODCs)—taxes that are applied only to imports and are additional to the customs tariff—should be consolidated into the tariff structure at the outset of the program, so that nominal tariffs reflect the true protection and the tariff regime is transparent.
- Ideally, over the medium term, a reform program should aim to unify the tariff structure at rates of between 5 and 10 percent.
- Tariff rates should be as uniform as possible, with little dispersion. Escalatory tariff structures—higher nominal tariff rates for processed goods than for unprocessed goods—are rejected. Similarly, those countries that categorize tariff rates according to product groups (e.g., consumer goods, capital goods,

¹² Least developed countries, countries listed in Annex VII of the Agreement on Subsidies and Countervailing Measures until their GNP per capita reaches US\$1,000, and certain small economies benefiting from temporary exemptions under Art. 27.4 ASCM.

and intermediate inputs) should be advised to move toward a uniform tariff rate across product groups.¹³

- In general, import surcharges should be avoided as a means to address revenue shortfalls or balance of payments problems. Where they cannot be avoided, temporary and time-bound trade restrictions in the form of across-the-board import surcharges, applicable to all trading partners, are the least distortive.
- The allocation of products within different tariff bands should proceed with a view to reducing tariff escalation and effective protection.
- Indirect import taxes (e.g., excises) must be equivalent to those on domestic goods.

B. Complementary Policies

30. **Trade reform works best when appropriately sequenced with macroeconomic and structural reforms in the context of a clearly formulated medium-term framework.** Thus, trade reform must be accompanied by policies that promote macroeconomic stability, as well as structural reforms that favor a competitive environment and efficient resource allocation. For example, an exchange rate regime and exchange rate level that are appropriate for the country will be important in the face of temporary balance of payments pressures that may result from a substantial opening up to imports. Appropriate complementary policies may also be needed to offset the costs of trade reform, such as a temporary increase in unemployment in affected industries, and a possible reduction in revenues from trade taxes.

31. **Fiscal considerations may necessitate a moderate pace of trade reform, and efforts to broaden the domestic tax base should be emphasized early in the reform agenda.** At the same time, the resource allocation costs of a restrictive tariff regime, the supply side impact of trade liberalization on the revenue base, as well as the experience of successful reformers suggests that fiscal considerations should not unduly delay trade reform.

32. **Policy reversals should be avoided.** A reorientation of production, consumption and investment patterns depends on sustained implementation of a credible reform program. If, however, in short-term crisis situations trade restrictions are imposed, they should be accompanied by a publicized timetable for their elimination.

33. **Reliance on trade policy instruments for nontrade policy objectives should be avoided, and such objectives should be pursued directly through the use of first-best instruments.** If trade policy measures are resorted to in the short term when there might be no better alternatives, a binding timetable for their phased elimination should be agreed.

¹³ Where important economic objectives are at stake, these are best addressed through other means. Stimulating investment, for example, is best done through capital provisions (e.g., depreciation rules).

C. Use of Import Surcharges

34. **This section reviews economic issues related to import surcharges and concludes that surcharges are normally a poor and ineffective way to address macroeconomic issues.** This is in part due to practical problems—surcharges typically cover a limited share of imports (as broad exceptions are made for certain products and partners) and have a limited impact on import demand or tax revenue. More conceptually, surcharges—like other trade measures—are unlikely to impact saving and investment aggregates or external balances. The adverse effects are clear, however: by increasing distortions, surcharges misallocate scarce resources and strengthen protectionist lobbies. In line with the Fund’s mandate, and consistent with WTO principles, the Fund opposes surcharges on economic grounds in the great majority of cases. Moreover, Fund policy advice must take into account adverse spillover effects of import surcharges on other countries. When used, a surcharge should be at a relatively low rate that is uniform across all products, and should be phased out rapidly according to a publicized timetable. Finally, in the context of Fund-supported programs, the imposition of import surcharges may breach a standard continuous performance criterion against the imposition or intensification of import restrictions for balance of payments purposes (see discussion below).

The Macroeconomic Implications of Import Surcharges

35. **The usual justification for import surcharges, as for raising import tariffs generally, is that despite their longer-term efficiency costs they have some short-term macroeconomic benefits.** In particular, they are justified as a means to address rapidly fiscal or BoP needs. It is sometimes argued that by raising the domestic price of imports, import surcharges switch demand to domestic goods and improve the current account, at least in the short term. Moreover, by raising revenue the surcharge is expected to improve the fiscal and savings-investment balances and the external position. The arguments against surcharges and tariffs are that they are distortionary and very much inferior solutions.

36. **The appropriate policy framework to address the circumstances in which surcharges are normally introduced would be a flexible exchange rate, accompanied by domestic expenditure policies, typically a tightening of fiscal policies.** With a flexible exchange rate, import surcharges are redundant and inefficient in addressing the BoP situation. The lower demand for imports will cause an excess supply of foreign exchange, leading to an appreciation of the domestic currency, offsetting the initial impact of the surcharge. Thus, without expenditure reduction policies, any impact of a surcharge on the current account will be short-lived. Under fixed exchange rates, an import surcharge initially may cause demand to contract and reduce imports. However, since it is an implicit tax on exports, it will over time undermine any impact on the current account.

37. **Introducing a surcharge or tariff to address an external imbalance leads to distortions that undermine efficiency and long-run adjustment.** The general case against protectionism is well known. Discrimination against imports through the trade system leads to resource misallocation, reduced trade, and lower consumer welfare. Protection also results in resources lost in rent seeking, less competition in domestic markets, reduced economies of scale, and increased uncertainty for

investors. In addition, surcharges heighten anti-export bias, with a potentially adverse effect on the current account. The tax diminishes the attractiveness of exporting by bidding resources to import-competing activities and by making inputs to exports more expensive. Moreover, a nominally uniform import surcharge or tariff would not be uniform in terms of effective protection.

38. **Surcharges also make the trade regime more complex and less transparent.** This is aggravated by the fact that surcharges are more liable to change at the authorities' whim, including changing the coverage, on account of the lesser legal impediments they confront compared to tariffs. The consequent policy instability makes surcharges more detrimental to confidence, deters investment, and raises governance issues.

39. **In practice, since surcharges are rarely uniform, their costs can be even higher and their macroeconomic benefits more questionable.** This suggests that many surcharges are in response to protectionist pressures, rather than as a means to address macroeconomic imbalances. Moreover, once installed, protectionist actions are often difficult to remove.

Institutional Factors

40. **To the extent that surcharges are a protectionist response to external difficulties, they run counter to the principle of liberal trade systems.** Fund advocacy of surcharges would run counter to our goal of promoting open international trade. Introduction of a surcharge in one country often triggers similar actions in others.

41. **Surcharges may also, in some circumstances, be contrary to WTO rules.** These require that members maintain their tariffs at no more than the bound levels, and that they be applied to all other WTO members on an MFN basis. Thus, an across-the-board tariff increase is within WTO commitments only if all tariff rates remain below their bound levels.¹⁴ A country introducing a surcharge beyond bound rates could justify them under the provisions of GATT Articles XII or XVIII:B. See the discussion below on exceptions to WTO rules.

Case Studies on Import Surcharges

42. **The experience with import surcharges** includes examples from Argentina, Bulgaria, Hungary, Poland, and Slovakia. Studies focused on the coverage, duration, level, and revenue impact of the surcharges, as well as the economic circumstances at the time of introduction. The case studies indicated that the BoP and the fiscal impacts of surcharges were generally limited.

43. **Those surcharges were usually introduced with the stated intention of correcting fiscal and/or external imbalances, and were frequently imposed in connection with other macroeconomic and structural measures.** The extent of imbalances preceding the imposition of surcharges varied dramatically. The

¹⁴A surcharge could be classified under "other duties and charges" for which separate bindings apply.

surcharges usually comprised a single uniform rate ranging from 3 to 8 percent. However, in all countries studied, certain sectors and products were exempt from surcharges. In most cases, surcharges applied to all trading partners—although at the time of these surcharges there were far fewer preferential trade agreements in place.

44. **The macroeconomic impact on the balance of payments was limited, in part because of important exceptions.** The data also suggest that the contribution of the surcharges to fiscal targets was usually insignificant: the anticipated revenue collection from the surcharges ranged from 0.2 to 1 percent of GDP, but actual receipts were markedly below expectations. All five countries had alternative revenue options such as broad-based consumption or output taxes. The duration of surcharges varied from 14 to 48 months, and their elimination was usually based on a preannounced timetable—usually in compliance with the WTO BPC—that was sometimes not adhered to.

Conclusion

45. **Import surcharges are appropriate only in very limited circumstances.** Arguments can be made for temporary surcharges in instances of inappropriate or inflexible exchange rates, and where alternative fiscal measures are unavailable. Even then, however, an import surcharge is inferior and may be ineffective. Moreover, surcharges are not typically introduced in these circumstances, but under other conditions where they are more clearly inappropriate. Moreover, fiscal and external balance impacts have in practice been small. Thus, surcharges are decidedly inferior policies that entail distortions and delay adjustment. The adverse distortionary impact is smaller to the extent the surcharge is low, uniform, and is phased out rapidly. Thus the Fund staff should argue against the introduction of surcharges and—where they are in place—for their early elimination.

V. WTO-Consistency

46. **Joint IMF-WTO members expect consistent policy advice from the two institutions.** For Fund staff, the demand for policy coherence is reflected in the Executive Board-approved IMF-WTO Cooperation Agreement and in other related guidance:

- “Fund staff needs also to ensure that...recommended policy measures and program conditionality are consistent with the member’s agreements under the auspices of the WTO. This has assumed particular importance in light of the more extensive commitments undertaken by members under the Uruguay Round....”¹⁵

¹⁵ “*Guidelines/Framework for Fund Staff Collaboration with the WTO—Revised Guidelines/Framework*” (EB/CGATT/95/1, Supplement 1), as endorsed by the Fund’s Executive Board. The Executive Board decided that the draft guidelines framework for Fund staff collaboration with the WTO, set forth in EB/CGATT/95/1, Supplement 1, may be used by the staff to discuss cooperation with the WTO staff, with the goal of reaching agreement on collaboration between the two institutions (Decision No. 10968-(95/43), April 21, 1995).

- “The Fund’s staff shall consult with the WTO Secretariat on issues of possible inconsistency between measures under discussion with a common member and that member’s obligations under the WTO Agreement.”¹⁶

This section summarizes certain areas of WTO rules that may arise from time to time in Fund program work, surveillance, and technical assistance. SPR trade staff can provide additional information and, when necessary, can assist by liaising with the WTO Secretariat. Such consultations provide a clearer understanding of WTO rules and how they apply to individual WTO members (the obligations of some of which may be affected by exemptions or phase-in periods). In some cases, however, doubt may remain because only WTO dispute settlement panels and the WTO Appellate Body can assess and decide whether a particular measure is consistent with all of a country’s WTO obligations.

A. Introduction

47. **The WTO agreements fall into six main parts:** an umbrella agreement (the Agreement Establishing the WTO); agreements for each of the three broad areas of trade that the WTO covers (the GATT for goods, the GATS for services, and the Trade-Related Aspects of Intellectual Property Rights for intellectual property); dispute settlement; and reviews of governments’ trade policies. There are then extra agreements and annexes dealing with the special requirements of specific sectors or issues. These agreements are collectively referred to as the “WTO agreements.”

48. **Trade and trade-related measures recommended by the Fund should be consistent with the member’s obligations under the WTO Agreement, including agreements and legal instruments annexed thereto.**¹⁷ The need to be aware of WTO-consistency issues has assumed greater importance in view of the increased coverage and scope of obligations undertaken by WTO members under the Uruguay Round. With the Uruguay Round, for example, the GATS was created, establishing the first multilateral rules covering trade in services—including financial services such as banking and investment. The GATS, importantly, covers not only cross-border trade but also the establishment by a service supplier of one country in the territory of another (e.g., through subsidiaries and branching).

49. **This note does not cover all WTO rules, nor does it pretend to address their often complex legal ramifications.** The WTO rules provide for numerous exceptions, allow long and variable transition periods, and afford certain members special treatment; some examples are indicated here, but the subject is by no means covered exhaustively.

50. **It is not the role of the Fund or Fund staff to pass judgment on the WTO-consistency of trade and trade-related measures.** This is the jurisdiction of the

¹⁶ “Agreement between the International Monetary Fund and the World Trade Organization,” adopted by the IMF Executive Board under Decision No. 11381-(96/105), November 25, 1996.

¹⁷ The basic document is “*The Results of the Uruguay Round of Multilateral Trade Negotiations—The Legal Texts*,” Geneva, 1994. Note that the GATT, as amended by the Uruguay Round, is among the WTO agreements.

WTO, and definitive rulings normally are made only by WTO dispute panels and the Appellate Body. Fund staff have a responsibility, however, to be aware of the issues so that potentially inconsistent policy measures can be identified at an early stage and alternatives explored, averting the prospect of Fund staff inadvertently advising inconsistent measures. Fund staff should be able to identify problems and discuss these with SPR trade staff, who can assist in identifying potential inconsistency issues and in liaising with the WTO Secretariat.

51. **Fund policy advice and program design often encourage members to improve economic efficiency by undertaking unilateral trade liberalization that may well go beyond the member’s WTO commitments.** This is perfectly valid.¹⁸ However, “cross-conditionality” should be avoided.¹⁹

52. **Finally, it may be noted that WTO rules also cover exchange measures that may have adverse trade effects (the note provides some examples).** Exchange measures subject to Fund jurisdiction and approved by the Fund under Article VIII or maintained under Article XIV cannot be challenged under the WTO.

53. **Even if a Fund member has not yet joined the WTO, the member should be advised to adopt measures that will establish a WTO-consistent trade regime so that the path to eventual WTO accession is eased.** Reflecting WTO accession negotiations, WTO members sometimes accept temporary or permanent obligations not applicable to other members; these may be reflected in the member’s WTO Protocol of Accession and associated documents.

B. Tariff Bindings²⁰

54. **It is very unusual for the Fund to recommend tariff increases, even on individual tariff lines.** In that unusual situation, however, care must be exercised to avoid breaches of the member’s WTO tariff bindings. In developing countries, bound rates typically exceed applied rates, and bindings may not exist for all industrial products (in the case of agriculture, the Uruguay Round has required all tariff lines to

¹⁸ Indeed, the “*Guidelines/Framework for Fund Staff Collaboration with the WTO—Revised Guidelines/Framework*” (EB/CGATT/95/1, Supplement 1) recognized that “Fund policy advice often encompasses features that require reforms consistent with or going beyond a member’s undertakings in the WTO. For example, tariffs may be reduced under a Fund-supported program to levels below “bound” levels in the relevant WTO agreements.”

¹⁹ The “*Guidelines/Framework for Fund Staff Collaboration with the WTO*” describe cross conditionality as “directly linking the use of Fund resources to the performance of obligations under the WTO-administered agreements.” It goes on to clarify that: “Fund-supported programs may include reductions in subsidies or trade barriers that are consistent with *or go beyond* [emphasis added] the commitments undertaken under the Uruguay Round when the Fund finds that such measures are necessary to achieve the objectives of the Fund-supported program, but not to enforce commitments to agreements under the auspices of the WTO.”

²⁰ A tariff binding is an agreed maximum tariff on a specific product (designated by several thousand tariff lines) that a WTO member has included in its “schedule of tariff concessions.”

be bound). An assessment of potential WTO-consistency problems will require a line-by-line comparison of applied (or proposed) tariffs with bound rates.²¹

55. Some exceptions exist in which a tariff binding can be exceeded if justified under special provisions of the WTO agreements (see below on Exceptions to WTO Rules).

C. Other Duties and Charges

56. WTO rules also discipline duties or charges other than the customs tariffs that are levied exclusively on imports.²² Such “other duties and charges” (ODCs) could include import surcharges, surtaxes, stamp duties, fiscal duties, etc. The obligation to bind each ODC is additional to the obligation to bind tariffs. That is, ODCs and tariffs are not bound additively.²³ Each binding has to be respected separately.²⁴

D. Fees and Formalities Connected with Importation and Exportation²⁵

57. Occasionally, governments levy a fee on imports, in part to finance customs administration costs (usually called customs user fee or customs service charge). The WTO requires that such fees should be limited to the approximate costs involved in processing individual import transactions (and not customs administration in general), and should not represent an indirect protection to domestic products or taxation for fiscal purposes; the fee should generally not be levied on an ad valorem basis (as the cost of processing import transactions normally does not rise with the value of imports). The above applies irrespective of whether a country has a tariff binding on a given product.

E. Customs Valuation and Import Reference Prices

58. Governments occasionally seek to address “under invoicing” problems through a system of threshold or reference prices. These typically would be WTO-

²¹ Also check for exceptions such as waivers from the WTO. Tariff bindings are available through www.wto.org; SPR trade policy staff can assist with their interpretation. Applied tariff rates are subject to change and in most cases should be obtained from the authorities. The WTO publication [Tariff Profiles](#) provides summary information on applied tariff rates and WTO bound rates.

²² GATT Article II:2(c) allows a member to impose “fees and other charges commensurate with the cost of services rendered.”

²³ For example, if the applied surcharge, surtax, and tariff are 5 percent, 10 percent, and 15 percent respectively and the corresponding bound rates are 7 percent, 11 percent, and 20 percent, respectively, the surcharge cannot be increased by 3 percentage points (to 8 percent), even if the surtax and/or the tariff is reduced by 3 percentage points.

²⁴ Data on the level at which ODCs are bound will be found in a special column in a country’s tariff schedules. If there is no entry under this column, no ODCs can be imposed or maintained, as the ODC is effectively bound at zero. Countries that currently levy ODCs but did not specify these in their schedule of commitments should clarify this matter directly with the WTO.

²⁵ GATT Article VIII.

inconsistent. Under the Agreement on the Implementation of Article VII of the GATT, 1994, the primary method of customs valuation is the transaction value of the imported goods on which the duty is assessed; where the transaction value cannot be accepted (e.g., because the price has been influenced by distortions resulting from certain conditions or restrictions), the Agreement provides for other methods of determining the customs value.²⁶ An assessment should not be based on the domestic prices for like goods or on “arbitrary or fictitious” values.

F. Discriminatory Domestic Taxes

59. **Domestic taxes, such as a VAT, excise taxes, other sales taxes, and related border tax adjustment rules (including in the context of regional arrangements) must not treat imported goods less favorably than “like” domestic products (GATT Article III).**²⁷ The same applies to those services covered in a member’s schedule of specific commitments (GATS Article XVII).

60. **Occasionally, countries assess domestic taxes on imports at the same rate as domestically produced goods, but apply a markup to the value of imports in the calculation of the domestic tax.** Such markups violate the WTO’s national treatment provisions.

G. Agriculture

61. **As a result of the (1995) Uruguay Round Agreement on Agriculture, all agricultural nontariff measures were to become tariffs (“tariffication”) and all tariffs were bound** (although in many cases at rates above those actually applied). Rules were introduced on export subsidies and domestic support. The prohibition on nontariff measures applies to minimum import prices, discretionary import licensing, nontariff measures maintained through state trading enterprises, etc. Tariff-rate quotas can be used to guarantee a certain minimum level of market access for products previously subject to nontariff barriers. Provisions for special safeguard measures that permit imposition of additional duties can be made under specified circumstances.

H. Textiles and Clothing

62. **The Uruguay Round Agreement on Textiles and Clothing (ATC) provided for the phased elimination of quotas on textiles and clothing trade that had been maintained under the Multi-Fibre Arrangement (MFA).** This transition was completed with the elimination of all MFA quotas at end-2005. A few major developed countries subsequently introduced special safeguard measures covering

²⁶ If the transactions value cannot be determined, importers are given the right to select certain alternative methods (transactions value of identical or similar imported goods (Article 5) or Computed Value (Article 6). If the customs value of an imported good cannot be determined under these alternative methods, “reasonable means” consistent with the Agreement are to be used—Article 7. See the Uruguay Round “*Agreement on the Implementation of Article VII of the GATT*” which contains detailed guidelines for assessing the “transactions value” for customs purposes.

²⁷ Equally, the use of domestic taxes should not discriminate between imported goods from one country in favor of another, including under regional trade arrangements.

certain textiles and clothing imports (several developed countries also retain relatively high tariffs in these product categories).

I. Voluntary Export Restraints²⁸

63. **Prior to the conclusion of the Uruguay Round, some countries were frequently pressured to exercise unilateral export restraint or to enter into “voluntary” agreements with importing nations to avoid the threat of antidumping or countervailing duties, or other actions against their exports.** The WTO Agreement on Safeguards explicitly prohibits the use of voluntary export restraints (VERs), orderly marketing arrangements, “or any other similar measures on the export or the import side.” “Similar measures” include: (i) export moderation; (ii) export-price or import-price monitoring systems; (iii) export or import surveillance; (iv) compulsory import cartels; and (v) discretionary import or export licensing schemes.

J. Import Licensing

64. **As a general rule, non-automatic import and export licensing procedures are prohibited under GATT Article XI.** Exceptions apply, for example, to prevent critical shortages of foodstuffs or other essential products, and restrictions necessary to the application of standards or regulations. The provisions of GATT Articles XX and XXI establish certain exceptions.²⁹

K. Trade-Related Investment Measures

65. **Trade-related investment measures (TRIMs) are requirements or incentives for an enterprise to use domestically-produced inputs or to export.** The WTO Agreement on TRIMs requires, *inter alia*, elimination of local content requirements (e.g., if a certain amount of domestically-produced goods must be used), trade balancing requirements (e.g., imports should not exceed a specified level of exports), and foreign exchange balancing requirements (e.g., foreign exchange for imports should not exceed a specified level that is related to exports).

L. Preshipment Inspection

66. **Preshipment inspection (PSI) activities covered under the WTO Agreement on PSI relate to the verification of quality, quantity, price (including exchange rate and financial terms), and the classification of goods.** The Agreement on PSI applies to all PSI activities, whether contracted or mandated by the government or any government body.

²⁸ Voluntary export restraints are bilateral arrangements between an exporter and an importer whereby the former agrees to limit exports of a given product. The arrangement may be concluded at government or industry level.

²⁹ Article XX provides for limited exceptions relating, among other things, to public morals, plant and animal health, and natural resources. Article XXI provides for security exceptions.

67. **The Agreement on PSI requires that government ensure that the PSI entity meet a wide range of provisions concerning transparency, treatment of business confidential information, avoidance of conflict of interest, prompt inspection, and appeals procedures.** It also requires governments to ensure that the PSI entity follow certain guidelines regarding price verification. Before recommending that a government introduce or expand PSI, Fund staff should consult the WTO Agreement on PSI and consider whether the authorities are in the position to meet its requirements and what assistance they may need before using PSI.

68. **Experience shows that PSI contracts can be expensive and their revenue-generating capability over-stated.** Countries often struggle to enforce contractual commitments made by the PSI provider to training and other capacity building in the customs service. In many cases, the information obtained and held by the PSI provider regarding import transactions is not made available to customs to help inform decision making, and build capability in risk assessment, valuation, and other aspects of the import clearance process. Unless there are compelling reasons to the contrary, PSI arrangements (and their modern day equivalent, “destination inspection”) should be seen as a short-term necessity only, ideally accompanied by an adequate government commitment to strengthen customs administration. Additionally, to ameliorate over-dependence on the services of the PSI provider, an exit date should be targeted in the contract and a strategy adopted to support that objective.

M. Subsidies

69. **As a general rule, the WTO Agreement on Subsidies and Countervailing Measures (ASCM) aims to circumscribe the use of specific trade-distorting subsidies.**³⁰ Farm subsidies are also disciplined by the WTO Agreement on Agriculture.³¹

70. **The ASCM applies to subsidies as defined in Article 1,**³² which are specific (targeted) within the meaning of Article 2.³³ Such specific subsidies may be either:

³⁰ In general, Fund policy advice is in the direction of reduction of subsidies, and hence problems of consistency with the WTO are unlikely to arise. It is nevertheless useful to be aware of the general WTO principles on subsidies, as summarized in this note. Details are found in the ASCM. Some of the terms used in the agreement are highly technical and their interpretation should be left to the WTO.

³¹ Some WTO members retain the right to subsidize the exports of particular farm products, up to specified value and volume limits; these remaining agricultural export subsidies would be prohibited under the draft provisions of a Doha Round agreement.

³² The ASCM covers subsidies involving a financial contribution by a public body that confers a benefit to specific enterprises or industries. A financial contribution exists where there is a direct or potential direct transfer of funds (e.g., loan guarantees); where government revenue is foregone, such as through fiscal incentives (although exported products may be exempted from duties or taxes borne by like products when destined for domestic consumption); where a government provides goods or services other than general infrastructure, or purchases goods; or where there are income and price support schemes.

³³ A subsidy is "specific" if it is targeted to (i) a particular enterprise or group of enterprises; (ii) a particular industry or group of industries; or (iii) enterprises or industries operating in designated

(continued...)

(i) Prohibited, if contingent on export performance or on the use of domestic over imported goods. Attachment 1 to the ASCM provides an illustrative list of prohibited export subsidies;³⁴ or

(ii) Actionable, when they cause injury to the domestic industry of another member, “nullification or impairment of benefits” for other WTO members, or “serious prejudice” to the interests of another member.³⁵

71. Countries can take actions within the WTO or impose countervailing measures under national procedures of the importing country (but subject to multilateral rules) against prohibited and actionable subsidies. Countervailing measures, which typically take the form of special duties, may be imposed only if subsidized imports are found to be causing or threatening to cause injury to a domestic industry, and cannot exceed the level of subsidization found to exist. Countervailing measures may be imposed only after an investigation, and there are detailed rules governing the investigatory process.

72. WTO rules also specify permissible duty drawback provisions. (See ASCM Annex III, “*Guidelines in the Determination of Substitution Drawback Systems as Export Subsidies.*”) Any drawback of the customs duty, sales tax, or the VAT on imports that are physically “consumed” (e.g., intermediates) in exported production are not deemed to be export subsidies and hence are permitted. A duty drawback on the import of capital goods used in the production of exports, including any drawback claimed on the depreciation of capital goods, would, however, constitute an export subsidy and thus be prohibited.

73. There are certain limited exceptions. For example, least-developed countries are allowed to use export subsidies, although the subsidized imports can still be subject to countervailing measures.

N. Dumping/Antidumping (AD)³⁶

74. Under certain conditions, and following specific procedures, antidumping duties may be used. These essentially allow a higher rate of duty (which may exceed the bound tariff rate) to be applied temporarily against a specific product imported from an exporting company and country found to have dumped that product.

regions within the jurisdiction of a granting authority. Prohibited subsidies are deemed to be specific (because they are targeted at exports or at import-displacing products).

³⁴ Several prohibited subsidies are relevant to Fund staff, such as those concerning provisions for the rebate of direct and indirect taxes and provisions for export financing.

³⁵ A category of “non-actionable” subsidies (for certain subsidies for R&D, disadvantaged regions and the purpose of meeting new environmental standards) was created in the Uruguay Round but expired in 1999.

³⁶ Dumping, under multilateral rules, exists when a product is sold abroad for less than “normal value.” Typically, this means that the export price is less than the comparable price in the home market.

75. **The Agreement on Implementation of Article VI (the “AD Agreement”) addresses the criteria to be met before imposing an AD duty.** Two criteria must be met: (i) dumping must be found to exist; and (ii) it must be established that dumped imports are causing or threatening material injury to a domestic industry. The AD Agreement contains provisions relating to the definition of dumping, determination of injury, definition of domestic industry, etc. As in the case of countervailing measures, AD measures may be imposed only after an investigation, and the AD Agreement contains detailed rules governing the investigatory process.

76. **An AD duty may not exceed the dumping margin, and the AD Agreement indicates that it is desirable (but not required) that the duty be less than the margin if a lesser duty is adequate to remove the injury.**

77. **Unless a review is requested and determines that the expiration of an AD duty would likely lead to continuation or recurrence of dumping and injury, AD duties are to be terminated no later than five years from imposition.**

O. Export Measures

78. **GATT Article XI forbids quantitative import and export restrictions, except for “temporary” restrictions to prevent or relieve critical shortages of food or other essential products.** Such temporary restrictions have been used quite frequently and sometimes maintained for long durations. Any export taxes must be applied according to the MFN (nondiscrimination) principle, but (with some exceptions for recently acceded WTO members) export taxes are not otherwise disciplined.

P. Major Exceptions to WTO Rules

79. **A number of exceptions are allowed in certain cases, for example, when there are balance of payments reasons, in order to afford temporary relief to an industry, for development purposes, and in a limited number of other cases.** Some important exceptions are outlined below.

BoP Trade Restrictions: Implications for Fund-Supported Programs

80. **The WTO has provisions permitting members to impose temporary restrictions on trade in goods for balance of payments purposes that otherwise would be inconsistent with their WTO obligations (GATT Articles XII and XVIII:B).** The GATS (Article XII) also permits members to impose temporary restrictions on services trade to protect the balance of payments. A number of WTO obligations apply to the use of BoP measures, including prompt notification and consultation with the WTO. Requests to maintain import restrictions under these BoP provisions are considered by the WTO Committee BPC. The Committee relies heavily on the formal Fund assessment of the member’s BoP and reserves situation and outlook, described in the next section. In imposing trade restriction for BoP purposes, price-based measures should be used rather than quantitative restrictions. If quantitative restrictions are used, the consulting member should provide justification

for choosing these over price-based measures.³⁷ Measures are to be broad-based and may not target a narrow range of products.

81. **Fund members with IMF arrangements should avoid imposing or intensifying import restrictions for BoP purposes.** All Fund arrangements feature a continuous performance criterion against such restrictions. Invoking import restrictions under the WTO's BoP provisions would normally indicate to the Fund that the member had imposed or intensified these restrictions for BoP purposes.

Emergency Action for Temporary Relief

82. **In the event of serious injury, or the threat thereof, to a domestic industry due to imports, GATT Article XIX and the Agreement on Safeguards allow member countries to apply additional import restrictions or “safeguard measures” on a given product on an MFN basis for a limited period of time.** Before taking such actions, written notice must be given to the WTO, and other WTO members must be afforded the opportunity to consult.

83. **A WTO member proposing to apply safeguards must attempt to maintain a substantially equivalent level of concessions toward other members.** This implies that the proposed trade restrictions may have to be compensated by trade liberalizing measures on other products as may be agreed with other WTO members.³⁸ If a safeguard measure is in place for more than one year, it is to be progressively liberalized over the period of application.³⁹

84. **Additional safeguard provisions elsewhere in the WTO agreements include the special safeguards under the Agreement on Agriculture and transitional safeguard provisions under China's Protocol of Accession.** Safeguard provisions are expected to be developed for services under the GATS (Article X).

General Exceptions and Security Exceptions

85. **The “General Exceptions” provisions⁴⁰ outline a number of types of measures to which WTO obligations do not apply—as long as the measures do not constitute arbitrary or unjustifiable discrimination or a disguised restriction on trade.** These measures include, *inter alia*, those relating to the products of prison labor; restrictions for the protection of national treasures of artistic, historic or archeological value; measures necessary for the protection of human, animal or plant life or health; and restrictions relating to the conservation of exhaustible natural

³⁷ The Understanding on the Balance of Payments Provisions of the GATT 1994.

³⁸ If no agreement can be reached on acceptable compensation, an affected exporting country may suspend equivalent concessions. However, under certain conditions, suspension shall not occur for the first three years that a safeguard measure is in effect (Agreement on Safeguards, Article 8:3).

³⁹ Agreement on Safeguards, Article 7:4.

⁴⁰ GATT Article XX and GATS Article XIV.

resources if such measures are made effective in conjunction with restrictions on domestic production and consumption.

86. **The “Security Exceptions”⁴¹ provide a general exception to all WTO obligations with respect to disclosure of national security information, regulation of fissionable materials, regulation of traffic in arms, and action in pursuit of UN Charter obligations for the maintenance of international peace and security.**

There is also a catch-all clause that allows any action that is deemed “necessary for the protection of its essential security interests...taken in time of war or other emergency in international relations.”

Modification of Tariff Bindings

87. **“A WTO member may modify or withdraw a concession” (e.g., raise a tariff binding or revise a specific commitment pertaining to trade in services) following agreement to compensate other members with equivalent concessions elsewhere.** The renegotiation rights of WTO members and the possibility of the withdrawal of equivalent concessions has helped to maintain discipline in preserving obligations on tariff bindings. Modifying or withdrawing a concession has not been a step taken lightly and is infrequent.

Waivers

88. **Under exceptional circumstances, WTO members acting jointly (and with certain super-majorities) may waive a WTO obligation for any party (GATT Article XXV).** Temporary waivers have been approved, for example, for certain subsidy schemes that would otherwise be prohibited under WTO rules.

VI. WTO Committee on Balance of Payments Restrictions

89. **WTO members may impose additional import restrictions for BoP purposes.** When these WTO provisions are invoked, the Fund has a formal role—requiring a Fund statement approved by the IMF Executive Board—in the WTO’s deliberations.⁴²

90. **The WTO Agreements require it to “consult fully” with the IMF when considering and dealing with “problems concerning monetary reserves, balances of payments, or foreign exchange arrangements” and to “accept all findings of statistical and other facts presented by the Fund relating to foreign exchange, monetary reserves and balances of payments....”** In deciding cases regarding a WTO member’s request to maintain additional import restrictions for BoP purposes, WTO members “shall accept the determination of the Fund as to what constitutes a serious decline in the [member’s] monetary reserves, a very low level of its monetary reserves or a reasonable rate of increase in its monetary reserves, and as to the

⁴¹ GATT Article XXI and GATS Article XIV (bis).

⁴² See Section IV (c) regarding the relationship between WTO BoP measures and Fund arrangements.

financial aspects of other matters covered in consultation in such cases” (GATT Article XV; see also GATS (Article XII).

91. **The IMF thus plays a central role in the WTO BPC.** The Fund’s assessment of the country’s BoP situation is a key factor in the BPC’s determination whether the additional import restrictions are justified, based on whether the country is experiencing a very low level of reserves, a serious decline in its reserves, or an imminent threat of such a decline.

92. **Fund collaboration with the WTO BPC has evolved.** The centerpiece of this collaboration is the basic macroeconomic analysis provided by the Fund in the form of a formal statement.⁴³ This statement is approved by the Executive Board, normally on a lapse-of-time basis. The Fund plays this role to the best of its ability under the circumstances (e.g., regardless of delays in Article IV consultation discussions) and, within reason, according to the timetable of the BPC. Fund staff responsible for coordinating with the WTO try to ensure a schedule that allows adequate time for the preparation of the formal Fund statement, while meeting the BPC’s requirements. And it is very much in the Fund’s interest that the BPC function effectively and that it relies on the Fund’s macroeconomic assessments.

93. **A better appreciation of the WTO Articles, the Fund’s input, the sequence of events, as well as the setting and procedures for BPC meetings will render the process more effective.** With this in mind, this note tries to achieve a more agreed focus on the concerns of the BPC for background information and statements.

A. Procedures

94. **A typical BPC formal consultation meeting is attended by about 30–50 country delegations (occasionally with representation from capitals) and several observer organizations.** The country consulted sends a delegation, typically including trade and Ministry of Finance and/or central bank officials. The BPC Chairman (normally a Geneva-based national delegate), WTO Secretariat staff, and the Fund representative share the platform. The consultation opens with a formal statement by the head of the country delegation, followed by the Fund statement. The Chairman then takes statements from the delegations present, which could cover the broad macroeconomic picture and the type and duration of the particular restrictions. After a recess, the meeting reconvenes in informal session to prepare the Chairman’s summing up. The following day, a further formal meeting is held to agree on the summing up. Processes can be lengthy, particularly if input from capitals is involved. Countries place considerable weight on their hearing with the BPC, which has so far usually succeeded in disciplining the use of restrictions. In this connection, it may be worth emphasizing the relevance of the GATT and WTO Agreements.

⁴³ Note that through the IMF-WTO Cooperation Agreement, approved by the IMF Executive Board in 1996, the Fund has committed to playing the role envisioned for it in the WTO Agreements.

B. The GATT and the WTO Articles

95. **GATT Article XII allows a WTO member to maintain additional import restrictions (normally tariffs) under the conditions specified in GATT Article XII, but such import restrictions must not exceed those needed:**⁴⁴

- a) to forestall the imminent threat of, or to stop, a serious decline in its monetary reserves, or
- b) for a member with very low monetary reserves, to achieve a reasonable rate of increase in its reserves.

In carrying out its domestic policies, the country shall pay due regard to the need to restore BoP equilibrium on a sound and lasting basis. Such restrictions will be relaxed as conditions improve, and the country shall eliminate them when conditions no longer justify such maintenance.

96. **The Understanding on the BoP Provisions of the GATT confirms:**

- members' "commitment to give preference" to those measures which have the least disruptive effect on trade, i.e., price-based measures rather than quotas;
- that members "shall seek to avoid the imposition of new quantitative restrictions, for Balance-of-Payments purposes, unless, because of a critical balance of payments situation, price-based measures cannot arrest a sharp deterioration in the external payments position";
- that import measures taken for BoP purposes "may only be applied to control the general level of imports [that is, they are not to be used to advantage individual sectors] and may not exceed what is necessary to address the balance of payments situation."

97. **The IMF-WTO Cooperation Agreement sets out a framework for consultation with the WTO BPC.** The Cooperation Agreement provides that the Fund agrees to participate in consultations carried out by the WTO BPC on measures taken by a WTO member to safeguard its BoP (paragraph 4).

98. **The Fund's input is sought by the WTO to:**

- present the general macroeconomic picture;
- assess, as candidly and explicitly as possible, the country's BoP situation and reserves adequacy at the time the restrictions were introduced;
- indicate whether the BoP need continues; and
- evaluate alternative macroeconomic policies.

⁴⁴ Note that somewhat more lenient provisions apply to developing countries under GATT Article XVIII:B. GATS Article XII contains similar language concerning restrictions on services imports.

C. The Fund Statement

99. **The Fund statement should:**

- Assess the country's BoP situation and reserves adequacy at the time the restrictions were introduced, ideally with reference to the standards laid out in GATT Article XV (noted above) and to address the question whether or not the country still has a BoP need. This requires an evaluation of the country's reserve position and policies, including of what constitutes a "serious decline" in an overall macroeconomic setting.
- Provide information and analysis on the member's reserve position. The WTO BPC will look to the Fund statement to explain country-specific circumstances and considerations. Reserves adequacy needs to be assessed in each case with reference to country-specific circumstances.
- Assess what is needed to restore BoP equilibrium on a sound and lasting basis. This may require assessing macroeconomic policies appropriate to achieve this and whether the authorities are placing appropriate weight on exchange rate, monetary and fiscal policies. There should also be an evaluation of a possible time line for the appropriate alternative policy to work. It is not the Fund's role to assess whether the trade measures are justified. Although not required, the Fund has commented on whether the particular trade measures are assisting BoP adjustment and offer views on their early or phased removal, with some indication of a reasonable timetable.

D. Scheduling and Representation

100. **SPR consults with the WTO Secretariat to anticipate suitable dates for scheduling BPC consultations.** SPR will normally request advance notice of eight weeks for a BPC meeting for which a Fund statement is required. This would allow adequate time for the area department country team to prepare the draft statement, for inter-departmental review (LEG and SPR), clearance by the SPR IO reviewer (according to standard deadlines), management clearance, and Board approval. Board approval on a lapse-of-time basis should be requested in time so that a request by an Executive Director to discuss the matter would not cause delays in the BPC meeting.⁴⁵ SPR staff who deal with WTO liaison normally represent the Fund in formal BPC consultations, with additional representation from the area department when considered useful.

⁴⁵ If controversial issues are foreseen, an informal briefing to the Board or to the Committee on Liaison with the World Bank, the WTO, and other International Organizations may be useful.