Background Document 6

IMF Surveillance of Trade Policies: General Observations and Case Studies of Advanced Countries

A. Introduction

1. This paper starts with a brief description of IMF surveillance of trade policies in all members and then reviews more closely surveillance of trade policies in three advanced countries. Trade policy issues featured regularly in IMF bilateral surveillance even though they were typically not at the center of the Fund's macroeconomic concerns.[1] The main objectives of the Fund's advice were to improve allocative efficiency, to investigate systemic or domestic macroeconomic effects of trade policy changes, and to call attention to negative spillover effects. In the three advanced countries examined in more depth, barriers to trade, taken together, were relatively low, and the focus of surveillance—on agricultural protection, use of countervailing duties and antidumping remedies permitted within the World Trade Organization (WTO) framework, preferential trade agreements (PTAs), and, to a lesser extent, trade in financial services—was appropriately selective.

2. The paper is organized as follows. The next section provides general indicators of the coverage and depth of IMF trade policy surveillance in 1996–2007 in countries that had a surveillance-only relationship with the IMF as well as those that also had lending arrangements. The following section examines the content of IMF advice on trade policy for the United States, Japan, and Norway. The United States and Japan were selected for close review because they represent the members of the Quad (Canada, the European Union, Japan, and the United States) where IMF advice on trade policy was most active (United States) and least active (Japan) during the evaluation period. Norway was selected because it provides an example of surveillance of a smaller advanced country where agricultural trade distortions were very large and PTAs were numerous. The final section summarizes findings.

B. Coverage and Depth of Surveillance of Trade Policies

3. Surveillance of trade policies reached across income groups, including countries that had lending arrangements with the IMF and those that did not. The case studies presented in the previous background documents examine IMF involvement in countries with borrowing arrangements. There, conditionality figured prominently, though program commitments were agreed against the backdrop of work done in connection with periodic surveillance exercises—which continued, though less frequently, during the lending arrangement. For this short comprehensive overview, we present snapshots (drawn from the full IMF membership) of the beginning of the evaluation period (1996) and toward the end (2006).

4. Broadly, surveillance in 1996 covered trade policies in some 60 percent of countries in all income groups (Figure 1). In each income group, the focus was on conventional trade policies (tariffs, quotas, subsidies, and contingent protection remedies). Fewer than 10 percent of the consultations covered one or more of the three other broad groups of trade policy issues—trade in services, PTAs, and preference erosion. In the mid-1990s, the background documents tended to include general descriptions of trade policy changes that had taken place in the preceding year; hence most of the advice on conventional trade policy issues, regardless of the country's income level, was based on some explicit staff background work.[2]

[1] Bilateral surveillance occurred through annual Article IV consultations, reports on which described the staff's exchange of views with the authorities, provided staff views, and served as the basis for the Executive Board's consideration of the country's macroeconomic policies and outlook. As background to Article IV consultations, staff prepared more in-depth analytical pieces—selected issues papers—on issues of specific interest.

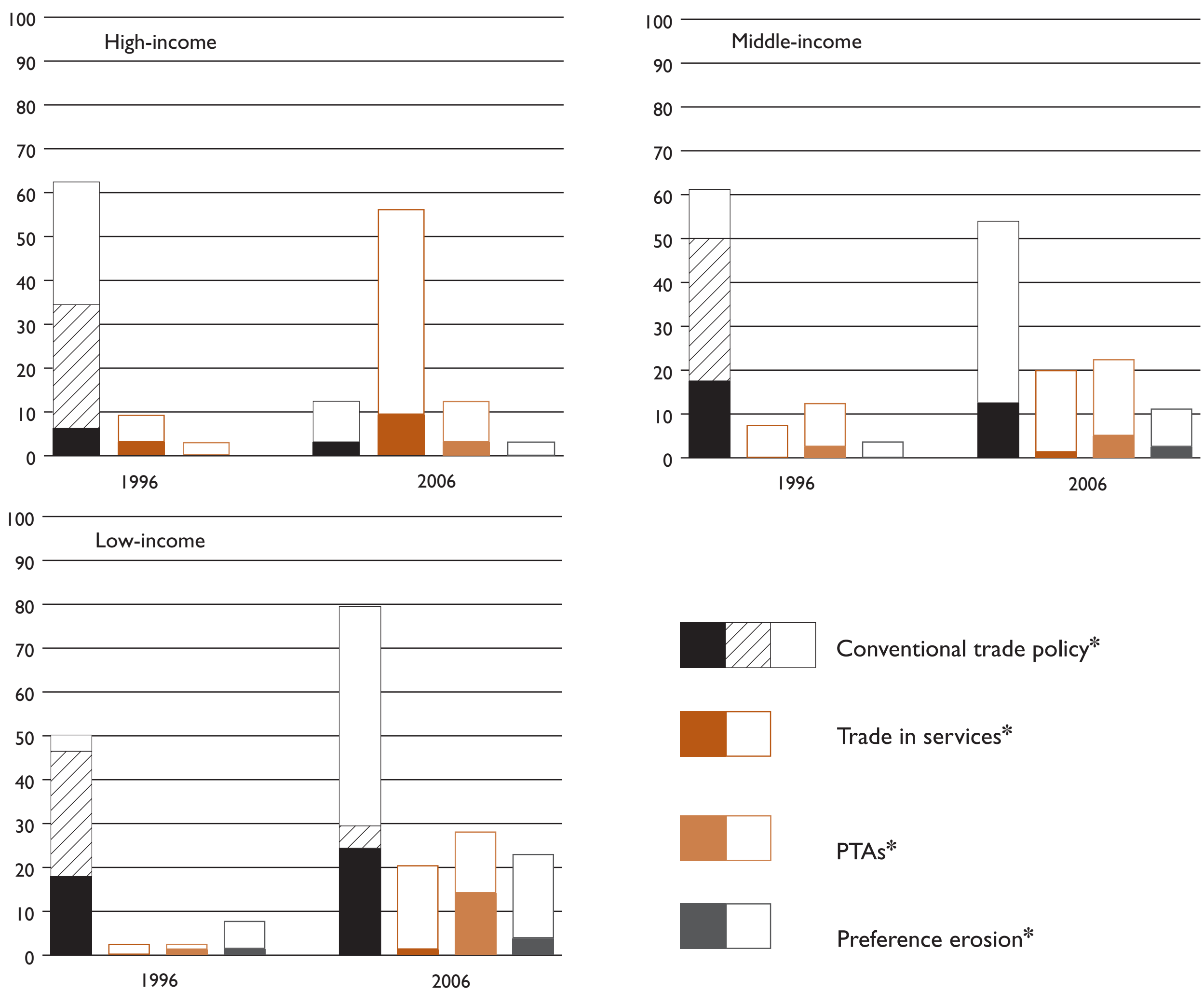
[2] In the 1970s and 1980s, most Article IV consultation documents included rather long descriptions of major policy issues, including trade policy. Gradually, during the 1990s, these were replaced by more analytical work on specific issues selected as the most important aspects of the IMF's advice to the country in that year. This meant that, starting in the mid- to late-1990s, trade policy was no longer automatically covered in background documents and could

5. By 2006, the pattern of coverage had changed significantly. For high-income countries in particular, the focus had moved sharply away from conventional trade policies: in fewer than 10 percent of high-income countries did Article IV consultations provide advice on these policies. A large shift had occurred toward issues of trade in services (especially trade in financial services among European countries) and, to a lesser extent, PTA issues. Far less of the advice was now backed by explicit analysis shown in staff papers; this pattern reflected a shift away from broadly descriptive background documents toward narrower, more analytically focused background papers that touched on trade policies less frequently. In middle- and low-income countries, the Fund's attention to conventional trade policy issues had remained broadly stable, though the share of advice that was backed by explicit analysis

even be excluded from any in-depth analytical examination for many years running.

Figure 1. Staff Views on Trade Policy in Bilateral and Currency Union Surveillance by Income Group, 1996, 2006

(Percent of all consultations in indicated year)



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

Source: IEO. Data reflect an examination of the surveillance documents for all IMF members (as well as currency unions and territories) in the years indicated and classification in terms of whether trade policy issues were covered and the depth of the analysis shown in staff work backing positions in staff reports. Annex I of the main report describes the classification system.

or description had dropped. Attention to other issues had risen. In both these income groups in 2006, some 10–30 percent of countries received advice on trade in services, PTAs, and preference erosion.

6. These trends are both reassuring and troubling. They are reassuring in that they broadly reflected the changes that took place in the trade policy landscape after the Uruguay Round. Tariffs fell during this period. In high-income countries, the average most-favored-nation (MFN) tariff fell to about 5 percent by 2006; and in low-income countries, the average tariff also fell sharply—indeed by more than that in high-income countries in absolute terms—but nonetheless its level in 2006 was twice as high as the high-income countries' average tariff had been in 1996 (Table 1). The issue of concern, however, is that the depth of explicit analysis underlying the IMF's trade policy advice fell across both middle- and low-income groups and across all issues.

C. Trade Policy Surveillance in Three Advanced Countries

United States

Initial conditions

7. The United States, a key advocate of multilateral trade liberalization with low overall measures of trade barriers yet significant pockets of protection, presented challenges for surveillance. In the mid-1990s, its tariff protection in the industrial sector was low; the simple average MFN tariff rate was 4.8 per-

Table 1. Degree of Trade Restrictiveness for Selected Advanced Countries

	1996[1]			2001			2007		
1. IMF TRI[2]	NTB	Tariff	Overall	NTB	Tariff	Overall	NTB	Tariff	Overall
Japan	2	1	4	2	1	4	2	1	4
Norway	2	4	7	2	1	4	2	1	4
United States	2	1	4	2	1	4	2	1	4
2. World Bank OTRI[3]	Mfg	Agri.	All	Mfg.	Agri.	All	Mfg.	Agri.	All
Japan	..	..	..	6.1	69.8	17.3	5.9	53.0	11.5
Norway	..	..	..	2.4	35.9	5.0	0.9	39.1	4.8
United States	..	..	..	9.4	27.2	10.5	6.2	19.9	7.0
High-income countries[4]	..	..	..	6.0	48.2	9.6	5.4	47.6	9.2
Low-income countries[4]	..	..	..	19.8	34.8	22.3	17.1	33.2	19.2
3. MFN Tariff (percent)[5]	Mfg.	Agri.	All	Mfg.	Agri.	All	Mfg.	Agri.	All
Japan	4.3	18.3	6.2	2.7	22.2	5.3	2.6	22.3	5.2
Norway[6]	5.9	12.6	5.3	2.1	9.2	2.6	0.6	37.6	6.7
United States	4.8	5.2	4.8	3.8	5.6	4.0	3.2	5.5	3.5
High-income countries	6.6	24.1	8.9	5.3	17.5	6.9	4.9	16.7	6.4
Low-income countries	23.0	25.3	23.3	13.9	17.8	14.4	11.6	15.9	12.1
4. OECD PSE (percent)[7]									
Japan	58			59			45		
Norway	67			68			53		
United States	14			23			10		
OECD	30			31			23		

Sources: IMF; World Bank, World Trade Indicators 2008; and OECD, Producer and Consumer Support Estimates: 1986–2007 Database.

[1] Figures for IMF TRI are for 1997.

[2] The Trade Restrictiveness Index (TRI) is a 10-point-scale (10 = most restrictive, 1 = most open).

[3] The Overall Trade Restrictiveness Index (OTRI) is a weighted sum of tariffs and ad valorem equivalents of nontariff measures at the tariff-line level. Weights are a function of import shares, elasticities of import demand at the tariff-line level, and aggregate levels of protection at the tariff-line level. See http://go.worldbank.org/C5VQJIV3H0.

[4] Based on World Bank income grouping standards as of July 2007; low (53 countries), lower middle (56 countries), upper middle (41 countries), and high (60 countries).

[5] Simple average applied MFN tariff.

[6] The 2007 agricultural tariff figure reflects a 2000 percent tariff on flour that was imposed beginning in 2002.

[7] The Producer Support Estimate (PSE) is an indicator of the annual monetary value of gross transfers from consumers and taxpayers to support agricultural producers, measured at farm gate level, arising from policy measures, regardless of their nature, objectives or impacts on farm production or income. The percentage PSE is the ratio of the PSE to the value of total farm production (at farm gate prices), plus budgetary support. See http://www.oecd.org/document/59/0,3343,en_2649_33797_39551355_1_1_1_1,00.html.

cent in 1996, and commitments under the Uruguay Round saw this fall to about 4 percent in 1999. However, nontariff protection in agriculture was substantial—mainly through quotas and other nontariff barriers to imports of sugar, fruits and vegetables, beef, dairy products, tobacco, and cotton among other commodities, along with price supports in a broad array of products. In textiles and apparel, the United States maintained a high level of nontariff protection, which through Uruguay Round agreements was to be dismantled by end-2004. Domestic protectionist pressures resulted in resort to contingent trade remedies. Despite strong support for, and activism in, multilateral trade negotiations, the United States actively pursued PTAs in the region and further afield (including preferential access to U.S. markets for some developing countries).

Main issues covered and policy advice

8. During the evaluation period, the IMF took positions on most trade policies that were widely regarded, including outside the IMF, as the key issues for U.S. policy. Most of the issues that were picked up were covered over two to three consultation cycles, but rarely for longer. Seldom was the reason for the discontinuation of attention to such issues (i.e., whether the issue was resolved or overtaken by other events) explained in subsequent staff reports. This pattern creates the impression of some arbitrariness in the selection of trade policy issues that were covered. Examples, described in more detail below, are the coverage of responses to protectionist pressures through domestic remedies versus through the WTO dispute settlement process (which peaked in the late 1990s) and of agriculture protection (which peaked in 2001–02). Some themes—the U.S. role in the Doha Round and domestic pressures for protectionism—were pressed, though with declining urgency, throughout the evaluation period. The IMF mission team to the United States in most years during the evaluation period included a staff member with trade policy expertise from the Trade Policy Division of the IMF's then Policy Development and Review Department (PDR).

9. The United States' approach to PTAs was a continuing theme in surveillance of the U.S. economy. This topic is covered in an accompanying background paper for this evaluation on the IMF's handling of PTA issues more broadly (de Melo, 2009) and will not be covered in depth here. Staff handling of PTA issues vis-à-vis the U.S. economy was quite consistent over the years. U.S. officials stated their intention to pursue liberalization aggressively through multilateral, regional, and bilateral agreements. For the most part, the tone of staff positions on PTAs was cautionary, urging the United States to pay close attention to ensuring that PTAs followed best practice vis-à-vis coverage of trade, rules of origin, preference erosion, and simultaneous pursuit of multilateral liberalization (IMF, 2001b, 2003d, 2004c, 2005d, 2006c). That said, in-depth work on the North American Free Trade Agreement (NAFTA) and PTAs more generally in 2003 calculated that gains from U.S. PTAs were considerable (Kose, 2003; Hilaire, 2003). Perhaps reflecting this evidence and the general perception that U.S. PTAs were as well constructed as those of any other major country, IMF staff tended to take a somewhat softer line on PTAs in the United States than in the European Union.

10. The Fund's attention to trade issues had fallen off sharply by the last few years of the evaluation period. After 2004, consultation documents included no in-depth work on trade policy issues, and coverage of the issues in reports on discussions with the authorities, staff appraisals, and Executive Board summings up were minimal and pro forma. Though few new trade policy issues (that is, ones that had not been examined in depth during the preceding three to four years) arose that were significant from a macroeconomic perspective, some critical issues—notably, the 2007–08 Farm Bill negotiations—that should have been covered were not.

11. The reduction in attention to trade policy reflected a number of influences. Although PDR rather consistently pressed for taking more and stronger positions on trade policy, particularly on PTAs and protectionist pressures, area department staff felt strong pressure to prioritize other issues (particularly financial sector issues) and given that their reports had to fit within prescribed word limits they decided that attention to trade issues should be scaled back. Also staff indicated in interviews that on a couple of occasions, IMF management requested less attention be paid to trade issues, and staff responded accordingly.

Agricultural protection

12. Article IV missions delved into agriculture issues around the time of the 2002 Farm Security and Rural Investment Act. Major farm bills that, inter alia, set the parameters for government support of agricultural activities, are considered and enacted every six years in the United States. These points present windows of opportunity for the IMF to address agriculture policy issues of macroeconomic and systemic relevance. However, staff coverage of the generally pivotal debates and actions surrounding these bills was highly uneven. Although the Federal Agriculture Improvement and Reform Act (FAIR) of 1996 marked a significant new and more market-oriented approach to government intervention in support of agriculture, it received no staff analysis

in Article IV consultations until 2001. Then, coinciding with the debate on and passage of the 2002 Farm Bill, agriculture protection was addressed in selected issues papers (SIPs) for the 2001 and 2002 Article IV consultations (MacDonagh-Dumler, 2001; MacDonagh-Dumler, Yang, and Bannister, 2002). Strong positions were taken in staff reports in both years against what staff saw as a retreat from the commendable objectives of the FAIR (IMF, 2001b and 2002e). Thereafter, coverage of the issue ceased, and the issue received no attention at the time of the 2007–08 Farm Bill discussions, when staff did not seize the opportunity to urge the authorities to move back toward the approach introduced in 1996 (IMF, 2007d).

13. The work undertaken in the 2001 and 2002 consultations is a good example of the capacity of the IMF, using limited resources, to take strong, well-substantiated positions on an issue that had systemic implications. SIPs by Fund staff in both years (MacDonagh-Dumler, 2001; MacDonagh-Dumler, Yang, and Bannister, 2002) laid out complex issues simply and for the most part clearly. Most of their characterization of effects of policy choices was derivative, interpreting the substantial analytical work done in the Organization for Economic Cooperation and Development (OECD), Economic Research Service of the U.S. Department of Agriculture, U.S. Congressional Budget Office, and research institutes. MacDonagh-Dumler, Yang, and Bannister (2002) produced simulations of effects of various subsidy reduction scenarios (in the United States and other Quad countries) on welfare in agricultural exporting countries.[3] The paper also compared agricultural tariffs and subsidies in the United States with those in other large trading countries. This put U.S. policies in a global perspective, producing an evenhanded approach.

14. The substantive work in these SIPs produced several observations on effects of the Farm Bills and provided analytically sound backing for strong views expressed in the 2001 and 2002 staff reports. The 2001 analysis (MacDonagh-Dumler, 2001) reviewed the degree to which the 1996 FAIR had shifted the government's approach from farm price support to income support as a transitional program to reducing overall farm support (IMF, 2001b). It reached several conclusions: the policy shift had not been implemented as planned due to "emergency" support to farmers and deficiency payments that were made when world prices fell in the late 1990s; after falling at one of the fastest rates in the world during 1980–96, U.S. subsidies to farmers doubled during 1996–99; these policies had helped to lower world prices for certain commodities; and U.S. farm payments went disproportionately to farmers with high gross sales. These conclusions laid the groundwork for the IMF to make a preemptive call—prior to the passage of the 2002 Farm Bill—for returning to the original goals of the FAIR and for resisting pressures for extending support to a wider range of products (IMF, 2001b).

15. Building from this position, the 2002 consultation assessed and criticized the outcome embodied in the 2002 Farm Security and Rural Investment Act (2002 Farm Bill). The staff report (IMF, 2002e), backed by analysis in MacDonagh-Dumler, Yang, and Bannister (2002), quantified the increase in subsidies (through a tariff-equivalent analysis) and the effects on the welfare of agricultural exporters. It strongly criticized the 2002 Bill for undermining the approach introduced in the 1996 FAIR and maintaining and augmenting policies that reduced the sensitivity of U.S. producers to market forces. In balanced recommendations for future efforts to turn back these features, the reports stated (though they did not quantify) that such a reversal would have important effects on domestic farm balance sheets that would need to be offset (through income support) as envisaged in the FAIR.

16. This work for bilateral surveillance was buttressed by a complementary analysis in the September 2002 *World Economic Outlook* (*WEO*) on the effects of the advanced countries' agriculture policies on low-income countries. The approach in the *WEO* analysis (IMF, 2002c) was similar to that for the U.S. consultation, but was broadened to include welfare effects of highly protectionist agricultural policies pursued by other advanced countries (the European Union, Iceland, Japan, Korea, Norway, and Switzerland). This analysis helped to put U.S. policies in perspective and placed the overall message on the systemic effects of protectionist agricultural policies on a larger stage than bilateral surveillance could provide.

17. IMF Executive Board support for the robust messages coming out of the 2001–02 staff reports was muted. During the evaluation period, the Board frequently urged the United States to reduce barriers to agriculture imports, though it typically couched these admonitions in the context of broad support for liberal trade policies. However, in the years (2001–02) when staff had placed special attention on agriculture issues, Board summings up either did not explicitly address the issue (IMF, 2001a), or approached it only with a light touch—"Directors urged the authorities to give priority in three policy areas—namely, disciplined fiscal policies; reforms of corporate governance and accounting; and strengthened leadership

[3] These simulations used the computable general equilibrium model of the Global Trade Analysis Program, a program run by a consortium of researchers worldwide, of which the World Bank and WTO are members.

in trade and agricultural policies" (IMF, 2002b).[4] In view of the staff effort to address the issue substantively, this was a missed opportunity for the Board to take a stand on an important issue.

Resisting and handling protectionist pressures

18. U.S. commitment to liberal trade conditions was strongly challenged during the evaluation period. The aftermath of the Asia crisis saw a substantial appreciation of the dollar against the currencies of several rapidly industrializing emerging market countries followed by a sharp slowdown in U.S. growth in 2000–02. Prior to and during these developments, the IMF persistently called attention to the costs of actual protectionist measures and the risks of succumbing to protectionist pressures. Staff supported this position with occasional in-depth work, which had three broad strands.

- During 1995–96, background papers for the staff reports (Leidy, 1995; IMF, 1996d) detailed each U.S. petition for protection that resulted in a dispute settlement request to the WTO or a domestically adjudicated trade remedy. This explicit reporting on individual cases (e.g., 14 were recorded in IMF (1996d)) was as effective a way to name and shame as the IMF could undertake. The process stopped in 1997, after which staff reports simply admonished the authorities to avoid, to the extent possible, resorting to even WTO-consistent trade remedies. In interviews with the evaluation team, staff said that detailed IMF attention to trade remedies had been discontinued because of the absence of such reporting in countries other than the United States and because the WTO began to publicize these developments.
- In 1996, staff examined the link between domestic economic developments (civilian unemployment rate and industrial capacity utilization) and petitions for protection through antidumping/countervailing duties (IMF, 1996e). They found a robust relationship even when controlling for other explanatory variables. This pointed to the likelihood of substantial ebbs and flows in protectionist pressure, well within the limitations posed by WTO rules.
- Staff preemptively cautioned against and later criticized safeguard tariffs that the United States imposed on steel imports in 2002 (IMF, 2002e). In 2001, as the U.S. debate on the proposal occurred, the staff report took a strong opposing position (IMF, 2001b). The 2002 staff report included calculations of the domestic and international welfare losses from the safeguard tariff—calculations that broadly affirmed estimates by other prominent researchers (IMF, 2002e). It also pointed out that retaliatory actions by other countries substantially increased the calculated welfare losses.

Each of these strands was appropriate. The treatment of trade remedies reflected a good adjustment to the WTO's activities (though an explanation in subsequent staff reports of why the treatment was changed would have been appropriate), while macroeconomic foundations of protectionism and the effects of the steel tariffs were issues on which the IMF voice was useful.

19. Throughout the evaluation period, surveillance addressed other issues surrounding the handling of protectionist pressures in the United States. Early in the period, a key issue was whether, and how fully, the United States would shift the handling of domestic producers' requests for trade remedies to the WTO dispute settlement process, away from domestic provisions (Sections 201 and 301 of the 1974 Trade Act).[5] During 1996–99, staff reports, supported by brief but clear wording in Board summings up, urged the government to work through the dispute settlement process and to work with the WTO to strengthen any aspects of the process that were regarded as weak (IMF, 1996a, 1996b, 1997c, 1997d, 1998c, 1998d, 1999b, 1999c). By 2000, the issue was dropped from staff reports despite the fact that U.S. use of domestic antidumping remedies rose through 2001.

20. At least until 2002, staff kept under review alternative approaches that the IMF could use to discourage U.S. responses to protectionist pressures. Two episodes stand out. In 2001–02, PDR pressed successfully to shift the IMF's approach from a presumption of wrongdoing to one of questioning the methodology used to evaluate antidumping and countervailing duty requests. Accordingly, in 2001–02, staff reports (and the 2001 summing up) urged the United States to change the administration of antidumping and countervailing duty procedures to provide import protection only when foreign producers were found to be engaged in anticompeti-

[4] Of course, the opening sentence of most summings up—affirming the Executive Board's support for the thrust of the staff appraisal—was indirect support for the staff's work on trade policy. But more telling of the Board's emphasis were the direct expressions of support in the later paragraphs of the summings up.

[5] Section 201 of the 1974 Trade Act implements Article XIX (the Safeguards Clause) of the General Agreement on Tariffs and Trade. It allows protection, on a nondiscriminatory (MFN) basis, to a domestic industry found to be seriously injured by imports. Section 301, as amended, may be applied to enforce U.S. rights under bilateral and multilateral trade agreements and to respond to unreasonable, unjustifiable, or discriminatory foreign government practices that burden or restrict U.S. trade.

tive behavior and to reduce the degree of discretion allowed in findings of injury to domestic producers (IMF, 2001a, 2001b, 2002e). This, they argued, would be consistent with the antitrust thrust of the underlying motivation for appropriate protection. More recently, staff reports pressed for greater support for workers displaced by imports. The United States responded that its current provisions were adequate (IMF, 2007d). Apart from this new attention to the adequacy of provisions for displaced workers, admonitions against protectionist policies became substantially shorter, less specific to particular episodes, and more pro forma after 2003.

U.S. positions in the Doha Round

21. One consistent theme in staff reports beginning in 2001 was encouragement for the United States to play a leadership role in the Doha Round. Acting on guidance from the Executive Board, staff discussed with the U.S. authorities (at a general level) U.S. views on, and aspirations for, the Doha Round. Staff consistently pressed for a more ambitious agenda for liberalizing protection of the U.S. agricultural sector as a means of moving the Round ahead and ensuring the strongest possible outcome. Board summings up conveyed this message quite explicitly most years (IMF, 2005c, 2006b, 2007b).

Market access

22. Staff reports during 2000–02 explicitly encouraged the U.S. authorities to broaden duty-free market access for least-developed countries (IMF, 2001b, 2002e). No background work was undertaken to support this position directly, though there was implicitly a substantial overlap between this issue and the work in 2001–02 on agriculture. After 2002, market access was generally not taken up explicitly, though indirectly it was reflected in general admonitions to liberalize trade conditions, especially in agriculture.

Other issues

23. A number of bilateral trade issues were addressed in staff reports; not all of them justified receiving attention on macroeconomic grounds. At the most relevant end of the spectrum, an SIP in 2004 (Alexandraki, 2004) addressed domestic and systemic implications of the rapid increase in China-U.S. trade. It concluded, on the basis of a constant market share analysis, that China's increased exports to the United States had largely displaced exports from other suppliers outside the United States, with rather little effect on the U.S. manufacturing sector. On the basis of more heuristic evidence, it concluded also that U.S. exports had benefited from greater access to the Chinese market. Nevertheless, the report noted that China had been on the receiving end of U.S. contingent protection measures, and the number of these was detailed in the background paper. This finding supported a gently worded cautionary note in which the Fund urged the authorities to avoid a defensive recourse to trade remedy actions (IMF, 2004c). There was no explicit uptake in the Board summing up.

24. At the least obviously relevant end of the spectrum of bilateral trade issues addressed was the Cuban Liberty and Democratic Solidarity Act. Mentioned in the Board summing up for the 1996 consultation (IMF, 1996b), the issue was explicitly addressed only in the 1997 staff report (IMF, 1997c). The macroeconomic or systemic relevance of this high-profile dispute between the United States and European Union, and therefore the merits of its inclusion in the 1996 Board summing up, was not obvious.

25. Staff reports did not systematically address any issues pertaining to trade in services, including financial services. Though staff appraisals and Board summings up called on the United States to play a leadership role in services trade liberalization (particularly after the United States withdrew from the financial services agreement under the General Agreement on Trade in Services in 1995), no in-depth work was done, and staff reports and Board summings up made no more than occasional, rather general statements on the issue. However (in an interesting departure from the more common line in bilateral surveillance in other countries), the 2003 staff report (IMF, 2003d) questioned whether the investment provisions in PTAs involving the United States could leave the partner countries in those PTAs too vulnerable to surges in capital inflows.

Interlocutors and effectiveness

26. Staff teams met with several senior officials involved with U.S. trade policy, and the quality of the dialogue varied. One meeting that stands out was that between the IMF Managing Director and the U.S. Treasury Secretary at the end of the 2002 Article IV consultation, when the Managing Director pointed critically to the adverse effects of the 2002 Farm Bill on developing countries. This was the year when the IMF had done substantial in-depth work on agriculture protection and taken a strong stand against the Farm Bill. According to the mission's minutes, the Secretary regretted the passage of the bill and encouraged the IMF to continue to support lower trade barriers. More generally, however, an obvious difficulty in staff discussions with the Office of the U.S. Trade Representative (USTR) arose from differences in approach to trade policy issues—the

IMF addressing them from an economic perspective and the USTR more from a legal perspective.

27. USTR and Treasury officials with whom the evaluation team spoke felt that IMF missions had provided added value on trade issues. Given the highly complex and multifaceted process through which trade policies are formulated in the United States, a direct effect of the IMF's advice would never be obvious. That said, USTR staff wrote a memo to the Treasury Department detailing the IMF's positions after each Article IV report was published, and these memos show that they generally thought that the IMF's work on trade policies in the United States and other countries was important in focusing attention on costs of protection and benefits of more open trade.

28. Looking ahead, officials from both the USTR's Office and the U.S. Treasury appear to feel that a strong presence of the IMF on trade issues would be important. From interviews with the evaluation team, four particular observations stand out.

- "The world would be a very dangerous place" if the IMF were to permanently reduce its attention to trade policy issues. When the new U.S. administration reexamines trade policy in 2009–10, this will be a very fertile opportunity for the IMF to discuss trade policy with the United States.
- The IMF needs to bring concrete analysis to meetings for discussion. U.S. officials commented that too often IMF staff did analysis after the fact or did not bring analysis with them to the consultation discussions.
- Far more useful than either broad-brush advocacy for trade liberalization or a critical appraisal of some detailed aspects of trade policy would be analytical work on the macroeconomic effects of trade policy initiatives. Officials pointed to IMF work on preference erosion and PTAs as embodying the IMF's best contributions. They also felt that the *WEO* was an effective platform for the IMF to address trade policy issues.
- Presentations of IMF work on trade policy issues should be strengthened so that they would reach lay as well as technical audiences. Officials felt that the IMF could make stronger contributions by presenting to broad audiences thought-provoking material on why certain policies were good or flawed.

29. Press coverage of IMF positions on trade policy for the United States was minimal. The evaluation team could find only one press report on IMF views on trade policy—following the 2002 consultation when the IMF's position on agriculture protection was prominent.[6] Three factors seem to lie behind this lack of coverage. First, trade policy was rarely a headline issue in U.S. Article IV consultations, and press coverage of the consultations themselves was usually limited. Second, with no press conference after consultations, scope was limited for directing media attention to IMF views on trade policy. Third, since 2004, IMF positions on trade policy have been minimal and certainly not concrete enough to make for good press coverage.

30. In contrast, press coverage of the 2002 *WEO* analysis on the effects of U.S. agriculture protection on developing countries received press coverage in several locations globally. Even a quick search of the media turned up seven citations from that period that characterized the IMF's position reasonably accurately. This suggests that if one criterion for effectiveness is contributing to the public debate, *WEO* (or likely also *Regional Economic Outlook*) coverage of trade issues may be relatively effective.

Japan

Initial conditions

31. Like the United States, Japan maintained a broadly open trade regime outside of agriculture. In the mid-1990s, Japan's average industrial MFN tariff was about 6 percent and over the evaluation period it fell to just over 5 percent. Measures of protection in agriculture, however, exceed those of the United States and the European Union, making Japan the most protectionist among the Quad countries in agriculture. The OECD's producer support estimate (PSE) put agriculture subsidies at over half of total farm income in 1996 and, due to some reforms during the evaluation period, at 45 percent of farm income in 2007. In the Uruguay Round, Japan committed to convert to tariffs all its nontariff barriers except for those on rice.[7] Though Japan was a strong supporter of trade liberalization through the Doha Round, it too became quite active in negotiating PTAs during the evaluation period, though generally somewhat later than the United States.

Main issues covered and policy advice

32. During the first half of the evaluation period, IMF attention to Japan's trade policy was scant. Staff involved explained to the evaluation team that

[6] "IMF says U.S. trade deficits threaten global growth," *Bloomberg Report*, June 25, 2002, includes a sentence on the IMF's position on the 2002 Farm Bill.

[7] Rice was exempted from tariffication for a six-year grace period from 1995 to 2000. Japan agreed, under the Uruguay Round Agreement on Agriculture, to minimum amounts of rice imports beginning in 1995 (increasing thereafter), and, in 1999, it effectively converted the special treatment of rice to an import tariff.

with few new commitments by Japan to trade policy changes after those embodied in the Uruguay Round and with major issues at stake in the real and financial sectors in the ongoing crisis, trade policy was not viewed as a priority for surveillance. Nevertheless, in two of those years, staff made effective use of OECD and WTO reports to motivate their positions (though at a relatively shallow level).

33. Starting in 2001, coverage of trade policy issues in Article IV consultations picked up. That said, during this relatively active period, only two background pieces were included in SIPs—one on agricultural policies (Nagaoka, 2002) and one of a more general, descriptive nature (Nagaoka, 2001)—and in 2006, trade policy was not mentioned in the staff appraisal or Executive Board summing up (IMF, 2006a, 2006d). Some consideration was given to Japan's growing interest in PTAs (the subject of a short annex in the 2007 staff report (IMF, 2007c)), but PTAs generally received less attention than in consultations with the United States. Still, as in the United States, staff appraisals pressed for MFN liberalization alongside the proliferation of PTAs. An economist with trade policy expertise from PDR's Trade Policy Division joined the mission teams in 2004–06.

Agriculture protection

34. In almost every consultation with Japan, staff discussed with the authorities the high protection of a wide range of agricultural products. The message that resulted reasonably consistently in staff appraisals (though only intermittently in Board summings up) was critical of the complexity and level of agricultural protection (IMF, 2002a, 2005b). During the late 1990s when staff attention was primarily on crisis-related issues, the language was typically general. As attention started to swing back toward trade issues in about 2001, the approach became somewhat more pointed: a recurring theme was the efficiency and productivity gains that a more open agriculture sector would make possible. This emphasis was consistent with the broader effort by staff—with occasional explicit backing from the Board—to advocate structural reform, deregulation, and liberalization to raise Japan's growth.

35. For much of the evaluation period, staff advocacy for agriculture liberalization was not backed by in-depth staff work. In 2005, an SIP (McDonald, 2005) addressed agriculture protection directly and provided the basis for subsequent positions in staff reports. This study was an effective amalgamation of simulations and other empirical work by several researchers inside and outside the IMF. The paper clearly reviewed the parameters of Japan's agriculture protection and then reported the effects of various multilateral agricultural liberalization scenarios on prices and volumes of agriculture imports to Japan, welfare in Japan, and value added in the Japanese agriculture sector. The work also drew on the 2002 *WEO* study on the effects of agriculture on developing countries (IMF, 2002c). As in surveillance on the United States, staff did not establish an explicit link between agriculture protection (a substantial portion of which was in the form of subsidies) and fiscal costs.

36. On at least one occasion, staff discussed with the authorities the main objective behind agriculture protection—food security. Staff acknowledged the authorities' concern but took the position that a better way to achieve food security would be to raise Japanese efficiency in food production, rather than to protect farmers (IMF, 2003c, 2004b). While this dialogue was useful, it would likely have been more effective if staff had provided even a simple numerical exercise to demonstrate the feasibility of the approach they suggested.

37. In contrast to the experience in the United States during the peak of staff interest in agriculture policy in 2001–02, the 2005 Executive Board summing up strongly supported the staff work. The summing up pointed to large potential benefits of liberalization given the agricultural sector's current low efficiency and used the opportunity to press for trade liberalization (IMF, 2005b).

38. The IMF's attention to agriculture dropped off rather sharply after 2005. Neither staff appraisals nor Board summings up mentioned agriculture policy during 2006–07. Insofar as the 2005 SIP had established a good basis for taking positions on agriculture protection for the next several years, this seems to have been a missed opportunity for continuity.

Resisting and handling protectionist pressures

39. By comparison with the United States, pressures for new protectionist measures were generally subdued in Japan during the evaluation period. In the first two years of the period, any new measures were detailed in the background paper to the staff report. Japan's bilateral relations with the United States and the European Union also figured prominently in these background papers (IMF, 1996c, 1997b). Though the issues generally did not spill over into the staff report, the detailed nature of the many issues reported clearly went beyond the macroeconomic concerns of the IMF. It was appropriate that this coverage ended early in the evaluation period, particularly as regular trade policy reviews by the WTO Secretariat more than amply covered such issues.

40. In contrast to surveillance in the United States, staff reports did not place much emphasis on using WTO dispute settlement procedures when protec-

tionist pressures did arise. This difference is quite reasonable insofar as Japan was not even among the top 20 users of antidumping initiations during 1995 to 2008, while the United States was ranked as the second most frequent user. Early in the period, staff only mentioned that progress had been made in resolving bilateral trade issues through active use of the WTO dispute settlement procedures (IMF, 1997a, 1998a). Later in 2002, however, staff called attention to instances of the use of safeguards (IMF, 2002d). In the first, Japan imposed safeguard protection on several agricultural commodities, but allowed these measures to expire shortly afterwards. In the second, Japan retaliated against the use of safeguards for steel in the United States. Staff reported the situation, but did not comment. The Board did not specifically take positions on the handling of requests for protection in Japan. It is unclear why staff took such low-key approaches.

41. Market access for developing countries was the issue on which the Executive Board most persistently pressed for Japan (IMF, 2002a, 2003b, 2004a). Staff did no in-depth work on this issue for the consultation per se, though of course they were able to draw on the work done on agriculture more generally in the 2002 *WEO* (IMF, 2002c). Still the result was a very general appeal for better terms of market access for developing countries rather than an attempt to give fresh perspectives on the problem every few years.

Japanese positions in the Doha Round

42. Just as for the United States, in 2001, staff began standard, though very brief, commentary on Japan's position in the Doha Round. As instructed by the Executive Board, these updates were direct reflections of the authorities' views, though the tone of reports was quite encouraging of Japan stepping up to a leadership role. The Executive Board also offered its explicit encouragement for such a role most years after 2000 (IMF, 2002a, 2003b, 2004a, 2007a).

Other issues

43. A few staff reports discussed issues of trade in financial services. Early in the evaluation period, an issue vis-à-vis the United States involved liberalization of Japan's insurance sector. Staff described the problem but did not take a position or involve themselves in the dispute (IMF, 1997a). In 2006, staff looked into overseas activities of Japanese banks (and included a box on the subject in the staff report (IMF, 2006d)). Both issues were noteworthy for their factual reporting with little in the way of a staff view on the questions.

Interlocutors and effectiveness

44. Both staff and the authorities saw the IMF's involvement in trade policies in Japan as quite limited, particularly when no in-depth work had been prepared before the mission. Routinely, IMF staff spoke to officials from the Ministry of Finance, the Economic Planning Agency, and the Ministry of Trade and Industry during the consultations. During the early part of the evaluation period, discussions were rather pro forma and uneventful, though in later years staff felt they had had quite good exchanges of views on PTAs and agriculture. From the Japanese side, the exchange of views was also seen as interesting, though Japanese officials explained to the evaluation team that several factors limited the IMF's effectiveness on trade (as well as on other issues): similarities of messages from many international institutions meant that new perspectives were infrequent; political considerations figured strongly in all policies, but particularly on trade issues where most actions were taken in negotiations; the Foreign Ministry was involved in trade policy formulation but did not meet with the IMF mission; and for most IMF missions, issues besides trade dominated the discussion.

45. The authorities suggested to the evaluation team that couching IMF advice on trade issues in the context of fiscal policy might make it more compelling. Specifically because agricultural subsidies were a key issue for Japan but were intensely political, greater traction might have been gained by examining the effects of subsidies on the fiscal position. More generally, the authorities felt that bringing fresh perspectives on the case against agriculture subsidies could be effective. However, in contrast to the U.S. authorities, who felt that the IMF's involvement in trade policy was crucial, Japanese authorities interviewed for this evaluation seemed to feel that trade policy was not an essential part of the Article IV consultation.

Norway

Initial conditions

46. Norway's trade regime during the evaluation period was characterized by very low protection of the industrial sector and very high protection of the small agricultural sector. Only a few agricultural product groups are produced domestically, yet farms received on average more than 60 percent of their income from budget support. In contrast, agreements in the Uruguay Round saw Norway's MFN industrial tariffs fall from an average of about 6 percent in the mid-1990s to less than 3 percent by 2001. Liberalization also occurred under the auspices of the European Economic Area; liberalization of trade in

services (including financial) was a particular focus there. Norway is also a member of the European Free Trade Association (EFTA), and primarily through EFTA, it participates in 17 PTAs.

Main issues covered and policy advice

47. By far the dominant trade issue in Norway's Article IV discussions was agricultural subsidies. Through 2005, the issue was raised each year in discussions, reported in the staff report, and mentioned explicitly in the Executive Board summing up. However, there was no in-depth staff analysis of the issue at any time during the evaluation period. And though the OECD pursued this issue in some depth in its regular series, *Agricultural Policies in OECD Countries*, no explicit references were made to that work or to WTO trade policy reviews. The 2002 *WEO* analysis of the effect of agriculture policies of advanced countries on developing countries (IMF, 2002c) explicitly included Norway (singled out along with Iceland and Switzerland as among the small advanced countries with exceptionally high agriculture protection). After 2005, the agricultural subsidy issue was not raised again in either the staff report or Board summing up.

48. The approach to the agriculture issue was, on the whole, similar across the years. Staff pointed clearly to the salient characteristics of the situation: at more than 50 percent of farm income, Norway's farm subsidies were at the top end of the industrial country spectrum; because Norway was a small producer on the global scale, the adverse effects were not systemic, but rather caused deadweight losses to consumers; whatever the aims of agriculture protection, they could be achieved with less distorting policies. The budgetary cost of subsidies (in 2001, 1.4 percent of GDP against a tax burden of 43 percent of GDP) was not a central issue in the staff's discussion of agricultural subsidies. In the dialogue, the authorities repeatedly made the point that subsidies served domestic nontrade objectives (support to sparsely populated parts of the country and food security) and that much of Norwegian agricultural production competes with European producers, rather than producers in developing countries. Therefore, agriculture policy did not contradict Norway's generous aid policy, as some critics claimed.

49. Other issues—specifically Norway's approach to the Doha Round and trade in services—were raised occasionally. Particularly during the consideration of Stage Three of the European Monetary Union in the late1990s, staff reports addressed the need for steps (especially liberalizing conditions for bank mergers and improving supervision) to help domestic banks compete when European competition increased (IMF, 1998b, 1999a). After 2001, staff also reported on the authorities' position in, and ambitions for, the Doha Round (IMF, 2003a, 2005a).

50. A surprising omission from the menu of issues raised with Norway was its abundant participation in PTAs. Though most of these agreements were organized through EFTA, and were therefore not the result of strictly domestic policy decisions, and though the PTAs typically embodied best practice with respect to regional cumulation of rules of origin, their sheer number suggests that the IMF should have analyzed their implications for Norway's economy.

Interlocutors and effectiveness

51. Trade issues did not form a central part of the Article IV discussions with Norway nor in turn of Executive Board discussions. The authorities with whom the evaluation team spoke felt that IMF advice had little effect on Norway's trade policies and that IMF staff expertise lay in issues other than trade policy—particularly in light of what they viewed as the very complicated nature of trade policy in Norway. That said, they felt that the IMF might be able to contribute more to the debate on trade policy if specific work were brought to the table on the effects of Norway's trade policies on its own macroeconomy or on developing countries. They were not specific about what such approaches might entail. The authorities to whom the evaluation team spoke did not however feel that the IMF should ignore trade policy issues. They felt that silence from the IMF on these issues would be taken as an indication of greater tolerance more generally for trade protection.

D. Findings

52. The IMF's surveillance in the United States until 2004 and, to a lesser extent, in Japan speaks to a reasonably strong attention to trade policy issues and willingness, for the most part, to take strong positions on trade issues in advanced countries. While this does not erase concerns about the asymmetry between IMF conditionality and surveillance in terms of forcefulness, it does ease concerns about whether the IMF *in surveillance* pressed on advanced countries to the same extent as it did on developing countries. Indeed, in advanced countries as in developing countries, the IMF urged countries to go beyond their WTO agreements in liberalizing trade policies.

53. Direct effects in terms of obvious changes in trade policies as a result of IMF surveillance are not obvious. As some country officials pointed out, however, the record on this score probably does not differ much from that in other areas of the IMF's involvement. That said, in two of the three countries examined, country officials felt that the discussions

had added some value and that IMF attention to trade policies should not be discontinued in their own countries or in other countries.

54. IMF advice on trade policy was often not seen as bringing a new perspective to trade policy issues. Typically, it did not depart from widely held views on best practice and often IMF staff brought no in-depth background analysis to the table. This suggests the need for some recalibration of the IMF's approach to trade policy in surveillance-only countries:

- Particularly in view of tight constraints on word counts in staff reports, attention to some of the more routine trade policy issues (such as countries' negotiating positions in the Doha Round) might best be omitted from staff reports, except when the authorities have made truly noteworthy points.
- At the same time, occasional in-depth attention to a key trade policy issue (for example, every three to four years) would establish the basis for strong IMF positions that are more likely to garner attention and influence the policy debate than is yearly more superficial attention.
- Such work should aim explicitly to draw micro-macro linkages, including between trade policies and fiscal balances—an area where the cases reviewed in this paper were rather thin.
- Analysis of trade policy in the *WEO* seems to have attracted better press coverage than that in bilateral surveillance. More attention in multilateral surveillance exercises to trade policy issues with implications for the global macroeconomic outlook and stability would have strong synergies with country-specific involvement in trade policies.

55. The coverage of trade policy issues in the countries examined generally encompassed the right issues from the IMF's perspective. That said, PTAs in Norway and trade in services issues more generally appear to have been underrepresented in Article IV consultations relative to their likely importance for macroeconomic outcomes.

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