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BACKGROUND PAPER



BP/09/01

Preferential Trade Agreements in IMF Economic Work 1996–2007: An Assessment

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April 26, 2009

Abstract

This paper reviews the IMF's approach to preferential trade agreements (PTAs) from roughly 1996 to 2007. During this period, skepticism toward regionalism prevailed among IMF staff while the IMF Executive Board felt that staff were unduly critical of PTAs. There was some coverage at the country level for each major PTA but much less at the regional and multilateral level. Looking ahead, the IMF can participate in efforts to "multilateralize" regionalism by adopting a more constructive view of PTAs, helping to gather and/or harmonize data on PTAs, and undertaking greater surveillance of PTAs at the regional level.

The views expressed in this Background Paper are those of the author(s) and do not necessarily represent those of the IEO, the IMF or IMF policy. Background Papers report analyses related to the work of the IEO and are published to elicit comments and to further debate.

JEL Classification Numbers: F13, F15, F33

Keywords: Economic integration, trade agreements, multilateralism, IMF

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ABBREVIATIONS

| | |
|----------|---|
| AAEU | Association Agreement with the European Union |
| ACP | African, Caribbean, and Pacific |
| AFTA | ASEAN Free Trade Area |
| AGOA | African Growth and Opportunity Act |
| ASEAN | Association of South East Asian Nations |
| BFTA | Baltic Free Trade Area |
| CACM | Central American Common Market |
| CAFTA-DR | Central America-Dominican Republic-United States Free Trade Agreement |
| CAP | Common Agricultural Policy |
| CARICOM | Caribbean Community |
| CBI | Cross-Border Initiative |
| CEFTA | Central European Free Trade Agreement |
| CEMAC | Central African Economic and Monetary Community |
| CGE | Computable general equilibrium |
| cif | cost, insurance, and freight |
| CIS | Commonwealth of Independent States |
| COMESA | Common Market of East and South Africa |
| CRTA | Committee on Regional Trade Agreements (WTO) |
| CUSTA | Canadian-US Trade Agreement |
| FDMD | First Deputy Managing Director |
| DTIS | Diagnostic Trade Integration Study |
| EAC | East African Community |
| EAEC | Eurasian Economic Community |
| EBA | Everything But Arms |
| ECOWAS | Economic Community Of West African States |
| ECCU | Eastern Caribbean Currency Union |
| EPA | Economic Partnership Agreement |
| ESA | Eastern and Southern Africa |
| EU | European Union |
| FTA | Free trade area/agreement |
| FTAA | Free Trade Area of the Americas |
| GATT | General Agreement on Tariffs and Trade |
| GCC | Gulf Cooperation Council |
| GEP | <i>Global Economic Prospects</i> (World Bank) |
| GSP | Generalized System of Preferences |
| LDC | Least developed country |
| MERCOSUR | Common Market of the South |
| MFN | Most favored nation |
| NAFTA | North American Free Trade Agreement |
| OECD | Organization for Economic Cooperation and Development |

| | |
|-------|--|
| OECS | Organization of Eastern Caribbean States |
| PTA | Preferential trade agreement |
| RED | <i>Recent Economic Developments</i> (IMF) |
| REO | <i>Regional Economic Outlook</i> (IMF) |
| RTA | Regional trade agreement |
| SAARC | South Asian Association for Regional Cooperation |
| SACU | Southern African Customs Union |
| SADC | Southern African Development Community |
| SAFTA | South Asian Free Trade Agreement |
| SAPTA | SAARC Preferential Trading Arrangement |
| SIP | Selected issues paper (IMF) |
| USBTA | United States-Vietnam Bilateral Trade Agreement |
| WAEMU | West African Economic and Monetary Union |
| WEO | <i>World Economic Outlook</i> (IMF) |
| WTO | World Trade Organization |

SUMMARY

This paper reviews the IMF's approach to preferential trade agreements (PTAs) from roughly 1996 to 2007. During this period, skepticism toward regionalism prevailed among IMF staff while the IMF Executive Board felt that staff were unduly critical of PTAs.

The (brief) guidelines on designing and implementing PTAs that were issued to staff in 1999 were generally appropriate: PTAs should liberalize trade among members as much and as quickly as possible, rules of origin should be simple and transparent, and PTA members should reduce protection toward nonmembers simultaneously. By and large staff reflected this advice consistently in their dialogue with country authorities. There was some coverage at the country level for each major PTA during the evaluation period. Some substantive work on PTAs was carried out in background papers for Article IV consultations. But there was close to no coverage of PTAs in the *World Economic Outlook (WEO)* and minimal coverage in the *Regional Economic Outlooks (REOs)*.

Regionalism is here to stay. The task ahead is to maximize the chance that the integration is "deep," i.e., that it will extend beyond eliminating tariffs to include behind-the-border measures (e.g. adopting common regulatory frameworks, integrating factor markets) that will save on resources and lead to gains for PTA members and nonmembers alike.

Multilateralizing regionalism in this way will help ensure that PTAs are building blocks rather than stumbling blocks for the world trading system. A concerted effort by the IMF, World Bank, and World Trade Organization (WTO) is required to achieve this.

The IMF can participate in this effort in several ways.

- First, IMF staff should abandon the view that PTAs are second-best. This view is not constructive. It was derived from too narrow a focus given the state of knowledge (and debate) on PTAs and it was not backed by sufficient hard evidence. Because the devil is in the details, IMF staff need more information on the depth of integration in PTAs before making an overall assessment.
- Second, the IMF should participate with the World Bank and the WTO in the collection of this information. Because of its frequent and regular consultations with 185 member countries, the IMF is in a good position to participate in efforts to gather and/or harmonize and/or disseminate such data. The Fund could use such data in bilateral and regional consultations and disseminate it more broadly via its regional and multilateral surveillance instruments, i.e., the *REOs* and the *WEO*.
- Third, the IMF should, within its overall mandate, undertake greater surveillance of PTAs at the regional level. This extended coverage could often rely on work carried out elsewhere and thus could be achieved with marginal increases in resources.

I. INTRODUCTION

1. Until the early 1980s, with the exception of European integration, multilateral nondiscriminatory trade liberalization was the main approach to speeding up integration in goods markets and developing an open world trading system. The wave of preferential trade agreements (PTAs) that had been signed among developing countries in the 1960s had largely remained on the drawing board.

2. By the time the World Trade Organization (WTO) came into existence in 1995, however, it was already clear that a growing part of world trade was taking place under PTAs. Furthermore, this new wave of PTAs usually went beyond discriminatory reductions of trade barriers and included some liberalization of trade in services and behind-the-border measures (such as harmonization of norms, reduction of trade costs, cooperation on trade facilitation, and integration of factor markets), leading to “WTO-plus” commitments, often referred to as “deep integration” (Box 1).

Box 1. What are PTAs?

The terms “preferential trade agreement (PTA),” “regional trade agreement,” and “regional integration agreement” are often used interchangeably. A PTA refers to an agreement between two or more countries to grant and/or receive more favorable trade conditions amongst themselves than vis-à-vis third countries. A PTA includes discriminatory preferences, whether unilateral or reciprocal. Examples of unilateral (nonreciprocal) PTAs are the Generalized System of Preferences which grants preferential tariff rates for developing country exports to industrialized countries; the Everything But Arms initiative which grants duty-free access to exports from least developed countries to the European Union; and the African Growth and Opportunity Act which grants preferential access for exports from certain African countries to the United States. Reciprocal PTAs include: partial scope agreements, which are PTAs that cover only certain products; free trade areas, in which trade barriers are lowered/eliminated among members but each member maintains its own trade regime vis-à-vis nonmembers; and customs unions, which are free trade areas with a common external trade regime for all members.

3. This paper evaluates the IMF’s work on PTAs during 1996–2007. Should PTAs have been covered in Fund work, and if so, was the coverage adequate? This paper concludes that the answer is “yes” to the first question and a qualified “no” to the second. Should more specific guidelines be developed on how to approach PTA issues? The paper argues that it would be better to think of an organizing framework under which the IMF could, with marginal additional resources devoted to regional surveillance, do a better job of raising public awareness of how well or badly various PTAs are functioning. This should help build support towards “multilateralizing” regionalism.

4. The paper is organized as follows. Section II covers the rise of the “new” regionalism (characterized by overlapping north-south PTAs and increasingly multidimensional PTAs) and its implications for the work of the IMF. Section III reviews the Executive Board’s views on PTAs and the guidance to staff. Section IV covers IMF advice on PTAs in bilateral and multilateral surveillance. Section V covers advocacy and research on PTAs. Section VI is the

overall assessment. Four annexes contain detailed reviews of Fund work on PTAs in surveillance and research activities.

II. THE RISE OF REGIONALISM AND ITS IMPLICATIONS

5. PTAs have proliferated (Box 2). This proliferation uses scarce resources and there is a danger that it will result in many minor agreements that will produce no appreciable gains because the integration that is embodied is, in effect, shallow. Multilateralists argue that even if PTAs increase trade, their effects on welfare and the world trading system may be harmful. First, trade diversion could occur with trade blocs maintaining high external barriers—a possibility that is now more likely under the current worldwide recession. Second, regionalism may hinder multilateralism as the growth of trade blocs may reduce the incentives of bloc members to participate in future multilateral negotiations.

Box 2. The Spread of Regionalism

PTAs have spread rapidly since the establishment of the WTO. As of end-2008, the WTO reported more than 400 PTAs of which 230 were in force, three-quarters of them covering trade in goods and one-quarter covering trade in services. In the 13 years from 1995 to 2008, more than 300 PTAs were notified to the WTO, compared with only 124 PTAs notified during the 47 years (1948–95) of the General Agreement on Tariffs and Trade (GATT). Whereas the first wave of PTAs under the GATT was among advanced economies (north-north) or developing countries (south-south) only, of the currently active PTAs a quarter involve north-north agreements and close to 40 percent are either north-south or south-south. It is estimated that about 15 percent of world trade for products with tariffs above 3 percent takes place on a preferential basis, significantly up from the early 1980s (World Bank, 2005).

In this new landscape, the cost-benefit appraisal of PTAs revolves mostly around the depth of these agreements and the exceptions they allow. These differ across PTAs and across types of PTAs. For example, in a north-south agreement like the North American Free Trade Agreement (NAFTA), trade diversion is not likely to be very important in the overall picture for Mexico since the United States is quite efficient in many activities. At the same time, since protection is generally low in the United States, the benefits of NAFTA to Mexico will be less in the form of additional market access than other forms, notably increased foreign direct investment. By contrast, trade diversion could be important in south-south agreements like the Common Market of the South (MERCOSUR) and the Common Market for Eastern and Southern Africa (COMESA) where the major partner (Brazil in MERCOSUR and Egypt in COMESA) is not likely to be the most efficient producer of many goods/services for which it gains preferential access to other members' markets.

Deep integration refers to PTAs that extend beyond removing trade protection to include other actions such as integrating factor markets, combining regulatory institutions, harmonizing standards, and cooperating intensively on trade facilitation (e.g., by reducing red tape for crossing borders and removing other behind-the-border restrictions). Despite recent efforts to catalog all existing PTAs (see Section VI below), we do not know how effective or deep these PTAs really are. The changing landscape of PTAs has been recognized in recent reviews of regional integration including IMF (2006g), World Bank (2000, 2005), OECD (2003), and WTO (2007).

A. Implications for the IMF

6. Three aspects of the proliferation of PTAs complicate IMF surveillance operations.

Proliferation leads to overlaps that constrain IMF surveillance

7. The proliferation of PTAs adds a layer of constraints on the conduct of policy at the country level. For example, IMF staff cannot recommend unilateral tariff reduction in a country that is a member of a customs union (say, Kenya in the East African Community (EAC) or Brazil in the Common Market of the South (MERCOSUR)). The implication is that surveillance of PTA-related issues should be carried out at the regional level, as acknowledged in IMF (2005a).

Multidimensionality complicates cost-benefit analysis and the design of an organizing framework for the Fund's activities

8. PTAs have always been multidimensional, extending beyond narrow economic efficiency concerns to include political/diplomatic objectives. These objectives can feature prominently in a country's overall decision to join a PTA (for example, democracy was a pre-condition for membership in MERCOSUR) even if they are beyond the purview of the IMF's bilateral surveillance.¹ But even if one restricts the evaluation to an appraisal of policy measures, these have become more diverse in the new wave of PTAs. For example, almost all PTAs include behind-the-border measures, such as reductions in trade costs, bilateral investment treaties, and harmonization of regulations. And in cases of deeper integration such as customs unions (of which very few are fully operative), there is some delegation of authority at the supra-national level, including dispute-settlement mechanisms. In the case of north-south PTAs (such as the North American Free Trade Agreement (NAFTA) and the EU's Economic Partnership Agreements (EPAs) with African, Caribbean, and Pacific (ACP) countries), the southern partner(s) may hope to gain some insurance of market access and of greater policy credibility than otherwise.

9. Unless none of the behind-the-border agreements is actually implemented, this increased multidimensionality complicates the cost-benefit analysis of PTAs. Thus, estimation of traditional trade creation and trade diversion effects will not suffice when assessing PTAs. Yet, most quantitative assessments of PTAs at the IMF (and elsewhere)—be they *ex ante* simulations (using partial or general equilibrium models) or *ex post* assessments (based on the interpretation of dummy variable coefficients in cross-country gravity models)—still do precisely that. Only recently have analysts even alluded to the cost-raising effects of rules of origin (which are necessary in all PTAs short of a customs union), and

¹ See, for example, Box 7.3 in Schiff and Winters (2003) and their discussion of the role of PTAs in strengthening democracy and political institutions.

these are rarely incorporated in the standard trade-creation/trade-diversion analysis.² Indeed, IMF Board members have on several occasions expressed the view that the staff's evaluation of PTAs has not recognized sufficiently their multidimensionality.

10. In sum, the shift in PTAs into different geographic dimensions (north-south, south-south) and the extension of the agenda beyond tariff reduction complicate the task of the IMF in its design of a framework for evaluating their macroeconomic effects.

Proliferation has systemic implications

11. The outlook for the multilateral system is likely to be closely bound to the development of PTAs. Informed views on how this relationship is playing out should be a critical aspect of the IMF's international surveillance. Indeed, a purpose of the IMF is to ensure that the world trading system develops in an orderly and balanced manner leading to greater integration of markets. PTA proliferation could endanger this process. The stalled multilateral negotiations under the Doha Round highlight the relevance of the "building block versus stumbling block" arguments regarding the systematic impact of PTAs on the world trading system. At the simplest level, is the "fortress Europe" argument—that members of deep PTAs (customs unions or even complete free trade areas) lose the incentive to open further their markets on a multilateral basis—true? A substantial political economy literature points out fairly general conditions under which this may be the case, but so far the evidence suggests otherwise.³ One could add that the rules of origin that accompany PTAs are in effect new trade barriers erected against nonmembers (goods can no longer be imported to a high-tariff member via a low-tariff member). On the other hand, it is easier politically to exchange concessions on a reciprocal basis in a smaller group of countries.⁴

B. Regional and Multilateral Agencies' Involvement in PTAs

12. The IMF, the World Bank, and the WTO are the three key players working toward providing the global public good of a well functioning multilaterally based world trading system. In this trio, the WTO is the sanctions-based organization, while the IMF and the

² The excessive complexity of rules of origin is now well documented. See Cadot and others (2006) for a review. On the vast array of nontraditional aspects of PTAs see Fernandez and Portes (1998) and Schiff and Winters (2003).

³ First formalized by Krishna (1998), this is now well accepted. Panagariya (2000) surveys the theoretical literature. Irwin (1993) provides an interesting description of how bilateralism led to global free trade in the nineteenth century, while Bhagwati (1993) cautions on the dynamics of bilateral trade policy for the future of the multilateral trading system. Estevadeordal, Freund, and Ornelas (2008) provide evidence that PTAs in Latin America did not lead to increased protection against nonmembers.

⁴ The collapse of the WTO ministerial in Cancun was partly due to the attempt to include the so-called Singapore issues (investment, trade facilitation, government procurement, and competition policy) in the agenda, showing that negotiating deep agreements is difficult on a multilateral basis.

World Bank are what Blackurst (1998) calls “best endeavors” organizations, i.e., organizations in which members are obliged to try to achieve certain objectives.

13. The WTO embodies the multilateral trading system, a key pillar of which is the principle of nondiscrimination. PTAs depart from this principle. However, WTO members are permitted to enter into such arrangements under specific conditions which are spelled out in three sets of rules:

- GATT Article XXIV permits the formation and operation of customs unions and free trade areas covering trade in goods provided that they eliminate trade restrictions on “substantially all the trade in products” among members and do not on the whole raise trade barriers against nonmembers.⁵
- The (less stringent) Enabling Clause permits PTAs among developing countries in trade in goods and preferential tariff treatment by advanced countries to developing country exports in accordance with the Generalized System of Preferences (GSP).⁶
- Article V of the General Agreement on Trade in Services (GATS) permits PTAs covering trade in services, for both developed and developing countries, as long as the agreements have “substantial sectoral coverage” and provide for the “absence or elimination of substantially all discrimination... between or among the parties, in the sectors covered.”⁷

14. The WTO hosts the negotiations that set these rules and it verifies that the rules are applied via several channels; ultimately the WTO enforces these rules via the dispute-settlement process. WTO members are required to notify the WTO when entering into a PTA. The WTO’s Committee on Regional Trade Agreements (CRTA) was set up in 1996 with the responsibility for examining individual agreements. However, the Committee’s work was hampered by a lack of agreement among WTO members on how to interpret the criteria for assessing the consistency of such agreements with WTO rules, and only a handful of agreements were examined.⁸ Recently, the CRTA has turned its attention to promoting transparency in PTAs by collecting and reporting information on PTAs and their content (see Section VI.B below).

⁵ http://www.wto.org/english/tratop_e/region_e/regatt_e.htm.

⁶ http://www.wto.org/english/docs_e/legal_e/enabling1979_e.htm.

⁷ http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm#articleV.

⁸ http://www.wto.org/english/tratop_e/region_e/regcom_e.htm

15. The World Bank primarily engages in a policy dialogue (or surveillance) and policy reform through conditionality where it is supporting a country's program.⁹ The Bank covers trade policies either via technical assistance or more recently via diagnostic trade integration studies (DTISs) for least developed countries (LDCs) in the context of the multi-agency Integrated Framework. The DTISs do not explicitly cover progress on PTAs. The Bank also carries out a broad research agenda in trade, including PTAs.

16. The IMF also carries out a policy dialogue (sometimes with conditionality when it is in the context of lending activities) and some research on trade. Of the three institutions, the IMF probably covered PTAs the least during the evaluation period. As discussed below, PTAs usually featured peripherally in Article IV consultation reports and they were covered very little in regional and multilateral surveillance. In many respects, PTAs fell through the cracks in the Fund's surveillance activities. IMF (2005a) notes that when all existing and planned PTAs are fully implemented some 100 IMF members will have much of their trade policy decision making transferred to the regional level, leaving a collective "blind spot" in Fund surveillance if consultations are not carried out at the regional level.

17. While there was some overlap between the IMF and World Bank as both engaged in policy dialogue, the IMF's focus was narrower as it concentrated mainly on the efficiency, fiscal, trade, and growth effects of PTAs and on how to manage macroeconomic policy in the presence of PTAs.¹⁰ Between the WTO and the IMF, there was very little overlap, since the IMF did not engage in the collection of data on PTAs, nor did it deal with PTA rules and their implementation.

18. Other institutions aside from the WTO, World Bank, and IMF, are involved in PTA issues. Regional development banks, particularly the Inter-American Development Bank (IADB) and the Asian Development Bank (ADB), have been engaged in PTA issues for some time. The IADB has assisted its member countries in trade liberalization via large complex north-south PTAs such as NAFTA, more traditional south-south PTAs such as MERCOSUR, or bilateral PTAs (as well as through multilateral and unilateral trade liberalization). The IADB was an active supporter of the Free Trade Area of the Americas (FTAA) initiative, housing the FTAA secretariat and providing advice and technical assistance to the potential member countries (Estevadeordal and others, 2004). The ADB has followed a similar route to that of the IADB, and provided training and advice to its members on how to negotiate PTAs (ADB, 2008.)

⁹ World Bank trade-related program support includes trade facilitation lending and infrastructure for trade lending, in addition to adjustment lending, which is similar to IMF lending. See the matrix presentation of the three institutions in IMF (2005a).

¹⁰ A concordat between the World Bank and the IMF in 1989 recognizes trade and structural reforms to be among the Bank's primary responsibilities but allows both institutions to "explore their legitimate concerns with regard to macroeconomic and structural issues" (IMF, 2005a).

III. IMF BOARD VIEWS AND GUIDANCE ON PTAS

19. The spread of regionalism has altered concerns and perceptions about how PTAs fit in the world trading system. These changing perceptions are reflected in the dialogue between IMF staff and the Executive Board.

20. Early IMF work on PTAs was carried out in the context of the assessment of the accomplishments of the Uruguay Round. An extensive paper (IMF, 1994a) took stock of regionalism and its causes and effects, covered in considerable detail recent developments in EU enlargement and NAFTA, and discussed developments in other PTAs in its appendices. With a few exceptions, Executive Board members' comments on this paper were positive, accepting that regionalism was second-best but likely to be a building block for future multilateral trade negotiations (IMF, 1994b).

21. The view that PTAs are second-best to multilateral liberalization was reiterated in later Fund documents. The 1999 guidelines to staff on designing and implementing trade policy reform stated that, "Generally, the Fund prefers that countries liberalize on a most-favored-nation (MFN) basis, but does not advise against entering into [P]TAs." PTAs, it noted, "raise concerns about trade diversion and the associated implications for resource allocation and economic efficiency" and "complicate Fund policy advice" because they often entail some loss of (trade) policy autonomy in member countries (IMF, 1999b). According to the guidelines, to further the principles of free trade and multilateral cooperation:

- PTAs should, "[a]t a minimum" be notified to the WTO and be consistent with GATT Article XXIV, but should go beyond the obligations of GATT Article XXIV as far as possible. For example, liberalization of trade among PTA members should be all-encompassing ("without exempting any sectors"), and the transitional phase should not last too long (i.e., less than ten years allowed by the WTO).
- PTA members should engage simultaneously in multilateral or unilateral trade liberalization to minimize trade diversion effects.
- Rules of origin that are necessary to prevent trade deflection should be "liberal and transparent."

22. If the IMF is to have a limited involvement in PTA surveillance, these guidelines represent a first order of business. They are uncontroversial, although they lack certain concreteness. For example, saying that rules of origin should be liberal and transparent is not enough—the many ways in which they can be made so all involve trade-offs (Cadot and de Melo, 2008).

23. The 2005 review of Fund work on trade (IMF, 2005a) maintained the same position on PTAs as the 1999 guidelines to staff. In support of this position, the review reported model-based simulation results showing that global trade reform would lead to greater

efficiency gains and that the loss in efficiency from bilateral agreements would be mostly borne by the low-income partner. (The discussion in the review was brief, because of the promise of a companion paper on PTAs.) The review recognized that regionalism was here to stay and that staff should concentrate on best practices in PTA design as reviewed in World Bank (2005).

24. The tensions in the 2005 review of Fund work on trade were apparent. The review noted that the Fund's regional surveillance had mainly focused on currency issues while regionalism was a broad phenomenon and "the Fund may have to form a view on [P]TAs—or aspects of [P]TAs—well before they are negotiated" (IMF, 2005a). The review recommended that for deep PTAs (e.g., customs unions), where trade policy making is carried out at the regional level, the Fund could supplement its bilateral consultations with individual members with consultations at the regional level.

25. At the Board discussion of the 2005 review, several Directors prefaced their remarks by saying that they were looking forward to the more detailed appraisal of PTAs in the companion paper to come. In their remarks, all Directors spent substantial time on PTAs. While agreeing that a pragmatic approach was needed when approaching PTAs, Directors were (almost unanimously) unsatisfied with what they perceived to be the lukewarm view of PTAs expressed by staff in the review. Their remarks covered three main points (IMF, 2005b):

- Staff skepticism may have been warranted but overall staff were, implicitly at least, too harsh on PTAs. Many Directors viewed PTAs as complementary ("building blocks") to multilateral liberalization. Some Directors saw PTAs as a practical way to speed up trade liberalization given the delays in the multilateral process; others noted that PTAs, especially south-south PTAs, could provide individual members with greater leverage in multilateral negotiations.
- The Fund has a comparative advantage in regional trade surveillance.
- The Fund should also pay attention to spillover effects of trade policy, particularly the policies of the advanced economies.

26. The long-awaited paper on PTAs (IMF, 2006g) focused mainly on the efficiency aspects, arguing that the other (nontraditional) aspects were beyond the purview of the IMF and that in any event, the Fund viewed them positively since they mostly concerned cooperation on a nondiscriminatory basis. The paper's coverage of efficiency and systemic effects (via spillovers) was balanced but not sufficiently critical to inform on where there were gaps in knowledge. The paper did devote some space to other aspects of PTAs—the so-called emerging areas—such as issues related to trade in services, investment, and regulatory cooperation. If regional cooperation in these areas is indeed welfare-enhancing,

then this would seem to make the staff's continued lukewarm overall stance toward PTAs—based solely on the efficiency-related effects caused by trade-diversion—harder to defend.

27. The 2006 paper on PTAs noted the frequent reference to PTAs in the Fund's surveillance work and concluded that staff had stressed the appropriate messages (carry out MFN tariff reductions simultaneously to minimize trade diversion, and keep rules of origin simple and transparent).¹¹ Annex III of the paper contained a useful but not very comprehensive list of “elements of efficient PTA design and implementation” (IMF, 2006g); in view of what was already known from the extensive work outside the Fund (especially at the World Bank), this list deserved to be more extensive.¹²

28. While the message in the 2006 paper was to make the best of regionalism because it was here to stay, staff still projected a lukewarm opinion of PTAs.¹³ The paper suggested that:

- At the bilateral level, the Fund should be “neither a PTA critic nor enthusiast,” but encourage transparency, communicate principles of PTA design that best serve the interests of individual members and of the multilateral system, and advise members on managing fiscal and other consequences of PTAs.
- At the institutional level, the Fund should argue for a well functioning multilateral trading system and urge moderation and common disciplines in the creation of PTAs.
- At the operational level, the Fund should refine its approach toward PTAs through discussions at the regional level.

29. The Board's reception to the 2006 seminar paper was lukewarm. While the Board welcomed the paper, several Directors still felt that the staff were too negative. In the end there was sufficient opposition that the paper did not reach the public domain. Staff remained frustrated as they did not get the guidance they were seeking from the Board.

¹¹ Recent evidence shows that this is indeed what has happened, at least in Latin America where MFN rates have been falling at approximately the same rate as preferential rates, dispelling fears that PTAs would be stumbling blocks to multilateral trade liberalization (Estevadeordal, Freund, and Ornelas, 2008).

¹² See, for example, the summary on making the best of regionalism and some rules of thumb in Schiff and Winters (2003) and the checklist approach to regionalism in World Bank (2000).

¹³ In the informal Board seminar at which the paper was presented, staff expressed concern that the proliferation of new PTAs was driven by a prisoner's dilemma rather than more fundamental economic assessments.

IV. ADVICE ON PTAS IN IMF SURVEILLANCE WORK

30. IMF policy advice on PTAs was provided mostly through bilateral surveillance in the context of Article IV consultations. Annexes 1–3 below review surveillance documents on individual countries on PTA issues: Annex 1 reviews staff reports of 1996, 2000, and 2006, for advice on PTAs; Annex 2 reviews PTA-related analyses in Selected Issues Papers (SIPs) of 1996–2008; and Annex 3 reviews IMF coverage of PTA issues in the European Union, Japan, the United States, MERCOSUR members, and COMESA members. The overall impression from the detailed review in the annexes is that Fund advice on PTAs was by and large consistent with the 1999 guidelines and sufficiently context-specific, though the tone varied from favorable to cautionary. But while some analytical work was done on most major PTAs during the evaluation period, often the advice in any given staff report was not backed by in-house analysis or by the results of analysis done elsewhere.

31. As detailed in Annex Table 1, PTAs were mentioned in 40 percent of the sample of 554 Article IV staff reports covering approximately the years 1996, 2000, and 2006, with coverage limited to factual descriptions in two-thirds of the cases. Some 49 SIPs and other Article IV background papers issued during the evaluation period covered PTAs in some depth. The following discussion summarizes the more detailed evaluation of the coverage in Annex 3 of the approach to PTAs in the European Union, Japan, and the United States; of MERCOSUR; and of COMESA. The section closes with an assessment of PTA coverage in regional and multilateral surveillance.

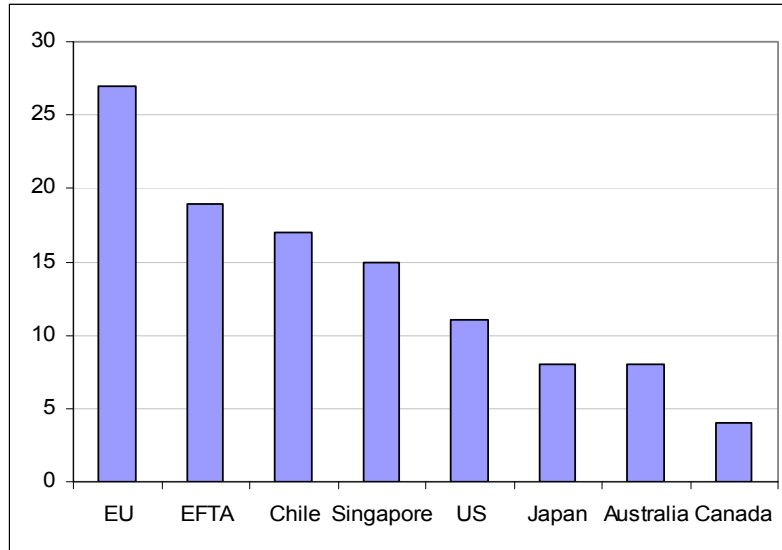
A. PTA Coverage in Advanced Economies

32. The European Union, Japan, and the United States are leaders in the number of PTAs joined (Figure 1), and because of their importance in world trade, their participation in PTAs has systemic effects. Thus, IMF consultations with these countries should have covered at least PTA-related three issues: (i) the possibility that this proliferation would be detrimental for the working of the world trading system; (ii) rationalizing the proliferation of PTAs; and (iii) avoiding the development of hub-and-spoke regionalism by offering similar and transparent access to partners (i.e., simple rules of origin).

33. IMF staff largely covered these issues in their consultations with the Euro Area, Japan, and the United States. In each country (or currency union, in the case of the Euro Area), staff engaged the authorities (at least once, and often several times) on their attitudes towards multilateralism, urging them to commit to multilateral rather than preferential liberalization. This was the right message to convey. Reducing protection in agriculture was also raised in the policy dialogue with the authorities. This too was the right message. Unilateral reduction in agricultural protection by the European Union, the United States, and Japan was certainly worth emphasizing from a systemic point of view because it would help breach the gap in negotiation positions at the Doha talks but also because it would reduce the

benefits that prospective PTA partners might hope to get on a bilateral basis by signing PTAs with these countries.

Figure 1. Number of PTAs in Force, Selected WTO Members



Source: WTO.

European Free Trade Area (EFTA) members are Iceland, Lichtenstein, Norway, and Switzerland.

34. Although the right topics and the right recommendations were covered in the dialogue, not much analytical/empirical supplementary work was done in accompanying SIPs. (The notable exception was on NAFTA, which was covered in some depth in Kose (2003).) This left some gaps in the IMF's attention to significant macroeconomic effects of numerous PTAs. Notably, little in-depth work was done on macroeconomic issues involved in the Economic Partnership Agreement (EPA) negotiations between the European Union and six regional groupings of African, Caribbean, and Pacific (ACP) countries. Studies elsewhere have shown that in north-south PTAs, the southern partner(s) are often in effect discriminated against in the major products they export to their northern partner(s); this issue was not touched upon in SIPs on the Euro Area, Japan, and the United States.¹⁴ Fund staff urged the adoption of simple rules of origin but did not provide supporting analysis showing that the complexity of rules of origin in effect negate market access to countries benefiting from preferential market access.

¹⁴ Carrère and de Melo (2009) show that taking into account the fact that the European Union and the United States are engaged in PTAs with countries that compete with the LDCs substantially diminishes the effective preferential margins for LDCs in these two markets. Thus, when one accounts for the EU's many regional trade agreements that give duty- and quota-free access to other countries competing with LDCs in the EU market, LDCs get only a three percent preferential margin for exports to the European Union. And in spite of preferences under the U.S. African Growth and Opportunity Act, LDCs are still discriminated against in the U.S. market (i.e., they get less preferential access to the U.S. market than other exporters).

B. MERCOSUR

35. Viewed in terms either of the IMF's mandate to promote policies conducive to growth and stability or of its coverage of PTAs in Africa, Fund coverage of MERCOSUR during the evaluation period was inadequate. Indeed, MERCOSUR is the most important and visible south-south PTA, struggling to become a full-fledged customs union. It is an extension of a long tradition of PTAs in Latin America and is more than a decade old. The issue is whether the move to deep integration (i.e., a customs union rather than a free trade area) was a step in the right direction. While it is difficult to guess what would have happened under an alternative nondiscriminatory trade policy, that question deserved greater scrutiny.

36. As detailed in Annex 3 below, the IMF analyzed the effects of MERCOSUR only once (albeit with careful and detailed analysis that showed much trade diversion), in a SIP that accompanied the 2002 consultation for Brazil (Bannister, 2002). No such analysis was done for other MERCOSUR members. MERCOSUR was not covered in any of the Western Hemisphere Department's *REOs* while shallower PTAs in Africa were covered in a few African Department *REOs*. Given the importance of MERCOSUR for its members and other countries in the region, an analysis from a regional viewpoint was warranted.

37. A consensus is emerging that MERCOSUR has been at best a mixed success.¹⁵ The reasons for this perception include evidence of strong trade diversion effects and an incomplete transition to a free trade area (let alone to a customs union). Because each MERCOSUR member has essentially kept its nontariff barriers, costly rules of origin are still necessary as in a free trade area. MERCOSUR has also been characterized by a lack of convergence in per capita GDP. This result conforms to predictions from standard trade theory and would be useful to document when discussing the best practice on choice of PTA partners.¹⁶ Fund staff had reservations regarding the prospective accession of Venezuela to MERCOSUR in 2006, including concerns about the pattern of growth of intraregional trade and the cost-raising effects of rules of origin. In light of these concerns, it would have been useful to have an evaluation of MERCOSUR in hand for dialogue with Venezuela when the latter was contemplating membership.

38. A detailed assessment of MERCOSUR would have also served as a lesson for other regions contemplating PTAs with deep integration (i.e., the EAC and COMESA). Such a study could have highlighted the consequences of asymmetries among partners (a very common feature of all south-south PTAs): for example, only 0.01 percent of regional GDP

¹⁵ See, for example, Tulchin, Espach, and Golding (2002).

¹⁶ Venables (2003) shows that in a Heckscher-Ohlin model, a free trade area between two southern partners (i.e., two countries with capital-labor endowments below the world average) will lead to a divergence in per capita income.

was available for structural and cohesion funds in MERCOSUR (compared to 0.5 percent in the European Union). A summary study would have highlighted the hurdles along the way towards a customs union: lack of implementation of dispute-settlement criteria, which ultimately meant that political solutions were prevalent; too many criteria in regulations, which led to heavy use of discretion; and lack of delegation to a supra-national authority.¹⁷

C. COMESA

39. Eastern and Southern Africa are regions with a large number of PTAs, many of which have significant overlap in their membership (Table A.2). The agendas in these PTAs all involve, but usually go beyond, preferential trade liberalization. Two issues arise for these PTAs: (i) the extent of overlap and its associated problems; and (ii) the depth of these PTAs and whether they allow member countries to integrate into the world trading system beyond what could be expected from sole participation in multilateral negotiations or unilateral reductions in trade barriers. COMESA, with its large and very disparate membership (currently 19 members including Egypt, Mauritius, Libya, Sudan, and Ethiopia), presents an interesting example of rapid success in reaching quasi free-trade status among members, but also of the difficulties of carrying out deep integration among very diverse members. Following a relatively rapid move toward full free trade area status within approximately five years and some delegation of authority to a secretariat, COMESA members' integration toward a customs union (which was signed in 2007 and is supposed to come into effect in 2009) proved to be too ambitious; more than 1,000 tariff lines have been exempted from the common external tariff.

40. In effect, COMESA members have engaged in deep integration and made some progress on integration in the following areas: the establishment of a fund for revenue-loss compensation and of a general fund, both of which are operational even though the amounts involved are small; measures to facilitate trade, e.g., customs harmonization and (air and surface) transport facilitation; trade insurance; the establishment of a common investment area to help pave the way toward a common market; cooperation on information, communications, and technology; and the establishment of a court of justice to deal with disputes.

41. During the evaluation period, all IMF consultations with COMESA members were carried out at the bilateral level, often revolving around strengthening tax administration and reducing exemptions and the number of tariff bands. All these were measures that would make the implementation of a free trade area easier and would facilitate the transition from a free trade area into a customs union. In some countries (e.g., Comoros, Djibouti, and

¹⁷ The enforcement gap of MERCOSUR was noted early on and has led Latin American observers to suggest that the best way forward may be to go for a free trade area rather than trying to patch up an incomplete customs union. See, for example, Bouzas (2002, 2008), and Vaillant (2005).

Seychelles) where tariffs primarily served revenue rather than protectionist purposes, IMF staff recommended replacing tariffs by excise taxes—a move that would also ease the implementation of a free trade area. These were sensible recommendations at the country level and supportive of the necessary steps to maximize the benefits of participation in PTAs.

42. Several consultations also discussed explicitly the frictions (and in some cases synergies) across PTAs. For instance, a joint SIP for Kenya, Uganda, and Tanzania (Everaert, Palmason, and Sobolev, 2006) warned that cross-membership between the Southern African Development Community (SADC) and COMESA meant that the transaction costs involved in border formalities could not be eliminated, necessitating multiple (and likely costly) rules of origin. In the case of Kenya, concerns were raised about the EAC customs union and the ongoing COMESA customs union negotiations and about how the relatively simple three-band EAC common external tariff could serve as the basis for the COMESA common external tariff.

43. In spite of this coverage at the country level, a study of the success and difficulties encountered by COMESA would have been welcome as part of the Fund's regional surveillance activities. It would have allowed a checking of the extent of deep integration among COMESA members.

D. Other Consultations

44. In other bilateral consultations covered in our sample (Annex 1), PTAs were seldom covered beyond a description of what was accomplished and a presentation of the next integration steps communicated by authorities. On some occasions, staff welcomed the PTA being negotiated as a stepping stone toward the country's better integration into the world trading system or as a way to reduce business costs (e.g., in the Caribbean Community (CARICOM)). On other occasions, staff warned officials not to push too far on multiple PTAs and to take a hard look at administrative costs and the potential for trade diversion. Staff occasionally suggested that multilateralism would be preferable or that reductions in MFN tariffs should accompany preferential reductions to minimize trade diversion effects. Staff's comments and/or advice were usually the same for all members in any given PTA.

45. In sum, even if coverage was very light, overall the advice was consistent and closely followed the recommendations in the 1999 guidelines (IMF, 1999): reduce MFN tariffs to minimize trade diversion, keep rules of origin simple, and avoid overlapping memberships.

E. Regional and Multilateral Surveillance

46. Beyond Article IV consultations with individual countries and currency unions that touched on PTA issues, IMF views/analyses on PTAs were also disseminated in the *WEO* and, starting around 2003, in the *REOs*. As detailed below, the coverage of PTAs in the *WEO* and the *REOs* was minimal during the evaluation period, in some cases possibly reflecting

the lack of in-house analytical work from which to draw. If one accepts that the future of the multilateral system depends largely on how PTAs develop, then it appears that the IMF has largely absented itself from a large part of the real-world trade policy debate by not taking a more active interest in the systemic and regional issues coming out of the debate on PTAs.

47. Coverage of PTA issues in the *WEO* was scant during the evaluation period; trade-related attention was mostly devoted to gathering support for the Doha Round. The May 2001 *WEO* contained an analysis of “Trade Integration and Sub-Saharan Africa,” which pointed to the deterioration of Africa’s trade performance during the 1990s despite a number of regional initiatives aimed at expanding trade. That paper recommended African countries to channel their regional integration in a way that would maximize its benefits and minimize its risks, namely by improving the implementation of their regional liberalization commitments; simultaneously pursuing “external liberalization” to lessen the risks of trade diversion; rationalizing overlapping PTAs or at least harmonizing rules of origin, external tariffs, and standards; and seeking reciprocal free trade agreements with advanced country partners (IMF, 2001c).

48. The September 2004 *WEO* (IMF, 2004c) contained a box on some of the main effects of NAFTA in its first ten years of existence. Drawing on Kose (2003), the box included a summary of findings on the efficiency effects of NAFTA (little evidence of trade diversion) and foreign direct investment into Mexico (an increase of more than 40 percent attributable to NAFTA during the early years), and reported evidence of increased productivity growth. It also included a discussion of the synchronicity of business cycles, suggesting that cyclical fluctuations in Mexico moderated under NAFTA.

49. In the *REOs*—the natural forum to tackle regional issues—the coverage of PTAs was minimal, and was largely limited to the Sub-Saharan Africa and Asia-Pacific regions.

50. The October 2004 *REO* for Sub-Saharan Africa (IMF, 2004d) contained a box on regional cooperation and integration in sub-Saharan Africa. The box described the many PTAs in the region and made the point that regional coordination should be pushed on all fronts (infrastructure, macroeconomic policy coordination) to unify and widen Africa’s domestic markets. The May 2005 *REO* for Sub-Saharan Africa (IMF, 2005c) contained a chapter on making PTAs more effective in Africa. Drawing on a study by Yang and Gupta (2005) (discussed in Section V.B below), the chapter reviewed the poor outcome of African PTAs and argued for several policy measures, such as further trade reform on a nonpreferential basis and more active participation in multilateral negotiations; reducing behind-the-border restrictions that raise transaction (especially transport) costs in the region; and streamlining PTAs to avoid spaghetti-bowl effects. This *REO* chapter is a good example of the kind of work that can be done on PTAs in *REOs* given the material available in SIPs and IMF working papers.

51. The Asia-Pacific *REOs* covered trade issues twice during the evaluation period. In the 2005 *REO*, the focus was on the rise of intraregional trade with much vertical intra-industry trade (in most other PTAs, regional integration gives rise to horizontal intra-industry trade). The chapter pointed to Asia's successful history of intraregional trade liberalization; suggested that greater openness to regional trade could foster competition in domestic markets and lead to an increased role for final demand in the region; and noted that bilateral free trade agreements could be building blocks for more comprehensive trade agreements and could induce other countries to enhance regional cooperation (IMF, 2005h). The 2006 *REO* contained a box on PTAs in the Asia-Pacific region, reporting on the results from a gravity model estimated for 1993–2003. The results suggested that Asian regionalism was “open,” insofar as extra- and intraregional trade was higher than would have been predicted for random country pairs not belonging to a free trade area (IMF, 2006a). Both the chapter and the box presented thoughtful analyses of trade patterns though neither aimed at nor presented policy advice.

52. The 2006 Middle East and Central Asia *REO* contained a box on regional cooperation in the Maghreb (Algeria, Libya, Mauritania, Morocco, Tunisia). The box reported on the results of a 2005 conference for Maghreb countries that had been organized by the IMF, and argued that trade facilitation would help expand intraregional trade. The box also suggested that intraregional trade was low because of tariff and nontariff barriers, but provided no supporting evidence (IMF, 2006f).

53. PTAs were not covered in Western Hemisphere *REOs* (which began only in 2006) but in 2005, an informal Board seminar on selected regional issues in Central America included two papers that analyzed the macroeconomic and tax implications of the Central America-Dominican Republic-United States Free Trade Agreement (CAFTA-DR). Drawing on Mexico's experience in NAFTA, Rodlauer and Schipke (2005) concluded that CAFTA-DR could have beneficial effects on growth and stability in Central America, provided these countries implemented the necessary structural reforms to sustain the gains associated with the agreement. Bronchi and Chua (2005) analyzed the revenue consequences of CAFTA-DR for the Central American members, considered possible compensating revenue measures, and reviewed the implications for tax policy and its coordination within the region. Both papers contained detailed and careful analyses and are a good example of macro-relevant work on PTAs.

V. ADVOCACY AND RESEARCH

A. Advocacy

54. Most speeches by senior IMF management that touched on trade policy focused on the benefits of a well-functioning open multilateral system for achieving sustainable growth (see, for example, Krueger (2004, 2006)). Very infrequently did these speeches refer

explicitly to the benefits or costs of PTAs as being on the path toward this open international system.

55. Of the many speeches by IMF management—the Managing Director and First Deputy Managing Director (FDMD)—only about a dozen mentioned PTAs with any specificity. These tended to be speeches delivered in a regional context, for example in Latin America or Africa. In those circumstances, the speech would usually allude to recent evidence of the superior performance of countries with open trade regimes, before engaging on the benefits of regionalism as a means to reduce protection further, but always noting that such regionalism should be compatible with WTO rules.

56. This rather positive view of regionalism as a stepping stone for multilateral liberalization began to wane as concerns began to be voiced that the proliferation of PTAs could be a hindrance for the completion of ongoing multilateral negotiations. Such concerns were raised in several speeches by the FDMD after the failure of the Cancún meeting in 2003. And in a speech in New Zealand June 2006, the Managing Director said:

“I am also concerned that a number of countries may be turning away from multilateralism toward bilateral and regional trade agreements. These agreements can certainly be useful, especially if they are combined with significant nondiscriminatory liberalization and if they contain transparent, simple, and liberal rules of origin. But they can also be a distraction, result in trade diversion, and can be confusing to exporters. For example, what has been called the ‘Asian noodle bowl’ contains many competing and overlapping agreements, whose net effects on global and even regional trade are uncertain. The answer is not necessarily to forego all bilateral agreements, but to ensure that these are well designed and that they are complemented by the further liberalization of trade with all partners” (de Rato, 2006).

57. As recently as September 2006, Anne Krueger explicitly referred to the uncomfortable co-habitation of regionalism and multilateralism:

“The misperception that Europe’s success has been largely attributable to its internal preferential arrangements has probably contributed to the failure to appreciate the importance of multilateralism, to the thrust toward preferential trading arrangements and to other bilateral and regional arrangements. ...[T]his is highly dangerous for all members of the international economy, as preferential arrangements will achieve their intended purpose only in the context of a strengthening of the multilateral system” (Krueger, 2006).

B. Research

58. Annex Table 4 provides an annotated list of 31 IMF working papers that focus on PTAs. Working papers reflect independent research by IMF staff (as well as visitors and consultants). Unlike SIPs, working papers are not IMF surveillance documents although

some working papers are extended or revised versions of SIPs. Since 1997, all IMF working papers have been available to the public on the Fund's website (not all SIPs are publicly released). Most of the working papers reviewed for this evaluation fell into the following three categories: (i) informed description and assessment of PTAs; (ii) ex ante simulations, either in partial or in general equilibrium; and (iii) ex post assessments using either the gravity model or other econometric specification.

59. The most researched PTAs were CARICOM, CEMAC, NAFTA, SADC, and WAEMU. Thus, there was fairly broad coverage encompassing most of the largest PTAs (except MERCOSUR which was covered in a SIP (Bannister, 2002)) and the EU EPAs. The different approaches (SIPs and working papers) complemented each other well. But taken together, these contributions were still not sufficient to produce comprehensive assessments of the state of PTAs. Even in the papers in category (i) above, the analyses did not amount to an overall evaluation of any PTA.

60. Two analytical descriptions of PTAs in Africa were particularly well done. Yang and Gupta (2005) is a good example of the kind of analysis that should be pursued with limited resources. Indeed, it was subsequently covered in a *REO*. It was informative, as it went well beyond the usual generalities on the second-best efficiency aspects of PTAs and emphasized aspects of integration that were specific to the region. For example it argued convincingly that Africa's regional integration should extend beyond a narrow focus on tariff reduction to include behind-the-border measures to lower transactions costs, in particular high transport costs for intraregional trade. Khandelwal (2004) provided a detailed, insightful description of the nuts and bolts of SADC and COMESA. These two papers represented a step toward formulating an appreciation of the functioning of PTAs in Africa and of some of the remaining challenges for successful integration. No such equivalent comprehensive coverage was carried out in other regions (most notably for Latin America) during the evaluation period.

VI. OVERALL ASSESSMENT AND RECOMMENDATIONS

61. Because of the disparity across PTAs, to produce a more credible assessment of the strengths and weaknesses of such agreements the IMF should continue to emphasize the traditional best practices that are suggested in the 1999 guidelines (IMF, 1999b), when applicable (i.e., for PTAs where trade barriers are still high), but it should also put more emphasis on PTA-specificity and pay more attention to the type and extent of deep integration. The best way to achieve deep regionalism would be to multilateralize it. Baldwin and Thornton (2008) provide several suggestions in that direction in which this process would be guided by the WTO. In any event, these changes and shifts in emphasis call more for an organizing framework than for new or additional guidelines.

62. Reaching this objective would be helped by focusing on the following three areas: (i) carrying out (or relying on) more disaggregate cost-benefit analyses of efficiency effects

of PTAs; (ii) extending cooperation with WTO and World Bank staff to increase data collection/dissemination for more informed monitoring; and (iii) extending the largely neglected surveillance of PTAs at the regional level.

A. Is Regionalism Second-Best?

IMF staff maintained the view throughout the evaluation period that PTAs are second-best, but they derived this assessment from too narrow a focus, given the state of knowledge (and debate) on PTAs. Because the devil is in the details, ideally more work—at least more analysis in SIPs laying the ground for coverage in REOs—should have been carried out to support this view.

63. While recognizing the benefits of being able to pursue a larger reform agenda at the regional than at the multilateral level (implying that PTAs are on the whole building blocks for the world trading system), IMF staff continued to maintain throughout the evaluation period that they should only concentrate on barriers to trade in goods (and services if more information were available). Viewed through this narrow focus, PTAs are indeed second-best.¹⁸ But even with this narrow focus, staff could have made a stronger case by quantifying the resource waste associated with the costly rules of origin that accompany the vast majority of PTAs that fall short of customs unions.¹⁹

64. The bottom line is that, at a minimum, the second-best case deserved to be made more strongly by digging deeper into the details of PTAs, with more efficiency analysis carried out at a disaggregated level (e.g., six-digit Harmonized System (HS)), and a more extensive discussion of the effects of preferential access in services.^{20,21}

¹⁸ Nondiscriminatory trade liberalization is also superior to discriminatory liberalization when there are economies of scale in production, so the existence of scale economies (which is often claimed by developing countries) is not an argument for choosing the discriminatory route.

¹⁹ Viewing PTAs in terms of the additional benefits they can provide relative to multilateralism is useful for this narrow focus. See de Melo and Panagariya (1993), and Panagariya (2000). The only exception is the (unrealistic, except perhaps in the current environment) case of a world divided in a few trading blocs that are engaged in trade warfare as in Krugman (1991): in this case, a small country would be better off being a partner of a large bloc than relying on the WTO and MFN treatment. Otherwise, there is no efficiency gain that a country can get with a preferential trade policy that it cannot get multilaterally.

²⁰ For example, careful analysis of PTAs at the disaggregated (HS-6) commodity level often reveals that the sectors that are excluded from tariff elimination are precisely those where trade creation would be greatest. This point was made forcefully in the context of MERCOSUR by Yeats (1998) and subsequently reinforced in Bannister (2002). Similar patterns have been picked up for the majority of interim EU EPAs where trade diversion was found to dominate trade creation because the EPA partners typically excluded highly protected sectors from tariff reductions (Carrère and de Melo, 2008). Only such disaggregated analysis can reveal the importance of trade diversion effects arising from the exclusion of sensitive sectors.

²¹ See Matoo and Fink (2004), and Mattoo and Payton (2007) for a cost-benefit analysis of multilateral versus regional reduction to barriers in services trade for Zambia.

65. By arguing that the IMF should only concentrate on efficiency effects of PTAs, staff opened themselves to the criticism of being too negative on PTAs. Given the multidimensionality of PTAs, staff should drop references to PTAs being second-best, PTAs being driven by a prisoner's dilemma, or PTAs being a stepping stone (or building block) for multilateral trade liberalization unless they back up such references with evidence along the lines of that in Estevadeordal, Freund, and Ornelas (2008).

B. Recommendation: Extend Data on PTA Implementation to Improve Monitoring

A more informed overall cost-benefit analysis of PTAs requires better data and monitoring at the regional and global levels. At the regional level, both the World Bank and the IMF can complement the WTO's efforts to step up the data collection necessary for improving the monitoring of PTAs. The IMF may be in a position to push for reporting and harmonizing data in the context of its Article IV consultations.

66. The best way to ensure that regionalism improves welfare is for countries to pursue deep integration. If regionalism becomes dominated by shallow PTAs (minor agreements are a real possibility under the Enabling Clause and inadequate implementation of measures to remove behind-the-border restrictions), then the result is likely to be a waste of resources. But if integration extends beyond goods markets to include the removal of behind-the-border restrictions, resource gains will accrue to both PTA members and nonmembers and regionalism will improve the working of the world trading system.

67. Short of WTO members agreeing to stricter rules for PTAs, the only way to know if integration is actually deep is to collect more information on PTA implementation. At the global level, efforts by the WTO and the World Bank are under way to do just that. The WTO's CRTA, which was set up to increase the transparency, efficiency, and consistency of the WTO's treatment of PTAs, has launched a new information system that will go some way toward providing information on how PTAs and their implementation are progressing around the world.²² This is part of the transparency mechanism that was agreed provisionally (under the "early harvest") during the Doha negotiations. The mechanism allows the CRTA to issue a "factual presentation" for newly notified PTAs (not for existing ones like MERCOSUR and NAFTA). So far, the WTO's website has a link to all the texts of notified PTAs. Factual presentations describe all the provisions in the PTAs and include trade and tariff data at the tariff-line level (i.e., at HS-6 to HS-12 level) and data on the schedule of tariff removals agreed in the texts. In response to requests by developing countries for help on how to design and implement PTAs, the World Bank is planning to develop a web-based tool to inform and

²² See <http://rtais.wto.org/ui/PublicMaintainRTAHome.aspx>.

assist developing country policymakers and trade negotiators with regard to the legal, economic, and development implications of different PTA provisions.²³

68. The IMF is unlikely to play a lead role in these information-gathering and monitoring efforts at the global level. However, the IMF could help ensure that countries engaging in PTAs use the same classification of goods when entering in a customs union, and/or help report data on PTA implementation in the context of surveillance.²⁴ In any event the IMF would be a prime consumer of the detailed PTA information collected by the World Bank and the WTO, which it could then disseminate to country authorities during Article IV consultations and to the public at large through the *REOs* and the *WEO*.

69. In cooperation with the WTO, the IMF mandate could even be amended to include further gathering of information as part of the Fund's review of the adequacy of statistics.²⁵ The regular Article IV consultations would provide the natural vehicle for such activities. The IMF already participates in initiatives on data standards, such as the Reports on the Observance of Standards and Codes and the Special Data Dissemination Standard. It is beyond the scope of this paper to evaluate whether it would appropriate to take advantage of the regular Article IV consultations to expand data collection. An alternative could be to extend the scope of the (less frequent) WTO trade policy reviews to take this data collection on board.

C. Recommendation: More Surveillance at the Regional Level

Surveillance of PTAs at the regional level has been insufficient (even by the criterion that only customs unions or deeper PTAs should be covered). Greater coverage of free trade agreements in Article IV consultations would also be welcome. This extended coverage could often rely on work carried out elsewhere and thus could probably be achieved with only marginal increases in resources.

70. Surveillance should extend beyond coverage at the country level (e.g., Brazil in MERCOSUR) to all members of a PTA, because some members gain at the expense of

²³ A preliminary meeting was held in October 2008.

²⁴ For example, in their study of the common external tariff proposed for COMESA's newly signed customs union, Carrère and de Melo (2008) discovered that only about one-third of the tariff lines were common in each one of the four-band common external tariff categories (raw materials, intermediates, capital goods, consumer goods) to be implemented by COMESA customs union members. Since COMESA members have also excluded about 1000 lines from the common external tariff schedule, in the absence of a common classification it will be impossible to estimate the efficiency effects of these exclusions.

²⁵ Blackurst (1998) concluded that even with a more efficient use of resources, the WTO is not in a position to carry out its mandate. Vines (1998) reached the same conclusion. The WTO's resource limitations are partly reflected in the relatively long gap between trade policy reviews for most member countries and the uneven quality of the reviews. Hence the WTO would benefit from help from the IMF and the World Bank.

others and intra-PTA compensation may not be adequate. As noted earlier, surveillance of PTAs at the regional level was scant during the evaluation period, even in Africa where PTAs were last covered in a *REO* four years ago. Surveillance should cover deep integration since it is deep integration that yields resource gains.

71. For the advanced economies, the IMF is in a unique position to engage in policy dialogue since there is very little engagement by the Organization for Economic Cooperation and Development (OECD) on PTAs. In the case of the European Union, though IMF staff were right to insist on (and take comfort from) a strong commitment to multilateralism, at no time did they express concerns that the EU's EPAs were not on the way to meet its partners' development objectives. Only NAFTA was thoroughly covered in SIPs during the evaluation period. The treatment of NAFTA could serve as an example of what can be done with relatively limited resources.

72. For information on the majority of PTA players, IMF staff could rely more on the World Bank which carries out substantial work on trade-related issues in its lending and technical assistance operations and also maintains a dialogue on PTAs at the regional level, especially in Africa. This work, which is typically carried out by consultants, often gets insufficient attention in high-level policy circles. On an occasional basis, therefore, the coverage of such work in IMF Article IV consultations or *REOs* would be helpful to raise awareness and help form a clearer opinion of how PTAs at large are functioning.²⁶ Other forms of cooperation with the World Bank would also help. For example, World Bank staff could occasionally join Article IV missions or contribute to writing bilateral/regional/multilateral surveillance reports when PTAs are covered. Regional seminars could be jointly organized (this does not seem to have been the case, at least for those seminars attended by this reviewer recently in the Asian, Middle East, and North African regions).

²⁶ In many developing countries, very often communication across ministries is weak and attention to the conduct of policy often takes place in the context of conditionality associated with IMF and World Bank lending and surveillance exercises. Other vehicles of dissemination do not seem to attract the required attention at the regional level where the integration is actually taking place.

ANNEX 1. PATTERNS OF PTA COVERAGE IN ARTICLE IV CONSULTATIONS

1. Annex Table 1 summarizes the coverage of PTA issues in all Article IV consultations in three sample periods corresponding to 1996, 2000, and 2006. Each sample included all Article IV staff reports for that year plus reports for the closest earlier year for countries that did not have an Article IV consultation in that particular year. For example, the 1996 sample included staff reports for all 143 countries that had 1996 consultations, plus—for countries that did not have 1996 consultations—35 staff reports from 1995 consultations and 1 staff report from a 1994 consultation. PTA coverage was classified as: absent (i.e., no mention of PTAs in the staff report); factual reporting only (e.g., “The authorities are taking steps to negotiate additional free trade agreements...”); and advice (i.e., staff expressed a view and/or provided a recommendation on one or more PTA-related issues). Advice was divided into two categories, depending on whether or not the staff recommendation was supported by underlying analysis found in a SIP or other background work (Annex 2).

2. Taken together, PTAs were mentioned in some 40 percent of the 554 staff reports sampled. Coverage in two-thirds of the cases was limited to factual reporting of the authorities’ actual/intended progress under ongoing/planned PTAs. When given, staff advice on PTAs was sometimes favorable (e.g., supporting regional integration for its potential beneficial effects on growth and/or as a route to multilateral trade liberalization); sometimes neutral (e.g., recommending complementary reforms to realize the potential gains from PTA membership); and sometimes cautionary (e.g., calling attention to the possibility of and suggesting measures to minimize trade diversion, and warning against the proliferation of PTAs or overlapping memberships).

3. The breakdown by time period in Annex Table 1 shows an increase in coverage around 2000, and a shift from factual description toward some form of advice in the later periods. Support for PTAs in Article IV staff reports increased over the three periods, perhaps because staff came to acknowledge that countries would pursue PTAs anyway. Cautionary views fell slightly as a share of the staff views expressed on PTAs over the three periods. Concerns that PTAs might divert countries from multilateralism mostly appeared in the second period (around 2000). Concerns about overlapping PTAs and restrictive rules of origin mostly appeared in the third period (around 2006) though they were rarely covered in supporting analytical work.

4. The breakdown by area departments indicates that the Middle East and Central Asia Department and—in the last period particularly—the African Department and Western Hemisphere Department gave the most advice (or most often expressed a view) on regional integration, including with supporting in-depth analysis. In the Middle East and Central Asia, staff were mostly cautionary in their views of PTAs, emphasizing the benefits of broad-based (multilateral) liberalization over a series of regional or bilateral agreements (including Association Agreements with the European Union (AAEUs)) in Egypt, Lebanon, Morocco, and Tunisia. Staff were realistic about the extent of integration and gains from trade that

could be hoped for under the Gulf Cooperation Council (GCC)—this was expressed in a neutral way in the consultations with Qatar and Saudi Arabia.

5. The African Department staff reports that expressed a view on PTAs were evenly divided between support and caution. Staff were supportive of regional integration in some cases (e.g., membership in the East African Community (EAC) by Burundi, Rwanda, and Uganda was welcomed) but in other cases, staff warned about the potential difficulties of overlapping PTAs (Kenya, Madagascar, Malawi, Mauritius, and Rwanda) and encouraged the authorities to minimize trade diversion by lowering trade barriers across the board (Madagascar, Mauritania) and/or adopting simple and liberal rules of origin (South Africa). Staff varied in their views on the EPAs with the European Union: in Mauritania, staff (without going into detail) urged the authorities to carefully assess the implications of the partnership with the European Union; as regards the Central African Economic and Monetary Community (CEMAC), staff noted the possibility of trade diversion under the EPAs; in the Democratic Republic of Congo, staff expressed the hope that the EPA negotiations would help rationalize overlapping PTAs; and in the Seychelles, staff encouraged the authorities to continue EPA negotiations with the European Union.

6. The Western Hemisphere Department staff reports sampled expressed mostly favorable views of PTAs. Staff were broadly supportive of CARICOM members' steps toward regional integration, arguing that these would help reduce transactions and other costs. Given the very small size of the Caribbean regional market and the high fixed costs of setting up a regulatory framework, this was certainly good advice. This view was reflected also in consultations with Dominica, Saint Lucia, and Saint Vincent and the Grenadines. Staff were also generally positive about the CAFTA-DR, reckoning that it had had (in El Salvador and Honduras) or was expected to have (in Costa Rica, the Dominican Republic, Nicaragua) a favorable impact on growth. At the same time, staff almost always advised the authorities to continue to pursue multilateral liberalization. This was also the case for countries with free trade agreements with the United States; for example, staff advice to Bolivia, Colombia, and Ecuador was to expand access to external markets beyond the bilateral agreement with the United States. Surprisingly little coverage was found on MERCOSUR in the periods sampled.

7. PTA coverage that went beyond factual reporting was scant for the other two regions, especially for Europe, where staff did not express any “deep” views on the EPA negotiations in the Euro Area Article IV consultations. For the Asia and Pacific region, staff mostly emphasized nondiscriminatory multilateral liberalization over PTAs (e.g., in India, Korea, Pakistan, and Sri Lanka.)

Annex Table 1. Coverage of PTA Issues in Article IV Consultations¹

| | Aggregate | | | Africa | | | Asia-Pacific | | | Europe | | | Middle East and Central Asia | | | Western Hemisphere | | |
|---|-----------|------|------|--------|------|------|--------------|------|------|--------|------|------|------------------------------|------|------|--------------------|------|------|
| | 1996 | 2000 | 2006 | 1996 | 2000 | 2006 | 1996 | 2000 | 2006 | 1996 | 2000 | 2006 | 1996 | 2000 | 2006 | 1996 | 2000 | 2006 |
| Number of staff reports | 180 | 184 | 190 | 43 | 45 | 46 | 32 | 32 | 34 | 43 | 44 | 45 | 28 | 28 | 30 | 34 | 35 | 35 |
| Number of staff reports containing: | | | | | | | | | | | | | | | | | | |
| No mention of PTAs | 71 | 139 | 101 | 18 | 36 | 21 | 20 | 25 | 16 | 16 | 34 | 38 | 11 | 19 | 15 | 6 | 25 | 11 |
| Factual reporting of PTA developments | 96 | 25 | 45 | 22 | 6 | 11 | 11 | 5 | 12 | 22 | 7 | 3 | 13 | 1 | 8 | 28 | 6 | 11 |
| "Shallow" views/ advice on PTAs | 10 | 14 | 28 | 2 | 2 | 8 | 0 | 2 | 3 | 5 | 2 | 4 | 3 | 4 | 6 | 0 | 4 | 7 |
| Favorable | 2 | 5 | 11 | 1 | 0 | 4 | 0 | 1 | 0 | 1 | 1 | 2 | 0 | 2 | 0 | 0 | 1 | 5 |
| Neutral | 3 | 4 | 5 | 0 | 2 | 1 | 0 | 1 | 1 | 2 | 0 | 1 | 1 | 1 | 2 | 0 | 0 | 0 |
| Cautionary | 5 | 5 | 12 | 1 | 0 | 3 | 0 | 0 | 2 | 2 | 1 | 1 | 2 | 1 | 4 | 0 | 3 | 2 |
| "Deep" views/advice on PTAs | 3 | 6 | 16 | 1 | 1 | 6 | 1 | 0 | 3 | 0 | 1 | 0 | 1 | 4 | 1 | 0 | 0 | 6 |
| Favorable | 1 | 2 | 8 | 1 | 0 | 2 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 1 | 1 | 0 | 0 | 4 |
| Neutral | 0 | 0 | 2 | 0 | 0 | 1 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Cautionary | 2 | 4 | 6 | 0 | 1 | 3 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 3 | 0 | 0 | 0 | 2 |
| Percent of staff reports containing: | | | | | | | | | | | | | | | | | | |
| No mention of PTAs | 39.4 | 75.5 | 53.2 | 41.9 | 80.0 | 45.7 | 62.5 | 78.1 | 47.1 | 37.2 | 77.3 | 84.4 | 39.3 | 67.9 | 50.0 | 17.6 | 71.4 | 31.4 |
| Factual reporting of PTA developments | 53.3 | 13.6 | 23.7 | 51.2 | 13.3 | 23.9 | 34.4 | 15.6 | 35.3 | 51.2 | 15.9 | 6.7 | 46.4 | 3.6 | 26.7 | 82.4 | 17.1 | 31.4 |
| "Shallow" views/ advice on PTAs | 5.6 | 7.6 | 14.7 | 4.7 | 4.4 | 17.4 | 0.0 | 6.3 | 8.8 | 11.6 | 4.5 | 8.9 | 10.7 | 14.3 | 20.0 | 0.0 | 11.4 | 20.0 |
| Favorable | 1.1 | 2.7 | 5.8 | 2.3 | 0.0 | 8.7 | 0.0 | 3.1 | 0.0 | 2.3 | 2.3 | 4.4 | 0.0 | 7.1 | 0.0 | 0.0 | 2.9 | 14.3 |
| Neutral | 1.7 | 2.2 | 2.6 | 0.0 | 4.4 | 2.2 | 0.0 | 3.1 | 2.9 | 4.7 | 0.0 | 2.2 | 3.6 | 3.6 | 6.7 | 0.0 | 0.0 | 0.0 |
| Cautionary | 2.8 | 2.7 | 6.3 | 2.3 | 0.0 | 6.5 | 0.0 | 0.0 | 5.9 | 4.7 | 2.3 | 2.2 | 7.1 | 3.6 | 13.3 | 0.0 | 8.6 | 5.7 |
| "Deep" views/advice on PTAs | 1.7 | 3.3 | 8.4 | 2.3 | 2.2 | 13.0 | 3.1 | 0.0 | 8.8 | 0.0 | 2.3 | 0.0 | 3.6 | 14.3 | 3.3 | 0.0 | 0.0 | 17.1 |
| Favorable | 0.6 | 1.1 | 4.2 | 2.3 | 0.0 | 4.3 | 0.0 | 0.0 | 2.9 | 0.0 | 2.3 | 0.0 | 0.0 | 3.6 | 3.3 | 0.0 | 0.0 | 11.4 |
| Neutral | 0.0 | 0.0 | 1.1 | 0.0 | 0.0 | 2.2 | 0.0 | 0.0 | 2.9 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Cautionary | 1.1 | 2.2 | 3.2 | 0.0 | 2.2 | 6.5 | 3.1 | 0.0 | 2.9 | 0.0 | 0.0 | 0.0 | 3.6 | 10.7 | 0.0 | 0.0 | 0.0 | 5.7 |

¹Includes Article IV staff reports for three territories (Aruba, Hong Kong, and Netherlands Antilles), and four currency unions (CEMAC, ECCU, Euro Area, and WAEMU).

Source: IEO.

ANNEX 2. ARTICLE IV BACKGROUND PAPERS ON PTAS

1. Annex Table 2 provides a list of selected background papers focusing on PTAs that were prepared for Article IV consultations over the period 1996–2008. The papers are listed by IMF area department in chronological order. The criterion for inclusion in the table is that the paper contains some analysis (either quantitative or qualitative) of a PTA (or PTAs) rather than a factual description. This rough criterion yielded 49 SIPs and chapters in Recent Economic Developments (RED) reports.
2. The papers listed in Annex Table 2 analyzed the implications of PTAs for trade flows, growth, fiscal revenue, business cycle synchronization, output, prices, and welfare. Some papers analyzed the implications of a country’s overall PTA strategy (e.g., the negotiation of various free trade agreements) rather than a specific PTA. In many cases, the analysis was qualitative, based on reasoning about the likely effects of a PTA taking into account the characteristics of the economy and its current trade policies. Among the quantitative studies, many used a gravity model to estimate the impact of a PTA; others used simulation analysis—either partial equilibrium (e.g. McIntyre (2004) for the EAC) or general equilibrium (e.g., Hilaire (2003) for U.S. free trade agreements).
3. Most major PTAs were covered in at least one SIP or RED chapter. For example, there were substantive pieces related to CARICOM, the EAC (for Kenya, Tanzania, and Uganda), the EU (on enlargement), MERCOSUR (for Brazil), and NAFTA. With the European Union a major player in PTAs, however, one might have expected some analysis of the EU’s approach to PTAs—as, for example, in connection with its EPAs with the ACP countries. While the EPAs were covered in some SIPs for African countries (notably Segura-Ubiergo (2008) for Senegal), no analysis was found from the EU’s perspective.

Annex Table 2. Selected SIPs and Background Papers on PTA Issues

| | Country/ PTA | Trade | Fiscal accounts | Growth | Output, prices, or welfare | Business cycle | Trade liberalization strategy |
|--|--|-------|-----------------|--------|----------------------------|----------------|-------------------------------|
| Africa | | | | | | | |
| IMF, 1996, "A Free Trade Arrangement with the European Union," Chapter IV in <i>South Africa—Selected Economic Issues</i> , SM/96/109 | South Africa/EU-South Africa FTA | x | x | x | | | |
| Randriamaholy, Richard, 1997, "UDEAC Customs Tariff and Indirect Tax Reform," Appendix in <i>Central African Republic—Recent Economic Developments</i> , SM/97/37 | Central African Republic/CEMAC | | x | | | | |
| IMF, 1999, "CEMAC Indirect Tax and Customs Reform," Appendix in <i>Chad—Recent Economic Developments</i> , SM/99/74 | Chad/CEMAC | | x | | | | |
| Leite, Carlos, 2000, "Evaluation of Customs Tariff Reform," Chapter II in <i>Sao Tome and Principe—Recent Economic Developments and Selected Issues</i> , SM/00/80 | Sao Tome and Principe/CEMAC, WAEMU | | x | | | | |
| Weber, René, 2000, "Recent Developments in Trade Policy," Chapter V in <i>Senegal—Recent Economic Developments</i> , SM/00/104 | Senegal/WAEMU | x | x | | | | |
| Lukonga, Inutu, 2000, "Experience with Trade Liberalization," Chapter III in <i>Malawi—Selected Issues and Statistical Appendix</i> , SM/00/281 | Malawi/COMESA, SADC | x | | | | | |
| Kozack, Julie, 2002, "Trade and Regional Integration Policies in Kenya," Chapter IV in <i>Kenya—Selected Issues and Statistical Appendix</i> , SM/02/72 | Kenya/COMESA, EAC | | | | | | x |
| Engstrom, Lars, 2004, "The New SACU Agreement And Its Effect On Revenues," Chapter IV in <i>Lesotho—Selected Issues and Statistical Appendix</i> , SM/04/5 | Lesotho/SACU | | x | | | | |
| Albertin, Giorgia, 2004, "Regional Integration: The Case of the Central African Republic," Chapter III in <i>Central African Republic—Selected Issues and Statistical Appendix</i> , SM/04/89 | Central African Republic/CEMAC | x | | | | | |
| McIntyre, Meredith A., 2004, "Trade Integration in the East African Community," Chapter V in <i>Kenya—Selected Issues and Statistical Appendix</i> , SM/04/418 | Kenya/EAC | x | | | | | |
| Akatu, Patrick, 2005, "The New SACU Agreement and Namibia's Revenue Outlook Over the Medium Term," Chapter II in <i>Namibia—Selected Issues and Statistical Appendix</i> , SM/05/36 | Namibia/SACU | | x | | | | |
| Burgess, Robert, 2005, "Trade Policy Issues in South Africa," Chapter V in <i>South Africa—Selected Issues</i> , SM/05/310 | South Africa/SACU, SADC, EU-South Africa FTA | | | | | | x |
| Martijn, Jan Kees, and Charalambos Tsangarides, 2006, "Trade Reform in the CEMAC: Developments and Opportunities," Chapter I in <i>Central African Economic and Monetary Community—Selected Issues</i> , SM/06/211 | CEMAC members/CEMAC | x | x | | | | |

Annex Table 2. Selected SIPs and Background Papers on PTA Issues (continued)

| | Country/ PTA | Trade | Fiscal accounts | Growth | Output, prices, or welfare | Business cycle | Trade liberalization strategy |
|---|-----------------------------|-------|-----------------|--------|----------------------------|----------------|-------------------------------|
| Everaert, Greetje, Axel Palmason, and Yuri Sobolev, 2006, "EAC Customs Union: Benefits of Further Trade Liberalization," Chapter III in <i>Kenya, Uganda, and United Republic of Tanzania—Selected Issues</i> , SM/06/385 | Kenya, Uganda, Tanzania/EAC | | X | | | | |
| Hallaert, Jean-Jacques, 2007, "The Economic and Fiscal Impact of Joining the SADC FTA," Chapter II in <i>Republic of Madagascar—Selected Issues</i> , SM/07/29 | Madagascar/SADC | X | X | | X | | |
| Goretti, Manuela, and Hans Weisfeld, 2007, "Trade in the WAEMU: Developments and Reform Opportunities," Chapter II in <i>West African Economic and Monetary Union—Selected Issues</i> , SM/07/119 | WAEMU members/WAEMU | X | X | | | | |
| Segura-Ubiergo, Alex, 2008, "Fiscal Implications of an Economic Partnership Agreement," Chapter III in <i>Senegal—Selected Issues</i> , SM/08/158 | Senegal/EU-EPA | | X | | | | |
| Asia-Pacific | | | | | | | |
| IMF, 1996, "Regional and Multilateral Trade Liberalization: Implications for Nepal," Chapter IV in <i>Nepal—Selected Issues</i> , SM/96/117 | Nepal/SAPTA | X | | | | | |
| Psalida, L. Effie, and Marc Quintyn, 1997, "ASEAN Membership: A Challenge and an Opportunity," Chapter XI in <i>Lao Peoples Democratic Republic—Recent Economic Developments</i> , SM/97/136 | Lao P.D.R./ASEAN | X | X | | | | |
| Thacker, Nita, 2001, "Trade Reforms and Export and Import Performance," Chapter IV in <i>Vietnam—Selected Issues and Statistical Appendix</i> , SM/01/334 | Vietnam/USBTA | X | | | | | |
| Hilaire, Alvin, 2004, "Thailand's New Focus on Free Trade Arrangements," Chapter IV in <i>Thailand—Selected Issues</i> , SM/04/283 | Thailand/Various FTAs | | | | | | X |
| Tumbarello, Patrizia, 2005, "Does Vietnam Overtrade with Its Neighboring Countries?" Chapter II in <i>Vietnam—Selected Issues</i> , SM/05/358, Sup.1 | Vietnam/AFTA | X | | | | | |
| Europe | | | | | | | |
| Carkovic, Maria, 1996, "Portugal's Performance After Accession to the European Union: The Growth Payoff of Policy Reform," Chapter I in <i>Portugal—Selected Issues and Statistical Appendix</i> , SM/96/253 | Portugal/EU | | | X | | | |
| Feyzioglu, Tarhan, 1997, "The Economic Impact of Accession to EU and Participation in EMU," Chapter IV in <i>Republic of Slovenia—Selected Issues</i> , SM/97/292 | Slovenia/EU | | | X | | | |
| IMF, 1998, "Latvia and European Union Accession," Chapter VI in <i>Republic of Latvia—Selected Issues and Statistical Appendix</i> , SM/98/70 | Latvia/EU | | X | | | | |

Annex Table 2. Selected SIPs and Background Papers on PTA Issues (continued)

| | Country/PTA | Trade | Fiscal accounts | Growth | Output, prices, or welfare | Business cycle | Trade liberalization strategy |
|---|-------------------|-------|-----------------|--------|----------------------------|----------------|-------------------------------|
| Taube, Günther, and René Weber, 1999, "Implications of EU Accession and Participation in EMU," Chapter V in <i>Republic of Estonia—Selected Issues and Statistical Appendix</i> , SM/99/133 | Estonia/EU | X | X | | | | |
| Rosenblatt, Julius, 1999, "The European Union's Longer-Term Policies—Impact on Economic Integration and External Economic Relations," in <i>Monetary and Exchange Rate Policies of the Euro Area—Annex</i> , SM/99/212, Sup.1 | EU members/EU | | X | | | | |
| Hallaert, Jean-Jacques, 2003, "EU Eastern Enlargement: Impact on Trade and FDI," Chapter V in <i>Euro Area Policies—Selected Issues</i> , SM/03/292 | EU members/EU | X | | | | | |
| Ruiz-Arranz, Marta, 2004, "The Effect of EU Enlargement on Portuguese Trade," Chapter III in <i>Portugal—Selected Issues</i> , SM/04/64 | Portugal/EU | X | | | | | |
| Middle East and Central Asia | | | | | | | |
| Enders, K., 1996, "The Association Agreement and the New Fisheries Agreement Between Morocco and the European Union," Chapter IV in <i>Morocco—Selected Issues</i> , SM/96/290 | Morocco/AAEU | | X | | | | |
| IMF, 1997, "Association Agreement with the European Union," Chapter II in <i>Tunisia—Selected Issues</i> , SM/97/117 | Tunisia/AAEU | | X | | X | | |
| Söderling, Ludvig, 2004, "Impact of the Barcelona Process on Morocco's Trade," Chapter II in <i>Morocco—Selected Issues</i> , SM/04/124, Sup.1 | Morocco/AAEU | X | | | | | |
| Finger, Harald, 2004, "Trade Integration Between Pakistan and India," Chapter VII in <i>Pakistan—Selected Issues and Statistical Appendix</i> , SM/04/390 | Pakistan/SAFTA | X | | | | | |
| Koranchelian, Taline, 2006, "The Association Agreement between Algeria and the European Union," Chapter I in <i>Algeria—Selected Issues</i> , SM/06/13, Sup.1 | Algeria/AAEU | | X | | X | | |
| Western Hemisphere | | | | | | | |
| IMF, 1997, "Impact of Caricom," Chapter IV in <i>Suriname—Recent Economic Developments and Selected Issues</i> , SM/97/125 | Suriname/CARICOM | | X | | | | |
| Quintero, A. Verónica, 1997, "The Southern Cone Common Market and Its Implications for Paraguay," Chapter III in <i>Paraguay—Selected Issues and Statistical Annex</i> , SM/97/229 | Paraguay/MERCOSUR | | | | | | |
| IMF, 1998, "Trade Regime—Openness, Structure, and the Effects of Trade Liberalization," Chapter III in <i>Guatemala—Recent Economic Developments</i> , SM/98/95, Sup.1 | Guatemala/CACM | X | | X | | | |

Annex Table 2. Selected SIPs and Background Papers on PTA Issues (concluded)

| | Country/ PTA | Trade | Fiscal accounts | Growth | Output, prices, or welfare | Business cycle | Trade liberalization strategy |
|---|-----------------------------|-------|-----------------|--------|----------------------------|----------------|-------------------------------|
| Dabla-Norris, Era, 1999, "Trade Regime: Openness, Structure and Effects of Trade Liberalization," Chapter III in <i>Trinidad and Tobago—Selected Issues and Statistical Appendix</i> , SM/99/124 | Trinidad and Tobago/CARICOM | X | | | | | |
| Bannister, Geoffrey, 2002, "Brazil and Mercosur: Identifying Trade Creation and Trade Diversion," Chapter VI in <i>Brazil—Selected Issues</i> , SM/02/12 | Brazil/MERCOSUR | X | | | | | |
| Kose, Ayhan, 2003, "Economic Integration in the Americas: Lessons from NAFTA," Chapter IX in <i>United States—Selected Issues</i> , SM/03/253 | United States/NAFTA | X | | | | X | |
| Hilaire, Alvin, 2003, "The United States and the New Regionalism/Bilateralism," Chapter X in <i>United States—Selected Issues</i> , SM/03/253 | United States/Various FTAs | | | | X | | X |
| Villafuerte, Mauricio, 2003, "Chile's Trade Policy: Strategy and Recent Agreements," Chapter V in <i>Chile—Selected Issues</i> , SM/03/274 | Chile/Various FTAs | | | | | | X |
| Kose, M. Ayhan, 2004, "Canada-U.S. Economic Integration: Developments and Prospects," Chapter VI in <i>Canada—Selected Issues</i> , SM/04/26 | Canada/NAFTA | X | | | | X | |
| Guimarães, Roberto, 2004, "Sustaining Rapid Economic Growth: The Role of CAFTA," Chapter II in <i>Costa Rica—Selected Issues</i> , SM/04/191 | Costa Rica/CAFTA | X | | X | | | |
| Suss, Esther, and others, 2004, "Regional Integration and Trade Regimes," Chapter VII in <i>Eastern Caribbean Currency Union—Selected Issues</i> , SM/04/141 | ECCU members/OECS, CARICOM | X | X | | | | |
| Druck, Pablo, 2005, "Fiscal Cost of a Free Trade Agreement with the United States," Chapter VI in <i>Panama—Selected Issues and Statistical Appendix</i> , SM/05/94 | Panama/US-Panama FTA | | X | | | | |
| Mlachila, Montfort, and Wendell Samuel, 2005, "Integration and Growth in the Eastern Caribbean," Chapter VII in <i>Eastern Caribbean Currency Union—Selected Issues</i> , SM/05/237 | ECCU members/CARICOM | | | X | | | X |
| Dauphin, Jean-François, 2005, "The Impact of CAFTA-DR on the Nicaraguan Economy," Chapter I in <i>Nicaragua—Selected Issues</i> , SM/05/432 | Nicaragua/CAFTA | X | | | | X | |
| Blavy, Rodolphe, and Luciana Juvenal, 2007, "Mexico's Integration into NAFTA Markets: A View from Sectoral Real Exchange Rates and Transaction Costs," Chapter III in <i>Mexico—Selected Issues</i> , SM/07/365 | Mexico/NAFTA | | | | X | | |

ANNEX 3. IMF COVERAGE OF SELECTED PTAs

A. The European Union and its PTAs

1. The European Union was engaged in more PTAs than any other country or regional group during the evaluation period. Accordingly, IMF Article IV consultations with EU members should have covered at least three PTA-related issues: the possibility that this proliferation would be detrimental for the working of the world trading system; how to rationalize the proliferation of PTAs during the EPA negotiations; and how to rationalize and simplify the rules of origin applied in these PTAs.
2. Starting in 1999, IMF staff held twice-yearly discussions with EU institutions responsible for common policies in the Euro Area. These discussions focused primarily on monetary and exchange policies of the Euro Area but also included developments in structural areas relevant to the Fund's surveillance over the policies of members of the Euro Area as a whole. Thus, EU trade policy issues began to be covered in these consultations with the Euro Area and not in bilateral consultations with individual EU member countries. A senior staff member from PDR's Trade Policy Division usually participated in the Euro Area missions once a year to discuss trade policy issues with the European Commission.
3. From the start, IMF staff were concerned about the number of PTAs being negotiated by the European Union. In the 2000 discussions, staff expressed concerns about the "risks of pervasive trade diversion" away from countries that traded with the European Union on a MFN basis and "likely difficulties in managing an unwieldy pyramid of preferences." Staff urged the authorities to pursue PTAs in parallel with, and preferably at the same pace as, multilateral trade liberalization (IMF, 2000b). This message was repeated in 2001 through 2007. In the 2006 Article IV consultation with the Euro Area, staff—observing the increased activity in PTA negotiations—went a step further and urged the authorities to stop contributing to the proliferation of PTAs and instead to renew their commitment to "tried and tested multilateralism" and to agree with other global players to seek stronger discipline in PTAs in order to multilateralize regionalism (e.g., through simpler rules of origin) (IMF, 2006d). The following year, staff softened their stance somewhat; allowing that well designed PTAs could provide benefits to their participants and might help to secure liberalization in "new" areas that fell outside the scope of Doha Round negotiations. But still, staff maintained, PTAs were "inferior to multilateral liberalization for both members and nonmembers" and PTA negotiations should not be allowed to divert political energy from the Doha Round negotiations (IMF, 2007a). The authorities agreed that shallow integration agreements were weakening the multilateral system, reassured staff that they were seeking improved discipline at the Doha negotiations, and noted that their PTAs were aiming at deep integration.²⁷ Had staff covered the ongoing EPA negotiations more carefully (see below), it

²⁷ The European Union has harmonized its rules of origin under the Pan-European system which established identical rules of origin protocols and product-specific rules of origin across the EU's existing free trade

would have been apparent that this improved discipline was unlikely to happen. In the 2008 Article IV staff report, no staff view on PTAs was expressed.

4. IMF staff followed developments in the EU's EPAs with the ACP countries starting in 1999, but the coverage tended to be bland. In 1999 and 2000, staff reported that the European Union was reorganizing its complex system of trade preferences with a view to gradually harmonizing the treatments offered to ACP countries and non-ACP countries, and making preferential access more compatible with WTO rules. Staff welcomed the extension of unilateral preferences to all LDCs (including non-ACP countries) under the Everything But Arms (EBA) initiative (IMF, 2002a). But staff dismissed the argument that a generalized (MFN) improvement in market access would hurt preferential suppliers; instead they made—though they did not substantiate—the argument that developing countries would benefit more from multilateral liberalization (including liberalization of agricultural trade through reform of the CAP) than through reciprocal PTAs with the European Union. Staff agreed that the EPAs could be beneficial to the extent that they helped to strengthen supply capacity and promote the diversification of exports in ACP countries (IMF, 2003d) and noted that the development impact of the EPAs would “depend partly on avoiding excessive discrimination favoring EU goods (e.g., through rules of origin) and services, and on the extent to which they supported open and competitive markets” (IMF, 2006d). Staff also “expressed hope” that the Agreements would rationalize complicated and often overlapping existing PTAs, especially in Africa (IMF, 2005f). None of these views was expanded on in background analyses. In the Board meeting for the 2005 Article IV Euro Area consultation, one IMF Director called attention to the “timid” analysis of EU trade policies in the staff report, noting that these policies were of critical relevance to emerging and low-income countries (IMF, 2005g).

5. Other PTA-related issues covered in the Euro Area staff reports were EU enlargement and intra-EU trade liberalization and harmonization of standards. Staff argued, based on a 2003 SIP that EU enlargement would boost trade, especially intra-industry trade, and entail only moderate adjustment costs and limited trade diversion (Hallaert, 2003). Staff noted that market access to the enlarged European Union might become more difficult for certain (agricultural) exports from Commonwealth of Independent States (CIS) countries, but the authorities demurred, arguing that tariffs in the new EU members would fall on average while growth would rise (IMF, 2003d). On intra-EU trade liberalization, staff on more than one occasion drew attention to the slow progress in eliminating remaining barriers to cross-border trade, especially services trade (IMF, 2002e; 2003d; 2006d).

agreements. However, these rules are very restrictive and have different effects across countries seeking preferential access to the European Union (Cadot and others, 2006). In spite of the intention to simplify its complex rules of origin (there are currently more than 500 different product-specific rules of origin) the European Union has not made much progress on this front beyond commissioning papers to be written in this area (Cadot, de Melo, and Pondard, 2006).

6. The consultations thus covered the main themes, superficially at least. However, since it was already quite clear in 2004–05 that the EPAs might not live up to their expectations—several ACP countries, notably the LDCs that already had close to full free trade access via EBA Initiative, were not interested in participating in the negotiations and some commentators, e.g., Hinkle and Schiff (2004), noted that the EPA negotiations might fall short of their developmental objectives—it would have been appropriate to address these issues in a SIP.²⁸

B. The United States’ PTAs

7. The United States was also a big player on the PTA scene during the evaluation period, signing a large number of free trade agreements with partners across the world, from Australia to Poland. This involvement in a large number of PTAs raises the same issues as for the European Union, namely, the potential systemic risk to the world trading system, and the need to rationalize the number of PTAs (and at the same time ensure adequate market access for LDCs, notably by simplifying complex rules of origin for textiles and apparel imports).

8. IMF staff coverage of PTAs during the 1990s was superficial. The U.S. authorities’ position was that while multilateral trade liberalization was preferable, they would also pursue greater trade liberalization, in line with WTO rules, through bilateral, regional, and multilateral fora. Staff essentially endorsed this position (IMF, 1997a; 1998c; 1999a).

9. From 2001, staff began to take a more cautious approach, suggesting that the pursuit of the FTAA and other trade agreements could detract from efforts to strengthen the multilateral trade system (IMF, 2001d). In 2003, staff were more explicit in their PTA advice, noting that free trade agreements should be “designed in a manner that limited trade diversion and avoided administrative complexity” and that the investment provisions of recent U.S. free trade agreements could limit the flexibility of countries in controlling the pace of capital flows in the event of crises (IMF, 2003b). In 2004, staff cautioned that the attractiveness of current and possible future free trade agreements could weaken support for multilateral liberalization among the U.S.’s trading partners, while also straining these countries’ administrative and negotiating capacity (IMF, 2004a). This point was reiterated in 2005 and 2006 (IMF, 2005d; 2006b). By 2007, the issue was boiled down to a summary entry in a staff report table of “long-standing Fund policy advice”:

Issue: There are concerns about U.S. leadership in advancing global trade liberalization.

²⁸ See Annex Table 2 for SIPs on PTA issues in the Euro Area.

Staff position: Proliferation of U.S. PTAs could undermine the multilateral fabric of world trade unless the agreements include open-access clauses and simple rules of origin.

Authorities' position: U.S. FTAs contain elements that complement and advance the multilateral trade agenda, and include rules of origin regimes that are simple and efficient to administer and operate” (IMF, 2007b; 2008b).

10. On U.S. preferential schemes, staff noted that these schemes (e.g., the GSP and the Caribbean Basin Initiative, among others) had resulted in limited market access for the beneficiary countries and urged the authorities to do more to improve market access for developing countries (IMF, 2001d; 2002d).

11. Two SIPs prepared for the U.S.'s 2003 Article IV consultations were the only substantive PTA-themed SIPs done for the Quad countries (Canada, the European Union, Japan, and the United States) during the evaluation period. Kose (2003) used a macro-simulation model to show that NAFTA had led to greater synchronization of business cycles in the region, especially for Mexico. While the focus on NAFTA was retrospective, this analysis had macroeconomic relevance; something similar would have been useful for the European Union. Hilaire (2003) presented Global Trade Analysis Project simulations evaluating the efficiency effects of U.S. free trade agreements with Australia, Chile, and Central America. His paper recognized the geopolitical and security goals in U.S. PTAs and discussed the emphasis on liberalization of services and investment flows, noting that the U.S. free trade agreements tended to be over-burdened by too many issues (e.g., labor, environmental, and intellectual property rights issues, among others).

C. Japan's PTAs

12. Among the advanced economies, Japan was one of the latest to engage in PTAs, starting to negotiate several free trade agreements only in the early 2000s. For Japan, then, the issue was whether this shift towards preferential rather than multilateral trade policy, was a step in the right direction.

13. No mention was made of PTAs in Article IV consultations with Japan until the 2001 consultations when staff reported that Japan had started to negotiate bilateral free trade agreements and that the authorities saw no conflict between their pursuit of such agreements and the multilateral approach to trade liberalization within the WTO framework (IMF, 2001e). In 2002, staff reported that the Japanese authorities “were pleased with” the free trade agreement signed with Singapore and were starting to negotiate similar agreements with Korea and Mexico; staff did not express a view on these PTAs (IMF, 2002c).

14. From 2003, staff began to sound increasingly strong warning notes on PTA proliferation. In 2003, they cautioned on the trade diversion effects of free trade agreements and emphasized that the agreements should be comprehensive in product coverage

(e.g., include agriculture). In 2004, the authorities pointed out that their bilateral agreement with Mexico included commitments on agriculture and that such commitments might be carried over to other bilateral agreements under negotiation (IMF, 2004b). In response to staff's recommendation that broad-based liberalization would be more supportive of the world trading system, the authorities characterized their free trade agreements as a defensive move against the proliferation of PTAs by the United States and the European Union; they also pointed out that PTAs were useful to advance their agenda on issues such as international investment rules that failed to get on the WTO agenda (IMF, 2003c; 2004b). In the 2005 consultation, which took place as Japan was negotiating several more new PTAs (with individual ASEAN countries, Korea, India, Chile, Australia, and Switzerland), staff noted that while the authorities declared their top priority to be the multilateral system, "the rapidly expanding network of regional trade agreements divert[ed] attention and resources from this priority" (IMF, 2005e). In 2006 and (in greater detail in) 2007, staff recommended that PTAs be designed with liberal rules of origin and complemented by reduced trade barriers for all partners (IMF, 2006c; 2007c).

D. MERCOSUR

15. MERCOSUR is the most important and visible south-south PTA. It was created by Argentina, Brazil, Paraguay, and Uruguay in 1991 with the aim of eliminating trade barriers, coordinating economic policies, and establishing common trade regulations among member countries and common trade policies vis-a-vis nonmember countries.²⁹ A widely debated issue for MERCOSUR during the evaluation period was whether the original aim of deep integration (i.e., a customs union rather than a free trade area) was the right choice. While it would have been difficult to guess of what would have happened under an alternative nondiscriminatory trade policy, this issue deserved careful ex post analysis.

16. IMF staff coverage of MERCOSUR was surprisingly slim. Coverage was usually limited to a factual description of what the authorities had implemented or were planning to implement within the MERCOSUR framework; advice was relatively infrequent and uneven across MERCOSUR members. For example, soon after MERCOSUR members imposed a "temporary" three percent surcharge on their common external tariff in 1997, staff urged Argentina and Uruguay to press for an early reversal; but it was only in 2000 that Brazil was urged to take the lead in eliminating the tax (IMF, 1998a; 1998b; 2000c). Staff occasionally reminded Brazil to further reduce tariff and nontariff barriers within the MERCOSUR framework (IMF, 2000c; 2001b; 2008a). For Uruguay, staff suggested that membership in MERCOSUR had "worsened somewhat the degree of free trade" (IMF, 2001a). Staff urged Uruguay and Paraguay to work within MERCOSUR's dispute-resolution procedures to

²⁹ Venezuela signed a membership agreement with MERCOSUR in 2006 but has not ratified it. Chile, Bolivia, Colombia, Ecuador, and Peru are associate members, meaning they do not enjoy full voting rights or complete access to the MERCOSUR market.

resolve trade concerns with the larger members (IMF, 2002b; 2003a). For potential/associate members (e.g., Bolivia, Chile, Ecuador, Guatemala, Peru, and Venezuela) staff only provided factual updates on their relationship with MERCOSUR but did not provide any views or analysis on the implications of full membership.

17. The review in Annex Table 2 and Annex Table 4 of SIPs and IMF working papers written during 1996–2008 turned up only two papers focusing on MERCOSUR. Quintero (1997) discussed the ex ante implications of MERCOSUR for Paraguay, based on a qualitative analysis of the agricultural, manufacturing, and informal sectors. Bannister (2002) discussed the ex post implications of MERCOSUR for Brazil, using index analysis and a gravity model to estimate the degree of trade creation and trade diversion.

E. COMESA

18. Eastern and Southern Africa was a region with one of the greatest number of PTAs during the evaluation period. The agendas in these PTAs always involved preferential trade liberalization, but usually went beyond trade issues. Two broad questions arose for these PTAs during the evaluation period: (i) What was the extent of overlap among the PTAs and what were the problems raised by overlapping PTAs? (ii) How deep were the PTAs in practice?

19. COMESA was established in 1994 with wide-ranging objectives including economic integration and the promotion of peace and security in the region. Membership in COMESA varied during the evaluation period.³⁰ There are currently 19 members: Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, and Zimbabwe. Most members also belong to other PTAs. Most, but not all, COMESA members are WTO members. Nine COMESA members formed a free trade area in 2000; they were subsequently joined by Rwanda, Burundi, Comoros, and Libya. In 2007, COMESA members announced that they would form a customs union by end-2008 (subsequently delayed to 2009). The complexity and degree of overlap is shown in Annex Table 3. That table also shows COMESA members' participation in country groupings for the EPA negotiations with the European Union. Most COMESA members are either negotiating as part of the Eastern and Southern Africa (ESA) group or as part of the SADC group. Libya and Egypt are not involved in EPA negotiations as they are part of the Euro-Mediterranean Partnership (formerly known as the Barcelona Process), one of whose key objectives is to form a Euro-Mediterranean free trade area by 2010.

³⁰ Angola, Lesotho, Mozambique, Namibia, and Tanzania withdrew; Egypt, Libya, and Seychelles joined.

Annex Table 3. COMESA Members and Overlapping PTAs

| COMESA member | Member of | | | | | Negotiating EPAs as part of | | |
|---------------|------------|------|------|-----|-----|-----------------------------|-----------|------------|
| | COMESA FTA | SADC | SACU | EAC | WTO | EAC group | ESA group | SADC group |
| Angola* | | x | | | x | | | x |
| Burundi | x | | | x | x | x | x | |
| Comoros | x | | | | | | x | |
| DR Congo | | x | | | x | | x | |
| Djibouti | x | | | | x | | x | |
| Egypt** | x | | | | x | | | |
| Eritrea | | | | | | | x | |
| Ethiopia | | | | | | | x | |
| Kenya | x | | | x | x | x | x | |
| Lesotho* | | x | x | | x | | | x |
| Libya** | x | | | | | | | |
| Madagascar | x | x | | | x | | x | |
| Malawi | x | x | | | x | | x | |
| Mauritius | x | x | | | x | | x | |
| Mozambique* | | x | | | x | | | x |
| Namibia* | | x | x | | x | | | x |
| Rwanda | x | | | x | x | x | x | |
| Seychelles** | | x | | | | | x | |
| Sudan | x | | | | | | x | |
| Swaziland | | x | x | | x | | | x |
| Tanzania* | | x | | x | x | x | | |
| Uganda | | | | x | x | x | x | |
| Zambia | x | x | | | x | | x | |
| Zimbabwe | x | x | | | x | | x | |

Notes: (*) indicates country withdrew from COMESA during the evaluation period; (**) indicates country joined COMESA during the evaluation period.

20. The incompatibilities arising from multiple PTA memberships became increasingly apparent during the evaluation period. For example, as noted, COMESA planned to form a customs union by 2008. But some COMESA members were also members of the EAC, which had established a customs union in 2004; others were members of SADC, which planned to form a customs union by 2010. The incompatibilities were noted in several Article IV consultations with COMESA members, with IMF staff sometimes warning the authorities that they might have to make a choice between PTA memberships. Such warnings began as early as 1998 (IMF, 1998d) and continued through 2006 (IMF, 2006e). Staff were sometimes (but not always) explicit about their concerns in regard to overlapping PTAs. In the 2001 Article IV consultation with Egypt (which was a signatory also of the Greater Arab Free Trade Agreement and the African Economic Community), staff noted that multiple PTA memberships would generate “excessive complexity and reduced transparency, due to differences in coverage, timing of tariff reductions, and rules of origin requirements.” (IMF, 2001f.) In a 2006 SIP for Kenya, Uganda, and Tanzania (Everaert, Palmason, and Sobolev, 2006), staff noted that cross-membership between the EAC, SADC, and COMESA (Annex Table 3) prevented the elimination of transaction costs involved in border formalities and impeded each country’s ability to effectively address nontariff barriers to trade by harmonizing standards and technical regulations, and that administering multiple and

overlapping rules of origin schemes “adds considerable complexity to the trading process, which increases the cost of international trade, places a burden on the administrative capacity of the customs services, and absorbs much-needed human and financial resources.”

21. In most instances, however, IMF staff were supportive of COMESA members’ efforts at regional integration and highlighted the benefits of PTA membership for liberalizing trade and boosting exports and growth. Detailed discussions were held with several countries on tariff and customs administration reforms to meet their COMESA commitments, including drawing up a timetable for tariff reduction and identifying revenue-compensating measures. FAD technical assistance was provided in many cases (e.g., Comoros, Democratic Republic of Congo, Seychelles, and Sudan). In Kenya (IMF, 2000a) and Zimbabwe (IMF, 1999c), the tariff reforms were incorporated into the design of the Fund-supported program.

22. Despite the staff’s awareness of the difficulties of pushing ahead with deeper integration in COMESA, no comprehensive review was carried out that would have raised key questions such as whether the member countries were ready to form a customs union, and whether this sequencing of integration was the one most likely to ensure the success of COMESA.³¹

³¹ Two working papers were produced on COMESA (Khandelwal (2004) and Mayda and Steinberg (2007); see Annex Table 4) but their focus was more on COMESA’s trade effects.

ANNEX 4. IMF WORKING PAPERS ON PTAS

1. Annex Table 4 lists 31 IMF working papers from 1996–2008 with a focus on PTAs. The inclusion criterion is whether the main focus of the paper was on some aspect of a PTA; both empirical and theoretical papers are included. Working papers that are closely based on SIPs listed in Annex Table 2 are not included in this table to avoid double-counting. Neither does Annex Table 4 include working papers on preference erosion, a topic that is tangentially related to PTAs.

2. Drawing on an extensive literature seeking to identify when a PTA will lead to trade creation or to trade diversion, most of the IMF working papers on PTAs focused at least implicitly on the effects of preferential market access in goods trade. These papers fall into three broad categories:

- Informed description and assessment of a PTA (nine papers), e.g., Khandelwal (2004) for COMESA and SADC, Yang and Gupta (2005) for various African PTAs, and Doe (2006) for CEMAC and WAEMU;
- Ex ante simulations, either in partial or in general equilibrium (three papers): Mattoo, Roy, and Subramanian (2002) for the African Growth and Opportunity Act (AGOA), Hallaert (2007) for SADC, and Tumbarello (2005) for the Eurasian Economic Community (EAEC);
- Ex post assessments using either a gravity model (six papers, e.g., Rodriguez-Delgado (2007) for the South Asia Free Trade Agreement (SAFTA); Herderschee and Qiao (2007) for various intra-European PTAs; and Egoumé-Bossogo and Mendis (2002) for CARICOM) or other econometric specifications (eight papers, e.g., Mayda and Steinberg (2007) for COMESA; Swiston and Bayoumi (2008) for NAFTA; and Sadikov (2008) for CARICOM).

IMF research did not examine the effects of PTAs on services trade, reflecting the dearth of literature in this area.

3. The working papers listed in Annex Table 4 cover PTAs in all regions of the world, with nearly all the major PTAs covered at least once. The PTAs studied included: NAFTA (four papers), CEMAC (three papers), COMESA/Southern African Development Community (SADC) (three papers), CARICOM (two papers), EU Association Agreements (two papers), WAEMU (two papers), Central European Free Trade Area (CEFTA) (one paper), and the South Asia Free Trade Agreement (SAFTA) (one paper). Absent from this

list are papers that focused exclusively on MERCOSUR and the EU's EPAs with the ACP countries.³²

4. With the exceptions noted above, the geographic coverage of PTA research was good and the use of different methods appropriate, with the authors doing their best to deal with data inadequacies. Of all the PTAs considered, MERCOSUR and NAFTA are two of the few fully implemented ones that have existed for long enough to enable researchers to discern empirically the effects of integration. It is regrettable that MERCOSUR did not receive more empirical coverage than in the one SIP noted in Annex Table 2 (even if that coverage was informative).

5. More recently, the literature has looked into the political economy of PTAs—when PTAs are desirable and/or sustainable and what effects PTAs may have on the prospects for multilateral liberalization. The theoretical IMF contributions in Annex Table 4 explored some of these political economy aspects (e.g., Frankel and Wei (1998), Duttagupta and Panagariya (2003), and Albertin (2007, 2008)). There were no empirical IMF studies of whether, in practice, PTAs have been benign or not, i.e., whether PTA members have raised trade barriers against nonmembers—though this is a distinct possibility for many developing countries whose applied tariffs are much lower than WTO-bound tariffs.

6. On the macro side, IMF research during 1996–2008 focused on the implications for business cycle synchronization of greater integration in goods markets (Kose, Meredith, and Towe (2004), and Cardarelli and Kose (2004)).

³² Croce, Juan-Ramon, and Zhu (2004) include partial (quantitative) coverage of MERCOSUR. Khandelwal (2004), and Martijn and Charalambos (2007) include partial (qualitative) coverage of the EU's EPAs in Africa.

Annex Table 4. Selected Working Papers on PTA Issues

| Title | Region/ PTA(s) | Methodology | Main Conclusions |
|--|---------------------------------|---|---|
| Africa | | | |
| Mattoo, Aaditya, Devesh Roy, and Arvind Subramanian (2002) "The Africa Growth and Opportunity Act and Its Rules of Origin: Generosity Undermined?" WP/02/183 | Sub-Saharan Africa /AGOA | Estimation of partial equilibrium model of preference | The African Growth and Opportunity Act (AGOA) will expand Africa's non-oil export volumes by 8-11 percent, but the benefits would have been five times larger with less stringent rules of origin. |
| Khandelwal, Padamja, 2004, "COMESA and SADC: Prospects and Challenges for Regional Trade Integration," WP/04/227 (December) | COMESA, SADC, EU-EPAs | Product complementarity index, qualitative analysis | Possibilities of growth in intraregional trade may be limited, but COMESA and SADC offer opportunities for member countries to gain policy credibility for trade reforms and tariff liberalization and to address structural weaknesses. EPAs with the European Union can also have a significant impact. |
| Yang, Yongzheng and Sanjeev Gupta, 2005, "Regional Trade Agreements in Africa: Past Performance and the Way Forward," WP/05/36 (February) | African countries/ African PTAs | Qualitative analysis | Regional trade arrangements in Africa have been ineffective in promoting trade and foreign direct investment. Small market size, poor transport facilities and high trading costs make it difficult for African countries to reap the potential benefits of RTAs. |
| Van den Boogaerde, Pierre and Charalambos G. Tsangarides, 2005, "Ten Years after the CFA Franc Devaluation: Progress Toward Regional Integration in the WAEMU," WP/05/145 (July) | WAEMU | Qualitative analysis | The eight WAEMU countries are not yet fully integrated. The expansion of intraregional trade has remained modest, and competitiveness has eroded. The eight countries will need significantly stronger political drive to overcome the narrowness of their economies and lessen structural rigidities. |
| Doe, Lubin Kobla, 2006, "Reforming External Tariffs in Central and Western African Countries," WP/06/12 (January) | CEMAC, WAEMU | Qualitative analysis | Overall, there is broad compliance with the reform of the external tariff initiated by the CEMAC and the WAEMU, but with significant deviations from the harmonized paths in several countries. West African Monetary Zone (WAMZ) countries, except Ghana, need to undertake major reforms in order to align their external tariff structures with that of the WAEMU as planned for 2007. |
| Mayda, Anna Maria and Chad Steinberg, 2007, "Do South-South Trade Agreements Increase Trade? Commodity-Level Evidence from COMESA," WP/07/40 (February) | Uganda/COMESA | Difference-in-difference estimates | COMESA's preferential tariff liberalization has not considerably increased Uganda's trade with member countries, on average across sectors, but the effect is heterogeneous across sectors. There is no evidence of trade diversion. |
| Hallaert, Jean-Jacques, 2007, "Can Regional Integration Accelerate Development in Africa? CGE Model Simulations of the Impact of the SADC FTA on the Republic of Madagascar," WP/07/66 (March) | Madagascar/SADC | Computable general equilibrium (CGE) model | The SADC FTA would only have a limited impact on Madagascar's real GDP because the liberalization affects only a small share of its total imports. Gains from the SADC FTA become substantial only when the regional liberalization is accompanied by a multilateral liberalization. |
| Martijn, Jan Kees and Charalambos G. Tsangarides, 2007, "Trade Reform in the CEMAC: Developments and Opportunities," WP/07/137 (June) | CEMAC, EU-EPAs | Qualitative analysis | The manifold weaknesses in the implementation by the member countries of the agreed customs union regime highlight a need for a renewed political commitment to regional integration. The ongoing preparations for an EPA should be buttressed by comprehensive analyses of its likely effects. There is a strong case for tariff reduction, with or without an EPA. |
| Oliva, Maria A., 2008, "Trade Restrictiveness in the CEMAC Region: The Case of Congo," WP/08/15 (January) | Republic of Congo/ CEMAC | Qualitative analysis | CEMAC's customs code is restrictive relative to that of comparable regional integration groups. Congo's trade regime is complex, nontransparent, and unpredictable, with many exemptions and a weak customs administration. |

Annex Table 4. Selected Working Papers on PTA Issues (continued)

| Title | Region/ PTA(s) | Methodology | Main Conclusions |
|---|---|--------------------------------|--|
| Asia-Pacific | | | |
| Feridhanusetyawan, Tubagus, 2005, "Preferential Trade Agreements in the Asia-Pacific Region," WP/05/149 (July) | Asia-Pacific PTAs | Qualitative analysis | Realizing the potential gains from Asia-Pacific PTAs requires a commitment to liberalize sensitive sectors, to maintain consistent provisions, and to enforce agreements. Administrative complications could undermine potential gains. |
| Rodríguez-Delgado, Jose Daniel, 2007, "SAFTA: Living in a World of Regional Trade Agreements," WP/07/23 (February) | South Asia/SAFTA | Gravity model | SAFTA would have a minor effect on regional trade flows; the impact on custom duties would be a manageable fiscal shock for most members. For individual South Asian countries and SAFTA, PTAs with NAFTA and the European Union dominate one with ASEAN. |
| Tumbarello, Patrizia, 2007, "Are Regional Trade Agreements in Asia Stumbling or Building Blocks? Some Implications for the Mekong-3 Countries," WP/07/53 (March) | Vietnam, Cambodia, Lao PDR/Asian PTAs | Gravity model | Membership in Asian PTAs has not, to date, occurred at the expense of trade with nonmembers. However, looking forward, given their discriminatory nature, a proliferation of PTAs that is not accompanied by continuing unilateral and multilateral liberalization, could run the risk of leading to costly trade diversion. |
| Europe | | | |
| Adam, Antonis, Theodora Kosma and James McHugh, 2003, "Trade Liberalization Strategies: What Could South Eastern Europe Learn from CEFTA and BFTA?", WP/03/239 (December) | Southeastern Europe/CEFTA, BFTA | Gravity model | The Central European Free Trade Area (CEFTA) and Baltic Free Trade Area (BFTA) helped expand regional trade and limit the emergence of a "hub-and-spoke" relationship between central and eastern European countries and the European Union. Southeastern European countries should reconsider their bilateral approach to trade liberalization and move toward multilateral FTAs like CEFTA and BFTA. |
| Tumbarello, Patrizia, 2005, "Regional Trade Integration and WTO Accession: Which is the Right Sequencing? An Application to the CIS," WP/05/94 (May) | CIS countries/EAEC | Partial equilibrium simulation | From a welfare (consumer surplus) standpoint, it would be preferable for Commonwealth of Independent States (CIS) countries to join the WTO ahead of the Eurasian Economic Community (EAEC) customs union. |
| Herderschnee, Johannes, and Zhaogang Qiao, 2007, "Impact on Intra-European Trade Agreements, 1990-2005: Policy Implications for the Western Balkans and Ukraine," WP/07/126 (May) | Various EU trade agreements with other European countries | Gravity model | The impact of trade agreements varied by country and over time. The Europe Agreements' impact on bilateral trade increased over time but their impact on exports to the European Union was smaller compared to the EU-Turkey customs union. The Europe Agreements and CEFTA had a significantly stronger effect on trade than the EU's trade preferences for the western Balkan countries. |
| Middle East and Central Asia | | | |
| Alonso-Gamo, Patricia, Susan Fennell, and Khaled Sakr, 1997, "Adjusting to New Realities: The Uruguay Round and the EU-Mediterranean Initiative," WP/97/5 (January) | Middle East and North Africa/EU-Mediterranean Initiative | Qualitative analysis | The EU-Mediterranean Initiative could bring potential benefits but the Southern Mediterranean Rim countries will have to take measures to minimize the transition costs. |
| Ghesquière, Henri C., 1998, "Impact of European Union Association Agreements on Mediterranean Countries," WP/98/116 (August) | Egypt, Jordan, Lebanon, Morocco, Tunisia/AAEUs | Qualitative analysis | Benefits of the EU Association Agreements (AAEUs) could be substantial but only if accompanied by deep supplementary reforms, including extending trade liberalization to services and agriculture on a multilateral basis, and improving the environment for foreign direct investment. |

Annex Table 4. Selected Working Papers on PTA Issues (continued)

| Title | Region/ PTA(s) | Methodology | Main Conclusions |
|---|---|---|---|
| Western Hemisphere | | | |
| Egoumé-Bossogo, Philippe, and Chandima Mendis, 2002, "Trade and Integration in the Caribbean," WP/02/148 (September) | CARICOM | Gravity model | Intra-CARICOM and extra-CARICOM trade both increased, but WTO membership had no effect on trade. |
| Kose, M. Ayhan, Guy Meredith, and Christopher M. Towe, 2004, "How Has NAFTA Affected the Mexican Economy? Review and Evidence," WP/04/59 (April) | Mexico/NAFTA | Dynamic latent factor model, dynamic stochastic general equilibrium model, qualitative analysis | NAFTA spurred a dramatic increase in trade and financial flows between Mexico and its NAFTA partners. NAFTA appears to have lowered output volatility in Mexico and synchronized business cycles in Mexico and the United States to a greater extent. There could be large gains from further steps to deepening economic linkages among the NAFTA members. |
| Croce, Enzo, V. Hugo Juan-Ramon, and Feng Zhu, 2004, "Performance of Western Hemisphere Trading Blocs: A Cost-Corrected Gravity Approach," WP/04/109 (June) | NAFTA, MERCOSUR, CACM, Andean Community | Gravity model (nonlinear) | For NAFTA, trade integration outweighed trade diversion; for MERCOSUR trade integration and trade diversion went hand-in-hand; and for the Central American Common Market (CACM) and the Andean Community there was only trade diversion. |
| Cardarelli, Roberto, and M. Ayhan Kose, 2004, "Economic Integration, Business Cycle, and Productivity in North America," WP/04/138 (August) | Canada, United States/NAFTA | Dynamic latent factor model, sectoral growth accounting | Increased trade integration contributed to business cycle synchronization and productivity convergence between Canada and the United States but country-specific and idiosyncratic factors remain important determinants for Canada's business cycle and the persistence of structural differences between the two countries has prevented convergence of aggregate labor productivity. |
| Swiston, Andrew and Tamim Bayoumi, 2008, "Spillovers Across NAFTA," WP/08/3 (January) | Canada, United States, Mexico/ NAFTA | Vector autoregression | A one percent shock to U.S. real GDP shifts Canadian real GDP by some ¾ of a percentage point in the same direction. After 1996, the response of Mexican GDP is 1½ times the size of the U.S. shock. These spillovers are transmitted through both trade and financial channels. |
| Sadikov, Azim, 2008, "External Tariff Liberalization in CARICOM: A Commodity-level Analysis," WP/08/33 (February) | Trinidad and Tobago, Jamaica, Barbados, Guyana/ CARICOM | Regression analysis | Reductions in the CARICOM external tariff increased the ratio of nonmember to member imports. In Trinidad and Tobago, the liberalization of the external tariff offset some of the trade diversion effects of CARICOM. |
| Not specific to a country or region | | | |
| Frankel, Jeffrey A., and Shang-Jin Wei, 1998, "Open Regionalism in a World of Continental Trade Blocs," WP/98/10 (February) | | Theoretical model – continental trade blocs | In a world of simultaneous continental trade blocs, an open regionalism in which trade blocs undertake relatively modest external liberalization can usually produce Pareto improvement. |
| Vamvakidis, Athanasios, 1998, "Regional Trade Agreements Versus Broad Liberalization: Which Path Leads to Faster Growth? Times-Series Evidence," WP/98/40 (March) | 89-137 countries/ various PTAs | Fixed effects growth model | Countries grew more rapidly in the short and long run after broad trade liberalization, more slowly after participation in a RTA. |
| Hacker, R. Scott and Qaizar Hussain, 1998, "Trading Blocs and Welfare: How Trading Bloc Members are Affected by New Entrants," WP/98/84 (June) | | Theoretical model – three-country duopoly model | In a model with two firms (one in the large country and one in the small country within the bloc) and three markets (two within the bloc plus the new entrant's), the small-country firm gains more than the large-country firm following entry of the third country into the bloc. |

Annex Table 4. Selected Working Papers on PTA Issues (concluded)

| Title | Region/ PTA(s) | Methodology | Main Conclusions |
|---|---|---|---|
| Duttagupta, Rupa and Arvind Panagariya, 2003, "Free Trade Areas and Rules of Origin: Economics and Politics," WP/03/229 (November) | | Theoretical model – small union general equilibrium | A welfare reducing FTA that was rejected in the absence of the rules of origin becomes feasible in the presence of these rules. A welfare improving FTA that was rejected in the absence of the rules of origin is endorsed in their presence, but upon endorsement it becomes welfare inferior relative to the status quo. |
| Jaumotte, Florence, 2004, "Foreign Direct Investment and Regional Trade Agreements: the Market Size Effect Revisited," WP/04/206 (November) | Developing countries, Maghreb countries | Regression analysis | RTA market size has a positive impact on the foreign direct investment received by member countries. Countries with a relatively more educated labor force and/or a relatively more stable financial situation tend to attract a larger share of foreign direct investment at the expense of their RTA partners. |
| Albertin, Giorgia, 2007, "Will A Regional Bloc Enlarge?" WP/07/69 (March) | | Theoretical model – endogenous bloc formation | Deeper integration may lead to wider integration when the demand side of membership is binding in the determination of the equilibrium size of the bloc. The equilibrium size of the bloc will be unaffected when the supply side of membership is binding |
| Albertin, Giorgia, 2008, "Regionalism or Multilateralism? A Political Economy Choice," WP/08/65 (March) | | Theoretical model – political economy analysis | A country's decision to enter a regional trade agreement unambiguously undermines the incentives toward multilateral trade liberalization. |
| Eicher, Theo, Christian Henn, and Chris Papageorgiu, 2008, "Trade Creation and Trade Diversion Revisited: Accounting for Model Uncertainty and Natural Trading Partner Effects," WP/08/66 (March) | 12 major PTAs | Bayesian model averaging | After controlling for natural trading partner effects, trade creation effects are found only in the European Union; trade diversion only in NAFTA; and open bloc effects are found among several PTAs in Europe and Asia. The actual impact of a PTA on bilateral trade depends not only on its own trade creation and diversion but also on its trading partner's PTA effects. |

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