Macroeconomic Reforms Through WTO Accessions

Alexei Kireyev

IMF

Third China Round Table on WTO Accessions for LDCs

Dushanbe, Tajikistan, June 2-5, 2015

Conclusions

Conclusions

Consensus:

- WTO membership creates an opportunity to accelerate reforms
- Leads to greater openness and better resource allocation
- In the short run, WTO membership can result in substantial adjustment costs, for the public and the private sectors
- In the long run, the short-term effects will be offset by substantial efficiency gains

Clarity

Contribution to legal and institutional reforms: regulations, governance

Ambiguity

Impact on trade volumes, growth, fiscal revenue; key sectors

Mystery

Macroeconomic implications: domestic and external stability, growth, fiscal and debt sustainability, exchange rate level

Recent WTO Accessions: Macro-Critical Commitments

Clarity

Country			Vietnam	Tonga	Ukraine	Cape Verde	Monte-negro	Samoa	Russian Federation	Vanuatu	Laos	Tajikistan	Yemen	Seychelles
Year of accession			2007	2007	2008	2008	2012	2012	2012	2012	2013	2013	2014	2015
Market access	Goods	Import tariffs	X	X	X	X	X	X	X	X	X	X	X	X
		Quantitative restrictions	X				X	X	X				X	X
	Services	Financial			X		X	X	X	X	X		X	X
		Other	X	X	X	X	X	X	X	X	X	X	X	X
Export duties			X		X		X		X			X		
Internal taxes							X		X		X	X		X
Fees and charges				X			X	X	X		X		X	X
Subsidies	Agricultural		X		X	X	X	X	X		X		X	X
	Domestic support				X	X		X		X				
	Export		X		X	X	X	X	X		X		X	X
	Industrial			X			X	X	X			X		
Price controls							X	X	X		X	X	X	X
TR investment measures									X	X	X	X	X	
TR intellectual property								X	X	X	X	X		X
Privatization							X	X	X					
Transparency							X	X	X	X	X	X	X	X

Two groups of macro-relevant WTO commitments

- **Commitments directly affecting trade:**
  - market access for goods (import tariffs and quantitative restrictions)
  - services (financial and other)
  - trade-related fiscal measures (export duties, internal taxes, fees and charges).
- **Commitments in nontrade areas of the economy:**
  - subsidies (agriculture, domestic support, export and industrial)
  - price controls
  - state monopolies
  - trade-related investment measures
  - intellectual property rights
  - privatization
  - transparency.

Trade liberalization commitments

Clarity

- **Bound tariffs are higher than the applied tariffs**
  - on some, mainly industrial products
  - applied immediately after accessions (Tajikistan, Lao, Samoa)
  - phased in over a transition period - one year (Tonga), three years (Vanuatu), five years (Ukraine) and ten years (Montenegro, Cape Verde).
- **Bound tariffs are lower than applied tariffs**
  - Russia: tariffs to be reduced from the applied rate of 10 percent to an average bound rate of 7.8 percent;
  - Vanuatu applied tariffs should be reduced for 98 tariff lines.
- **Quantitative restrictions are usually eliminated**
  - eliminated and not reintroduced (Russia, Montenegro).
  - tariff quotas are usually allowed (in Russia for beef, pork, poultry some whey products; eggs, tobacco, sugar and salt in Vietnam; raw cane sugar in Ukraine), temporarily, with the view of elimination.

Macro-critical services: FDI and financial services

Clarity

- **Improve foreign commercial presence**
  - allowing office, branch, or subsidiary in its country
  - may imply foreign direct investment
  - enhance market access in financial services (banking, insurance, accounting)

- **Other services: transportation, communication, R&D, business services**
  - open for foreign ownership immediately upon accession (accountancy in Vietnam)
  - limits to foreign ownership (telecommunications in Vietnam, participation in the banking system in Russia),
  - gradual phasing out of foreign ownership (courier services in Vietnam, telecommunication and insurance in Russia)
  - restrictions on foreign ownership to promote local businesses (Vanuatu).

Other trade-related commitments

Clarity

- **Export duties**:
  - not to apply or reintroduce (Montenegro)
  - eliminate with some exceptions (300 items, Tajikistan)
  - reduce only on specific items (ferrous and non-ferrous metals in Vietnam)
  - reduce and bind in line with a detailed schedule (oil seeds, live cattle, hides, ferrous and non-ferrous scrap in Ukraine), and
  - bind at a certain level (for over 700 tariff lines in the case of Russia).
- **Internal taxes**: national treatment - VAT, excise, and other taxes on imports should be the same as applied to domestic products (Lao, Montenegro).
- **Other fees and charges:**
  - bound at zero from the date of accession (Lao, Samoa, Montenegro) or
  - not to be applied at all (Ukraine).
- **Tax exemptions**: to be eliminated, In the case of Russia, the VAT exemption applied to certain agricultural products should be eliminated upon accession.

Accession commitments on subsidies

- **Allowed agricultural subsidies**: fixed to a certain amount (Lao, Russia)
- **Domestic support**: usually allowed, e.g., for environmental purposes, forest management, and water conservation (Cape Verde, Ukraine, Vietnam)
- **Other agricultural subsidies**: bound at zero (Russia, Samoa)
- **Trade-distorting domestic support**: limited by an annual ceiling
- **Industrial subsidies**: eliminated (Tonga) or modified
- **Export subsidies and import-substituting subsidies**:
  - do not exist (Cape Verde)
  - banned upon accession (Lao, Samoa, Ukraine, Vietnam, Montenegro)

Other commitments

Clarity

- **Price controls**: apply national treatment
- **Trade-related investment rules**: prohibit the local component requirement, the trade-balancing requirement, and any foreign exchange restrictions
- **Privatization**: report on the privatization program (Russia, Samoa, Montenegro, Tajikistan)
- **Trade-related aspects of intellectual property rights**: enforce the corresponding WTO agreement (Russia, Samoa)
- **Transparency**: publish trade-related laws, licensing, procedures, and notifications of trade-related measures to the WTO
- **Related areas**: PTAs, anti-dumping, countervailing and safeguard measures, monopolies, technical barriers to trade, customs valuation, licensing, information technology, standards, competition.

Impact on Structural Reforms

Clarity

- Membership in the WTO generally has been conducive to domestic reforms (more efficient and credible trade policies, an improved business)
- A credible anchor for domestic regulatory and administrative reforms
- An important instrument for domestic policy reforms and had allowed them to advance a broader domestic reform agenda well beyond trade
- Improved governance, higher institutional quality and efficiency, and reduces rent-seeking behavior and corruption
- By committing to free trade, governments may credibly distance themselves from domestic lobbies
- Limit tariff evasion because the implementation of WTO rules limited discretion of customs officials in assessing unit values of goods
- The impact on the quality of institutions in member countries has been positive, although at times uneven.

Impact on trade: no conclusive evidence

Ambiguity

- **Virtually none**: countries joining or belonging to the WTO do not have different trade patterns than outsiders (Rose, 2004, 2005).
- **Uneven**: WTO membership has a powerful, positive, but uneven impact on trade (Subramanian and Wei, 2007):
  - Large increase in imports, mainly for industrial and developing countries that joined the WTO after the Uruguay round, but not for other developing countries
  - Asymmetric impact across sectors
- **Positive**: WTO membership leads to increased trade (Goldstein, Tomz, and Rivers, 2007).
- **Depends on country**: National experiences are very different (Evenett and Cage, 2005).
- **WTO Article XII countries**: nominal/real; what of 33 countries; best practices

Ambiguity

Impact on growth: generally positive

- **Positive if reforms are undertaken**: if substantial reforms are undertaken as a result of the post-1994 rule requiring acceding countries negotiate their terms (Tang and Wei, 2009)
- **Good governance is key**:
  - only high-income economies experienced faster growth after accession (Li and Wu, 2004)
  - openness is not sufficient to promote growth
  - needs to be combined with proper economic institutions
- **The reasons are not clear**: probably, long-lasting nature of accession commitments, which are legally binding as long as the country remains a WTO member.

Fiscal implications: country-dependent

Ambiguity

- **Uncertain**:
  - depend on the tariff structure
  - initial conditions
  - the reform strategy, especially if their tariff structures are complex (Ebrill, Stotsky, and Gropp, 1999)
- **Revenue loss and recovery**:
  - high-income countries recovered revenue losses (Baunsgaard and Keen, 2010)
  - middle-income countries - recovery was about 45–60 percent
  - weak in low-income countries – not more than 30 percent
- **Impact on fiscal revenue depends on country**: no problems in transition economies (Drabek and Bacchetta, 2003)
- **Impact on expenditure:** significant budgetary and other adjustment costs (Drabek and Woo, 2008) and Liard (2009)

Offsetting trade tax losses

Ambiguity

Difficult, in particular in LDCs

Recommendations:

- Combine tariff reduction with increases in consumption taxes (IMF, 2011).
- Offset import tariff cuts on excisable products by an increase in excise taxes.
- Apply a withholding tax on imports, if there is an informal sector, (Keen, 2008).
- Increases in a range of domestic taxes, including the income tax (IMF, 2005)

An increase in VAT rates generally is not recommended (Baunsgaard and Keen, 2010).

Macroeconomic Impact of Membership

Mystery

- **Fundamental linkages**: between national saving and investment and the current account in the balance of payments known from economic theory.
- **Discussed in the WTO**: in the context of coherence in the international policy making between the WTO, IMF, and World Bank (WTO, 2004).
- **"Well understood"**: "These linkages have been well understood by the original GATT negotiators" (Drabek, 2004).
- **"Remains a mystery"**: "Nevertheless, the effects of the WTO discipline on macroeconomic policies remains, perhaps, the least familiar and most understated in the whole debate about the WTO, including in the assessment of WTO accessions" (Drabek, 2004).

The macroeconomic framework for impact evaluation

Goal

- **Preserve domestic stability** – interest of the acceding country
- **Preserve stability of the multilateral trading system** – interest of all WTO members

Systemic stability

- **External stability:** a balance of payments position that does not, and is not likely to, give rise to disruptive exchange rate movements
- **Domestic stability:** orderly economic growth with reasonable price stability, and orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions

An accounting framework

Solving the mystery

Domestic economy

Real balance

$$\boxed{\overbrace{Y + Im}^{\text{Supply}} = \overbrace{C + I + X}^{\text{Demand}}} \qquad (1)$$

$$Y = C + I + \underbrace{X - Im}_{CA} \qquad (2)$$

$$\underbrace{Y - C}_{S} - I = CA \qquad (3)$$

Savings-Investment balance

$$\boxed{S - I = CA} \qquad (4)$$

$$\overbrace{(Sg + Sp)}^{S} - \overbrace{(Ig + Ip)}^{I} \qquad (5)$$

$$CA + FA = -R \qquad (6)$$

$$\overbrace{(Sg - Ig)}^{Rev - Exp} + (Sp - Ip) \qquad \textbf{External balance: } \boxed{CA = -FA} \; - \; \textbf{Monetary balance: } \boxed{R} \qquad (10)$$

Fiscal balance

(7) $Ext + Dm = -F = B = Rev - Exp$

(8) $Td + Ti = Tx$; $\quad W\&S$

(9) $Fs + Oth = Ntx$; $\quad G\&S$

$$Rev = Tx + Ntx + Grnts, \qquad Exp = W\&S + G\&S + Sb$$

External balance

$$CA = X - Im + NT + NF, \qquad FA = FDI + PI + Oth$$

Monetary balance

$$R = R + NDA = M \qquad (11)$$

$$NDA = Cg + Cp + Oin$$

Exchange rate (12)

Rest of the world

Saving-investment balance

- In any economy, there is supply of resources and demand for resources
- The S-I balance depends on the performance of the public and private sectors.
- The S-I balance of the public sector reflects the government's budget position.
- The current account is a crucial component of the BoP and the external balance.
- The S-I balance has an important impact on monetary accounts.
- The S-I balance is linked to the level of the exchange rate.
- Membership reforms affect the S-I balance.
- The impulse may originate in any of the four sectors from variables shown in red.

Basis:

The External Balance Assessment (EBA) methodology developed by the 2013 and updated annually, used for External Sector Report http://www.imf.org/external/np/res/eba/

Behavioral Framework

Solving the mystery

- **The sources for the external imbalance can be domestic and external** (External Balance Assessment Methodology, IMF, 2015).

$$S(Z_S) - I(Z_I) = CA(Y, Z_S, Z_I, Z_{CA}, Z_{FA}, R)$$

- **On the domestic side**, any factors affecting national saving and investment would have an impact on the CA.
    - saving/consumption shifters - per capita income, population growth, aging speed, dependency ratio, fiscal balance, changes in savings patterns;
    - investment shifters - current and expected per capita income, investment climate, the relative price of capital, competitiveness and productivity.
- **On the external side**, there are several exogenous factors that impact the CA:
    - terms of trade, commodity prices including oil, interest rates;
    - financial account shifters - global risk aversion and share of the country's currency in the world total stock of international reserves.

Two stages of behavioral assessment

- **First stage**:
  - evaluate article XII country for consistency with fundamentals
  - Identify a gap, if any, as a difference between the actual and the estimated CA norm.
- **Second stage**:
  - Evaluate the impact of membership commitments on the estimated gap
- **CA fundamentals:**
  - Variables that cannot be directly affected by public policies
  - Financial variables
  - Cyclical variables
  - Policy variables

The current account norm

Solving the mystery

Dependent variable: CA/GDP		
Non-policy variables		
Relative output per worker*Capital account openness (lagged one period)	0.065	***
Output per worker, relative to top 3 economies	0.007	
GDP growth, forecast in 5 years	-0.471	***
Net foreign assets/GDP (lagged one period)	0.016	**
Net foreign assets/GDP*(dum=1 if NFA/GDP< -60%), (lagged one period)	-0.012	
Oil and gas trade balance*Resource temporariness/GDP (if > 10%)	0.615	***
Financial center dummy (1 if country is a financial center)	0.033	***
Aging speed (relative to world average)	0.156	***
Dependency ratio (relative to world average)	-0.030	
Population growth (relative to world average)	-0.629	
Safer institutional/Political environment index	-0.109	***
Financial variables		
Own currency's share in world reserves	-0.045	***
Risk aversion index*(1-capital control index) (lagged one period)	0.068	***
Risk aversion index*(1-capital control index)*(currency's share in world reserves)	-0.136	*
Private credit/GDP	-0.260	***
Cyclical variables		
Output gap	-0.400	***
Terms of trade gap*Openness	0.230	***
Policy variables		
Cyclically adjusted fiscal balance (instrumented)	0.324	***
Public health spending/GDP (lagged one period)	-0.551	***
Changes in reserves/GDP*Capital control (instrumented)	0.346	**
Constant	-0.014	***

Contribution of policy variables

Solving the mystery

- If a member country is found in external disequilibrium, at the second stage, the contribution to the CA gap of the policy variables should identified.
- The CA measured in percent of GDP can be estimated as

$$CA = \alpha + Z'\beta + P'\gamma$$

where Z′ is the vector of non-policy variables, and P′ is the vector of policy variables.

- If P′ is the vector of desirable values of policy variables, then simply adding and subtracting P*′γ from the right-hand side of the equation would obtain:

$$CA = \underbrace{\alpha + Z'\beta + P^{*\prime}\gamma}_{\text{current account norm}} + \underbrace{(P - P^{*})\gamma}_{\text{contribution of policy gaps}}$$

Specification of benchmarks

- **Growth:** positive and stable in per capita terms
- **Fiscal policy**: the desired level of the fiscal balance targeted for the medium term (3 percent)
- **Inflation**: low and stable (2-3 percent)
- **Social protection**: derived from a regression of public health spending on per capita GDP, the age dependency ratio, and income inequality.
- **Financial policies**: (private credit/GDP) selected for the acceding country if there are signs of overheating owing to inappropriate financial policies.
- **Capital controls**: the cross-country average level of the capital controls index (0.17 in 2011, out of a range from 0 to 1) or a country's actual level
- **International reserves:** at least 3 months of imports
- **Monetary policy**: the monetary policy gap can be defined as the interest rate differential.

Closing policy gaps

Solving the mystery

- The sum of differences P-P′ between the observed levels and the benchmarks for all policy fundamentals equals the overall CA gap.
- Once the contribution of each policy variable to the overall CA gap is identified, WTO membership commitments may be designed to closing the gap.
- If the CA **gap is due mainly to expansionary fiscal policies** and high fiscal deficits, WTO membrship commitments could put more emphasis on the need to preserve tax revenue and reduce subsidies to improve the fiscal balance.
- If the **gap is explained by suboptimal capital controls**, WTO membership commitments may put additional emphasis on the liberalization of commercial presence and observance of trade-related investment rules.
- If there are signs of **inadequate financial policies**, additional commitments in trade in financial services may be justified.

The Fund stands ready to help

- Surveillance: multilateral , regional, and bilateral
- Diagnostic and policy advice: Article IV consultations , programs
- Research: policy implications of trade landscape
- Technical assistance and training: customs, tariffs, statistics

IMF	WTO
Macro	Micro
Short-term	Long-term
Temporary	Permanent
Negotiated with staff	Negotiated with members
Reviews (1/4-1/2-1/1)	TPR (2-4-6)
Conditionality - program	Conditionality - accessions
Violation – suspend disbursements	Dispute settlement
Counterpart – MoF, Central Bank	Ministry of Economy and Trade

Conclusions: Reforms

Conclusions

- WTO membership create a unique opportunity to **accelerate domestic structural reforms.**
- The scope of this positive impact will depend on the **macroeconomic content**, the economic structure of the membe country, and the length of transition periods.
- The reforms would adapt the existing institutional structure to the internationally recognized standards
- The reforms will go **beyond trade** and trade policies and may require
    - a substantial overhaul of the **tax system**,
    - improvement in the procedures for international **capital mobility**,
    - the **business climate**, and governance.
- WTO membership would encourage to take a look at **competitiveness**, remove the sources of inefficiencies, and promote the most promising sectors
- This would ultimately drive **growth** and **employment** creation.

Stability

Conclusions

- Preserving **systemic stability** is in the core interest of a member country and other WTO members as macroeconomic stability is important for trade.

- Both **external and domestic imbalances** reflect macroeconomic policies and conditions.

- The macroeconomic components of the Article XII WTO packages cannot by themselves address these imbalances because they are **not designed for this purpose**.

- However, by locking countries into a negotiated set of policies for the length of their WTO membership, such commitments can play an **important complimentary role** to fiscal, monetary, exchange rate, and structural policies in reducing systemic imbalances.

- At the very least, the design of the membership commitments **should not aggravate** the existing imbalances from the outset.

Framework

- The impact of membership should be assessed within a **holistic macroeconomic framework**.

- This framework could consist of a simple **accounting framework** anchored on the saving-investment balance and a **behavioral framework** for the current account fundamentals.

- The **accounting framework** would allow assessing the impact of WTO accession commitments for consistency of sectoral developments with the overarching goal of preserving systemic stability.

- The **behavioral framework** would allow assessing the current account for consistency with fundamentals and identifying policy areas that can be influenced by accession commitments, in addition to other policies, to improve systemic stability.

Public policies

Conclusions

- Public policies have an important role to play in **closing policy gaps** and helping countries cope with the adjustment costs of accessions.

- The appropriate **public policy response** includes measures of fiscal, monetary, exchange rate, and structural policies.

- Usually fiscal and structural policies are better suited to promote **domestic stability**, and the monetary and exchange rate policies to promote **balance of payments stability**.

- Public policies should provide **social support** to the sectors and groups of population affected by the adjustment induced by WTO membership, help reform the institutional structure, and rebalance the tax system from external to domestic taxes.

- Overall, implementation of WTO accession commitments is a matter of public policies that should support promoting **systemic stability and reforms**.