

programs. It also found that while marked progress was achieved in the majority of countries, a significant number of the countries reviewed, including LDCs, continued to have relatively restrictive regimes at the end of the period.

25. In its trade policy advice, the staff has developed a number of guidelines for designing trade reform that follow recommendations of trade theory and established practice. For example, trade reform needs to be comprehensive; that is, it should include tariff reform, the removal of QRs and other NTBs and elimination of export taxes, and other barriers. Trade liberalization should begin with the most distortive and least transparent policies, namely the elimination of NTBs, to be followed by tariff reform (including reductions in exemptions), geared toward establishing a relatively low and uniform tariff.

26. The findings of the study indicate that trade reform in the Fund-supported programs reviewed generally followed the recommended sequencing of removing NTBs as the first stage of comprehensive tariff reform. Further, two-thirds of the programs studied set medium-term trade liberalization objectives at the outset of the program, although these objectives were not always specific enough to allow effective monitoring. Thus more could have been done to develop clearer, preannounced medium-term reform targets, which generally facilitate reform.

27. The extent and speed of trade reform needs to take into account the country-specific circumstances. In addition to the initial degree of restrictiveness, speed of reform may depend on factors such as need to coordinate with other structural reforms, such as price liberalization or privatization, the extent of real or perceived short-term adjustment costs and the readiness of social safety nets to address these costs and the government's commitment to liberalization policies and the extent of political resistance to liberalization. The above study noted that a number of "good practice" countries, with strong records of growth and trade development, moved from restrictive to open trade regimes within a 7–10 year period.

28. Trade reform needs to be coordinated with macroeconomic policies, especially with fiscal policy. Fiscal considerations—generating and maintaining revenues—may be a major factor shaping trade reform and the speed of its implementation. Although trade taxes are not optimal instruments to raise revenues, in practice, many developing countries rely heavily on them. A gradual approach to tariff reform may be necessary in countries where trade taxes are a high proportion of tax revenue and development of other less distortionary fiscal measures requires time. However, this does not preclude liberalization of NTBs or reduction in exemptions. Moreover concern about the revenue impact of trade reform may not be well founded in all cases. Table 4 provides a list of the potential revenue impact of different components of trade reform. As can be seen, the fiscal impact of many of the elements is likely to be positive or ambiguous. Thus a well-designed trade reform, crafted to match a country's particular circumstances, may actually improve tax collection rates: for example, import tax collection is likely to increase as NTBs are removed. Moreover in many cases tax collection rates are below statutory tariffs, reflecting the widespread use of exemptions, as well as smuggling, tax evasion, and poor administration of customs that is encouraged by high tariffs

and lack of transparency. In these circumstances lowering average tariffs in combination with curtailing exemptions and streamlining tax administration may well be fiscally positive.

Table 4. Fiscal Impact of Trade Reform Elements

Trade Reform	Expected Fiscal Impact
Reduce moderate or low average tariff	Negative
Reduce high average tariff	Ambiguous
Lower maximum tariff	Ambiguous
Reduce tariff dispersion	Ambiguous/Positive
Replace quantitative restrictions with tariffs and liberalize other nontariff barriers on trade	Positive
Eliminate tariff exemptions	Positive
Eliminate trade-related subsidies	Positive
Eliminate state trading monopolies	Ambiguous/Positive
Eliminate export taxes	Ambiguous/Negative

Sources: Fund and Bank documents.

29. Although fiscal policy concerns were often cited as an important potential factor limiting the initial extent of trade reform targeted, an examination of fiscal indicators for the countries in the study did not always support such caution. Many countries achieved important trade liberalization despite a relatively high dependence on trade taxes and absence of broad-based consumption taxes as an alternative revenue source. More detailed country studies also indicated that successful programs were designed in a way to counter fiscal or other concerns raised at the outset. This included focusing initially on the removal of NTBs, with potentially revenue-reducing tariff reform left to a later stage; introducing broader-based taxes and early action to reduce tax exemptions.

30. The study on trade policy in Fund-supported programs identified a number of other important policy characteristics that contributed to successful trade policy reform. The results emphasized the importance of the authorities' commitment to and ownership of the program for successful and sustained trade reform. This was a common characteristic of the most ambitious programs. In these successful programs trade reform was viewed as a key medium-term objective with preannounced targets. This gave the right signals to policymakers and private agents, and served as an anchor for adjustment.

31. The study also found that trade reforms were successful when they were consistent and continued for a longer period than one Fund-supported medium-term program. The more ambitious and successful liberalizers had reforms that were a continuation of previous efforts

initiated in the late 1980s. This implies that the authorities had already gained the initial political support for liberal trade policies which is essential to sustain the reform process.

D. Policy Complementarity—Trade Reform, Macroeconomic Stability, and Economic Growth

32. While prudent macroeconomic policies and open trade policies are important for export development in their own right, recent research has underlined the importance of complementarity of these policies. Accordingly, openness alone may not lead to successful growth performance, but may need to be pursued in concert with complementary macroeconomic policies.

33. The importance of complementary trade and macroeconomic policies in achieving economic growth is demonstrated by another recent Fund study that looked at the growth performance of 110 developing countries during the period 1985–95 (IMF, 1997b). The study examined trade openness, the degree of macroeconomic stability as proxied by the standard deviation of inflation, and the degree of government intervention in the economy as proxied by the share of government spending in GDP.²⁴ The study found a strong overall correlation between these policies and growth performance: countries with open trade policies, stable macroeconomic conditions, and a relatively small government tended to show better growth performance than countries that were less open, less stable, and had larger governments.

34. None of the three policy categories seems to have been sufficient on its own to ensure that a country would experience high growth. That is, good performance in one category, but mediocre or poor performance in the other two categories, appears to have been a recipe for low growth. In particular, for countries with the most open trade stance, but with only low or medium macroeconomic stability and large- to medium-sized governments, only about one-fourth experienced high growth and about one-fourth low growth. The key lesson seems to be that no policy by itself is sufficient for fast growth, and that at least a degree of policy success is necessary in several areas to support fast growth: good policies tend to be mutually reinforcing and policy complementarities are important.

35. In this area as well the LDC performance seems relatively poor and characterized by policies that resulted in lower growth. Using data for LDCs from 1990–96, similar measures for openness, macroeconomic stability, and government intervention in the economy were

²⁴For each category, a country's performance was rated high, medium, or poor. Countries were divided into three categories based upon 1985–95 real per capita GDP growth: countries with a real GDP per capita growth of 2.9 percent or higher were classified as high-growth countries; those with growth rates between 0.5 percent and 2.9 percent were classified as medium-growth countries; and those with growth rates lower than 0.5 percent a year were classified as low-growth countries. All together 28 percent of all developing countries were classified as high-growth countries, while 44 percent fell into the low growth category.

constructed for the purposes of this paper. On average, the LDCs performed poorly on macroeconomic stability and fell into medium categories on openness and government intervention. This characterization would put LDCs into the category of low growth with a probability of 63 percent—and a probability of 88 percent in either low or medium growth categories (Table 5). This reinforces the previous discussion that LDCs need to ensure that the macroeconomic environment is stable while pursuing market-oriented policies (such as trade liberalization and less government intervention in the economy) in order to grow more quickly.

Table 5. Developing Countries: Relationship between Policies and Growth, 1985-95
and Conditional Probabilities of Success¹

	High Growth	Medium Growth	Low Growth
	(In percent)		
<i>Probability of high, medium, or low growth given the following policies:</i>			
High openness ²	41	19	41
High macroeconomic stability ³	41	32	27
Small government ⁴	30	33	37
Policy combination with at least two categories being high and the other at least medium	57	19	24
<i>Probability of high, medium, or low growth given policies similar to those in LDCs on average:</i>			
Low macro stability with two other categories being at least medium	13	25	63

Source: IMF (1997b)

¹High growth countries were the ones with average per capita real growth rates of 2.9 percent or higher over the period 1985-95, while low growth countries were the ones with average real growth rates below 0.5 percent. For all variables, the high and the low cutoff points were determined as mean plus one-half standard deviation and mean minus one-half standard deviation of the respective distributions.

²Openness is measured by the ratio of total foreign trade to GDP. A high degree of openness is defined as the case where the average of exports and imports as a percent of GDP is higher than 45 percent, while in the case of low openness it is lower than 27 percent. Openness, however, tends to be biased by country size. Large countries have small trade/GDP ratios because of large home markets.

³Macroeconomic stability is measured by the standard deviation of the rate of inflation in the period. Low macroeconomic stability was defined as having a standard deviation of inflation higher than 19 percent while high stability required a standard deviation of 5 or less.

⁴Size of government is measured by the ratio of government expenditure to GDP. A large government is categorized as one with public expenditure of the central government above 38 percent of GDP, and a small government is one with less than 23 percent. The measure can, however, miss other forms of government intervention in the economy.

III. SUMMARY AND CONCLUSIONS

36. The Fund's central role in member countries in supporting policies that promote macroeconomic stability is closely linked to trade development. In addition, structural reforms, including trade policy reform, are important elements in Fund-supported programs and in its surveillance activities. The Fund's approach to trade development is to integrate trade reform (and other structural policies) with comprehensive macroeconomic adjustment (including appropriate fiscal, monetary, and exchange rate policies), taking into account the many links between trade and macroeconomic performance.

37. This paper argues that LDCs need to try to achieve both macroeconomic stability and outward-oriented trade policies in order to develop their trade potential and participate in the global expansion of trade and capital flows. Without a more stable macroeconomic environment, reforms such as trade facilitation, enhanced trade-related technical assistance, improved infrastructure, institutional development, and new technologies are unlikely to lead to an adequate supply response. In general, appropriate fiscal, monetary and exchange rate policies facilitate export growth by improving the overall stability of the economy, improving incentives for private sector development, maintaining market-based prices for production activities, ensuring that exports are competitive, and helping attract FDI. The hallmarks of a trade friendly macroeconomic environment include low fiscal and current account deficits, low inflation, competitive exchange rates, and high savings rates.

38. However, in addition to macroeconomic stability, LDCs need to reform their trade regimes in order to reduce impediments to trade and to boost export growth. A trade regime that promotes trade is one with reasonably low and uniform tariff protection and few or no restrictions on imports or exports, including particularly QRs and other NTBs. Simplicity and transparency are also important elements of an appropriate trade regime. Available data for LDCs indicate that their trade regimes are generally more restrictive than those in the fast-growing developing country exporters. This underlines the need for comprehensive trade reform in support of trade development.

ANNEX

**List of the 48 Countries Designated as Least-Developed Countries
by the United Nations**

Afghanistan, Islamic State of	Liberia
Angola	Madagascar
Bangladesh	Malawi
Benin	Maldives
Bhutan	Mali
Burkina Faso	Mauritania
Burundi	Mozambique
Cambodia	Myanmar
Cape Verde	Nepal
Central African Republic	Niger
Chad	Rwanda
Comoros	Samoa
Congo, Democratic Republic of	São Tomé and Príncipe
Djibouti	Sierra Leone
Equatorial Guinea	Solomon Islands
Eritrea	Somalia
Ethiopia	Sudan
Gambia, The	Tanzania
Guinea	Togo
Guinea-Bissau	Tuvalu
Haiti	Uganda
Kiribati	Vanuatu
Lao People's Democratic Republic	Yemen, Republic of
Lesotho	Zambia

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