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Minutes of Executive Board Meeting 94/93

10:00 a.m., October 19, 1994

Contents

Executive Board Attendance

S. Fischer, Acting Chairman
A. D. Ouattara, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
	D. Desruelle, Temporary
J. Bergo	
H. Evans	J. Shields
K. P. Geethakrishnan	
	S. Arifin, Temporary
	W. C. Keller, Temporary
	M. C. B. Arraes, Temporary
	G. Y. Glazkov, Temporary
	J. Prader
	M. Giulimondi, Temporary
K. Lissakers	M. W. Ryan, Temporary
	A. Galicia, Temporary
	T. Fukuyama
	T. Oya, Temporary
	M. Daïri
	B. S. Dlamini
G. A. Posthumus	
	J.-C. Obame, Temporary
	E. Wagenhoefer
A. S. Shaalan	
D. E. Smee	S. O'Connor, Temporary
	A. M. Tetangco, Jr.
	Wei B.
	A. F. Jiménez de Lucio

L. Van Houtven, Secretary and Counsellor
S. Bhatia, Assistant

Also Present

IBRD: A. Yeats, International Economics Department. European I Department: D. McDonald. External Relations Department: M. R. Kelly, Deputy Director; R. R. Brauning. Fiscal Affairs Department: A. A. Tait, Deputy Director; P. Shome. Legal Department: P. De Boeck. Policy Development and Review Department: J. T. Boorman, Director; T. Leddy, Deputy Director; M. L. Agarwal, A. Basu, N. Calika, R. T. Harmsen, A. Ibrahim, R. A. Jayatissa, N. Kirmani, M. Leidy, C. Puckahtikom, C. R. Shiells, A. Singh. Secretary's Department: R. S. Franklin, K. S. Friedman. Southeast Asia and Pacific Department: L. M. Koenig, Deputy Director; T. Callen, R. P. Kronenberg, C. H. Lim, E. L. Rojas-Suarez. Office of the Managing Director: S. Sugisaki, Special Advisor. Advisors to Executive Directors: J. M. Abbott, A. Chang Fong, S. K. Fayyad, T. K. Gaspard, J. Jonáš, R. Kannan, N. Mancebo, P. A. Merino, G. Mucibabici, J. Ortiz Vely, B. A. Sarr. Assistants to Executive Directors: S. Al-Huseini, R. N. A. Ally, P. I. Botoucharov, M. Dzervite, G. El-Masry, S. S. Farid, R. Glennerster, A. Guennewich, H. Golriz, J. Hamilius, M. A. Hammoudi, O. Himani, P. Jilek, A. M. Koulizade, E. Kouprianova, K. Kpetigo, V. Kural, K. J. Langdon, J. Pesola, H. Petana, G. A. Sánchez, V. Trivedi, R. von Kleist, Wang Y., J. B. Wire.

1. REGIONAL TRADING ARRANGEMENTS

Executive Directors considered a staff paper providing a review of recent developments and issues in regional trading arrangements (SM/94/193, 7/22/94).

The staff representative from the Policy Development and Review Department made the following statement:

> The staff is taking the opportunity of the Board's consideration of the regional trading arrangements paper to update Directors on some evolving aspects of Fund collaboration with the future World Trade Organization (WTO). Directors will have the opportunity for further consideration of these issues when the forthcoming paper on legal implications for the Fund of the Uruguay Round is available for Board discussion. 1/
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> During the Board consideration of the comprehensive trade paper (EBM/94/74, 8/24/94), Directors had a preliminary discussion on collaboration between the Fund and the WTO. They agreed at that time that "the requirements for future collaboration will be an evolving subject requiring periodic review." Since the Board discussion, senior staff level discussions were held in Madrid on collaboration issues with the General Agreement on Tariffs and Trade (GATT) Secretariat in both bilateral and trilateral meetings--the latter among Bank/Fund/GATT staff. 2/ The Fund staff also discussed these issues informally in Geneva with the Chairman of the WTO Preparatory Committee's Subcommittee on Institutional, Procedural, and Legal Matters. 3/
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> This buff provides the staff's further thinking on the elements of future cooperation between the Fund and the WTO, drawing on the above-mentioned Board discussion and informal consultations with senior GATT officials. It is intended to prepare the groundwork for an eventual draft framework on Fund/WTO collaboration. The elements considered here build on existing channels of collaboration with the GATT; they may need to be

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1/ This note does not prejudice consideration of jurisdictional issues that are the focus of the legal paper.

2/ Several meetings were held in Madrid during the Annual Meetings with Mr. J. Seade, GATT Deputy Director General, and Mr. G. Sampson, GATT Director of Regional and Preferential Trade, and Trade and Finance Division.

3/ The Subcommittee, which is in charge of collaboration issues, is currently considering observer status for international organizations in various WTO committees/bodies. The Chairman has asked GATT delegations to reflect on the manner of dealing with coherence/collaboration issues between the WTO and the Bretton Woods institutions; discussions on this topic are at an early stage.

elaborated or modified in the light of further consideration of cooperation issues in the respective institutions--including the forthcoming discussion of the legal paper--and as the collaborative relationship between the Fund and the WTO evolves. The Bank staff has prepared a similar note on Bank/WTO collaboration.

An existing channel of Fund/GATT collaboration is through the Fund's participation in the consultations of the GATT Committee on Balance of Payments Restrictions. In the WTO, the role of the Fund in balance of payments consultations will be expanded to cover both goods and services. The Fund should stand ready to provide timely information and assessments of the consulting member's balance of payments situation, so as to enable the WTO Committee on Balance of Payments Restrictions to assess the appropriateness of the member's trade restrictions on goods and/or services maintained for balance of payments purposes.

The basic objectives of the Fund and the WTO are mutually consistent, although the two institutions have different mandates and emphasis. The WTO's charter calls for the achievement of greater coherence in global economic policymaking. The Fund, in view of its responsibilities in the macroeconomic policy area, including with respect to exchange rates, is well placed to assess issues of coherence between macroeconomic and trade policies. Directors will recall, for example, that at the request of the Director General of the GATT in the 1980s, the Fund prepared a study on possible linkages between exchange rate volatility and trade flows. To help ensure consistency in the implementation of the respective surveillance functions of the two institutions and avoid duplication, Fund staff should place greater emphasis on specific macroeconomic/trade linkages of mutual interest--including particularly those where WTO staff or members have expressed concern--and bring them to the attention of Executive Directors as necessary.

Under the Uruguay Round, many countries have taken on more extensive commitments than in the past. Against this background, the Fund staff needs to be even more vigilant to ensure that recommended policy measures and program conditionality are consistent with obligations under the WTO. To promote economic efficiency, Fund policy advice often encompasses features that require reforms that are consistent with--although they may go beyond--a member's undertakings in the WTO. In some cases where economic efficiency considerations may conflict with WTO obligations, the Fund staff should encourage the member to consult with the WTO to resolve the issue. Cross conditionality should be avoided.

Existing channels for staff contacts between the Fund and the GATT/WTO should be enhanced, and possibly supplemented by staff exchanges, with a view to ensuring effective cooperation and interaction between the two staffs. The Fund's Geneva office will continue to provide liaison between the Fund and the WTO on an ongoing basis. This should be supplemented by periodic meetings--at least annually--between appropriately senior staff of the institutions to review issues of mutual interest and/or concern and possible solutions. It is anticipated that part of these meetings would be held jointly with senior Bank staff. Furthermore, in cases involving important trade policy issues, there should be more active use of informal Fund staff visits to exchange views with WTO staff, for example, en route to Article IV and/or use of Fund resources consultations. Similarly, WTO staff should be encouraged to visit Fund headquarters periodically to informally discuss specific country cases or policy issues. Such strengthened informal staff contacts would help the respective staffs to exchange views in areas of mutual interest and concern. Meetings at head of institution level would continue to be arranged as needed.

No major changes appear needed at this time regarding formal arrangements for representation. The Director-General of the GATT has been regularly invited to the Interim and Development Committees and has made presentations to them. Arrangements for the GATT's attendance at the Bank and Fund Annual Meetings as an observer have been resumed. The Fund enjoys observer status and may make statements at almost all official GATT bodies. The question of observer status in the various WTO bodies/committees is under consideration in the WTO Subcommittee on Institutional, Procedural, and Legal Matters.

Current procedures for document exchange involve the receipt by Fund staff of most GATT documents on a confidential basis. On the basis of formal arrangements approved by the Board, the Director-General of the GATT is provided Article IV consultation reports regarding common members. The Fund also transmits to the GATT Balance of Payments Committee the latest background paper on the consulting member--in addition to a Fund statement where relevant. While these procedures have worked well thus far, Fund staff should stand ready to explore the need for strengthening document exchange as necessary. For example, there may be a need to provide WTO staff with Article IV consultation reports regarding Fund members that are seeking accession to the GATT/WTO. This may require instituting additional procedures for the transmittal of documents; provided that Directors agree to this approach, the staff would seek such transmittal authority as needed. The Fund staff should also ensure that an up-to-date assessment of a country's macroeconomic situation is available to the WTO staff at the time of preparation of the latter's Trade Policy Review Mechanism (TPRM) reports--which feature, inter alia, the macroeconomic situation of the concerned country--or as needed; where there is a considerable interval between the Article IV discussion and the TPRM, the Fund staff should be able to provide the WTO staff updated factual information on the macroeconomic situation.

The Fund and WTO staffs should, at an early stage of preparation, seek each others' views on staff reports in which international trade policy issues are prominently featured. This would help keep each informed of the other's activities, identify issues of common interest, and potentially increase the coherence between their positions. Joint studies on topics of mutual interest should be considered from time to time. The feasibility of better access to each other's databases should also be explored. For example, access to the GATT's Integrated Database would benefit Fund staff in its analysis of the economic impact of the implementation of the Uruguay Round on individual countries.

Mr. Daïri made the following statement:

At the outset, we would like to welcome today's discussion on regional trading arrangements and thank the staff for preparing a succinct and informative report, the importance of which has been frequently pointed out by this chair. Owing to the growing importance of regional trading arrangements in the world economy, we hope that the present report is only an initial effort and that it would be updated periodically.

Before commenting on the specific issues proposed for discussion, I would like to make some general comments on recent developments of regional trade arrangement.

Although the present paper refers to regional trade arrangements, there are some other arrangements that help create or facilitate trade in a specific region. For instance, multilateral clearing or payment--or credit--arrangements are useful instruments in creating and facilitating trade that in some cases, in time, develop into a trading arrangement. A good example of such arrangements is the Asian Clearing Union (ACU) which has been operative in Asia since 1974. These arrangements merit a study by the Fund as well.

A number of studies, including the Fund's Occasional Paper No. 93, suggest that the economies of scale and complementarity are perhaps the main forces justifying regionalism. But it appears that other factors, such as cultural, social, and even political links have played an important role in establishing some of the existing regional trade arrangement. In some other cases, the members of an arrangement among developing countries might have intended to introduce limited competition and thereby progressively increase the efficiency of domestic activities without taking the risk of opening their economies to more active competition from much stronger economies.

A survey of the present arrangements reveals a positive development, namely, the membership of a specific country in several arrangements. Multi-membership is definitely a step toward more integration of the concerned country in the world trade system, as membership in each arrangement requires further liberalization.

Our last general comment relates to the future development of regional trading arrangements through integration of existing ones. Initiatives in this direction should be supported, as such integration is undoubtedly an advancement toward greater liberalization of the economies in question and, thereby, a step toward the most-favored-nation status, which the staff rightly considers the best choice. The rising trend of a specific country becoming a member in two and more arrangements indicates that such integrations are not a remote possibility.

Turning now to the suggested issues for discussion, we note that the staff has offered an interesting set of questions covering principal aspects of regional trading arrangements. We would like to briefly comment on some issues of interest.

We share the staff's view that recent growing interest toward regionalism should be attributed to factors beyond the frustration with the slow progress in Uruguay Round. However, looking at the list of arrangements established since 1990, we note that different parts of the world do not experience the same development in regional cooperation. It may be argued that demonstration and domino effects have played a more important role in, for instance, the Western Hemisphere than in Asia. But it could also be said that in Asia some motivations to regionalism, like economies of scale and complementarity, could have called for more regional integration. It appears that trade regionalism, depending on the level of economic development of the region, is based on different motivations. Although in Europe--except Eastern Europe--and North America, arrangements aim at trade creation through "inside coordination," in less developed areas, regional integrations aim at policy coordination versus outside competition.

As the staff has noticed, the existing arrangements do not share the same pace of progress toward integration. It is worth noting that in an arrangement where the pace of liberalization and reform efforts is different among the members, the integration process may remain sluggish despite strong political will.

There is no doubt that the European Union (EU) is the most advanced regional trading arrangement and although the forces behind its integration are not easily replicated, valuable lessons may be learned from its past practices. The significant and long persistent protection that EU has adopted in some areas, such as agriculture, indicates that not all sectors of the economy are prepared to be exposed to unconditional competition. This implies that in any arrangement a priority plan may be worked out in which vulnerable, or perhaps politically sensitive, sectors would be liberalized gradually. In other words, though nondiscriminatory free trade should be regarded as a final goal, partial liberalization inside a trading bloc should be encouraged as the first step toward global liberalization.

In referring to the North American Free Trade Agreement (NAFTA), the staff indicates its uniqueness on the ground that it attempts integration among economies at very different levels of income. From this point of view, some other arrangements, such as the Economic Cooperation Organization (ECO), share the same characteristic. The staff's recommendation for NAFTA to pursue an open door policy applies to other arrangements as well. Openness to new members is a good yardstick. The Fund should encourage any arrangement which has no, or minimal, membership conditionality.

We do not fully share the staff's conclusion that the increased emphasis on regional trading arrangements has not apparently occurred at the expense of ongoing integration between regions. Developments in intra- or extraregional trade as a share of total trade challenges such a conclusion. More specifically, in a context where total foreign trade as a share of GDP has increased substantially, this increase has stemmed more from intraregional trade than from extraregional trade.

We appreciate the staff's updated information on some evolving aspects of the Fund's relations with the future World Trade Organization. We would like to emphasize that the Fund, World Bank, and WTO collaboration is so crucial that it requires separate Board discussion, and we look forward to seeing the first draft report on Fund/WTO relations in the near future. We understand that presently the Fund's Geneva office works as a liaison between the Fund and the WTO. Owing to the routine work load of the Geneva office, we wonder whether it would not be advisable to revise or expand the mandate of the Committee on Liaison with the Contracting Parties to the GATT (CGATT) for this purpose. The consistency that is required between the Fund and the WTO, as well as the avoidance of possible duplications and cross-conditionality support the strengthening of this committee's mandate.

We would support the publication of interesting studies on regional arrangements, such as the one prepared by the Middle Eastern Department on the Maghreb Union, for widespread dissemination.

Mrs. Wagenhoefer made the following statement:

We completely agree with the staff's assessment that the first-best trade policy is most-favored-nation (MFN) liberalization and that the ultimate goal is global free trade. We share also the staff's view on the conditions necessary for regional trading arrangements to minimize trade diversion and contribute to global trade liberalization. These include, as the staff has mentioned correctly, coverage of all sectors, transparent rules of origin, liberal rules of accession, and strengthened disciplines on the use of antidumping action and other trade actions against third parties.

Notwithstanding certain exceptions noted by the staff, the major regional initiatives in the recent past have performed well. One notable exception seems to be sub-Saharan Africa, where the number of regional trading arrangements is reversely proportional to the development of intraregional trade. I would like to invite the staff to comment on why the multitude of trading arrangements has obviously not had any perceivable trade-enhancing effects, and what could be done to change this situation. It is noteworthy, however, that the developing countries in Asia have much higher intraregional trade as a share of GDP and a much lower extra-regional trade as a share of GDP than have the developing countries in Africa. This chair has often stressed the importance of regional trade for developing countries as a development strategy.

Another interesting observation is that extraregional trade of mature industrialized countries seems to be the same worldwide, as witnessed by the figures for Western Europe, North America, and Japan, which are grouped in a band within 1.6 percentage points of each other. Does the staff believe that this is a coincidence, or could one theorize that the share of extraregional trade decreases as an economy develops, for instance, because growth in nontradable sectors is generally faster than growth in tradable sectors in developed economies, which would account for this phenomenon?

One regional trading arrangement which I missed when going through the otherwise excellent staff documentation is the officially demised, but still at least partially structurally present, trading bloc of the former communist countries of Central and Eastern Europe and the former Soviet Union (FSU). The economic effects of that trade area still burden many of the regional economies, and documentation about the evolution of these arrangements and their far-reaching economic effects should be kept up to date at least in order to show us the effects on trade of the ongoing efforts regarding transformation and liberalization, but also to serve as a warning against these past endeavors.

I would like to add something about the European Union. Regarding developments in the European Union, I think that the pace of trade liberalization of the European Union toward Central and Eastern European economies in transition for most industrial products has been impressive. The remaining restrictions in the areas of steel, clothing, and textiles will be phased out within a reasonable period of time. It is noteworthy in this context that the timetable for the elimination of tariffs and quotas on textiles and clothing entails a pace of liberalization more than twice as fast as agreed to under the Uruguay Round. In addition, access of the transition countries to the European agricultural market will also be improved.

Concerning the contentious agricultural policy of the European Union, it appears to me that there is broad agreement among its members that further comprehensive reforms will be needed to reduce surplus production, the degree of protection, and any negative external effects which may be associated with the Common Agricultural Policy (CAP).

Mr. Shaalan made the following statement:

The staff has produced a comprehensive, although largely descriptive, paper on regional trading arrangements.

The main conclusion that is reached regarding the Fund's role vis-à-vis such arrangements is that the Fund's policy advice should actively support the implementation of such initiatives in a manner that would serve the long-run goal of multilateral liberalization. This, of course, is a recommendation with which none of us would take issue.

The more difficult question that naturally follows, however, is how can the Fund perform this role in an effective manner? This quickly brings us to the issues covered by the staff paper on collaboration with the future World Trade Organization and the importance of the work being undertaken in setting up the framework of Fund/WTO collaboration. As this work is still at an early stage, however, it would be premature to venture into its discussion in the Board today.

For my part, I am content to reiterate today what I have said concerning regional trading arrangements in our August discussion of the comprehensive trade paper (EBM/94/74, 8/24/94): Although existing regional arrangements can, as the staff points out, "be viewed on the whole as building blocks" to the goal of multilateral liberalization, strengthened and more effective Fund surveillance of trade divergence effects of regional trading arrangements is needed. A case in point, in view of its major impact on the world economy and the potential for its further expansion, is the European Union where there remain significant trade diversion effects as a result of the Common Agricultural Policy, and also of continued protection in some areas of the manufacturing sector. I would hope that this will be conveyed in Article IV consultations. Additionally the growing role for regional trading arrangements calls for integrating this aspect in our regional surveillance.

Also important are the effects of NAFTA on selected sectors and individual countries. These, however, are yet to be determined but would need to be carefully monitored as they become apparent.

It is to be hoped that strengthened surveillance by the Fund and the future WTO of all regional trading arrangements would boost the pace of global trade liberalization and in so doing weaken the exclusionary character of such arrangements.

Mr. Al-Tuwaijri made the following statement:

I welcome today's discussion, which complements our discussion of the comprehensive trade paper last August. My remarks will focus on issues that pertain directly to the Fund's policies.

While the trend toward regional integration gained impetus from frustrations with the slow progress in the Uruguay Round during the 1980s, I agree with the staff that interest in regionalism can be expected to remain strong in the future. This development is not necessarily incompatible with multilateral trade liberalization, provided that regional trading arrangements develop as building blocks to such liberalization.

There are clear risks that regional trading arrangements can lead to greater discrimination against third parties. For example, the staff paper points to pockets of discrimination within the EU. The staff presents conditions under which regional trading arrangements would contribute to greater global trade liberalization. Among these, I would particularly emphasize the importance of discipline on the use of antidumping action against third parties. Discipline in the use of other justifications for discrimination against third parties also needs to be strengthened. For example, product, environmental, or social standards introduced at the regional level can also be used as an important barrier to trade.

The Fund's advice should continue to be strongly supportive of measures that would ensure that regional arrangements are indeed building blocks for greater global liberalization, to minimize the trade diversion and maximize the trade creation effects of such arrangements. The Fund's advice in this area is particularly important as the impetus for greater regional integration is not always purely economic. Indeed, political considerations can sometimes play a primary role in motivating such integration.

The Fund's contribution to the promotion of greater global trade liberalization will be most effective through fostering close cooperation with the WTO. I welcome the staff's statement on this important subject.

Trade and payments are opposite sides of the same coin, and it is obvious that close collaboration between the Fund and the WTO is essential to ensure the consistency of policy advice and to enhance the effectiveness of each organization in discharging its mandate. Here, the statement by the staff raises a number of important issues; in particular, issues relating to the possibility of cross-conditionality, to areas where economic efficiency considerations may conflict with WTO obligations, and to areas where our respective mandates may overlap. Clearly, we need to address areas of possible overlapping of responsibilities well in advance of the emergence of such problems. Thorough analysis and a thoughtful understanding of such issues should not be put off for too long. It is important to ensure that decisions we take regarding our policies on collaboration are not prejudiced by any particular circumstance or conflict.

Enhancing contact between our staff and that of the WTO is also an important element in this process. In this regard, I wonder whether a more formal arrangement for regular contact between the staffs of the two organizations would be useful.

With regard to the exchange of documents, I see no reason for us to depart from existing practices. Certainly, our input regarding the macroeconomic situation of a member country is important; however, I think that our current policies are sufficient. Furthermore, I do not believe that the Fund should provide Article IV consultation reports for countries that are in the process of accession to the GATT/WTO. It is the responsibility of the applicant to provide the WTO with all relevant information for membership. I see no reason for the Fund to get involved in this process.

In sum, issues relating to Fund/WTO collaboration warrant an early and comprehensive discussion. I look forward to the discussion of the forthcoming legal paper on jurisdictional issues. Furthermore, other operational issues are also numerous, and I hope that we will revisit them at an early date.

Mr. Prader made the following statement:

The paper on regional trading arrangements contains a complex and differentiated analysis of the underlying issues. Our chair agrees with most of this analysis and with its conclusions.

The most interesting aspect of this staff study is that its conclusions contradict a number of widely-held assumptions. The study found that regional trading arrangements do not necessarily conflict with multilateralism and do not appear to have hindered economic integration between regions: on the contrary, it seems they have even aided the global liberalization of trade and boosted trade and economic growth. With particular respect to the European Union, the staff's assessment bolsters the view that the dire predictions of Europe's trading partners that the single market program would create a "fortress Europe" have not materialized.

Even though this assessment may seem comforting to the members of some of the regional trading arrangements that have been criticized by the public and by nonmembers, it would be a mistake to become complacent, or to forget that regional trading arrangements are only second-best solutions to be adopted when multilateral progress in trade is going too slowly. It can also be argued that the study's positive verdict on regional trading arrangements should be tempered somewhat: even though it is empirically shown that trade with other regions grows at the rate of GDP growth, the growth rates of trade within regions are much higher still, indicating that trade could perhaps increase still more if the international trading system as a whole were less regionalized. Moreover, even those who are already members or those about to join major regional trading arrangements cannot deny that regional trading arrangements inherently pose some major problems. A prospective or new member of a major regional trading arrangement may too quickly forget that one of its principal economic motives for seeking membership was rooted in concern about the diversion of investment flows and restrictive rules of origin imposed by some other regional trading arrangements.

I should also emphasize that we concur with the staff's description and conclusions about potential tensions between the concept of regional trading arrangements and multilateralism. In this connection the staff has identified areas for improving existing regional trading arrangements, particularly the need to adhere to a strict interpretation of GATT Article XXIV or even to go beyond it by making regional trading arrangements complementary to the multilateral trading system.

Second, despite the staff's generally positive review of the EU as a model of integration, we recognize that the European regional trading arrangement is far from perfect: there is much room for improvement and future work, especially in such sectors as energy and telecommunications, and in some areas such as that of the Common Agricultural Policy, the record is even negative.

The EU and NAFTA, the two regional initiatives described in the paper, are also interesting because of their different attitudes toward the compensation of losses incurred during implementation. The EU has opted for the "enhancement of economic cohesion, requiring substantial financial transfers from the wealthiest member states to the weaker regions in the EU." The amounts committed to these transfers for the period 1995-99 total ECU 176 billion. NAFTA, on the other hand, does not provide any such mechanism.

My next point has to do with the reasons given by the staff for the increased number of European Free Trade Association (EFTA) members petitioning for membership in the EU. According to the staff, the most important single factor is "the economic success of the EU," but this may have to be put into perspective, at least for the cases of the Scandinavian applicants and Austria. If I am not mistaken, most of these applicants have been at least as successful--or even more successful from the economic standpoint--as the EU itself, so that except for the so-called domino effect, that is, the fear of being left out of the emerging single market, the economic arguments risk igniting contention. In the final analysis, decisions to seek membership in the EU were probably fueled more strongly by political arguments--that is, that doing so would make a statement that the country was indeed a part of Europe--than by speculative and possibly unprovable economic reasoning. The challenge for policymakers in some EFTA countries was simply how to convince a reluctant public of the benefits of EU membership at a time when their own economies were apparently doing better than the EU in terms of some major economic indicators. I mention all this in order to ensure that the Fund does not contribute to the creation of a myth that the new EU members have been joining the EU as impoverished neighbors rather than as successful economies with a strong economic record.

The staff's own analysis of EU expansion also should have stressed somewhat more strongly the crucial role of the end of the East-West conflict, which made it possible for a number of countries to apply who would otherwise have been constrained from doing so.

For the sake of completeness, the staff should also have included in their survey the customs union between the Czech and Slovak Republics in its list of regional trading arrangements.

As to the major economic reasons for the development of regional trading arrangements, as opposed to the desire to attain various noneconomic objectives, the paper gives several, including the economic effects of regionalism. However, the regional trading arrangements can also be viewed as a means of strengthening and developing the pre-existing economic exchanges: one can even ask whether the regional trading arrangements are not necessary as a means of reorganizing, in a better way, the economic links between neighboring countries.

Other, longer-term trends have also played a part in the rise of regional trading arrangements; for example, lower freight charges, lower telecommunication charges, lower stocking charges and lower hedging costs. All these factors have tended to increase the advantages of trade, and the regional trading arrangements can be seen as a response to these trends and to the expansion of optimal economic zones.

Extending his remarks, Mr. Prader said that, in a conflict between the Fund staff and the WTO staff, the management of the Fund should support the Fund staff and not leave the staff to resolve the conflict single-handedly.

Mr. Galicia made the following statement:

The strong impetus of regionalism initiated around 1948 and its most recent revitalization since the second half of the 1980s, is very well captured in the useful and interesting material presented for this discussion. The staff has produced an excellent survey paper, which can be used as a solid background for those interested in the evolution and the analysis of trade policy. Certainly the future collaboration between the Fund and the World Trade Organization will contribute to reviewing more closely all the trade issues and its macroeconomic implications, and, at the same time, it will reinforce the consistency of policy advice on these matters.

Within the analysis made by the staff on the factors contributing to the regional trading arrangements, two basic elements are implicit in the eight considerations mentioned in the document. First, countries will always try to sell to the strongest regional market, that is, they tend to identify the geographic areas with a robust demand for imports; in other words, they will always try to sell to the richest region or regions in the world. Second, they will attempt to sell the kind of product, or products, that also have a strong demand. Although these two criteria of identifying properly the demand by region and by product are very simple, and indeed very useful to evaluate the success of trade, their implications are very interesting and can be related to the structure followed in the staff's research paper. I will come back to this issue later.

On the reasons the regional trading arrangements are pursued, I would not think of more factors than those comprehensively analyzed by the staff. Nevertheless, the noneconomic objectives of the regional trading arrangements are worth some comments. Assuming that, in general, there is no single overriding motivation in creating a regional trading arrangement, it is interesting to note that some authors related the interest of the United States to sign NAFTA with Mexico basically to the political objective of enhancing the prosperity and stability of its neighbor to the south. This assertion could have been partially true because of geographic, cultural, and historic motives, but also it is interesting to mention that this same stimulus was present within the United States-Israel Free Trade Agreement signed in 1985. Actually the United States-Israel Free Trade Agreement is a trade arrangement of a reciprocal nature in which the regional element, de facto, is not present. Referring to this particular example, some broad ideas can be drawn. First, the geographic proximity is not always necessary to attain considerable progress from an RTA; second, if political willingness is present, economic cooperation can be enhanced using trade policy as a main tool; and third, there is scope to promote these trade arrangements even more, in order to speed up development in countries with solid fundamentals.

Concerning the principles for assessing regional trading arrangements, I fully concur with the selection made by the staff derived from several authors. These guidelines should be followed by all countries pursuing a regional trading arrangement or in the process of improving the system currently in use. In this vein, one can say that NAFTA, for example, incorporates most of these principles. Of course, it is expected that NAFTA will evolve in a constructive manner.

With respect to the evaluation of regional trading arrangements, two elements should be kept in mind; first the basic question whether a particular regional trading arrangement promotes trade growth, and second, what the impact of trade is on the main macroeconomic indicators of the countries involved in a trade agreement. The two elements are usually related with their static and dynamic effects, on one hand, and with the difficult task of finding a clear and straightforward causality between trade and growth, on the other. In general, the best regional trading arrangements are those that divert the least trade and create the most, but usually the criteria for assessing the regional trading arrangements are partial and take into account only one method of analysis. With the constant evolution of regional trading arrangements and the eventual Fund/WTO collaboration, a good selection of basic indicators and common criteria could prove to be useful in assessing the level of success of different trade arrangements as well as world trade in general.

In addition to the intra- and extraregional trade flows analysis mentioned by the staff, I would like to make reference to the theory of constant market-share analysis that could also be used in the more difficult task of assessing the effects on countries excluded from the regional trading arrangements. Comparing ex post the market shares by product and by region of those countries not included in regional trading arrangements gives a broad idea of who has not been able to penetrate the most dynamic markets. The correct identification of the market by products and by regions--either the country is included or not in a regional trading arrangement--contributes to a more efficient development of its external sector. This probably reinforces the implication derived by the staff, that thus far the trend toward regionalism appears to have been broadly compatible with the goal of deeper multilateral economic integration.

Another conclusion that can be derived from the theory of constant market shares, and is worth mentioning here, is that a single diversification of exports is not automatically conducive to higher export growth, and does not offset the constant changes in the structure of world trade.

Finally, the statement by the staff representative on collaboration with the WTO is extremely pertinent because it mentions the future areas in which the Fund will be very active in its coming relations with the World Trade Organization.

Mr. Jiménez de Lucio made the following statement:

We wish to commend the staff for the interesting document prepared for today's discussion on regional trading arrangements. Regardless of the original reasons for entering into such arrangements, their popularity is likely to continue as many countries rush to become members of one or more regional trading arrangements out of concern for ensuring market access for their exports. Thus, interest on the subject is likely to remain strong in the future.

Countries that are considering joining regional trading arrangements would be well advised to remember that multilateral free trade is the optimal alternative for promoting trade and increasing welfare. Regional trading arrangements should only constitute building blocks in that direction, not a substitute. To this effect, the establishment of regional trading arrangements should be accompanied by a reduction in protection against imports from third countries. Otherwise, regional trading arrangements risk exacerbating and perpetuating inefficiencies at a regional level, as well as creating new powerful regional lobbies that oppose multilateral liberalization. These risks are well illustrated by the failure of the import-substitution industrialization strategies pursued in Latin America and sub-Saharan Africa during the 1960s and 1970s under the infant industry argument, which demonstrates that countries cannot become efficient in the production of goods by simply setting high levels of protection against third countries, if they have not yet attained the necessary comparative advantage, as determined by their relative factor accumulation.

Another concern related to the regional approach to trade liberalization is the temptation to resort to antidumping and countervailing practices against third countries. The staff mentions the existence of casual empirical evidence supporting this concern. A proliferation of those measures would entail a large systemic trade inhibition risk and would adversely affect multilateral liberalization.

We share the staff's view regarding the importance of rules of origin designed with a high degree of transparency and shielded from manipulation by protectionist interests. Nontransparent rules of origin, apart from being a potential source of conflict within the regional trading arrangement, could result in substantial investment diversion from nonmembers, which may be particularly harmful for those developing countries that are in dire need of foreign direct investment flows to support their stabilization and transformation efforts.

From the staff report, it seems that thus far regional trading arrangements have generally been accompanied by most-favored-nation liberalization and nondeclining volumes of extraregional trade, and in most cases appear to be part of an overall strategy of domestic market deregulation. These are encouraging signs. Nonetheless, recent work on the politics of free trade agreements has found that their formation is more likely when the agreements provide enhanced rather than reduced protection to most sectors, and when some industries are excluded from the agreement or at least granted long periods of adjustment. In this regard, the Fund, in close coordination with the World Bank and the WTO, should actively seek to minimize the trade-diverting effects entailed by the regional trading arrangements. Strengthened multilateral rules on this subject would be particularly useful.

In view of the size and economic significance of the European Union, and the impact that its commercial policies have on international markets, it is crucial that it minimize the implementation of trade-diverting measures. In this regard, the prevalence of trade creation over trade diversion in the manufactured goods sector and the likely net positive effects of the single market program on third countries are undoubtedly positive contributions to world welfare. However, the significant trade diversion generated by the Common Agricultural Policy has had deleterious effects, in terms of both efficiency, welfare, and fiscal costs within the EU, and the sizable negative impact on the real income of those developing countries that are major agricultural exporters. We thus agree with the staff that the Fund should actively press for further liberalization in the EU, especially in those areas still subject to substantial protection and distortive subsidization.

The EU has set an example in terms of how the successful performance of a regional trading arrangement depends significantly on the harmonization of macroeconomic policies and regulatory standards between member countries. The importance of coordination conveyed by these arrangements may prove to be a key benefit for those developing countries engaged in regional trading arrangements with industrial countries, as it might help them to lock in their own stabilization and reform efforts by importing "virtuous" policies. It would be thus desirable that the regional trading arrangements involving industrial countries include liberal rules of access for trading partners from the developing countries group.

In this vein, we agree with the staff that the Fund needs to encourage NAFTA members to pursue an open door policy that spreads the benefits of liberalization to a wider group of countries and eventually globally. Besides, such a stance would signal a strong commitment by the United States to multilateral liberalization, which is deemed of utmost importance as some consider that the conversion of this country to regionalism was probably the most important reason behind the current rise of regional trading arrangements. Therefore, we urge the U.S. authorities to continue their efforts aimed at prompt approval of the Uruguay Round Agreement.

In relation to the potential trade-diverting effects of NAFTA, the fact that Mexico accounts for only about 7 percent of U.S. exports and imports would suggest that Mexico is not the lowest-cost supplier in a large number of items. Therefore, we share the staff's view that there is scope for substantial trade diversion that could seriously affect certain sectors or individual countries. Close monitoring of NAFTA developments is required.

Finally, we share the staff's overall appraisal of the Southern Cone Common Market (MERCOSUR), which is perceived by the member countries in our constituency as complementing domestic deregulation and locking in the unilateral trade liberalization currently being implemented in the region, thus being supportive of multilateral liberalization.

Mr. Desruelle made the following statement:

I welcome this opportunity to discuss regional trade arrangements, which have been a topic of much debate recently.

The staff document offers a good basis for this discussion. The main impression I draw from this document is one of optimism. It is true that theory does not offer unqualified support to regional trade arrangements. It is true that, in practice, it is quite difficult to precisely assess the benefits and costs of specific regional trading arrangements. But, overall, it seems reasonable to draw the conclusion from the information given that, in fact, regional trade arrangements have, in general, been beneficial to both members and nonmembers, and that regional trade liberalization has not come at the expense of multilateral trade liberalization.

In support of this conclusion, let me use developments in the two arrangements discussed at some length in the staff paper, namely the EU and NAFTA. Leaving aside extensive benefits that are outside the economic domain, the benefits of the EU to its members are obvious. The overall benefits of the EU to nonmembers are clear as well: as indicated in the paper, these benefits obtain largely from the increased level of GDP--and thus of imports--that results from regional trade liberalization and, in recent times, through the extension to non-EU firms of the benefits of the single market. While the existence of NAFTA is still new, one can expect that similar positive results will hold for that arrangement as well. From the preliminary figures available this year, it seems already apparent that trade between Mexico and the United States is rapidly increasing.

Furthermore, neither the deepening and enlargement of the EU, nor the establishment of NAFTA can be said to have been detrimental to multilateral trade liberalization. The member states of the EU worked hard during the Uruguay Round to achieve a successful outcome to the negotiations, including in particular the creation of the WTO, with the expectation of a reinforcement of multilateral trade rules. NAFTA, viewed from the point of view of Mexico, appears to have been part of an overall strategy of opening up to the outside world that included joining the GATT. The same observation could also be made of developments in Latin America where the flourishing of new regional trading arrangements has been part of an overall shift away from strategies of import substitution. In short, in practice, regional trade liberalization and multilateral trade liberalization have been complements and not substitutes. This may, of course, have something to do with the fact that regional trade arrangements often have purposes other than purely economic ones, that regional integration and multilateral liberalization are therefore two worthwhile but not perfectly substitutable goals, and consequently that both are simultaneously pursued.

This positive assessment of existing regional trade arrangements, and the history of presently "successful" regional trading arrangements, lead, I believe, to viewing with pragmatism new developments in this area. I do not necessarily disagree with the staff's assessment that the first-best regional trading arrangements are comprehensive in coverage, liberal in their accession rules, and best accompanied by most-favored-nation liberalization. However, second-best regional trading arrangements can also be beneficial, if only because they can lead to better arrangements down the road. After all, the EU directly descends from a specific agreement on steel and coal, and NAFTA, I believe, can trace its ancestry to a sectoral pact dealing specifically with trade in automobile and automobile parts between Canada and the United States.

Past successes, of course, do not eliminate the need for vigilance. The Fund, as a global institution, is right to emphasize the benefits of multilateral trade liberalization and to stay alert to eventual risks to progress in this domain.

As discussed in this Board in August, discussion of, and recommendations on, trade policy are an important part of the Fund's surveillance activities with all its members, be they members of regional trade arrangements or not. We expressed our views then as to the way in which we feel this work can be most effective; and I will not repeat them now. As part of these activities, it certainly is a prerogative of the Fund to address issues related to a member's participation in regional trade arrangements, such as the level of external tariffs, the transparency, or lack thereof, of rules of origin, or nontariff barriers applied to nonmembers. It evidently will remain a responsibility of the GATT, and it is to be hoped very soon of the WTO, to assess the conformity of a specific regional trade arrangement with the requirements of GATT Article XXIV; and, in this respect, one can be comforted by the tighter enforcement of the Article that is included in the relevant Uruguay Round Understanding.

Let me conclude with two comments. The first is not directly related to today's topic of discussion, but is on the description of the lessons that can be drawn from the history of European integration. Specifically, the staff paper notes that "the process of integration and liberalization took place over a prolonged period. The transition period--1958-1969--was unduly long, and before 1985 integration was confined to only a few--albeit important--areas of economic activity." I am quite convinced that this description, which might give the impression that the creation of the EEC--or the Common Market as it was then known--was a timid and partial affair, which would come as a great surprise to all those that were its proponents or its opponents at the time. If this document were to be published as part of the comprehensive trade paper, it would be appropriate to amend this description.

The second comment refers back to the interesting remark of Mrs. Wagenhoefer on trading arrangements in the FSU. We have seen a very substantial decline in trade between countries of the FSU; some of it was probably inevitable, but some is also because of difficulties related to the transition process. Some countries of the FSU are natural trading partners. Discussions of regional trading arrangements were initially complicated by the mixing of this issue with currency issues and balance of payments financing issues. Now that the currency question is settled and most countries of the FSU are or will be soon under Fund programs, it might be worthwhile revisiting the issue of regional trading arrangements in the FSU.

Mr. Keller made the following statement:

We will limit our comments on regional trade arrangements to one short remark and elaborate more extensively on the staff's statement on the future collaboration between the Fund and the World Trade Organization, which will be at the heart of the global approach to trade liberalization.

We compliment the staff for its useful work on the current state of regional trade integration. However, like former speakers, we regret that there is not more elaboration in the papers on the considerable efforts going on within the former Soviet Union to establish new bases for trade and payments. Undoubtedly, it becomes more evident that progress in these areas is crucial to the success of reforms in these countries.

With regard to collaboration with the World Trade Organization, we are entering an evolving process of establishing a working relationship, which must be organized in the most effective way for both institutions to fulfill their respective purposes. For the Fund alone, this process might imply a reshaping of the focus of its activities with regard to liberalization of the trade and exchange regimes of member countries.

Our authorities have taken note with interest of the staff's ideas and suggestions on how future collaboration could be organized. We would like to take this occasion to share two early reactions on the consistency of policy advice and cooperation at the staff level, where we would like to see a shift in emphasis in an otherwise agreeable statement.

The staff states that "in some cases where economic efficiency considerations may conflict with WTO obligations, the Fund staff should encourage the member to consult with the WTO to resolve the issue." We would go further and add first that, in turn, Fund programs should not involve any nullification of the advantages accruing from the new trade agreements under the WTO, either. Indeed, Fund programs should take due account of the new obligations contracted by member countries with the WTO, and inconsistencies in Fund policy advice with these obligations should be avoided. There is a strong need for increased vigilance. Second, in the event that recommendations by the Fund enter into conflict with WTO obligations, the Fund should help the member country and duly inform it of the steps to be undertaken to deal with the matter, in order to find ways and means--in consultations with the WTO--to implement the Fund's WTO-inconsistent recommendations in accordance with WTO procedures; in most cases, this would mean requesting a waiver or offering compensation for tariff increases. This should be done with a view to working out a mutually acceptable solution for the member country. This procedure should precede the implementation by the member country of the Fund's recommendations.

On cooperation at the staff level, we would simply like to stress here that an improved collaboration between the Fund and the WTO should go beyond strengthened informal staff contacts. On the basis of a voluntary collaboration, both institutions could use, on an individual basis, expert staff from each other to assist in the analysis of policy issues in the institutions' respective spheres of competence.

As soon as the staff paper on the legal implications for the Fund of the Uruguay Round is available, we will have to come back to this and other issues and revisit them in detail. Then we should take stock, in a systematic way, of the Fund's ideas and suggestions to be discussed--without delays--with the WTO, with a view to including the institutional arrangements into a cooperation agreement. At any rate, the Fund should avoid treating the WTO as a junior partner, as the Fund's long-term interests clearly lie in establishing a well-balanced relationship with this youngest sister of the Bretton Woods twins.

Mr. Obame made the following statement:

First of all, let me commend the staff for providing us with an excellent paper on recent developments and issues pertaining to regional trading arrangements. Although we find it very comprehensive, we do hope that further work could also be devoted to the impact that the existing regional trading arrangements are having on African, Caribbean, and Pacific countries. In this regard, although I would like to endorse the remarks made earlier by Mrs. Wagenhoefer regarding the apparent weaknesses of intra-regional trade in Africa, I think that, among other factors, it should be emphasized that statistics are lacking on intra-regional trade in Africa and that trade between African countries is largely unrecorded. Therefore, we encourage the staff to seek ways to improve cross-border trade data in sub-Saharan Africa.

Having said that, we very much welcome today's discussion which in our view, should not only update our knowledge on the functioning of regional trading arrangements but, more important, should allow us to review the Fund's role in conjunction with other multilateral institutions, including the GATT and its successor, the WTO, in promoting global economic growth through trade and international economic collaboration. This review of regional trading arrangements is also timely as it is undertaken when regionalism is now an integral part of the trading environment. Therefore, we believe that the Fund should follow closely developments of these regional trading arrangements and adapt its multilateral surveillance accordingly.

Although we welcome the fact that earlier concerns on net trade losses have not materialized, it is our view that the trend toward growing regional initiatives in trade could, if unchecked, lead to discriminating trade practices and could especially affect many small-sized countries of the developing world and the transition economies. As a result, the affected countries could either enter existing regional arrangements or create new ones of their own. In any case, we endorse the framework presented by the staff in assessing the contribution of regional trading arrangements to the good of multilateralism, namely, that it divests the least amount of trade and that it is in line with Article XXIV of the GATT. Looking ahead, we believe that the building up of regional integration would require, through the supervisory function of the Fund, strong economic policy coordination and harmonization between member countries if the regional trading arrangements are to succeed. In this context, we note the significant progress toward reform under Fund-supported programs, particularly, in the liberalization of quantitative restrictions. Thus, the number of Fund-supported programs with restrictive trade regimes has fallen substantially over the past few years. With regard to tariff reforms, albeit with some conflicts between short-term fiscal objectives and medium-term trade reform goals, they are beginning to receive more attention in Fund-supported programs. But, needless to say, one would also want to see the Fund playing a more effective role vis-à-vis countries without Fund-supported programs.

Let me now focus the rest of my statement on the broad issue of trade liberalization and the consistency of policy advice to the common membership by the Fund and the WTO in the context of a trade policy surveillance function that these two institutions have to implement in the future.

On trade liberalization, we share the views of those who strongly believe that the Fund should continue to emphasize the danger of any form of aggressive bilateralism that incorrectly focuses on bilateralism in trading arrangements without paying attention to the impact on other countries outside these restrictive arrangements. The Fund should be able, with its full analytical capacities, to provide insights on the issue of overall payments imbalances which are determined by such variables as the saving/investment ratio and the behavior of the real exchange rate, both of which are more durably addressed through macroeconomic and structural policy changes than through trade practices. We also believe that the Fund should reinforce its regional surveillance activity, especially in the case of regional trading arrangements, so as to insure that their evolution does not damage the multilateral trading and payments system or adversely affect developing countries that might remain outside such regional groupings.

As far as the relations between the Fund and the WTO are concerned, we share the view that the Fund, through its surveillance activities, will need to provide the WTO with its assessment of the balance of payments situation of its members and offer its opinions on the consistency between macroeconomic and trade policies. In this regard, the various proposals to strengthen the staff contacts of the two institutions, improve mutual access to relevant documents, and undertake joint research are commendable.

Finally, we support the publication of the staff documents.

Mr. Wei made the following statement:

We commend the staff for the high-quality paper which has given a comprehensive review of the recent developments of regional trading arrangements. In general, we share the staff's assessments and conclusions.

While recognizing the difficulties in commending any specific regional trading arrangement because of the different economic and noneconomic dimensions in each of them, I would like to comment on the implications of regional trading arrangements on the Fund's surveillance activities and our view on regional trade liberalization.

First, we could not agree more with the staff that the emergence of regionalism "should not be allowed to divert attention from the fact that the first-best policy is most-favored-nation liberalization, and the ultimate goal is global free trade." The most practical way for the Fund to enhance the effectiveness of its surveillance under a multilateral framework would be to facilitate the inclusion of its members in the international multilateral trading system. We think such action is consistent with the principle of encouraging the integration of member countries in the world economy. It appears that the effectiveness of Fund surveillance might be weakened if the member is not subject to the rights and obligations of the international trading organization.

Despite the many economic advantages of regional trading arrangements, including information transfers, increased competition, accelerated technological change, and the perception of improved investment opportunities, ensuring that they are building blocks to the multilateral trading system is still the subject that requires the attention of the international community. It is certainly inappropriate to present regionalism as an alternative to multilateralism in order to strengthen a future negotiating position.

Moreover, regional trading arrangements should be friendly and nondiscriminatory to nonmember countries. Among the factors outlined in the report that regional trading arrangements are likely to contribute to global trade liberalization, we would like to stress the importance of strengthened discipline on the use of antidumping action against third parties. Regionalism is an integral part of the global trading environment; it will be a "building block" to global trade liberalization only if it is not at the expense of ongoing integration between regions. In this respect, we see merit in the Fund's continuing to study the likely impact of the behavior of different regional trading arrangements on the global trade environment and continuing to press for multilateral trade liberalization.

Let me briefly turn to our views on regional trade liberalization.

Like other speakers, we believe that regional trade liberalization will contribute to economic growth in the region. In East Asia, the staff rightly says that private market forces are a leading factor behind regional economic integration. As a member of the Forum for Asia-Pacific Economic Cooperation (APEC), China strongly believes that unconditional and long-term most-favored-nation trading status among members--which is also the core of the GATT--is the key in bringing about regional trade liberalization. We are also of the view that the principles adopted by the region should be consistent with those of the GATT.

Lastly, on the issue of the Fund's relations with the future World Trade Organization, I share Mr. Daïri's view that it would be in the interests of Fund members if cross-conditionality were to be avoided.

Ms. Lissakers made the following statement:

The staff paper assessing regional trade and economic arrangements is quite a useful component of our effort to increase regional surveillance in this institution. The staff paper is well done, with some limitations--which I will return to--and we generally agree with its conclusions. In particular, as we noted in our August discussion, we share the staff's view that properly constructed regional trading arrangements can be and, in fact, appear to be serving as, building blocks toward multilateral trade liberalization. That is certainly the case with NAFTA, for example. The fear often voiced in recent years of trading fortresses, with some implicit higher barriers and even hostility among regional trading groups, has not materialized. On the contrary, I think one can see clear gains to the global economy through the regional trading arrangements that have multiplied and expanded.

I am a little surprised that a Fund paper on regional trading arrangements barely mentions the spillovers in the financial sector. One can see very clearly through NAFTA, for example, that there are significant side benefits that will, in fact, help to expand trade and commercial activity in the region and between the NAFTA members and the rest of the world--harmonization of accounting standards, greater transparency in securities, disclosure, taxation, technical harmonization, some of which are included explicitly in the agreement and some of which are a consequence of the trade liberalization among the three countries. These are at least as important as straight tariff reductions in increasing world trade and have clear benefits. The opening of the financial services sector in Mexico, for example, which has been restricted up to now, will benefit other countries--non-NAFTA members as well as the NAFTA members.

Mr. Shaalan mentioned reducing the "exclusionary nature" of NAFTA and other regional trading arrangements. If you have a club--like the United States-Canada Free Trade Agreement--and expand the membership of the club by 40 percent, are you more or are you less exclusionary? I would argue that it is less exclusionary. Certainly there are provisions for expanding the NAFTA benefits over time to other members in the region.

The staff paper also rightly points out that in fact the trade-diversion effects of NAFTA for other countries in Latin America and outside the region would appear to be quite insignificant, not significant, as Mr. Jiménez de Lucio seems to suggest. One area that has been of particular concern is textiles and apparel, and the United States is, in fact, prepared to take measures to help the Caribbean region, for example, which has been particularly concerned with this problem. The fact is that many other countries, like Argentina, for example, have never made full use of their textile export quota to the United States, in any event. So the actual diversionary consequences would appear to be relatively insignificant. We are prepared to address specific problems, if and when they arise.

With regard to collaboration with the World Trade Organization, certainly the staff statement indicates that there is considerable activity and useful progress in this area. We think it is very important that this relationship be put on a sound and clear footing from the very beginning, as GATT evolves into the WTO. Obviously, as the WTO is not yet operational, the evolution still has a long way to go, and we would not expect to have fully articulated specifications on how the two organizations plan to work together. But the level of interaction is very positive.

The limited recommendations in the staff statement probably carry the subject about as far as one could expect at this point. We certainly would support the specific suggestions regarding elaboration of the balance of payments consultation, staff contacts, representation, document exchange--which Mr. Al-Tuwaijri seemed to question. In view of our experience and expertise in-house, it is very important that the WTO, as it gets up and running, has the direct benefit of our expertise and advice, particularly for accession countries.

The objectives of the three institutions, the Bank, the Fund and the WTO, are identical, namely, to open the world economy and enhance prosperity across-the-board. Both the Fund and the Bank have been major forces, as is set out clearly in the Articles of Agreement establishing the Fund, for the liberalization of an expansion of world trade even though our specific mandates are different. In dealing with the overlapping areas of interest and responsibility among these institutions a sharper assessment of macroeconomic and trade linkages would be useful. Greater attention to consistency between Fund conditionality and WTO obligations will also be necessary. With experience, I am sure other areas of common concern will emerge that will require more refined delineation of responsibilities.

On this note, two criticisms I have of the report are that I find it somewhat disconnected from the Fund's specific areas of responsibility and activity. It seems to me it would have been useful to draw some conclusions--however tentative--from the analysis of regional trading arrangements for the design of Fund-supported adjustment programs. For example, in designing adjustment programs in Africa, we need to take a more regional approach rather than a national approach, and address more specifically the regional cross-benefits and implications for specific adjustment programs. I am not sure we do that as well as perhaps we should. In light of the analysis of the benefits of intraregional trade expansion, we should address that more specifically. The same applies to the question of the FSU. Mrs. Wagenhoefer's point is well taken in that the paper barely addresses the collapse of trade where there was a regional trading arrangement. The data that we have on intraregional trade ends at 1990, and obviously, the 1990-93 picture in the former Soviet Union and the former Council for Mutual Economic Assistance (COMECON) region would show a very drastic decline in trade. It may be that in our dealings with those countries we did not address as specifically, and as thoughtfully, as we should have the implications of the drastic decline in trade. There may have been things that we could have done and should be doing now in the design of adjustment programs to address specifically that issue of intraregional trade and the preservation of it, and in this case the recovery, to some degree, of that trade.

Mr. Shaalan observed that, with the expansion of membership, the exclusionary character of NAFTA had diminished, but had not disappeared. There were some countries that already made full use of their textile export quotas and would export more if there were fewer barriers.

Ms. Lissakers remarked that the issue was whether regional trading arrangements created any new barriers, and the evidence was that NAFTA had not done so. Furthermore, the conclusion of the North American Free Trade Agreement had not impeded member countries' participation in the Uruguay Round. In fact, the two processes had been complementary. The regional trading arrangement that had created substantial trade-diversion effects was the EU's Common Agricultural Policy. She hoped that the consensus among EU members about a reform of the CAP--as noted by Mrs. Wagenhoefer--would be translated into policy action in the near future.

Mr. Bergo made the following statement:

The staff has presented an excellent and most welcome overview of existing regional trading arrangements, as well as an interesting and reassuring analysis of the consequences of such arrangements, both within and outside the region, even if this analysis, given the multitude of such arrangements with their wide variation in content and nature, almost by necessity must be a little impressionistic. I am certainly pleased with the conclusion that, in general, these arrangements are building blocks rather than stumbling blocks to global trade liberalization. I acknowledge that this is not necessarily so, that the theoretical case is rather ambiguous, and that the "proof of the pudding is in the eating." But I am not particularly surprised by the result, at least not with regard to the European regional trading arrangements with which I have better firsthand knowledge. In these cases, the positive effects on global trade were more by design than by chance. The goal of an open, global trading system has certainly been there all the time.

I admit, of course, that not each and every element in these arrangements is as good as might be wished for from that perspective, and the staff gives examples with which I have no great difficulty in agreeing. Representing three countries that might become EU members in the near future, I must say that I largely share the observations made by Mr. Prader regarding their motives for applying. Representing these countries, I should also have reason to be worried over the outlook for higher prices, and, I suspect, lower quality of the bananas we import in the case of EU membership. And there are other examples. But, by and large, these are exceptions that should not overly mar the positive assessment of these regional arrangements as steps toward an open and liberal trading system globally. And I am glad to see that the staff concludes that most other regional trading arrangements, most notably the NAFTA, can be viewed in the same way. I also note that those regional trading arrangements that were designed more with a view to import substitution were the least successful also in promoting trade and growth within the region. Furthermore, the Uruguay Round has helped, and continued negotiations under the auspices of the WTO in the future will, it is to be hoped, further help in correcting the blemishes of present regional arrangements and keep in check temptations to stray away from the narrow road. Thus my authorities, in addition to their interest in deepening their participation in regional arrangements, are also staunch supporters of continued efforts to advance liberalization at the global level. This chair's consistently positive attitude toward both unilateral and multilateral trade liberalization must be seen in that perspective. Of course, the Fund also has an important role to play in continuing to press for liberalization and to resist protectionism. There is a case for vigilance here.

Let me, at this point, also say that I believe the staff has a good starting point in the suggested general guidelines for assessing the regional trading arrangements in its surveillance, in the context of Article IV consultations and otherwise. The increased number and importance of regional trading arrangements is certainly also an additional argument for increased emphasis on regional surveillance.

Although the overall trend has so far been toward a more liberal regime of trade, and also has been extended to other forms of international relations, as for example capital movements, there are simultaneously strong pressures for using different kinds of protectionist measures. Often they are easily recognizable as such, and should be withstood, even if the ability to fight back special interest groups certainly could be improved in many countries. However, sometimes--and increasingly so--the requests for trade measures come under the disguise of worthy causes. Even when there are no protectionist intentions present, care must be taken not to overload trade policy with such objectives, which can easily distort its primary function of efficient resource allocation. The same would often go for antidumping actions, which should be avoided to the fullest extent possible. Because these allegations can also appear in the context of the changed exchange rate, the disputes can also come to the area where the Fund has a policy responsibility. Hence, there is a clear need for close collaboration between the Fund and the WTO in this area. I would agree, however, that it would be more appropriate to discuss fully the future collaboration between the institutions when the legal paper is available, it is to be hoped in the very near future.

Let me also point to a few additional areas where, in my opinion, regional trading arrangements have contributed positively to world trade.

Even if I voiced skepticism about the introduction of too many objectives in trade policy, I certainly do not deny the need for standards on product safety and consumer protection in trade arrangements. In these areas, I would argue that the large regional trading arrangements have contributed importantly in unifying standards, and thus reduced what might in practice have constituted serious impediments to trade both within a region and with other regions.

Procedures for settlement of disputes and limitations on subsidies agreed within a regional trading arrangement will also often have positive effects on interregional trade through the establishment of clearer rules and increased transparency, which it could be difficult not to apply also to trade with other regions.

Lastly, I would certainly be happy to see, as suggested by Mrs. Wagenhoefer and others, studies on the recent collapse and future prospects for trade between transition countries.

Mr. Fukuyama made the following statement:

The staff paper on regional trading arrangements is a useful survey, concisely describing characteristics of regional trading arrangements and their merits and demerits.

It is encouraging that the paper draws the conclusion that regional trading arrangements in general are beneficial. At the same time, however, we notice some descriptions in the paper that the EU and the NAFTA, at least to a certain extent, divert trade and bring about adverse effects to consumers in member countries and producers in nonmember countries. Therefore, as this chair argued in August, the Fund should continue to monitor the development of regional trading arrangements so that they are not stumbling blocks but building blocks to the multilateral trading system.

On collaboration with the World Trade Organization, a potentially complicated issue is how to ensure consistency between assessment and advice on trade policies by the WTO and assessment and advice on macroeconomic policies by the Fund.

Although we must wait for the forthcoming paper on the jurisdictional aspects, I do not find any obvious need to create a new framework for that purpose, at least at this stage. Close contacts between the Fund staff and the WTO staff at various levels will prove to be the most effective channel.

Mr. Evans made the following statement:

I will start by making one or two comments on the staff paper, which was very helpful, and then move on to discuss the issue of coordination between the WTO and the Fund.

Like Ms. Lissakers, I think that it is helpful for Fund surveillance of individual countries to be set--and perhaps set more than we have done in the past--in the context of regional developments and trade in the region. Mrs. Wagenhoefer made a point about the need for and hope for fundamental reform of the Common Agricultural Policy. The good news there is that 95 percent of the people in the European Union would benefit from such reform, plus others outside, and the prospect of accession of countries in Eastern Europe should concentrate the mind. But, of course, the bad news is that the 5 percent or so of vested interests have been extremely effective in the past in resisting change. Therefore, we must all work to ensure that this hope becomes a reality.

On the issue of regional trading arrangements, I think some people may find it a little surprising that multilateral trade negotiations have often made very slow and painful progress, whereas regional trading arrangements have been embraced with rather more enthusiasm. Quite a lot of countries seem happy to open up their domestic industries to competition from their neighbors, recognizing the mutual benefits of trade within a region, and yet are reluctant to extend the logic and accept the benefits of global free trade. Of course, that is partly because of the complexity of negotiating agreements multilaterally, but in all probability, political factors are more important. We have already been reminded that in many of these regional trading arrangements, the political factors--and this applies to the European Union, in terms of the single market, and indeed to other arrangements such as monetary union--are often the driving force. The fact that this is the underlying motive does not, of course, take away from the need for serious economic analysis. In fact, it reinforces that need. I wonder if the staff would like to comment on the view that, as we are moving to a world where there are a smaller number of regional trading arrangements, negotiating reductions in tariff barriers and other barriers to trade between these regional trading arrangements may itself help the process of global liberalization.

A number of colleagues have referred to the possibility of distortions because of trade diversion. One of the areas where I would be particularly concerned is the risk that investment flows get distorted because of the cost in reversing investment when external barriers are shifted. The evidence presented in the paper is that distorting effects have been quite limited, and I very much welcome the staff statement that worries about "fortress Europe" have been unfounded.

With regard to the publication of this paper, I would be very happy to see a version of this paper--no doubt taking into account comments made here--published.

On the question of cooperation between the Fund and the WTO, I think it is useful to say a few words now, and we will need to discuss it later. The history of cooperation between this institution and the World Bank illustrates the hard work that needs to go into this kind of cooperation over a period of time. After all, here we have two institutions separated only by 19th Street and yet it has required, on the part of the staff, management, and

Directors, a sustained, and I would say, largely successful effort to ensure successful cooperation. We have to ensure that in the future there are good and close relations between the WTO, the Fund, and the Bank. Simply defining areas of responsibility in broad terms, however necessary, is only a first step. There need, as well, to be good contacts between the organizations--information flows, identification of problems--at an early stage.

If we are talking about contacts between staff members, we need to bear in mind the importance not just of contacts at senior levels, but also at working levels as well. Secondments are an important way of helping and developing these contacts. A few years ago, when I was talking with the European Commission, I was struck by how the secondment of a Fund staff member--particularly a rather persuasive and influential one--to the Commission really did improve their understanding of the Fund's work and what it could do. That secondment, I am sure, prevented quite a number of misunderstandings developing.

Another lesson is that the creation of the WTO in Geneva means that it is even more important than in the past for the Fund to be well represented there. That does not mean a substantial increase in staff. The importance of representation in Geneva is going to be even greater than in the past. But the whole issue of relations between the WTO and the Fund is one we shall need to come back to and discuss in detail.

Mr. Smee made the following statement:

As one member of this Board that has pushed for including more regional focus in the Fund's analysis, I welcome the paper prepared for today's discussion on regional trade arrangements. I see it as a useful building block to providing greater integration of regional issues into the Fund's surveillance of individual member's economic policies and its policy analysis.

I endorse the paper's main conclusions, in particular, that regional trading arrangements can be beneficial to multilateral trade liberalization if they are properly conceived and implemented consistent with Article XXIV of the GATT. This was my own country's objective in pursuing a two-track strategy of regional trade liberalization through the Canada-U.S. Free Trade Agreement (CUSFTA) and then to build on through the NAFTA, while also pressing forward on multilateral trade liberalization through successful completion of the Uruguay Round.

Progress achieved in the area of intellectual property trade liberalization is just one example of how tackling such an issue in the context of regional trading arrangements--as was done in

CUSFTA and NAFTA--can help to spur progress in trade liberalization on a broader front at the multilateral level.

As I mentioned earlier, I see the paper before us as a first step in improving the regional aspects of the Fund's surveillance. I believe that its analysis needs to be followed up by including an annual assessment of regional trade issues and/or their impact in the Fund's individual Article IV exercises and programs for those countries involved in regional trading arrangements and, perhaps more important, with regard to the impact of regional trading arrangements on nonmember countries.

During our discussion of the comprehensive trade paper in August, I advocated setting up more formal contacts for collaboration between the Fund, the Bank, and the WTO. The staff statement on this issue is very much welcome and makes more concrete the means to improving policy coherence and collaboration among the institutions. In particular, I fully support the exchange of documents between the Fund and the WTO and the establishment of regularized meetings between senior staff.

Nevertheless, several of the ideas raised to ensure policy coherence seem to rely on voluntary exchanges between the Fund staff and the WTO staff. I would prefer to make these more formal through an explicit agreement on collaboration among the three institutions. For example, analysis of the impact of regional trading arrangements on nonmember countries or the impact of regional trade issues in the Fund's individual Article IV exercises would benefit, I believe, from direct and formal involvement of the WTO. I look forward to discussing this matter in more depth at our discussion on the legal implications for the Fund of the Uruguay Round.

I am rather puzzled by some of my colleagues wanting to look back at the collapse of trade in the former Soviet Union in this discussion of regional trading arrangements. Trade among the FSU countries was based neither on most-favored-nation status, nor on market forces; they did not have convertible currencies; and they did not belong to the GATT. It is an important issue and it is interesting perhaps to look at, but I do not know why one would ask to look at it in terms of looking at regional trading arrangements and their relationship with economic policymaking and multilateral liberalization. Let us examine, if that is what people want to, the impact of trade collapse on COMECON, and what may have contributed to it, but I do not know what that says about regional trading arrangements at all, or should say anything about it.

Mr. Bergo raised the issue of bananas; I have some countries that produce bananas, so I cannot let this remain just sitting there. As we all know, products are not a matter of price only. I think what you fail to recognize, Mr. Bergo, is that now, with the single market, the European Union can taste the higher quality of Caribbean bananas that perhaps were not available to them before.

Mr. Desruelle recalled that the speakers who had mentioned the issue of COMECON trade were interested in the future prospects of trade among those countries. Their close proximity and diversity made them natural trading partners. It could be expected that if they joined the GATT/WTO, trade would pick up. But a multilateral approach to liberalization could possibly be complemented by a regional approach to liberalization. Whether a regional approach would facilitate trade in the region was a question that deserved further study by the Fund.

Mr. Dlamini made the following statement:

Regional trading arrangements can hardly be considered a new phenomenon. They seem, however, to be assuming an increasingly important role in the relations among the various countries. Nevertheless, the multilateral trading system is still alive, having received a new lease on life with the recent completion of the Uruguay Round. The two are not mutually exclusive, and many developing countries consider efforts to expand regional trade to be an important pillar of their development strategy. This is certainly the case in Africa which has just ratified the Abuja Treaty establishing the African Economic Community. There are also smaller regional arrangements in Africa such as ECOWAS (Economic Community of West African States) and SADC (Southern African Development Community) which have the potential of becoming building blocks toward the larger African economic union, thereby promoting greater trade liberalization.

The aim of such arrangements is clear, that is, to exploit economies of scale associated with a larger market. But there are serious obstacles, both economic and institutional. Therefore, it is important to give priority to developing appropriate institutional mechanisms to support the integration process. African countries will need the technical support from the international community in this endeavor. Also, reform and adjustment programs should pay greater attention to the issue of diversification which would give rise to complementarity within the region.

It is expected that the progress already made under some regional integration arrangements would continue to build on the basis of the guidelines set out in the GATT Article XXIV, thus ensuring the complementarity of these arrangements with the goal of global trade liberalization. Although there is little doubt that the regional trade arrangements will continue to coexist with the global trading system, the importance of maintaining an outward orientation that would prove beneficial for the purpose of trade creation, minimizing tariff restrictions and liberalizing procedures to facilitate the accession of newer members cannot be overemphasized. It is also vital that the resurgence in the regional integration mechanisms be closely and tactfully monitored in order to avoid potential risks of trade tensions and protectionism.

Regarding the issue of the collaboration of the Fund with the World Trade Organization, it seems for the time being that the current informal mechanisms of consultation and cooperation have worked well and therefore could be maintained. The important factor is that cooperating partners should be fully aware of the specific responsibility of each institution over a certain economic domain, and more important, of its autonomy in decision-making. While the collaboration with the WTO--and the possible involvement of the World Bank too--is fundamental for the purpose of attaining policy consistency, duplication of work should be avoided, which could be achieved through a more systematic sharing of information, without jeopardizing confidentiality.

Mrs. Arraes made the following statement:

Regional trading arrangements have been instrumental in fostering liberalization before the completion of the Uruguay Round. However, this chair agrees with the view that interest in regional trading arrangements will remain strong even after the completion of the Uruguay Round. The main explanation is given by the staff in the document. Uruguay Round-related reasons are only one cause in a list of several. For developing countries, economic incentives, mainly the possibility of exploiting economies of scale and attracting investment by expanding the regional market, are an even more important motivation for the formation of regional trading arrangements as a means to face global competition.

In the case of MERCOSUR, the possibility offered to lock in domestic policy reform was an important driving force. The case of Argentina is mentioned in the document. I want to mention briefly the case of Brazil. MERCOSUR had an important anchor role in the process of opening up the Brazilian economy. The Asuncion Treaty and the automatic tariff cuts were approved by Congress and turned into law, which made it much easier to implement the provisions. Brazil was also a showcase for the consumer benefits derived from a more open economy. From 1990 until today, the Brazilian economy has become more competitive and efficient; trade has been liberalized--not only within the MERCOSUR--but globally.

The point we just made on Brazil shows that we agree that regional trading arrangements can constitute building blocks to the liberalization of international trade. Moreover, regional trading arrangements should be as wide as possible in coverage of trade among the countries of the regional trading arrangements in accordance with Article XXIV of the GATT agreement and the Uruguay Round understanding.

Finally, a brief comment on NAFTA. Trade diversion can be important for selected sectors or countries, including some of this constituency. The Fund should encourage NAFTA members to spread the benefits of liberalization to a wider group of countries and, eventually, globally, as mentioned in the report.

Mr. Tetangco made the following statement:

The way the staff paper is written, it is tempting to focus solely on the static gains and losses that could result from a regional trading agreement. This is probably because these are easier to conceptualize and the possible gains from trade creation and possible losses from trade diversion are relatively easier to measure. However, one thing is clear: there are dynamic impacts of establishing a trade agreement that can be significant and should not be ignored. Our experience with Article IV consultations suggests that, over time, the second round or indirect impacts of a policy initiative can be very important, and I support the proposal to include an assessment of the effects of pertinent regional trade agreements in members' Article IV consultations. Because the presence of indirect benefits is true for individual economies, it is also likely to be true for the international economy.

In the case of the Asia-Pacific Economic Cooperation Forum (APEC), for example, member countries produce similar goods and services for export and, therefore, reducing internal trade barriers was initially perceived as not leading to large economic gain. Recent findings, however, indicate that lowering or eliminating intraregional tariffs would result in a significant increase in intra-APEC trade. This is now clearly supported by available data. In the future, businesses in these countries are expected to continue to reap considerable benefits from the increased competition and improved investment opportunities that a trading arrangement can bring about.

A second point that I think is worth mentioning is that governments are rarely successful in taking the lead in developing international trading relationships. Governments can and do alter private sector decision making on trade and political considerations can play some role. But at the end of the day, the private sector usually deserves most of the credit for breaking new ground, as rightly observed by the staff and previous speakers. In this context, it appears to me that many of the recent trade agreements in which considerable progress has been made are simply an official recognition of the trading arrangements that have already been established by private businesses.

There appears to be a strong perception among businessmen in Asia, for example, that the APEC agreement is a natural progression; governments started talking about making regional trade agreements in the Asia-Pacific area well after strong ties between businesses in the various member countries had been formed.

Indeed, businesses in Asia and the Pacific are sending a clear message that they cannot wait for governments to react to the changing economic environment, and that they will go where bureaucracy is minimal and government procedures are straightforward and transparent. Moreover, businesses are the ones urging heads of government in the region to reform procedures and regulations more quickly to assist them in exercising their comparative advantage.

Where private sector ties between countries are not strong, the foundations for governments to reach trade agreements are less solid. These agreements have less chance of achieving positive results, and run the risk of having an adverse impact on the economic well being of those they are designed to help.

Ms. Lissakers wondered why Japan's intra-regional trade as a share of GDP had remained virtually unchanged since the 1950s, while that of developing countries in Asia had increased substantially. It would have been useful if the paper had included an analysis of the direct investment flows in the region, and, in particular, of whether there was a correlation between investment flows and intra-regional trade.

Responding to Mr. Smee's query on the utility of studying trading arrangements in the former COMECON countries, Ms. Lissakers considered that it was important in the design of Fund-supported programs to pay greater attention to the revival of intra-regional trade on a market-oriented basis.

Mr. Glazkov commented that new regional trading arrangements in the FSU countries were emerging, but those countries were not experienced in trade-related matters and needed guidance. Thus, the Fund should pay close attention to trade issues in those countries.

The Acting Chairman noted that, although Directors considered that the collapse of regional trading arrangements in Eastern Europe and the FSU countries raised interesting questions, they agreed that the important issues of trade arrangements among those countries lay in the future.

Ms. Lissakers remarked that, as the staff paper was largely retrospective, it could have included a section on the disappearance of COMECON, and the consequences of that for the economies of the region.

The staff representative from the Policy Development and Review Department observed that the staff had not focused on the defunct COMECON because a staff paper dealing exclusively with FSU trade policy had been prepared a year earlier and had been discussed by the Board. Moreover, the impact of COMECON on eastern Europe and the FSU had already been extensively studied by the World Bank, other institutions, and in academic circles; and the Fund staff's assessments had been included in various Article IV reports, in working papers, and in the world economic outlook paper.

Although the staff paper had not studied in depth the spillover effects of regional trading arrangements, such as in the financial sector, the paper had made reference to them in the discussion on the European Union, for example, harmonizing product standards, accounting standards, and so forth, and other spillover effects were mentioned more generally in the discussion of increased regionalism, the staff representative said. The section on NAFTA had mentioned the importance of liberalization in the banking, insurance, and brokerage sectors, and in the area of investment.

The dearth of intraregional trade in sub-Saharan Africa was partly the result of the history of that region, the staff representative explained. Many of those countries were not natural trading partners because they specialized in producing primary products. Those countries had inherited trading relationships from their colonial past, and undoing those would take some time. Another reason for the lack of intraregional trade was that their policy orientations were not conducive to trade. For instance, manifestations of an outward orientation, such as the removal of export restrictions, promotion of currency convertibility, and adoption of prices closer to international market prices could be found in East Asia, but were lacking in sub-Saharan Africa. The importance of an outward orientation for growth and trade had been analyzed by the staff in the comprehensive trade paper (SM/94/192, 7/19/94). The World Bank, in a study entitled the "East Asian Miracle," and another on adjustment in Africa, had reached similar conclusions.

Finally, the staff representative from the Policy Development and Review Department confirmed that the staff was planning to publish the paper on regional trading arrangements together with the comprehensive trade paper in early November; any further comments by Directors prior to publication would be appreciated in the course of the following week.

Another staff representative from the Policy Development and Review Department recalled that the 1991 staff paper on regional trading arrangements--published in 1992--had extensively explored efforts toward regional integration among developing countries; hence, the current staff paper had not focussed on this aspect. During the 1960s, 1970s, and part of the 1980s, developing countries of sub-Saharan Africa, as well as in Latin America, had adopted import-substitution policies, which entailed high tariffs and quantitative restrictions on imports. Such policies were not conducive to trade liberalization on a regional basis or meaningful regional integration. However, many of those countries were beginning to liberalize trade both regionally and globally, that is, according to the most-favored-nation principle, and it could be expected that, with increased liberalization, regional trade would pick up; hence, current efforts toward regional integration had a better chance of success than in the past. The staff was attempting to take better account of the implications of regional trading arrangements in its analysis. Where countries were keen to intensify regional integration, the staff was advising them to liberalize internally and to reduce external barriers simultaneously, so that regional integration furthered multilateralism; this approach was being adopted, for example, in designing programs in the 13 member countries of the Cross Border Initiative (CBI).

The tables on extra- and intraregional trade could be used as rough indicators of the extent to which regional trading arrangements had produced a greater regional concentration of trade flows; as the paper had pointed out, they should not be considered to provide definitive evidence on whether regionalism was occurring at the expense of deeper extraregional trade, the staff representative noted. A number of other factors, such as changes in comparative advantage, technology, factor endowments, and consumer preferences, as well as noneconomic events, affected intra- and extraregional trade. The trends in extraregional trade since 1958 for Western Europe, North America, and Japan were quite different: North America's extraregional trade as a share of GDP had doubled, Western Europe's had declined slightly, and Japan's had remained relatively stable. Hence, the similarity of the ratios for the three groups in 1990 was, in all probability, a coincidence. In any case, it could not be definitely concluded that, as industrial countries matured, their ratios of extraregional trade as a share of GDP must necessarily decline or converge on some universal constant. It was true that the ratios of Japanese trade both within the Asia-Pacific region and outside that region had remained stable, but this had little to do with regional trading arrangements--Japan was not a participant in any formal regional trading arrangement except APEC, which was a cooperation agreement and not a free trade area as normally defined.

Increasing the number of regional trading arrangements would facilitate multilateral liberalization, provided that the creation of regional trading arrangements was accompanied by a continuous process of most-favored-nation liberalization; if not, there was a risk of conflict among regional trading arrangements, the staff representative considered.

Finally, on the question that Fund advice might not always be consistent with a country's GATT/WTO obligations, the staff representative explained that the World Bank and the Fund often advised countries to reduce the level and dispersion of their tariffs with the aim of both reducing protection levels, as well as reducing government intervention in decisions about tariff levels for different industries. Because a lowering of the high tariff levels had fiscal consequences, in some cases the Bank and the Fund advised a country to reduce tariff dispersion by raising the lower levels; that might not be consistent with the member's obligations under the GATT in cases where the tariff increases went beyond "bound" levels. In such cases, it was necessary to reassess the advice or obtain a GATT waiver prior to implementation.

Mr. Daïri wondered whether the growth in intra-regional trade had occurred at the expense of extraregional trade.

The staff representative from the Policy Development and Review Department replied that the evidence pointed to the fact that thus far extraregional trade had increased absolutely and in line with GDP, or at least had not declined significantly, despite the proliferation of regional trading arrangements. Of course, that did not mean that extraregional trade might not have increased even faster if liberalization had been on a most-favored-nation basis rather than a regional basis.

The Acting Chairman observed that the substantial growth in intra-industry trade might explain why intra-regional trade had grown faster than global trade.

Mr. Glazkov commented that it would be useful to analyze trading arrangements of the transition economies in the framework of the standard trading arrangements to assess the progress in trade and economic relations between those economies.

The staff representative from the Policy Development and Review Department remarked that the staff planned to study, in the following year, major issues of trade policy in the countries of the former Soviet Union and their integration into the multilateral trading system.

The Acting Chairman made the following summing up:

> Today's very interesting and constructive discussion has focused on the increasing trend toward regional trading arrangements; the consistency of such arrangements with the long-term objective of global free trade; and the role of the Fund in monitoring and assessing the economic implications of such arrangements.
>
> Speakers generally emphasized the first-best policy of most-favored-nation liberalization and the goal of global free trade. They welcomed the evidence that the trend toward regional trading arrangements had thus far been broadly consistent with the objective of global trade liberalization. The successful completion of the Uruguay Round, in particular, seems to support the view that regional and multilateral trade liberalization may be complementary. A number of Directors cited developments in Europe as evidence that successful regionalism can propagate itself, spreading trade liberalization outward across a growing number of countries. A similar process appeared to be developing in the Western Hemisphere, and many speakers expressed the hope that the North American Free Trade Agreement (NAFTA) would become a

catalyst for deeper hemispheric economic integration in the context of multilateral liberalization.

At the same time, however, the statements of Directors revealed a strong note of caution against complacency about the spread of regionalism. The development of regional trade arrangements could have potentially adverse effects on countries that are left out of such arrangements. Even in those cases where trade diversion resulting from a regional trading arrangement was estimated to be minimal in the aggregate, there might be uneven effects on individual countries; some could experience disproportionate trade diversion, implying possibly significant economic dislocation. This might occur, for example, for a small country and/or when a country's export base was relatively concentrated and directed predominantly toward the market of a country entering a regional arrangement. Thus, unfettered regionalism was not without risk.

Given that the interest in pursuing new regional initiatives is likely to continue in the foreseeable future, Directors considered that it is all the more important for international institutions such as the Fund to continue to emphasize that regional trading arrangements should develop as building blocks for multilateral trade liberalization and global free trade rather than as stumbling blocks to multilateral liberalization. Directors encouraged participating countries to design and implement regional arrangements with a view to this ultimate goal. In addition to ensuring consistency with the rules of the General Agreement on Tariffs and Trade and the World Trade Organization, this could be done, for example, by undertaking multilateral liberalization along with moves to eliminate regional barriers to trade and investment; by the regional entity being open to accession by new members in the spirit of inclusion rather than exclusion; by strengthening discipline in the use of antidumping actions; and by implementing simple, transparent, and liberal rules of origin that did not operate to keep markets closed to third countries.

Directors emphasized that the Fund's interest in monitoring developments in regional trading arrangements is essential to its surveillance function. Some Directors emphasized that Article IV consultations might benefit from more analysis of the implications of regional trading arrangements for members and nonmembers alike.

Directors also offered preliminary comments on collaboration with the WTO on the basis of the staff's statement on this issue; they emphasized the need for collaboration between the Fund and the WTO and among the Fund, the WTO, and the World Bank. They noted that there would be further opportunity to express their views on the subject at the time of the consideration of the paper on the legal implications of the Uruguay Round for the Fund.

Directors welcomed the recent staff dialogue with Bank and GATT staffs, which was working toward an eventual framework for Fund-WTO collaboration. They agreed that it was important to build on existing channels of collaboration with the GATT, including in the areas of Fund participation in balance of payments consultations, consistency of policy advice, strengthening staff contacts, representation, and document and information exchange. Similarly, Directors thought it would be useful to hold periodic meetings between appropriately senior staff of the Fund, the WTO, and the Bank to review issues of mutual interest.

Noting that collaboration is an evolving subject which will develop further as the WTO is established and gains experience, Directors generally took the view that the staff statement carried specific suggestions for Fund-WTO collaboration about as far as it could go at this stage, pending examination of the legal implications for the Fund of the Uruguay Round and the scope and need for more formal collaborative arrangements between the Fund and the WTO.

I also note the wish expressed by some Directors that the staff revisit and update developments in trade and trading arrangements between the former Council for Mutual Economic Assistance countries, and examine how this trade can be promoted in a multilateral framework. The forthcoming statement by the Managing Director on the work program will include further information on this matter.

2. WESTERN SAMOA - 1994 ARTICLE IV CONSULTATION

Executive Directors considered the staff report for the 1994 Article IV consultation with Western Samoa (SM/94/227, 8/23/94, and Sup. 1, 10/17/94). They also had before them a background paper on recent economic developments in Western Samoa (SM/94/261, 10/6/94).

The staff representative from the Southeast Asia and Pacific Department stated that he had received information that the Central Bank had ceased granting permission for imports of automobiles that were more than five years old. He also noted the following corrections to the tables in the staff report: Table 6, the figures for the fiscal deficit as a percentage of GDP should read 21.9 percent for 1992/93 and 11.6 percent for 1993/94; Table 2 of the staff report should be replaced by Table 1 of Supplement 1.

Mr. Tetangco made the following statement:

Western Samoa's economic growth in real terms has been moderate, averaging about 2 percent in the 1980s. Since 1990, however, the average annual rate of economic growth has been negative owing to natural disasters, with the country experiencing damaging cyclones in both 1990 and 1991. Following this spate of disasters, the authorities undertook an extensive rehabilitation program, which boosted GDP growth to 5 1/4 percent in 1993.

Last year, however, the main cash crop, taro, was struck by a leaf blight, which has caused extensive damage and will take some time to correct. This problem, as well as the decline in construction as rehabilitation activities wind down, will have a substantial impact on real GDP in 1994, with output possibly falling further than the projected decline of 5.5 percent.

Notwithstanding these setbacks, Samoa's slow economic growth and balance of payments problems also stem from structural weaknesses in its economy. As the country is heavily dependent on a narrow range of crops, natural disasters tend to have a pervasive effect on the entire economy.

It is for these reasons that my authorities are intending to pursue a medium-term strategy that will diversify Samoa's agricultural base, expedite privatization, and expand tourism and other services further.

The short-term financial outlook will be difficult owing to the accommodating stance of fiscal and monetary policy since 1993 to allow for rehabilitation of damaged infrastructure and residential buildings. However, efforts were made in the 1994/95 budget to contain the budget deficit to about 3 percent of GDP from 11.6 percent in the 1993/94 fiscal year.

Since approval of the 1994/95 budget in June this year, the massive debt-obligations of the national airline have necessitated consideration of a supplementary budget by Parliament late this month. It is estimated that the magnitude of indebtedness stands at WS$73.0 million, with government-guaranteed debt of WS$43.0 million due in the current financial year.

As a first step toward improving the operations of Polynesian Airlines, my authorities have decided to provide debt relief by assuming responsibility for the settlement of the company's debts incurred up to August 31, 1994. As well, a massive restructuring program is now under way, as described in the supplement. The Government is also anticipating further financial assistance to the airline under guaranteed arrangements, to be spread over a period of four to five years. To meet current airline debt obligations of WS$43 million, the authorities propose to provide financing from budget savings, proceeds from the sale of some of its assets, and a national development loan.

This turn of events means that the external position will continue to deteriorate in 1994, as the Government's net foreign assets are drawn down. Currently, gross international reserves are at about five months of import cover. As the staff has pointed out, the deterioration in the fiscal position could further reduce reserves by 25 percent in 1994. However, my authorities feel that the continuing improved performance of the tourism and services sector, as well as the anticipated gradual recovery in agricultural production may provide some relief toward mitigating the effects of this downward trend. It is also anticipated that with the recovery now under way in the United States, New Zealand and Australia, private remittances from Samoans living abroad will improve from their current low levels.

My authorities believe that the fiscal and balance of payments impact of Polynesian Airlines will be a continuing challenge to sustaining recovery in the short to medium term. However, they have no alternative but to absorb the costs for now, and plan for more stringent measures to improve the fiscal position in the medium term, while also maintaining tight monetary policy to contain the destabilizing effects of its fiscal stance. In the meantime, they will continue to exercise restraint in other areas such as salaries and wages, while also examining options to further downsize the public sector.

On monetary policy, my authorities acknowledge that the stance in the last two years had been fairly expansionary. However, the extent of damage to the physical infrastructure and residential buildings required urgent rehabilitation action in order to minimize hardship, and aid recovery of the economy. Currently, monetary policy has been tightened to protect the external position as well as contain inflation. This involves primarily limiting expansion of credit over the last year's ceilings from the Central Bank to the two commercial banks in operation. The Government is also pursuing parliamentary approval of a Financial Institutions Bill, which will extend the Central Bank's supervisory role to nonbank institutions such as the National Provident Fund (NPF), the Development Bank, and the Western Samoa Life Assurance Corporation.

Samoa's exchange system is free of restrictions on payments and transfers of current international transactions. Accordingly, my authorities have informed the Fund of their willingness to accept the obligations of Article VIII Sections 2, 3, and 4.

Finally, my authorities wish to record their appreciation to the Fund for its continuing support including the provision of technical assistance. The frank exchange of views with the staff, and their helpful advice also provided a basis for continuing internal scrutiny of my authorities' policies.

Mr. Shields made the following statement:

The economy of Western Samoa has clearly been through an extremely difficult time. It seems as though as soon as reconstruction from one disaster is under way, another hits. Nevertheless, it did at least appear at the time of the Board's last discussion in 1992 that the macroeconomic consequences were being dealt with; inflation was being brought under control while output was projected to pick up. However, the latest projections, following on further disasters, suggest another surge in inflation, bringing the rate to 18 percent, even higher than back in 1991; meanwhile, output is projected to fall by over 5.5 percent this year.

While much of this performance can be explained by natural, unavoidable events, the latest shock to hit the economy has been, as one might observe, rather more the product of human forces: the large losses of Polynesian Airlines which are now causing havoc to the budget and adjustment costs to many. This episode is a clear lesson in the dangers of giving government guarantees to enterprises. Having said that, I applaud the authorities for their decisive action in cutting back on unprofitable routes and in sharply reducing the size of the work force.

On monetary policy, I recognize the need under the current system of monetary controls to bring the nonbank sector under a regulatory environment consistent with that of banks, as set out in the Financial Institutions Bill. However, this extension of quantitative controls makes it even more important that credit ceilings are imposed in a way that interferes as little as possible with market structures and with potential competition. It is crucial that controls not be substitutes for an appropriate level of interest rates, but supports for them. It is always tempting to impose draconian limits on one sector so that other sectors, the government or the central bank, can gain cheap credit for themselves. Such distortions simply accumulate problems for the long run, as fiscal imbalances get covered up and resources are misdirected. This is not a plea for a premature ending of controls, but for a balanced use of them. The point is that, as the staff appraisal recommends, the general level of interest rates should also rise.

The economy has already suffered a 5 percent fall in output this year. The cutbacks in Polynesian Airlines, and the fiscal measures taken to offset these losses, combined with the suggested rise in interest rates will, themselves, have a further depressing effect on the economy. In these circumstances, I wonder whether an exchange rate policy that does not accommodate the recent inflationary surge might be too restrictive. The fiscal and monetary measures themselves, despite the hole caused by the problems of Polynesian Airlines, will provide some support to the nominal exchange rate. But to suggest, as I think the staff does, that the whole of the loss in competitiveness caused by the relative rise in costs should be sustained as a counterinflationary force, seems rather arbitrary and perhaps draconian. Two alternatives would be to either make exchange rate policy more passive with an emphasis on getting domestic monetary policy better balanced, or to accept a further adjustment in the rate.

These obviously have been difficult, and at times distressing, years for the economy of Western Samoa. The authorities have shown themselves willing to take firm action to put the economy and its institutions back on track.

Mr. O'Connor made the following statement:

We commend the authorities in Western Samoa on their acceptance of the Article VIII obligations. The authorities also deserve credit for their diligent efforts to reconstruct their battered economy following a series of natural disasters over the past few years. Until the most recent agricultural setback, these efforts were yielding obvious economic gains.

We are in general agreement with most of the staff's appraisal. In particular, we too applaud the authorities' decision not to push through the recent negative supply shocks by accelerating demand growth, but instead to continue along a path of patient restructuring. The recent steps, outlined in the staff supplement and Mr. Tetangco's statement, are indicative of the authorities' commitment to this approach. The program is designed first to resolve the operating losses of the national airline by rationalizing and downsizing its operations and then to control the program's impact on the fiscal deficit. We urge the authorities to remain committed to their fiscal program in order to limit the future growth of public sector debt, which could sidetrack their restructuring efforts.

In this regard, we agree with the authorities that industrial diversification, partly through the development of its tourism industry, is a relevant goal for the economic reconstruction. But, as the staff suggests, this goal may be more effectively accomplished in conjunction with programs to privatize state enterprises that are solvent and to relax price controls, including trade tariffs.

This chair has been sympathetic to the authorities' measured pace in liberalizing interest rates and credit controls in periods of reconstruction. This sympathy was predicated on the authorities' acknowledgement that prolonged reliance on interest rate restrictions and credit controls is ultimately distortionary and potentially destabilizing for the financial economy.

However, the financial distortions now seem to be more pronounced and, indeed, have contributed most likely to the severity of the recent macroeconomic instability in Western Samoa. Negative real interest rates on bank deposits have resulted in disintermediation. Nonbank financial institutions now participate directly in funding domestic credit growth at positive real interest rates. Inflation is rising even after adjusting for value-added tax changes, resulting in real exchange rate appreciations. Also, net foreign assets are declining, thereby reducing the cushion against future negative shocks, even though gross reserves are as yet still stable.

Accordingly, we would urge the authorities to direct their efforts once again toward further development of a market-oriented financial system. Although small, the financial sector is open to foreign participation and is well diversified with a variety of banking operations and with insurance and pension fund organizations. The Financial Institutions Bill, which will provide the Central Bank with broad supervisory powers over these institutions, could become the platform for financial liberalization rather than additional restriction. Indeed, effective markets for the Government's development bonds, which are part of the new fiscal financing package, and for the Central Bank's securities depend critically on such liberalization.

The authorities could start by quickly finalizing the privatization of the Post Office Savings Bank. At the same time, the ceilings on commercial bank loan rates and informal restrictions on consumer lending should be eliminated to permit bank loan rates to approach the higher loan interest rates in nonbank credit markets. The authorities should also allow the banks to raise savings deposit rates in line with their more competitively determined time deposit rates.

In view of the Government's new financing program, the staff or others may wish to comment on the advisability and timing of financial liberalization.

Mr. Ryan made the following statement:

For a small economy dependent on a limited range of products, the impact of natural shocks on productive activity can be especially severe. By the same token, mismanagement of even one state-owned enterprise can have a similarly exaggerated impact on macroeconomic conditions, as evidenced by the restructuring costs of Polynesian Airlines. While the Western Samoan economy is inherently vulnerable to the impact of natural disasters, more can be done to reduce the impact of public sector miscues. Downsizing the public sector's role in the economy is the general tack that needs to be pursued.

To their credit, the authorities have begun this process--albeit under rather forced circumstances. The restructuring plan for Polynesian Airlines is appropriately far-reaching. It will entail substantial short-term fiscal costs--although the staff suggests some possibility of smoothing the impact through rescheduling of debt obligations. These costs, in turn, appear to have provided an impetus to broader goals of accelerating privatization and reducing government expenditures. The substantial increase in the Government's role in the economy in recent years can be traced in part to the substantial costs associated with post-cyclone reconstruction, but current expenditures have shot up as well, as noted in the staff paper.

The supplementary budget addresses the need to offset some of the costs associated with Polynesian Airlines' losses, but a more strategic effort to trim back the growth in public sector departments and employment would also seem in order. Increases in some areas, such as social services and land titles and surveys, appear appropriate and are likely to pay dividends, but the substantial run-up in general administrative expenses, for example, appears ripe for pruning. There is also the longer-term concern associated with the introduction of noncontributory universal old age benefits and associated increases in government liabilities over time because of demographic shifts.

The expansion in domestic credit points up some monetary policy issues. The authorities contend that credit controls remain the most effective tool for conducting policy. During the last Article IV discussion, there was some sentiment in the Board in support of this position--despite the staff's misgivings. One wonders whether the apparent obstacles toward indirect monetary management might not be overplayed, however. Western Samoa has a small financial sector but the majority ownership of its two commercial banks by outside financial institutions suggests that moves to the use of indirect tools could be accommodated. In view of current price pressures and excess liquidity, now may not be a propitious time for such a reform. Liberalization of interest rates, however, might usefully be considered. Such a move could, it appears, be implemented within the current credit control scheme and would address the apparent excess demand for credit at current rates. Currently, monetary policy is drifting in the opposite direction, however, as authorities seek to account for credit expansion by nonbank financial institutions, particularly, the National Provident Fund, by expanding controls. I wonder if the staff could comment on how Western Samoa's policy approach compares with other comparably sized countries in the region.

Mr. Oya made the following statement:

First of all, I congratulate the authorities on having accepted the obligations of Article VIII of the Articles of Agreement. I also commend the authorities for having implemented necessary corrective measures in the face of substantial external and domestic imbalances in the fiscal and external position in the past two years. I sympathize with the authorities, however, because most of the deterioration is attributable to the urgent rehabilitation action to minimize the hardship inflicted by the two enormous cyclones. I welcome the authorities' efforts in the 1994/95 budget to contain the budget deficit, and welcome their intention, in particular, of pursuing a medium-term strategy that will diversify Western Samoa's industry, including the expansion of tourism.

In light of the massive debt obligations of Polynesian Airlines, immediate priority should be given to its speedy restructuring. It is impressive that an ambitious restructuring program is now under way, and I believe the authorities are going in the right direction. However, I am somewhat concerned that the planned contraction of the activity of Polynesian Airlines might not be compatible with the authorities' intention to expand tourism. I would appreciate the staff's comments on the impact of this restructuring on tourism.

The staff representative from the Southeast Asia and Pacific Department considered that, in current circumstances, an exchange rate adjustment would not be appropriate. It was important to contain the price pressures that had been building up over the previous ten months. Although inflation had been declining more recently, it was essential that those lower levels be maintained. Moreover, the nominal exchange rate had depreciated slightly in the first and second quarters.

There was scope for liberalization of monetary policy and for a move toward less direct instruments of monetary control over the medium term, the staff representative remarked. Other countries in the region had moved to indirect monetary management, and those had been generally successful. Over the short term, however, interest rates ought to be liberalized in order to control credit and inflation.

In the past, the goal of promoting tourism had given rise to a rapid and unplanned expansion in the airline's activities, which had proved to be excessively costly, the staff representative observed. However, there was now a consensus in Western Samoa that development of tourism was desirable.

Once the necessary infrastructure was in place, air links could be developed in a more viable manner. In that connection, large foreign airlines could also be expected to expand their existing services to Western Samoa as tourism demand increased.

Mr. Tetangco stated that his authorities believed that they were not yet ready to move to indirect monetary management. The Central Bank would not be able to respond appropriately to market conditions because timely, accurate statistics were not available. It was not clear whether resource allocation would improve by moving to indirect methods of monetary policy. Furthermore, current monetary policy was capable of achieving its objective of reducing inflation--as it had in 1991 and 1992. A major inadequacy in the current institutional arrangements was the lack of central bank influence over the operations of nonbank financial institutions; the new Financial Institutions Bill was aimed at correcting that.

The economy continued to face difficulties which were exacerbated by the problems of Polynesian Airlines, Mr. Tetangco continued. A number of steps had been taken to improve the airline's performance, and his Samoan authorities were committed to redressing the situation and to placing the airline on a sound footing.

The authorities realized that the dearth of technical and entrepreneurial skills constrained the development process and, as a result, they were looking at increasing investment in human capital development, Mr. Tetangco commented. They attached great importance to having a highly skilled work force and to improving job creation opportunities in the private sector.

The authorities had a difficult agenda for the short and medium term, Mr. Tetangco concluded. They expressed their appreciation for the continued assistance provided by the international financial community, particularly their development partners who had provided financial and technical support. He hoped that the international community would continue to provide assistance during the period ahead.

The Acting Chairman made the following summing up:

> Executive Directors were in broad agreement with the thrust of the staff appraisal. They observed that growth had resumed in 1993 but noted that the spread of a leaf blight had severely affected agricultural production in the latter part of the year, cutting short the recovery and increasing the difficulties of the economic management task facing the authorities. Shortages of local food staples, along with the introduction of a value-added goods and services tax, had contributed to sharp price increases in the first half of 1994, while the external current account deficit widened further, and the overall balance of payments deficit remained large. Directors expressed concern at the

decline in international reserves, which were now at an uncomfortably low level.

Directors noted that recent fiscal developments, linked to the problems of Polynesian Airlines, had been extremely adverse, reinforcing concerns about the vulnerability of the external position to shocks and the need for prudent fiscal management. They therefore welcomed the authorities' decision to undertake further major expenditure cuts and to accelerate privatization in order to partly offset the additional cost of servicing the liabilities of Polynesian Airlines.

Directors observed that stemming the loss in international reserves would require that growth in net domestic assets of the banking system be tightly restrained. They also noted that the expansion of lending by the National Provident Fund over the past two years had further complicated the conduct of monetary policy. Under these circumstances, Directors recommended that the authorities act to raise interest rates and to move toward a more market-oriented approach to monetary policy. The financial institutions bill, which is presently under consideration, could become an important instrument for financial liberalization. The acceleration of inflation, the widening external deficit, and the appreciation of the real effective exchange rate underscored the urgency for the Government to implement and persevere with strong macroeconomic stabilization policies.

Over the longer term, Directors believed that maintaining external competitiveness of the economy would depend on the success of structural reforms, and they urged the authorities to further their efforts in this area. They welcomed the authorities' recent decision to accelerate the process of privatization and encouraged the Government to take steps to corporatize those enterprises that could not be divested. Directors welcomed the progress that had been made in freeing up land for private sector development, noting that this was particularly important for the development of a viable tourism industry.

The Fund's continued involvement in analyzing economic developments in this and other small economies was warmly welcomed.

Directors welcomed the authorities' decision to accept the obligations of Article VIII, Sections 2, 3, and 4, noting that this was an important signal of Western Samoa's commitment to maintaining an open and outwardly oriented economy.

It is expected that the next Article IV consultation with Western Samoa will be held on the standard 12-month cycle.

3. PHASE III - PUBLIC ALLEY CASE - REPORT BY ACTING MANAGING DIRECTOR

The Acting Managing Director reported that the D.C. City Council, meeting as a Committee of the Whole, voted to recommend to the City Council that it approve closure of the alley. Pending final approval of the alley closing, an excavation permit would be issued, and the Fund could begin excavation in early November, 1994.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/94/92 (10/17/94) and EBM/94/93 (10/19/94).

4. ERITREA - REPRESENTATIVE RATE FOR ETHIOPIAN BIRR AS CURRENCY OF ERITREA

The Fund finds, after consultation with the authorities of Eritrea, that the representative rate under Rule 0-2(b)(i) for the Ethiopian birr (as the currency of Eritrea) against the U.S. dollar is the rate for U.S. dollars at which the National Bank of Ethiopia deals with authorized banks as ascertained by the National Bank of Ethiopia. (EBD/94/168, 10/13/94)

Decision No. 10816-(94/93) G/S, adopted
October 18, 1994

5. GABON - REVIEW UNDER STAND-BY ARRANGEMENT

1. Gabon has consulted with the Fund in accordance with paragraph 3(c) of the stand-by arrangement for Gabon (EBS/94/57, Sup. 2) and paragraph 5 of the letter of February 18, 1994 from the Minister of Finance, Budget, and Participations in order to review the progress made in the financing and implementation of the program, and to reach understandings on performance criteria for the remainder of the period of the arrangement.

2. The letter dated September 7, 1994 from the Minister of Finance, Budget, and Participations shall be annexed to the stand-by arrangement for Gabon, and the letter dated February 18, 1994, with the attached Memorandum on Economic and Financial Policies for 1994, shall be read as supplemented and modified by the letter dated September 7, 1994.

3. Accordingly, paragraph 3(a)(i), 3(a)(ii), and 3(a)(iii) and paragraph 3(b)(i) of the stand-by arrangement shall comprise a reference to Table 1 attached to the letter dated September 7, 1994.

4. The Fund decides that the first review contemplated in paragraph 3(c) of the stand-by arrangement for Gabon is completed and that notwithstanding paragraph 3(a) of the stand-by arrangement with respect to the nonavailability of data for end-September 1994 performance criteria, Gabon may proceed to make purchases under the arrangement up to the equivalent of SDR 23.163 million until November 15, 1994. (EBS/94/194, 9/28/94)

Decision No. 10817-(94/93), adopted
October 18, 1994

6. WESTERN SAMOA - ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4

The Fund notes with satisfaction that, with effect from October 6, 1994, Western Samoa has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. (EBD/94/167, 10/13/94)

Decision No. 10818-(94/93), adopted
October 18, 1994

7. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 94/45 are approved.

8. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by Advisors to Executive Directors as set forth in EBAM/94/165 (10/17/94) and by an Assistant to Executive Director as set forth in EBAM/94/164 (10/13/94), is approved.

APPROVAL: October 2, 1995

LEO VAN HOUTVEN
Secretary