HOW TO

NOTES

Industrial Policy

Trade Policy and World Trade Organization Considerations in IMF Surveillance

Brad McDonald, Michele Ruta, and Elizabeth Van Heuvelen

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Industrial Policy: Trade Policy and World Trade Organization Considerations in IMF Surveillance
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With the use and complexity of industrial policy rising, along with the need for active policies to address climate, food, health, and other emergencies, IMF staff are often expected to provide policy and technical advice on trade-related industrial policies to national authorities. This note aims to support country teams with staff guidance, useful questions for engagement with national authorities, and resources on trade-related aspects of industrial policies.

Introduction

Industrial policy (IP) broadly refers to government efforts to shape the economy through targeted measures on specific domestic industries, firms, or economic sectors to achieve certain economic or strategic objectives. Since such actions often have an explicit trade policy component, IMF staff's general view is that:

- Discriminatory features are almost always unnecessarily costly, encourage retaliation, and should be discouraged.
- Other industrial policies that avoid discriminatory features may still distort trade and foreign direct investment (FDI) patterns (indeed, this may be the aim); in these cases, the trade and investment spillovers should be considered by members and staff along with the domestic benefits and costs.

Design matters. Many industrial policies aim to correct important market failures or to address economic and social emergencies and some may do this well. But many others do little to advance their stated objectives or do so with high domestic costs or with harmful effects on the global commons or other countries; the design of such measures can often be improved. Still others aim to give a competitive advantage to particular domestic sectors or firms; these policies often reflect political economy pressures and should be approached critically.

World Trade Organization (WTO) considerations. IMF staff should primarily assess policies and provide advice based on economic arguments. This said, IMF staff needs to ensure that recommend policy measures and program conditionality are consistent with a member's WTO legal obligations[1]—which cover various trade measures including tariffs, subsidies, and other domestic measures. Questions have arisen in certain circumstances, for example, corporate tax policy reforms, excise taxation, subsidy programs, and import duties.

[1] Guidelines/Framework for Fund Staff Collaboration with the New World Trade Organization, Decision No. 10968-(95/43), April 21, 1995. As explained in the Reference Note, it is not the role of the IMF or its staff to pass judgment on the WTO consistency of trade and trade-related measures with the member's obligations. This is the jurisdiction of the WTO and definitive rulings normally are made only by WTO dispute settlement panels and the Appellate Body. IMF staff have a responsibility, however, to be aware of the issues so that potentially inconsistent policy measures can be identified at an early stage, and alternatives explored, averting the prospect of IMF staff inadvertently advising inconsistent measures. The *Reference Note on Trade Policy and WTO Consistency* further elaborates on these considerations.

The material that follows touches on key areas of WTO commitments.[2] Important exceptions to the commitments exist but they are narrow. More information is available in the IMF's *Reference Note on Trade Policy and WTO Consistency*.

National or international security considerations. In recent years, there have been several examples in which measures that resemble industrial policies have been presented by authorities as having national security motivations. Guided by the usual surveillance criteria, staff should examine and discuss in the staff report the economic impact of these measures, including cross-border spillovers. Staff could also discuss the economic impact and spillovers, alternative policies considered by the authorities, if any, and note this discussion in the staff report. However, staff would neither assess the appropriateness of the actual measure or alternative measures nor would provide policy advice on the measures or advise alternatives.[3] These limitations would not normally apply to policies motivated for "economic security" which is defined as policies that are taken to further economic objectives. If the WTO has ruled on measures invoked on the grounds of national security (for example, US steel and aluminum tariffs), the status of the ruling could also be noted where relevant.

Guidance on trade and trade-related policies

Country teams should apply standard surveillance criteria in determining whether to address a trade or industrial policy issue.[4] In general, and according to the Integrated Surveillance Decision (ISD), such measures should be addressed when they are macro-critical or generate spillovers.[5] Specifically, even where individual IP measures are not macro-critical domestically, they may still generate significant cross-border spillovers through international trade and warrant coverage. Whether the measure falls under WTO or other trade rules does not affect staff's decision to address it. However, IMF policy advice should not contradict the country's WTO legal obligations.[6] The guidance below aims to promote consistency in policy advice across these issues.

Export restrictions are generally an unnecessarily costly and inefficient means to promote domestic industry and can have significant negative spillovers.

- Export restrictions are often rationalized to promote a downstream industry. For example, restricting minerals exports reduces the domestic price of minerals, giving a competitive advantage to domestic processors. Costs to the domestic economy result from lost export revenue, incentives for circumvention and corruption, and the diversion of scarce resources into activities that would not be profitable at world prices. If the country is a "large" producer, important spillovers can result if the restrictions drive up prices and volatility on the world or regional markets.

[2] As of March 2024, 22 countries are currently in the process of acceding to the WTO. In general, IMF staff would not deviate from the guidance covered in this note, and where questions may arise would encourage close collaboration with the WTO Accessions Division to ensure consistency of policy advice.

[3] In concluding the Trade Review in March 2023, "Directors noted that the [IMF] is not well placed to assess the appropriateness of trade measures imposed for national or international security reasons, but that it should assess the economic implications of such policies, including spillovers" (emphasis added). On this matter, see also footnote 19 of *The Review of the Role of Trade in the Work of the Fund.*

[4] See the authoritative discussion in the 2023 *Review of the Role of Trade in the Work of the Fund—Background Paper* (IMF Policy Paper No. 2023/013), annex on "Legal Aspects of the Fund's Involvement in Trade Matters" as well as a more detailed discussion in the companion note on "How to Cover Industrial Policy Issues in Country Work".

[5] The ISD requires Article IV consultations to discuss spillovers arising from policies of individual members that may significantly influence the effective operation of the International Monetary System.

[6] Economic policy considerations can lead the IMF to advise a member to go beyond WTO obligations. The example of import tariffs can illustrate. Consider Country A, a member of both the IMF and the WTO, which imports three goods (Good 1; Good 2; and Good 3) and has committed in the WTO not to exceed the "bound" tariff rates on these three goods of (0 percent; 10 percent; and 20 percent). Suppose that "A" currently applies tariffs on the three goods at their bound rates (0 percent; 10 percent; and 20 percent). IMF staff could advise "A" to reduce the tariff on Good 3 from 20 percent to 10 percent, thus reducing both the average tariff and tariff dispersion. IMF staff would not advise "A" to increase the tariff on Good 1, however, since "A" has legally committed in the WTO to a maximum tariff on Good 1 of 0 percent.

- In the WTO, Article XI of the General Agreement on Tariffs and Trade (GATT) generally prohibits bans and other quantitative restrictions on the importation or exportation of goods, although they are allowed in specific circumstances including temporarily to prevent or relieve critical shortages of foodstuffs or other essential products. Obligations regarding export duties vary by country. Export duties, like for imports, are generally subject to the Most-Favored-Nation (MFN) principle, that is, WTO member countries should not discriminate between other WTO member countries and treat them equally. Unlike import duties, most WTO members do not have maximum export duty rates; however, many of the members that have acceded since the creation of the WTO in 1995 have accepted binding maximum export duty rates on particular products; accordingly, teams must check on these on a country- and product-specific basis, accordingly.

Export subsidies introduce domestic economic distortions, have fiscal costs, and directly distort international markets. With very few exceptions, they are prohibited by WTO rules.

- Export subsidies involve benefits from a public entity to a firm or industry contingent (de facto or de jure) on export performance. They may arise from direct or indirect tax provisions, including tax incentives, financing on non-commercial terms, and in other forms.[7] They are generally costly to the domestic economy because of fiscal and quasi-fiscal costs, reduced economic efficiency, and incentives for rent-seeking. They directly distort international markets and often trigger retaliatory measures by other governments.
- WTO rules prohibit export subsidies, including corporate tax provisions that incentivize exports. A few remaining exceptions are being phased out, and there are special provisions for least developed countries. See also the discussion that follows on WTO rules for subsidies not contingent on exporting or on import-substitution, including on how subsidies are defined.

Import restrictions raise economic distortions and are in common use. IMF staff advises governments to move toward tariffs that are relatively low and relatively even and to avoid policy reversals which create policy uncertainty. This position is explained and elaborated in the *Reference Note*.[8]

- Measures that treat imports the same as domestically produced goods normally raise no concerns, e.g., border adjustments common to excise and value-added tax regimes. While similar in intent, border carbon adjustments (for example, EU CBAM), however, raise special issues (see Box 1).
- Each WTO member has a binding, maximum tariff rate on most or all of the several thousand lines in its tariff classification. IMF staff does not advise a government to exceed the tariff binding but may advise to reduce rates to below the binding.

[7] Exemptions for exports from indirect taxes levied on “like” products sold domestically, or rebates of such taxes not exceeding amounts paid, are deemed not to be a subsidy under WTO rules.

[8] In IMF-supported programs, however, IMF staff advice should be mindful of existing conditionality against import restrictions for balance of payment reasons. All IMF arrangements include a standard continuous performance criterion against the imposition or intensification of import restrictions for balance of payments purposes (See paragraph 81 of the Reference Note). Import restrictions include tariffs and import surcharges as well as non-price-based policies.

Box 1. WTO Rules and Border Carbon Adjustments[1]

Domestic carbon taxes. WTO rules allow charges on imports (and rebates on exports) that are equivalent to internal indirect taxes on the same ("like") good when produced domestically. Common border adjustments include those that accompany domestic product ("indirect") taxes such as excises and value-added taxes. Adjustments may not be applied with respect to property, income, or other "direct" taxes.

- Adjustments are allowed to an internal tax on a particular good or on an *input* used in a product. While WTO jurisprudence is not definitive, it appears that carbon emissions may be considered an "input," so that a domestic carbon tax can be applied to the carbon embodied in imported products (and, symmetrically, a rebate paid on carbon emissions embodied in exported goods). Alternatively, some argue that applying border adjustments to "like" products based on the carbon intensity of their production processes would result in a differing treatment between physically indistinguishable products, which could only be justified under the exceptions (discussed below).
- Methods of measuring embodied carbon must not be biased toward domestically produced goods.

Emissions trading systems (ETS). An ETS arguably could be considered an adjustable tax and subject to the considerations above. But it might alternatively be considered a form of a domestic regulation.

- In this case also, imported products must be treated no less favorably than a *like* domestic product, but the border adjustment would likely need to take the form of an equivalent regulation.
- Export rebates might be allowed (although views vary among some experts) so long as the rebate does not exceed the costs incurred by domestic consumers as a result of the regulations.

Differentiating partners. Rules allow border carbon adjustments to vary based on objective emissions-related criteria, but not simply on the country of origin.

- Favorable treatment of some countries could be allowed in certain circumstances, such as: (a) participation in a treaty provides an objective test of emissions-related characteristics of different countries, and (b) discrimination in favor of developing economies on the basis of development considerations.

Exceptions. Based on its objectives and design, a border carbon adjustment (BCA) that violates the provisions discussed above *might* nonetheless qualify for an exception. Subject to provisions in its 'chapeau,' GATT Article XX provides (among others) exceptions for measures "relating to the conservation of exhaustible natural resources *if such measures are made effective in conjunction with restrictions on domestic production or consumption.*" This has been interpreted to require that the measure in question, in this case, a BCA, must have an environmental goal and a scope proportionate to that goal, and link clearly to the domestic policy.

To qualify for the exception, the chapeau language in Article XX also requires that the measure is not in practice a "disguised restriction" on trade and does not lead to "arbitrary" or "unjustifiable" trade discrimination. This will require that the BCA have a genuine environmental rationale and is implemented in such a way that advances that objective. A BCA that aims to preserve the "competitiveness" of domestic industry might not qualify for the exception. It has been suggested (OECD, 2020) that a BCA might fail to meet the chapeau language if, for example, it provides for BCA exemptions or other favorable treatment based on criteria unrelated to climate mitigation, or if it conditions favorable treatment on another country following specific policies.

[1] See also the discussion of WTO rules in OECD (2020), "Climate Policy Leadership in an Interconnected World: What Role for Border Carbon Adjustments?"; IMF (2021), "Carbon Pricing: What Role for Border Carbon Adjustments?", and in UNEP-WTO (2009), "Trade and Climate Change."

Subsidies not contingent on exporting are also common and their use is growing rapidly (see the Joint Subsidies Paper).[9] They can be an important tool to address market failures or particular policy objectives. They may also distort trade and investment, undermine the value of trade policy commitments, carry fiscal costs, and

[9] The impending implementation of the recently agreed global minimum tax is also expected to result in countries to increasingly look to non-tax instruments as subsidies (see International Corporate Tax Reform).

prompt counter measures. [Recent data] for China, the European Union, and the United States shows that on average there is a 73.8 percent probability a subsidy for a given product by one major economy is met with a subsidy for the same product by another within one year.

- *In assessing subsidies, IMF staff should consider the underlying policy objective,* whether the design of the subsidy will actually further that objective, fiscal and other domestic costs, and the potential spillovers, including the policy response of other governments. IMF staff should also consult with the WTO Secretariat when there are possible concerns of WTO inconsistency.[10] To aid this assessment, Annex 1 provides a series of suggested questions to pose to the authorities. If staff assesses that the subsidy does not meet the underlying objective, could be costly, and the potential spillover risks high such a conclusion should be reflected in the staff report.

  - In their follow-up to the agenda of the Joint Subsidies Paper, the IMF and partner organizations are also encouraging improved transparency and analysis to fill existing gaps, and inter-governmental dialogue aimed at building more common perspectives on the appropriate use and design of subsidies. It will be important that these efforts involve both the finance and the trade communities.

- *Other than the general prohibition on export subsidies (described previously), WTO rules do not prohibit these "domestic" subsidies.* Domestic subsidies may be "actionable," meaning that other governments can impose unilateral countermeasures ("countervailing duties") or pursue the removal or modification of the subsidy through WTO dispute settlement; to pursue these actions, however, the other government must demonstrate to a certain standard that the subsidies impact their markets or firms. Different frameworks apply for subsidies in the service, agriculture, and other (non-agricultural) goods sectors. WTO and other international rules on subsidies are discussed in greater detail in the [Joint Subsidies Paper].

"Local content requirements" (LCRs) in their various forms require, either directly, or as a condition to receive a subsidy or other "advantage," the use of a certain amount of domestically produced goods. While not new, governments have increasingly used LCRs in conjunction with green subsidies and other environmental policies to promote the use of local inputs and foster domestic industries.

- LCRs can be a particularly distortionary type of trade measure, as they are typically specified in volume terms (akin to quotas) rather than price terms (like tariffs); as such, they tend to be opaque. Like other forms of trade restrictions, they inhibit competition, reduce product diversity, raise prices, and divert scarce resources away from more efficient uses. They also promote rent-seeking and encourage harmful policy responses from trading partners.
- LCRs will normally directly violate WTO non-discrimination principles, and should be flagged in IMF reports if macro critical.

Policies to attract or limit FDI have been common for industrial policy purposes and other reasons, including national security.

- IMF staff have generally discouraged direct interventions to favor or disfavor FDI in particular industries or sectors, while recognizing that many economies stand to benefit from greater FDI overall. Broad export promotion initiatives such as public-supported initiatives to help businesses identify export opportunities can be positive, as can initiatives targeted toward attracting investment to underdeveloped regions.
- Screening mechanisms for inward or less often outward FDI can be important to non-economic objectives and are increasingly common with regard to national security. Experience suggests that providing an active role

[10] The IMF-WTO Cooperation Agreement requires the IMF's staff and the WTO Secretariat to consult one another on an informal basis about matters that one organization is discussing with a common member that could raise issues of possible inconsistencies regarding that member's obligations under the charter of the other organization.

for senior economic officials in the screening process, together with relevant non-economic experts, can help ensure that economic costs and benefits are weighed appropriately.

- Investment measures in the service sector may be covered by the WTO General Agreement on Trade in Services (GATS). The WTO General Agreement on Tariffs and Trade (GATT), which applies to trade in goods, does not generally cover investment measures.

Resources Available to Staff

As staff engages in the review process they should consider whether a country has undertaken any such measures and whether the measure is macro-critical and/or may generate spillovers. There are several additional resources available to aid staff in their assessments:

- The *Subsidy Platform* is a joint effort by the staff of the IMF, OECD, World Bank Group, and WTO. Its purpose is to increase transparency on the use of subsidies across economies and sectors and to serve as a "one-stop shop" for information and analysis on subsidies respectively maintained by these organizations. This data offers a wide spectrum of information on subsidies. A caveat is that each organization uses its own definition, methodology, and coverage for the information it maintains. Thus, these differences should be noted when using data and information from each organization.

- *New Industrial Policy Observatory (NIPO):* The SPR Trade Team has made available to country teams this new dataset. Updated monthly, it has been developed in collaboration with the Global Trade Alert (GTA), augmenting their collection efforts to include technology-related measures, each policy's stated motive, and targeted strategic sector. This data will help country teams monitor the evolving new industrial policy landscape. The data are described in detail in Evenett et al. (2024).[11]

- *Early Warning Tool:* Based on the NIPO data, SPR is developing a tool to alert teams to measures likely to be of significant relevance for their country. This tool also will include different indicators, such as the share of global trade covered by a particular measure which will help country assess the potential for spillovers though trade. The NIPO and the Early Warning Tool will be updated regularly and made available in the intranet.

- *Reference Note on Trade Policy and WTO Consistency*: Elaborates on WTO considerations and policy guidance on many of these measures.

- *WTO Trade Policy Review Mechanism:* Provides periodic reviews of member countries' trade policies and practices.

[11] In brief, the data contain information on industrial policy-related trade and subsidy measures implemented from January 2023 in a set of 70 jurisdictions, their motivation, and the products and sectors they target. An important caveat is that real-time data are affected by a "revelation bias" as information becomes available at different speeds across various jurisdictions.

Annex 1. Possible Questions for Country Authorities

This annex aims to support country teams with possible questions that teams could use in discussing trade-related industrial policies with country authorities. Teams should reach out early to SPRXP for guidance if they plan to raise trade-related industrial policies for their AIV consultations.

- What are the specific policy objective(s) of the measures (for example, employment, environmental, health, investment promotion, regional development, balance of payments, national or international security)?
- What is the timeline of implementation? Is there a sunset clause that would trigger the end of the proposed policy?
- What indicator is being used to assess the policy objective, and what would be considered a success?
- Which specific firms, industries, or regions are targeted for benefits?
- How is the policy implemented? For example:
  - Grants? From what level of government and/or public agency?
  - Tax provisions?
  - Financing? (for example, concessional lending; loan forgiveness; connected lending)
  - Public – private partnerships?
  - Regulatory provisions?
- What are expected fiscal / quasi-fiscal a) expenditures? b) foregone revenues? How is the measure financed?
- What is the authority for the program? What entity has approval authority? What entity has oversight?
- What domestic industries, groups, or regions will be disadvantaged by the policy?
- Which foreign investment and foreign trade partners will be impacted? Are there estimates of the impact on investment and trade in aggregate? With particular partners?
- Have the authorities considered the policy's consistency with their legal obligations in the WTO or other international trade and investment agreements?
- What alternative approaches have been considered to address the objectives? What were the pros and cons of these alternatives, including with respect to their impact on trade and investment partners?

Annex 2. Examples of IMF Policy Lines on Trade-Related Industrial Policies

This annex presents examples of recent coverage of trade-related industrial policies in IMF Article IV staff reports.

Industrial Policy: Examples of IMF Policy Advice	
Country	**Description**
China	*2023 Article IV*: Staff emphasized that the use of industrial policies and state interventions are contributing to trade distortions, generating spillovers to the trading system and called for scaling back such policies, accelerating SOE reform, and relying on market forces. Staff also emphasized that export controls, including those on critical minerals, should be phased out and not be used to provide competitive advantage to domestic industries.
Euro Area	*2023 Article IV:* Staff emphasized that subsidies, investment screening, and export controls should be narrowly targeted to specific objectives, and the authorities should resist calls to use such tools to provide a competitive advantage to domestic industries. Staff also stressed that the EU should continue to work toward globally cooperative green solutions that minimize distortions.
India	*2023 Article IV*: Staff emphasized that export restrictions on wheat and rice could have wide-ranging cross-border spillovers and could contribute to volatility of international food prices, domestic resource misallocation, rent-seeking behavior, and potential retaliation by trading partners. Staff noted that the introduction of an Import Management System for IT equipment such as laptops, tablets, and personal computers carries an administrative cost and will create frictions that would hold back growth in important sectors of India's economy. Staff called for the expeditious phase-out of the recently-introduced restrictions and called on the authorities to work towards reducing India's longstanding high tariff and non-tariff import barriers.
Indonesia	*2023 Article IV:* Noting that Indonesia accounts for roughly half of global nickel output, staff pointed out that the costs and other drawbacks of Indonesia's restrictive policies could include foregone fiscal revenues, domestic resource misallocation, rent seeking, the disruption of international commodity markets, and the potential retaliation by trading partners.
United States	*2023 Article IV:* Staff characterized certain "Made in America" provisions as "bad for U.S. growth, productivity, and labor market outcomes" and called on the authorities to roll back the tariffs and other trade distortions introduced over the past five years. Such policies "distort trade and investment decisions, disrupt global supply relationships, and risk creating a slippery slope that fragments global supply chains and triggers retaliatory responses by trading partners." Moreover, the U.S. "should avoid favoring domestic producers over imports or creating incentives that lead to a fragmentation of the global system for trade and investment."