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Working Paper

Effects of WTO accession on policy-making in sovereign states: Preliminary lessons from the recent experience of transition countries

WTO Staff Working Paper, No. DERD-2002-02

Provided in Cooperation with:

World Trade Organization (WTO), Economic Research and Statistics Division, Geneva

Suggested Citation: Bacchetta, Marc; Drabek, Zdenek (2002) : Effects of WTO accession on policy-making in sovereign states: Preliminary lessons from the recent experience of transition countries, WTO Staff Working Paper, No. DERD-2002-02, World Trade Organization (WTO), Geneva, <https://doi.org/10.30875/cfaab512-en>

This Version is available at:

<https://hdl.handle.net/10419/90680>

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World Trade Organization

Development and Economic Research Division

**EFFECTS OF WTO ACCESSION ON POLICY-MAKING
IN SOVEREIGN STATES:**

Preliminary lessons from the recent experience of transition countries

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Manuscript date:	April, 2002

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ABSTRACT:

The purpose of the paper is to discuss the effects of WTO accession on policy-making and institutional reforms in transition countries. This is done by looking at the experience of those transition countries which are already Members of the WTO. We start by examining the effect of accession on trade policy and distinguish between the effects of accession negotiations and those of autonomous policy initiatives. Other areas of domestic policy-making considered in the analysis include market access, governance, government budget, structural reforms, trade and investment arrangements with regional partners and macroeconomic management. We find that no precise blueprint of accession conditions can be ascertained, that WTO played a role, albeit not an exclusive one in the process of liberalization, that the costs of WTO Membership are not negligible, that the benefits of WTO Membership are also significant in terms of a better market access, improved governance and a recourse to better economic policies.

Key Words: WTO Accessions, Trade Policy, Transition Countries

JEL Classification No. [F1] [F13]

**EFFECTS OF WTO ACCESSION ON POLICY-MAKING
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The views in this paper are strictly personal. They should not be attributed either to WTO Members or the Secretariat. We are grateful for assistance to Indradeep Gosh.

I. INTRODUCTION

One of the most remarkable successes of the World Trade Organization in recent years has been the expansion of WTO Membership and the continued stream of applications of countries to accede to the WTO. Of the 43 countries that have applied to accede the WTO under Article XII since January 1st 1995, approximately one half are countries in the process of transition from a planned to a market economy. Ten of the 14 countries that have already completed their accession process and between 9 and 13 countries - depending on whether East Asian countries are included or not - of the 28 countries negotiating their accession are transition countries. Clearly, the WTO represents a powerful attraction for countries in transition (CIT) which treat their WTO membership as a "stamp of approval" of their policies and the admission into the international community – a feat quite important for CIT that have been isolated from world markets for more 50 years.

The strong interest of CIT in the WTO Membership raises the obvious question about the benefits to these countries from their accession to the WTO. It is clearly not enough to say that the main benefits are their rights to participate in the proceedings of the WTO Working Committees, Working Parties or the Council. What matters at the end of the day are the tangible benefits from Membership. Only if they can point at such benefits will the governments of these countries be able to convince their critics that the decision to join the WTO is right. Only then will they be able to demonstrate to their populations that the government policies are also on the right path.

The purpose of this paper is to discuss one particular aspect of WTO accession - the effects of WTO accession on policy-making and institutional reforms in transition countries. We shall do so by looking at the experience of those transition countries which are already WTO Members. We believe that this will offer a useful picture of the forces that ultimately shape the economic performance of these countries and in particular that it will show how economic performance has been affected by WTO accession. Annex Table 1 shows the dates of application and membership of all CIT. Six of them - the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia – had signed GATT by 1994. As all other GATT Contracting Parties, they became WTO members upon signing the new WTO agreements. More recently these countries have been joined in the WTO by ten other CIT. These ten new Members which are in the process of transition are, by order of accession, Bulgaria, Mongolia, the Kyrgyz Republic, Latvia, Estonia, Georgia, Albania, Croatia, Lithuania and Moldova.

The advantages of our approach are twofold. First, by drawing on the experience of these countries we hope to shed more light on much debated issues such as the advantages of multilateral as opposed to autonomous trade liberalization. Second, given that the accession often raises high hopes

while in reality it also represents heavy commitments and costly adjustments to new legal and institutional requirements, it is our aim to objectively assess the costs and benefits of accession. The economic transition of the kind undertaken by the former centrally-planned economies is not an easy process and like all other transition countries, the new Members face specific transition related problems.

In order to evaluate the effect of WTO accession on the CIT, we shall adopt the following approach. We shall first ask how much of the trade policy reforms can be attributed to the accession negotiations and how much they reflect autonomous policy initiatives. We shall, therefore, review the policy reforms in the examined countries, identify the autonomous trade measures as well as those that were not covered by the reform. The actual effects of accession on policy-making will then be examined in the following areas: (1) market access, (2) governance, (3) government budget, (4) structural reforms, (5) trade and investment with regional partners, and (6) macroeconomic management. These are areas which we believe are affected by WTO accession most. The CIT have acceded under Article XII of GATT, and we shall consider whether this Article or other rules have constrained domestic policy-making and if so how. The idea is to identify factors that partly offset the positive effect of accession.

Terms of accession are of a major concern to every acceding country. Moreover, there is a perception among some observers that accession conditions may vary among countries and that these conditions may be in excess of measures that incumbents would be willing to take in their own countries.¹ Even though we shall make general comments on accession conditions, we do not intend to discuss this issue in detail. This is quite a major omission. The effects of accession must clearly be dependent, *inter alia*, on the outcome of the negotiations, that is on the conditions which each country is able to negotiate with the WTO Members. We have felt that the issue of accession conditions is so important and, at the same time, complex that it will need to be addressed in a separate paper.

The paper is divided into two parts. The following Part II which includes three sections, reviews the role of the WTO and its accession process and looks at the main features of the process. Section A shortly describes the New Members' accession packages, and Section B provides an assessment of the scope of autonomous trade policy reforms. The main benefits of joining the WTO

¹ In reporting on discussions in the General Council, Naray noted that "*....a number of developing countries delegations recalled that in the accession process unreasonable conditions were required of, and imposed on, applicants because developed country members had requested that acceding countries accept more stringent conditions and a higher level of commitment than was required from members themselves ('WTO-plus' requirement). For example, the requirement to adhere to several plurilateral agreements, to guarantee full*

are discussed in Section C. The subsequent Part III then looks at various aspects of economic policy-making that we have been able to identify and that are affected by WTO accession. The areas have been delineated above and they constitute the subject of the seven sections of Part III. We shall look at the impact of accession on market access, governance, customs revenues, adjustment costs, regional policies and stabilization policies. The paper is concluded with a summary of the main findings and some policy conclusions.

II. THE WTO ACCESSION PROCESS

A. THE CONTENT OF ACCESSION PACKAGES

Only few WTO rules regulate the process of accession.² Accession is governed by Article XII of the Marrakesh Agreement establishing the WTO, which defines in highly general terms the rules for accession to the WTO. The specific terms of accession must be negotiated between the WTO Members and the applicant country. Because each accession is a negotiation between the WTO Members and a particular country with typically different economic conditions, each accession is unique. As Lanoszka (2001) put it : "*Article XII does not stipulate any membership criteria, and this signals perhaps the most problematic legal aspect of the accession process. ...No guidance is given on the 'terms to be agreed', these being left to the negotiations between the WTO Members and the Candidate. Furthermore, Article XII does not identify any concrete steps nor does it provide any advice when it comes to the procedures to be used for negotiating the terms of accession*".³ To streamline the examination of accession requests, though, WTO Members have designed administrative procedures some of which are based on unwritten rules. In fact, the best that can be said about the process is that the process is largely governed by unwritten rules derived from precedents and previous rulings.⁴

The main outcome of the accession negotiations are the terms of accession set out in the protocol of accession. The protocol of accession includes all the commitments made by the acceding country on trade and trade-related policies. Those commitments take the form of a general commitment to abide by WTO rules, of a series of specific commitments referred to in the Working Party Report – for instance on transparency in the privatization process or on price regulations, and of tariff concessions and other commitments as listed in the country's Schedules. The lessons that can be

transparency and objectivity and that markets access commitments should be about the same as those made by countries at similar level of development." Naray (2001), p.91.

² For a detailed description of the procedures see, for example, Lanoszka (2001).

³ *Ibid.* p. 589.

drawn from the examination of the negotiated terms of accession and of the length of the negotiation process mainly concern the accession process itself.

Ideally, acceding countries should accede on terms that are broadly comparable both for acceding countries among themselves and in comparison with incumbents. In practice, however, the situation may evolve somewhat differently. In several areas acceding countries have made commitments in excess of incumbent Members.⁵ Acceding countries, for instance, are required to bind all tariffs while many developing countries still have relatively high shares of their non-agricultural tariff lines unbound. Similarly, there is pressure on new Members to sign all plurilateral agreements. The question whether this practice serves the interests of acceding countries or not is hotly debated. As already mentioned, we will not enter this discussion here except noting the reason why differences such as those noted arise. The reason is that Article XII, which governs the WTO accession process, is limited in scope and lacks precision in terms of setting the specific operational procedures, as we have already noted above. As a result, countries accede to the WTO on "the terms to be agreed by negotiations."⁶

Another unwritten rule concerns the status of acceding countries. A Member's status determines whether it is entitled to use the Special and Differential (S&D) treatment provisions of the WTO agreements. In general, there are no WTO definitions of "developed" and "developing" countries. The general principle is the selection based on the principle of what can be called a "self-appointment". A country can present itself to the WTO as a "developing nation". Other Members, however, may challenge the "request", as it frequently happens in specific subject areas of the WTO Agreements – in particular in the area of intellectual property. For countries joining the WTO through the accession process, their status largely depends, once again, on the terms agreed in each specific area of the accessions negotiations. If there is no explicit mention of the status in the protocol of accession, a new Member can designate itself as a developing country and even though there is very little formal importance to this act. The actual commitments may restrict the scope for S&D treatment provisions. For instance, if an acceding country makes an explicit commitment to restrict its domestic

⁴ *Ibid.* p.589.

⁵ See Langhammer and Lücke (1999), Michalopoulos (2000) or Naray (2001). For further details see also footnote 1.

⁶ The choice of the commitments of original Members with similar levels of GDP per capita as a benchmark for assessing the terms of accession was based on the idea of fairness, ie. treating "similar" countries in a similar way. However, accession terms could be also evaluated against other benchmarks such as, for example, the "free trade package". The package is based on the notion that the optimal policy is the one that leads to the elimination of all trade restrictions. Yet another benchmark could be cross-country comparisons in which a country's "package" of accession conditions is compared to that of other country (ies). Clearly, the main problem is to define the optimal package, but the cross-country comparisons remain the most frequently used benchmark in practice. See Michalopoulos (2000) or Langhammer and Lücke (1999).

agricultural support at a level that is lower than what is allowed for developing countries, the commitment would be binding even if the country self-appoints itself to the developing country status or if it wanted to increase its agricultural support to the level allowed for "developing countries" at a later stage.⁷ In contrast, the rule is quite clear with respect to "least-developed" countries. The WTO recognizes as least developed countries those countries which have been designated as such by the United Nations. There are currently forty nine least developed countries on the UN list, of which thirty are Members of the WTO as of end of 2001 and nine are in the process of accession to the WTO.⁸

The status issue is related to another issue – the right to *transition periods* to implement the WTO Agreements. Article XIV.2 of the WTO Agreement states that a Member which accepts the Marrakesh Agreement after its entry into force shall implement those concessions and obligations in the Multilateral Trade Agreements that are to be implemented over a period of time starting with the entry into force of this Agreement as if it had accepted this Agreement on the date of its entry into force. Transition periods are thus by no means made automatically available to acceding governments. Article XII on the other hand offers Members a margin of manoeuvre. In practice, Members have made it clear that transition periods will only be granted if the applicant is successful in making a strong enough case to prove that such a period is necessary.

Another important, but this time a formal rule concerns the scope of acceding countries commitments. According to Article XII/1, "(T)he accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto". In other words, acceding countries are expected to accept all the rules and conditions as specified in each of the WTO Agreements. This rule is known as the *principle of single undertaking*.

It should also be noted that countries are joining the WTO under what may be called *status quo* for the incumbent countries. The acceding countries cannot negotiate any change in the incumbent countries' commitments of market access nor can they negotiate any change in the rules of the WTO Agreements. The acceding country is joining the WTO under the existing commitments of the Members. As any new member of a "club" has to abide by the rules of the club he/she wants to join, countries acceding into the WTO must accept the terms and conditions of the WTO as they stand. This is an unwritten but fully respected "rule" of accession.

⁷ The "de minimis" level for developing country Members is 10 percent while it is 5 percent for developed countries and certain categories of domestic support are exempted from reduced commitments for developing country Members. See Article VI of the Agreement on Agriculture.

⁸ The nine countries include Bhutan, Cambodia, Cape Verde, Lao People's Democratic Republic, Nepal, Samoa, Sudan, Vanuatu and Yemen. Furthermore, Ethiopia and Sao Tome and Principe are WTO Observers.

B. AUTONOMOUS OR MULTILATERAL TRADE LIBERALIZATION?

In order to dispel any misunderstanding about the subject of this section, it is important to specify the framework of our discussion from the outset. The purpose of the section is not to discuss the merits or pitfalls of one method of trade liberalization as opposed to the other.⁹ The aim is to discuss the role of WTO accession in the reform process of transition countries. Based on the idea that trade agreements can play the role of external anchors and thereby facilitate trade policy reforms, it may seem that WTO accession has played different roles in different countries. For example, in transition countries that were already WTO Members before the start of their transition, regional integration obviously played the leading role in facilitating the reform process. In other transition countries, WTO accession and regional integration both played a role while in a third group of countries, WTO accession most likely played the most important role. Nevertheless, the WTO disciplines are critical even for countries which may be more reliant on regional agreements since these must typically be WTO consistent. In this section we briefly discuss the relevant experience of four Central European countries - the Czech Republic, Slovakia, Hungary and Poland.

In the four Central European countries - all four GATT Contracting Parties - trade policy reform measures were taken largely autonomously in the first half of the 1990's, that is prior to the conclusion of the Uruguay Round Agreements. Following the collapse of central planning, the countries eliminated foreign trade monopolies and introduced competition into virtually all foreign trade activities. They unified exchange rates and devalued their currencies. Licencing requirements have only been retained for few foreign trade transactions such as trade in arms, drugs, goods of historical or artistic value and other transactions normally permitted in international practices. Price controls have been eliminated on all but a few non-tradeables, export and other trade-related subsidies have been abolished. Eliminated were also all quotas – the pillar of trade policy under central planning.

Thus, the countries were left with tariffs as the only instrument to control the flow of imports. The tariff schedules were all inherited from the previous trade policy regime with a fairly low tariff incidence. For example, the former Czechoslovakia inherited a tariff schedule with about 5 per cent average tariff incidence – clearly one of the lowest in the world. The other two countries – Hungary

⁹ For reasons why countries may be interested in joining international agreements see, for example, Staiger (1995). The reasons for autonomous trade liberalization have been discussed at length and constitute a major part of economic literature.

and Poland - had a tariff incidence somewhat higher but even these two countries demonstrated a fairly open foreign trade regime.¹⁰ Most of their tariffs were bound.

The trend towards trade liberalization was boosted by RTA negotiations with the European Union. In the early 1990's the countries began their negotiations of the Association Agreements, later relabelled as the Europe Agreements. These were extremely important steps and they affected the course of trade policy in each of these countries. The agreements provided for the establishment of a free-trade area between the EU and each of these four countries but the agreement extends far beyond a simple free trade arrangement.¹¹ The agreements led to a radical opening of markets for foreign investment – direct and portfolio – and they covered various other activities such as economic cooperation, customs administration, labour issues, etc. They include provisions covering not only manufactures but also agriculture and services. In addition to the Europe Agreements, these countries have also signed other preferential trade agreements. For example, the Czech Republic has a customs union agreement with Slovakia; it has signed the Central European Free Trade Agreement (CEFTA) with Hungary, Poland, Slovakia, and later with Romania, Slovenia and Bulgaria; it has an agreement with EFTA countries; and it has put in place its own generalized system of preferences. The Czech government has also signed dozens of bilateral agreements on investment protection.

While the speed of liberalization provided under the umbrella of the Europe Agreements was quite impressive, and so was their scope, the agreements have not gone as far the Uruguay Round Agreements in several areas. For example, in services the Europe Agreements only provided a reference to the ongoing Uruguay Round Agreements binding both the EU and the countries concerned to incorporate into the Europe Agreements the commitments of both parties made in the Uruguay Round. Similarly, the Uruguay Round has gone further than the Europe Agreements in specifying in detail the technical standards as well as sanitary and phytosanitary standards. Excluded were also provisions concerning protection of intellectual property as well as trade-related investment measures such as those covered under TRIPs and TRIMs respectively in the Uruguay Round. Safeguards and anti-dumping measures were also referred to the WTO standards. In brief, the Europe Agreements were the second important stimulus for trade liberalization – in addition to the governments' own commitments. However, the Agreements have not covered everything – several topics were negotiated under the umbrella of the Uruguay Round.

¹⁰ For more details, see Drabek and Smith (1995).

¹¹ In the case of Czechoslovakia, the agreements were originally negotiated with the Federal Republic of Czechoslovakia. After the breakup of the federation at the end of 1992, the agreements were negotiated and signed separately with the Czech Republic and Slovakia respectively.

In sum, the actual Uruguay Round negotiations have brought relatively little in terms of further market opening and trade liberalization in these transition countries. Most of the liberalization measures have been taken autonomously and/or as part of various RTAs. As a feature of trade policy-making, the experience of transition countries is not unique; it is a part of a general trend towards "new liberalism" of the 1980s and 1990s.¹² The Uruguay Round Agreements have supplemented the existing reforms in some areas – especially in services, TRIMS, TRIPS as noted, and they have brought disciplines into these countries' trade regimes by adopting multilateral rules on safeguard, anti-dumping and others.

C. REASONS FOR JOINING THE WTO

Economists have identified different reasons why countries might be interested in joining an international trade agreement. These can be conveniently fitted into two categories – theoretical arguments and practical considerations. In the first (theoretical) category is the argument stating that governments may be in the position to pursue what is known as "beggar-thy-neighbour" policies and that they will agree to sign international trade agreements as a way of mitigating the incentives to do so. The countries can pursue the "beggar-thy-neighbour" policies by imposing externalities on their trade partners in the absence of an agreement, and the main mechanism through which a country can do so is through changes in terms-of-trade. These changes are, of course, only possible due to the country's large size or its monopolistic position in the market. To put it differently, governments can act in their own interest if they are in the position to impose *optimal tariffs* in order to maximize the country's welfare. However, other (large) countries can do the same, which could lead to trade wars and an erosion of national welfare in each country. By joining a trade agreement, large countries can reach a higher level of national welfare by making their commitments to lower tariffs subject to an international agreement backed by sanctions.¹³

A related theoretical argument concerns strategic interaction between governments and its private sector. As shown in the pioneering work of Kydland and Prescott (1977), the **necessary** condition for economic policy to be *time-consistent* is that governments pursue the first-best policies. This is virtually never the case in the presence of trade interventions. The failure to pursue the best policies will lead to a search for better alternatives and pressures for policy changes. As a result the credibility of government policies to the original commitments will be adversely affected. Once

¹² The policy changes are discussed and documented in Drabek and Laird (1998).

¹³ Following on the original work of Scitowsky and his own recent work, these issues are reviewed by Staiger (1995). For specific references to transition and vulnerable developing economies, see, for example, Langhammer and Lucke (1999) and Michalopoulos (2000).

again, an international agreement that locks in the original commitments will boost the government credibility.

On practical level, the attractiveness of WTO has several dimensions. The first attraction of the WTO is that governments are able to obtain an improved access to markets for their exports. The accession itself will not affect the MFN rates of trade partners of the acceding countries. However, the latter will be able to benefit from all commitments made by signatories of the WTO Agreements in future trade negotiations¹⁴. By staying outside the WTO, the countries' trade partners would be in the position to apply discriminatory tariffs against non-members. In addition, non-member countries would have to negotiate border measures with their partners bilaterally or regionally and may be exposed to undue negotiating strength of their partners. The multilateral trading system is, therefore, particularly important for small countries which have a limited power to exploit their (small) size to improve their terms of trade. Their impact on terms of trade maybe enhanced if terms of trade (and, therefore, world prices) are negotiated on a multilateral level.

The second practical reason why countries may be interested in joining the WTO- one that has been already noted above in the theoretical context – is the beneficial effect of the WTO on the *credibility* of government policies. Governments often face a "credibility gap" in trying to convince foreign and domestic investors and the rest of the business community about their commitments to particular policies. By framing the countries' concessions into legal commitments, the WTO Membership provides powerful guarantees of governments' policy directions. Unlike in the case of unilateral policy reforms, policy reforms supported by multilateral commitments are more credible, in particular because of the strategic interaction between the government and the private sector which makes the agreement attractive. In this setting, governments use international trade agreements to enhance the credibility of their policy choices with respect to the private sector. The "credibility gap" is particularly important and present in the case of many if not most transition countries due their history of central planning and political instability.

The third reason is the beneficial effect of the Membership on domestic policies and institutions involved in the conduct of international trade. Acceding countries are required to put in place *a set of norms* and institutions, which support the liberalization of markets and increase transparency and promote the rule of law, contract enforcement and the evolution of an independent judicial system. In principle, nothing would prevent governments from putting in place these norms

¹⁴ In practice, countries have often benefited from reductions of MFN rates even if they remained outside the GATT/WTO. In such situations the main benefit of joining the WTO would be the certainty and

and regulations on a unilateral basis. The role of the WTO in this process is to facilitate the introduction of effective reforms not only by reinforcing the credibility of the government's trade policies but also help introduce the policies that are based on best-practices and that must be harmonized.

The fourth reason why the WTO is considered to play an important and positive role is its contribution to the *predictability, security and transparency* of market access. For example, one of the major motivations for the Chinese government to accede to the WTO was the uncertainty to Chinese businesses and the government arising from the temporary nature of tariff provisions applied against Chinese exports in the United States. These provisions have been subject to annual reviews by the US Congress. China's accession to the WTO abolishes this practice, removes the uncertainty and thus reduce transaction costs of doing business and reduce distortions pertaining into investment decisions.. Moreover, exports from countries which are considered by their partners as non-market economies are often a main target of anti-dumping measures. Many transition countries could fall into the category of non-market economies. In addition, not only are these measures used frequently but they are usually more restrictive when applied against non-market economies. In sum, the issues of importance are the extension of permanent and unconditional MFN status, and the termination of the designation of transition countries as "non-market economies" by major trading partners such as the US and the EU.

The fifth reason is tied to the WTO's dispute settlement mechanism. The possibility of *resolving disputes* through the dispute settlement mechanism may appear, in particular to smaller and "weaker countries", as one of the most tangible benefits from WTO accession. There are very few effective vehicles to resolve international trading disputes outside commercial arbitration, and those that exist can pity small trading nations against big ones. The WTO dispute settlement mechanism provides a uniquely fair, accessible and effective opportunity to each WTO Member – irrespective of its size and level of income.

Finally, the sixth reason is the opportunity for acceding countries to shape the future rules and disciplines of the WTO. Acceding countries will undoubtedly be interested in participating actively in subsequent multilateral trade negotiations since only through direct negotiations rather than through an oversight from sidelines may they hope of protecting their interests. WTO membership offers them the most direct access to the forum where multilateral trade rules and disciplines are negotiated.

III. THE WTO AND POLICY-MAKING IN SOVEREIGN STATES: STYLISTIC EVIDENCE FROM TRANSITION COUNTRIES

Accession to the WTO has an important impact on the acceding country. In the rest of this paper, we shall consider how accession affects policy –making and domestic institutions. Accession implies the adoption of WTO disciplines, and this poses a number of challenges for the country concerned. First, accession will affect the access of foreigners into the country's domestic markets, and it is likely to facilitate the country's access to foreign markets. The challenge for the acceding country is to ensure that its industries (i.e. firms producing tradeables) are sufficiently competitive in the face of foreign competition. Second, accession will impose not only certain disciplines and rules but it will also require the establishment of those institutions and policies that are critical for the enforcement of these disciplines. One area of particular importance is "governance of public and private institutions which will be affected by the WTO accession. Third, accession will also affect government budgets since border measures constitute an element of government policies towards budgetary revenues. Fourth, accession will also lead to various adjustment costs, and these can be divided into two groups - the government (public) financial costs of implementing the WTO disciplines and private costs of market adjustments due to changes in relative prices. Finally, accession will affect the conduct of macroeconomic policy. All these issues will now be discussed in turn.

A. MARKET ACCESS: LIMITATIONS OF WTO COMMITMENTS

Arguably the most important and, undoubtedly, most visible effect of the WTO on policy-making concerns border measures affecting the flow of exports and imports. These measures are typically "visible" because they affect market access of acceding countries for their exports and the access of foreign firms to the markets of acceding countries. Thus, the first type of questions that one can ask about the influence of the WTO on policy-making is the following: "How does the WTO affect the extent to which markets of acceding countries have to be opened? Are the acceding countries 'forced' to take unreasonable commitments?" The second type of questions concerns trade policies of other countries and their effect on market access of acceding countries. In particular, are trade policies of incumbent WTO Members affected by the accession of new Members? Is market access of acceding countries improved by the accession? All of these questions are, of course,

further below.

important for acceding countries because they affect the exposure of these countries to foreign competition and the opening of markets for their exports.

An answer to the first type of questions can be provided with the help of data presented Table 1. The table shows for a selected number of countries their bound and applied tariff rates on imports of manufactured and agricultural goods. The distinction between bound and applied tariffs is important because it demonstrates the degree of acceding countries' commitments agreed in the WTO (bound rates) as opposed to the rates actually applied in practice. Bound rate is the critical commitment in the WTO. A bound rate higher than applied rate implies that the country in question is actually pursuing more liberal policies towards imports than it was willing to concede under the terms of accession. Sometimes, of course, countries may not bind their tariff rates in the WTO and agree with Members on a certain level of tariff without binding. This, by definition, gives them a greater flexibility to change tariffs.

What the data in our Table 1 suggest is that acceding transition countries have not been exposed in the WTO to unreasonable pressures to open up their markets. Many acceding countries have liberalized their trade regimes unilaterally and have been able to negotiate the terms of their WTO accession within the scope of measures already taken. As a result, their WTO commitments are less "liberal" than the measures actually applied. As can be seen from the table, all countries in our sample actually applied lower tariffs than those bound in the WTO. The only exceptions were the Czech Republic, Hungary and Poland which essentially bound the rates at their actual levels. However, the actual levels were already relatively low, especially in the case of the Czech Republic, and the bindings constituted, therefore, these countries' main concessions on market access. These findings apply both to industrial goods and agriculture. Moreover, some countries were "allowed" to bind their industrial and agricultural tariffs at fairly high levels, as the figures for Bulgaria and Romania indicate. Their bound rates are not only high in absolute terms or relative to other countries but they are also high relative to the corresponding actual rates.

INSERT NEW TABLE 1: Bound and Applied Tariff in Selected Transition Countries

The reply to the second type of questions – how incumbent countries respond to accession of other transition countries – which was brought up in the beginning of this section is relatively simple and straight-forward. As we have noted above, accession to the WTO does not require any change in the existing policies of the incumbent WTO Members. The "rule" also applies to market access conditions for all incumbents including, of course, transition countries. When countries negotiate their

WTO accession, incumbent Members make no new concessions on access to their markets. The only changes in their policies may be their commitment to maintain the actual market access conditions on a permanent and thus more predictable basis. *Pari passu*, we have no evidence at present to suggest that any of the incumbent transition countries would have changed their trade or any other policies as a result of accession of another country.

However, an issue that needs to be stated at this point is that the commitments of incumbents are not necessarily granted to the acceding countries automatically. An example of this problem is the recent experience of some transition countries with the provisions of the Jackson-Vanik amendment in the US Congress. WTO membership should in principle automatically confer new Members permanent and unconditional MFN status. In practice, however, this has not always been the case. The MFN treatment extended by the United States to the Kyrgyz Republic was still contingent at the time of writing this paper (2001) on the latter country's adherence to the provisions of the Jackson-Vanik amendment to the 1974 Trade Act regarding freedom of emigration. The US invoked the non-application clause of Article XIII of the Marrakesh Agreement before the accession of the Kyrgyz Republic. Without it, the US would be in violation of their WTO obligation towards the Kyrgyz Republic because of the latter's MFN status being subject to the Jackson-Vanik amendment. The authority for the permanent extension of MFN status to the Kyrgyz Republic has been enacted but not yet implemented.

Some of the newly acceded countries graduated from the Jackson-Vanik provisions before their accession, while others had to wait some extra time after their accession. The permanent MFN status was extended to the Baltic states in November 1991. Bulgaria graduated from Jackson-Vanik in October 1996, three months before its formal accession to the WTO. But permanent MFN status was extended to Mongolia only in July 1999, that is more than 2 years after the date of accession.¹⁵

Perhaps even a better example of the importance of political factors on "market access" of acceding countries is related to the question of "non-market status". In some WTO Member countries, anti-dumping and, in some cases, safeguards procedures applied to the so called "non-market

¹⁵ The political conditionality may have at least two important implications for acceding countries. First, the absence of guarantees regarding the application of the MFN treatment restricts the benefits of WTO accession to new Members. This element of uncertainty undermines the stability of market access conditions that is conferred by WTO Membership. Given the importance that new Members attribute to the stability and improvement of market access conditions resulting from WTO Membership, the presence of political conditionality reduces the benefits from WTO Membership. Political liberalization is often linked to the liberalization of economic policy which, in turn, is likely to lead to the adoption of measures making the economy more competitive, open and less-inward looking. Examples of countries are numerous, including the Russian "Perestroika", the Viet Nameese *Doi Moi*, the Chinese economic reform, the Czech "*Velvet Revolution*", and others.

economies" differ from those applied to other countries, as we have noted above. Transition countries acceding to the WTO may have expected that their accession to the WTO would automatically entail their "graduation" from the status of non-market to market economy. However, these expectations turned out to be overly optimistic. In 2000, the Kyrgyz Republic and Mongolia were still on the European Union's list of non-market economies.¹⁶

B. GOVERNANCE AND CORRUPTION

Beyond its direct impact on efficiency through import liberalization, the most immediate effect of WTO Membership should be its indirect impact on efficiency through improved governance. Corruption and lack of transparency have large costs for economic development. There is a strong evidence, based on cross country comparisons, that higher levels of corruption are correlated with slower growth and lower levels of per capita income.¹⁷ Corruption is very costly. It undermines well-functioning markets in five ways: as a tax, as a barrier to entry, it leads to a loss of government revenue, it disrupts the operation of markets, and it subverts the legitimacy of the state and its ability to provide institutions that support markets.¹⁸

Membership in the WTO should help reduce incentives for corruption by providing countries with what are perhaps the most powerful institutional checks and balances in the international economic sphere. Accession imposes changes both in institutions and policies. As discussed above, accession to the WTO provides, once fully implemented, a set of norms which should contribute to the opening of the economy, enhance the transparency of policies, and promote the rule of law and the evolution of an independent judicial system. Theory and evidence suggest that openness reduces

¹⁶ The "non-market status" has been a major cause of trade frictions between many transitions countries on the one hand and the United states and the European Union on the other. It is true that the WTO Agreements do not formally require candidates for accession to have a market economy, even tough the Agreements may be interpreted as implying the condition for firms to operate on strict commercial principles and with prices formed in competitive markets in order to avoid implicit taxation and subsidies. Without full transparency in price policy, the current rules and disciplines of the WTO would be virtually unusable. *e facto*, therefore, the incumbents tend to impose the "market status" requirement on acceding countries. For this reason alone, transition countries have a powerful incentive to introduce such measures that would have them removed from the list of "non-market economies". Some observers argue that the WTO Membership already implies demonstration of policies that are fundamentally market – driven These observers have suggested that the "non-market status" should be terminated upon the countries' accession to the WTO. See, for example, Michalopoulos (2000).

¹⁷ See Kaufmann *et al.* (1999b).

¹⁸ By way of an example, Bulgaria experienced in the second half of the 1990s corruption and problems with border controls. This created severe bottlenecks in international trade, with effects similar to those resulting from protectionist policies. It became evident that a radical customs reform was required in order to improve the border controls. Measures to address corruption have been now incorporated in many projects of the World Bank. For a more general discussion, see World Bank (2001).

corruption.¹⁹ Binding market-access commitments, increased transparency, and market-based institutions should further reduce rent-seeking behaviour and corruption. The adherence to internationally acceptable rules for international trade and FDI imposes stricter disciplines on governments and indirectly on firms.

An assessment of the impact of WTO accession on institutional quality in the acceding countries is difficult and can only be estimated or inferred from business surveys. In addition, many other factors affect the quality of governance. Accession to the WTO is only one of many measures with effect on institutional quality and, most likely, its effect is conditional upon other policies. Moreover, the causality may go in both directions; a high level of institutional quality will facilitate the accession while the accession promotes good institutional quality. Also, it is not, of course, possible to trace the precise time pattern of the effect of accession. It is quite likely, for example, that the institutional quality may be affected long before the actual accession in view of the preparations that the country in question may want to undertake in the anticipation of the actual conditions required by the WTO Membership.

Bearing these limitations in mind, it may be interesting to compare the quality of institutions across countries and over time. By comparing institutional quality indices across countries focusing on the differences between WTO Members and non-members, we can make a simple test of the effects of WTO Membership. The information is summarized in Table 2 reproduced from a recent IMF study (IMF 2000). The table provides two indicators of institutional quality.²⁰ The first indicator – a "narrow composite index" of institutional quality - is an aggregate of four component indicators: government effectiveness, regulatory burden, rule of law, and graft. The second indicator – a "broad composite index" of institutional quality - is an aggregate of the same four components plus an indicator for the extent of democracy ("Voice and accountability") and one for political instability and violence. The indices, as well as the component indicators, range from –25 (the lowest) to 25 (the highest).

¹⁹ See Bonaglia et al. (2001), Broadman and Recanatini (2000) and Treisman (2000).

²⁰ All component indicators have been developed by Kaufmann *et al.* (1999a and 1999b). They are based on 300 separate indicators from two types of sources: ratings produced by commercial risk rating agencies and other organizations, reflecting expert opinions; and surveys of firms and households, compiled by international organizations and other institutions. The aggregates are simple averages.

[INSERT TABLE 2: Indices of Institutional Quality, 1997-1998]

The most striking feature of the data in Table 2 is the relatively low value of the institutional index for all transition countries across the board. Clearly, countries in transition (CIT) generally face a major challenge of increasing the quality of their governance. Nevertheless, the table also suggests fairly significant differences. Limiting ourselves to the CITs which acceded to the WTO before 2000 (under Article XII), Estonia, Latvia, and Mongolia have been assessed as countries with a relatively high level of institutional quality. The quality of Estonia's institutions, measured with the narrowly defined index, ranks third among the countries on the track to the EU accession and Mongolia has a higher quality than all CIS countries. The Kyrgyz Republic's institutional quality is among the best compared to other members of the CIS. Bulgaria is lagging behind the other countries on the path to the EU accession with a value of the index that is still above the value of the index for CIS countries. Overall, the table provides some evidence that WTO membership goes hand in hand with higher institutional quality. Bulgaria did not achieve the same level of institutional quality as the Czech and Slovak Republics, Hungary, Poland or Slovenia, but these countries acceded to the WTO long before Bulgaria.

At a more detailed level, the table reveals the second most striking feature - all of the CITs which acceded the WTO before 2000 except Estonia have corruption as the origin of the low values of the composite indices of institutional quality. Corruption turned out to be the main problem in Bulgaria, Latvia, Mongolia as well as in the Kyrgyz Republic. In the Kyrgyz Republic, however, the index of regulatory burden is as low as the graft index. Since assessments of corruption used by different agencies may be affected by the methodology we have compared two different methodologies which are also reported in Table 2. The ranking of countries using different methodologies comes out remarkably similar.²¹ This fits into the broader picture that corruption is generally the main problem of governance in all transition countries, and that the ranking of transition countries is not likely to be subject to large random errors.

The positive change emerging from the studies of corruption over time is that the level of corruption may be changing, and that WTO Membership might also have played some role. Three of the five CITs that have acceded to the WTO between 1995 and 2000, saw their corruption indices improve over time even though for two of these countries, the perceived level of corruption has remained a matter of serious concern. As can be seen from Table 3, Estonia with its very low tariffs

²¹ The results are reported in the actual table. They show that the Spearman Rank Coefficient was 0.89.

has an impressively low corruption index, and Latvia is not lagging far behind. Mongolia has achieved a lower level of graft than all CIS countries. The "outliers" are Bulgaria and the Kyrgyz Republic. The relatively high corruption level in Bulgaria may be due to the fact that trade liberalization accompanied a prolonged recession which led to a dramatic reduction in real incomes and hence stronger incentives to enter informal and illegal activities.

[INSERT Table 3: Indices of Corruption, 1999]

The case of the Kyrgyz Republic is interesting. According to Broadman and Recanatini (2000), the implementation of clear and effective regulations and policies must be paired with effective steps to reduce corruption. This conclusion is confirmed by various other studies. The Kyrgyz Republic, for example, is fairly open and its customs tariff is transparent. However, the implementation of the customs tariff has been slowed down by the lack of a functioning administration. As a result, a widespread corruption has developed among customs officials. Supporting evidence is provided by measures of administrative corruption based on the 1999 Business Environment and Enterprise Performance Survey (BEEPS) taken from Hellman *et al.* (2000).²² These authors have unbundled the concept of corruption and distinguished between "administrative corruption", "state capture" and "influence". Administrative corruption is defined as the extent to which firms make illicit and non-transparent private payments to public officials in order to alter the prescribed implementation of administrative regulations placed by the state on the firms' activities. The figures in Table 4 below show that the level of administrative corruption in Kyrgyzstan is the second highest in the sample of more than 22 transition countries. It is much higher than the overall unweighted average and significantly higher than the CIS average. In general, the message coming from these business surveys is very clear and strong – trade liberalization and WTO Membership are not sufficient to eradicate corruption – an effective implementation of trade policy measures plays a critical role.

[INSERT Table 4: Measures of Administrative Corruption]

Good governance is also extremely important as an incentive to attract foreign investment. This is especially critical for transition countries and for all other countries that are dependent on foreign investment inflows. WTO membership is seen as an important element of policies aimed at

²² The 1999 BEEPS, conducted by the World Bank and EBRD, was designed to assess the quality of governance across 20 countries of Central and Eastern Europe and the Former Soviet Union from a firm level perspective.

attracting foreign investors by committing Members to apply open, transparent, and stable policies and regulations. As already noted above, WTO accession is only one of many factors that may influence the level of FDI inflows. However, there is now new evidence emerging from the literature that transparency and good governance – supported by WTO Membership - can be instrumental in attracting new foreign direct investment. Evidence provided by the EBRD and others shows that progress in the transition process, which includes effective establishment of market-oriented policies and institutions, together with effective implementation of privatization, trade linkages, political stability, perceived risk and the predominant type of investment play a key role.²³ A similar message is obtained from a cursory examination of the shares of FDI in GDP in 1995 and 1999 in transition countries presented in Table 5. The fast reformers - which are also the more open countries - have been relatively more successful in attracting FDI than the slow reformers. Among the Baltic countries, Estonia and Latvia have a higher share than Lithuania and when compared to the non-oil exporting countries in the region, inflows into the Kyrgyz Republic are relatively important. The same conclusion has been reached in more rigorous studies in which the effects of governance and transparency on FDI inflows has been tested in a formal model. Controlling for other economic factors, Drabek and Payne (2002) find a significantly positive statistical relationship between governance and FDI inflows.

[INSERT TABLE 5: Inward FDI Stocks in Transition Countries, 1995-1999]

C. CUSTOMS REVENUES

WTO accession may affect customs revenues which is often of an important source of government revenues in countries with relatively low levels of income per capita. This concern is linked to the importance of tariffs as a source of government revenue in many developing countries. But the effect of WTO accession may differ from country to country, and the final outcome is indeterminate *a priori*. To the extent that accession leads to a reduction of tariffs *rates* in the acceding countries, this will tend to reduce tariff revenues. At the same time, however, WTO accession may broaden the tax base. Accession will lead to the elimination of quotas, which are on the WTO list of prohibited trade policy instruments. Quotas are typically replaced by tariffs in the acceding countries, and this switch should add to the governments' capacity to generate revenue. The WTO Agreement on Customs Valuation should also broaden the tax base and thus contribute positively to tariff revenue as

²³ The factor "governance including corruption" is only one of the variables affecting the FDI and it is included in the EBRD analyses under the term "progress in transition". See Lankes and Venables (1996) Holland and Pain (1998), and Resmini (2000).

customs authorities are more effectively able to register import transactions and collect tariffs. Last but not least, lower tariffs will stimulate in the long run economic activity, and thus the *volume* of imports. This will have a positive impact on tariff revenue as well as on the base of other taxes.

Authorities in many transition countries have also been arguing that WTO accession may be detrimental to their ability to mobilize resources since tariff reductions will result in a severe drop in tariff revenue. Before considering the evidence, it may be useful to make two general comments about the impact of WTO membership on government revenues. The impact of the WTO is likely to be greatly exaggerated for at least two reasons. First, the argument about the adverse impact on government revenues assumes that tariff revenue represents an important source of government revenue. However, most transition countries have acceded the WTO with tariff structures inherited from central planning and these tariffs were relatively low²⁴. Second, several transition countries have pursued unilateral trade liberalization with most of their market opening taking place before their accession to the WTO (e.g. Estonia). Moreover, transition countries have tended to bind their tariffs on industrial products at a relatively low level²⁵. For all these reasons, there was a relatively less pressure from WTO Members for additional tariff reductions.

Empirical evidence on the evolution of collected tariff rates in transition countries is brought together in Table 6. Collected tariff rates are calculated as the share of tariff revenue in the respective country's imports. Figures show that only in a limited number of countries collected rates were relatively high in the first half of the nineties (e.g. Hungary, Poland, Slovenia, Macedonia, Croatia and Russia). Over time, the number of transition countries in which tariff revenue is an important source of government budgets has considerably dropped. In Hungary, Poland and Slovenia, collected rates fell steadily and dramatically during the nineties. In Macedonia, Croatia and Russia, the trend is less clear as the most recent figures show a rebound. By the end of the decade, however, only the South-Eastern European countries, together with Romania, Azerbaijan and Russia still collected custom revenues at the rates above 5 percent of imports. Nevertheless, even in these countries the tariff revenue shares are roughly at the level of non-OECD countries.²⁶ The data thus confirm that the incidence of tariff protection has in general declined in transition countries during the nineties but they also confirm that tariffs do not generally play a major role in transition countries.

INSERT TABLE 6: Tariff Revenues in Transition Countries, 1991-99

²⁴ The reason for the low tariff was their purely administrative character since trade flows were decided by fiat. The example with relatively low tariff include the Czech Republic, Slovakia and to a lesser extent also Hungary and Poland. For more details, see Drabek and Smith (1995).

²⁵ For more details, see, for example, Drabek and Laird (1998) and Kierzkowski (2000).

²⁶ Compare, for example, with Ebrill, *et al.* (2001).

This raises the question of how much of the decline was brought about by the accession to the WTO? The answer must be – very little, if at all. In Hungary, Poland and Slovenia, the three countries which experienced the largest reduction of their collected rate, the changes in tariff revenue have primarily reflected autonomous measures and the effects of the Europe Agreements. The latter have tied the trade relations of the Central and East European countries closely with the European Union. The Agreements have established, *inter alia*, free trade areas with tariffs eliminated over a period of 10 years. The case of Bulgaria, which acceded the WTO in 1996, is similar. In Bulgaria, the collected rate fell from its peak at 7.6 per cent in 1994 to 2.8 percent of total imports in 1999. This reduction is less significant than the reductions in Hungary, Poland, or Slovenia where the rates peaked at respectively 13, 15 and 11 percent before falling to levels around 2-3 percent, but it reflects the same influences. In the Baltic countries, the peak was around three percent which does not leave much room for WTO-induced reductions. No clear downward trend can be observed in the South-Eastern European countries up to 1999 but Croatia only acceded by the end of the year 2000. The evolution in the CIS countries is not homogeneous either but, except in one or two cases, the collected rate has remained low during the nineties. The only country which experienced a significant reduction of its collected rate - from 7.1 in 1992 to 0.4 percent in 1998 – and which might be related to its accession to the WTO is Mongolia. However, given that Mongolia's average bound tariff on industrial products is 18 percent and that its average bound tariff on agricultural products is even above 19 percent, the drop in the collected rate is most likely not the consequence of the WTO bindings. Note that in Georgia, the collected rate dropped from 4 to 2 between 1998 and 1999. Given that Georgia acceded in 2000, it is clearly too early to assess the effect of WTO accession but, as with Mongolia, the role of WTO accession can only be limited as the bound rates on industrial products and agriculture were respectively reduced to 6 and 12 percent.

While the specific reasons for the drop in the collected tariff rate should be investigated and solutions found, we shall confine ourselves to identifying the countries in which a reduction in the collected tariff revenue could potentially pose a serious budgetary problem. As Table 6 shows, in some transition countries the share of international trade taxes in total government revenue was not negligible, even if it remained significantly lower than, for example, in African countries where it reaches 30 percent on average. Mongolia is the country for which the fiscal revenue problem associated with a fall in tariff revenue may be most serious. The figures in Table 7 confirm that in Mongolia international trade taxes expressed as a share of total revenue dropped from a relatively high level - more than 11.4 percent - in 1996 to a relatively low level - less than one percent - in 1998. Similarly, in Georgia where tariffs accounted for about 12 percent of government revenue in 1997 and 1998. Based on the information at hand, only two other acceding transition countries had a high share

of international trade taxes in total government revenue for extended periods of time during the nineties: Azerbaijan, and Albania. In those two countries the fiscal aspect of liberalization may also be important.

INSERT TABLE 7: Share of International Trade Taxes in Total Government Revenues

Among the main causes of the decline in collected rates in Mongolia as well as in the other countries are poor customs administration and smuggling. According to press reports, for example, the effectiveness of the border control agencies in Bulgaria was well below par especially during the mid-1990's. Customs revenue collection fell short of targets, and smuggling became widespread. The government authorities were painfully aware of the revenue losses resulting from the poor functioning of its customs administration and invited, therefore, the EU to help Bulgaria improve its customs, as part of its pre-accession assistance. Bulgaria is also currently pursuing a budgetary reform with the creation of a Unified Revenue Agency which will consolidate the collection of taxes and social contributions under a single agency. In Georgia the government has been recently collecting "perhaps 20 per cent, may be even less than 20 per cent of the applicable customs duties, excise taxes and VAT."²⁷ The same observer noted that "[I] will be surprised if there is any single customs officer on the line who understands, let alone applies the (WTO) customs valuation regulations."²⁸ The implementation of the WTO's Customs Valuation Agreement may contribute to increased transparency and stability in customs collection.

Two conclusions stand out. First, in most transition countries, tariffs never contributed significantly to government revenue during the last decade. Tariff reductions should, therefore, not cause major budgetary problems. This is not to say that transition countries may not face budgetary constraints but the origin of these problems will most likely not be trade liberalization. Second, the fall in tariff revenue expressed as a share of imports observed in transition countries who joined the WTO may not be entirely attributable to the lowering of tariff rates following the accession. The tariff reductions are likely to be the consequence of the signing the Europe and similar type of agreements by the Central and East Europeans with the European Union which has led to the creation of free trade areas. In some cases, it may also be the consequence of weak customs administrations, a problem which governments will be well advised to address. An effective implementation of the customs valuation agreement should help countries improve tariff collection and customs administration.

²⁷ Quoted from Allen Shinn, Executive Director of IRIS Caucasus Centre; Report on seminar on Georgia's and Kyrgystan's Accession to the WTO, 22 March 2000, Tbilisi, funded under TACIS.

²⁸ *Ibid.* pp.28-9.

D. IMPLEMENTATION COSTS AND BUDGETARY POLICIES.

The WTO accession poses another major challenge for acceding countries – they will typically have to carry out fairly significant changes in their policies and institutions to ensure full compatibility of domestic legislation with that of the WTO and the existence of all institutions required for the implementation of the countries' WTO commitments. This raises serious questions for governments of acceding countries. What are the implementation costs resulting from the accessions? While recognizing that the costs may differ among countries, can we identify the main elements of these costs? How high are these costs? Can they be fully and easily absorbed by the acceding country? If the implementation costs are high, should the country pursue its accession objective by taking all or, at least the bulk of the measures before the negotiations or can the measures be introduced during the time of negotiations? Would it be better for the country concerned to plan its accession in such a way that the adjustment costs are minimized? These are important questions for policy makers and negotiators. We shall not attempt to answer all of these questions which would be beyond the scope of this paper. However, we shall address the first two issues - the main elements of implementation costs and the orders of magnitude of these costs.

Implementation costs are a part of adjustment costs of WTO accession which, in turn, can be divided into two broad categories - public and private costs. The former, in turn, typically includes different types of costs resulting from the implementation of the WTO Agreements, noted above. The first important group includes costs that arise out of *the harmonization of the country's policy instruments* with those of the WTO. For example, under the GATT and the WTO Article XI, quotas must be replaced by tariff as the sole instrument of trade protection. The economic rationale for this rule is to replace administrative instruments of protection by price-based policy tools. This is a particularly important policy change for transition countries which had traditionally relied on explicit and implicit quotas representing the governments' planning instruments. Thus, replacing the forbidden policy instruments and moving from administrative to market-based instruments will be a radical step. These switches of policy regimes can be complicated, disruptive as well as costly as it is documented on the example of Mongolia and its cashmere industry (Box 1). The changes must obviously be handled carefully and only after thorough preparations.

The second important group of adjustment of costs includes the *costs of institutional changes*. The implementation of the WTO agreements is not a simple matter of adopting new laws. For developing and transition countries, it typically involves the setting up of new administrative capacities and substantial changes in technologies and new investment. For example, the Agreement

on Sanitary and Phytosanitary Measures, and on Technical Barriers to Trade require the existence of specific testing equipment, legal provisions for SPS and TBT norms, sufficient number of staff with adequate and appropriate skills and so on. The implementation of Article VII of GATT requires the establishment of administrative capacity, the training of customs officers, the learning of commercial practices, the development of risk analysis and audit systems. The implementation of the TRIPs Agreement is equally investment-intensive and it also requires drafting new legislations, augmenting the administration to review applications, build-up of computerized information systems, extensive training, the setting up of enforcement agencies, etc.

These costs may be quite high. In their study of the World Bank and UNCTAD projects in support of the implementation of technical, sanitary, and phytosanitary standards and of the intellectual property law, Finger and Schuller (1998) concluded: *"Implementing (such) reforms are investment decisions in that implementation will require purchase of equipment, training of people, establishment of systems of checks and balances, etc. This will cost money, and the amounts of money are substantial. ... Those figures (of project costs) for just three of the six Uruguay Round Agreements that involve restructuring of domestic regulations, come to \$130 million. One hundred thirty million dollars is more than the annual development budget for seven of the twelve least developed countries for which we could find a figure for that part of the budget."*²⁹

²⁹ See Finger and Schuler (1998), abstract and p. 25.

BOX 1 - Mongolia's policy in the cashmere sector

Since the early 1990s, Mongolia's cashmere sector has been going through important turbulences. World supply of cashmere has increased considerably through the 1990s. Mongolia, whose share of the world market is approximately one third, has contributed significantly to this increase. The breakup of the Soviet-era system left herders free to expand the size of their herds. The size of the flock has increased from 5 million heads in 1989 to more than 11 million in 1998. At the same time, demand for raw cashmere has fallen partly as a result of recession in Japan. The resulting fall in price has been partly offset by sustained purchases of raw cashmere by the government of China, the world's largest producer and exporter.

The Mongolian government has been trying to promote a domestic processing industry. During the last decade, Mongolia's processing capacities have increased significantly, from a handful of processing firms to nearly 30. However, because Chinese processors pay higher prices and, unlike domestic buyers, most often pay in hard cash, herders have increasingly been exporting their raw cashmere to China. Of Mongolia's total yield of 2'700 tons of cashmere in 1998, it is estimated that more than one third went to China. In order to help domestic processors faced with a shortage of raw cashmere, in 1994 the government of Mongolia introduced a ban on exports of raw cashmere which has been in place until 1996.

In October 1996, as part of a series of reforms requested by WTO Members as conditions for Mongolia's accession, the government substituted the ban with an export duty at the rate of not more than 30 per cent *ad valorem* to be phased out and eliminated within 10 years of the date of Mongolia's accession to the WTO. GATT Article XI severely restricts the use of export quotas, while export taxes are allowed. It is estimated that of some 1'000 tons that were exported to China, all but 16 tons were smuggled across the border, escaping taxes. The processing industry, which according to specialists is not competitive, complains about the high prices and the shortage of raw cashmere. The herders, whose income had declined by 50 percent as a result of the ban, continue to be heavily penalized by the export tax and seek the higher prices paid by Chinese processors.

The export tax did not achieve its objective mainly because of implementation problems. But even if it indeed restricted exports, it would still have involved a dead-weight loss and large transfers from the herders to the processors, without helping the herders. Neither the ban nor the export tax were the panacea to the industry's problems. The way out of the present crisis requires a thorough analysis of the industry's problems at each stage. One of such studies revealed, for example, that the main reason for the processors' low competitiveness compared to that of their Chinese competitors is their difficulty to access credits.

The experience of transition countries has been similar – the costs of implementing the institutional reforms appear also quite high. This is documented in Table 8 which provides details on costs of the World Bank projects related to the implementation of three agreements – on customs valuation, TBT and SPS.³⁰ Even though the costs can be, and in practice they indeed are spread over several years, they still force governments to make difficult choices. Moreover, since these projects are not automatically self-financing (like, say, borrowings against the future stream of income in an industrial project) and they are funded by a foreign currency debt instrument (e.g. IBRD loan), they increase external indebtedness of what may already be vulnerable economies.³¹ Full costs of the legal

³⁰ For more details see *Report on CIS Workshop on WTO Accession*, Moscow, May 17-18, 2000 under the TACIS programme. See also discussion in Section II.5 below.

³¹ For more details see the World Bank web-site.

and institutional harmonization with WTO standards and requirements are much higher.³² We shall return to these questions further below.

INSERT Table 8: Costs of World Bank Projects Related to the Implementation of Three WTO Agreements

The experience of transition economies in the area of TRIMs is also interesting. Only Romania has notified its use of trade-related investment measures and has requested a delay in the implementation of its TRIMs commitments. In order to provide some empirical evidence with regard to TRIPs, we have reviewed all reports concerning transition countries prepared by the WTO under the TPRM provisions and the degree of success in implementing the TRIPs Agreement. The results are summarized in Box 2. As can be seen from the case studies under review, compliance with the TRIPs Agreement has also run into implementation problems in the transition countries. Furthermore, according to the International Intellectual Property Alliance, a private sector coalition formed to represent the US copyright based industries, there is a lack of effective intellectual property rights enforcement in Bulgaria, Estonia and Latvia.³³ Anti-piracy resources are thin and judicial enforcement is almost non-existent. Estonia, for instance, is alleged to have an ineffective copyright enforcement on almost all levels: criminal, civil, administrative and border operations. Enforcement is also hampered because the appropriate officials do not know the proper procedures to take on piracy cases.

Box 2 Implementation of TRIPs Agreement in Selected Transition Countries

Hungary

- Signatory to most multilateral agreements protecting intellectual property
- Patent and trademark laws have been harmonized with EU legislation
- Hungary's legislation is now more stringent than the minimum standard laid down by the TRIPs Agreement
- A substantial unofficial economy persists, making the sale of pirated and counterfeit goods a continuing (though declining) problem.

Poland

- Signatory to most international agreements protecting intellectual property and member of WIPO
- However, serious effort required to improve protection of intellectual property to match the EU, especially in the sphere of enforcement.
- Very high piracy rates and a history of lax enforcement led the International Intellectual Property Alliance in 2000 to recommend that Poland be placed on the "priority 301 watch list" by the USTR.

Romania

- Signatory in recent years to a large number of multilateral conventions on the protection of IPRs.
- Insufficient enforcement at the border remains an outstanding gap in the protection of copyright.

Sources: WTO TPRM Reports for Hungary 1998, Poland 2000 and Romania 1999.

³² Although not exactly comparable, the costs associated with accession of transition countries to the European Union provide some indications of the size of problem. The Czech authorities estimate that adoption of the EU environmental legislation alone will cost the government 350 billion KC, or about US\$ 10 billion.

³³ IIPA 2001 Special 301 Report on Estonia, IIPA 2001 Special 301 Report on Latvia and IIPA 1999 Special 301 Report on Bulgaria.

The implementation of SPS and TBT Agreements has run into similar problems, and their origins were typically the same - budgetary constraints. For example, a study of implementation of the WTO measures in Bulgaria related to the implementation of the SPS and TBT measures concluded that the main implementation problems lie in the poor financial situation of these countries and in the small scale of production. The study distinguished between two types of regulations: those which require substantial changes in the production process and those that do not. The authors conclude that the main problem with the implementation of those agreements which do not require any changes is the shortage of financial resources. The problem with the implementation of the second group of measures is that they require major changes in fixed assets and technologies, and thus – once again - heavy investment.³⁴ Regulations of the second type are mainly related to the Law on Animal Breeding and regulations issued under the relevant law.

In sum, the budgetary implications of the WTO Agreements cannot be underestimated. The financial burden may vary from country to country but the full implementation costs of accession are never negligible. However, the question still has to be asked how these costs compare with benefits which WTO accession is likely to generate for acceding and incumbent countries, an issue to which we shall return in the next section when we discuss another element of adjustment costs – those related to changes in relative prices.

E. ADJUSTMENT COSTS AND POLICY RESPONSE

The second, and arguably the most controversial cost of accession are adjustment costs resulting from changes in relative prices and competitive conditions following the accession to the WTO. Liberalization of the country's trade regime will change the domestic relative prices of goods and services, which, in turn, will lead to increased competitive pressures on industries that had been until now protected by tariffs (or quotas). This, in turn, will create incentives for resources – capital and labour – to move into sectors which are more profitable and efficient. This process of resource re-allocation is not without costs as labour is retrenched and must move and be re-trained (or the opportunity costs of unemployed labour must be imputed into the calculations of adjustment costs). Capital is more mobile than labour but investors will also compute their adjustment costs and take into account, *inter alia*, the sunk costs of capital.

These adjustment costs are principally private costs but they are also likely to have profound implications for economic policy. It would be very rare indeed that the private costs of adjustment would be fully financed by private individuals or firms. More common is for governments to share in

³⁴ See Ivanova and Georgieva (2000).

financing the costs in order to facilitate the adjustments. The relevant measures include, for example, measures towards labour retraining, unemployment support, etc., all of which force governments to organize their business differently than before.

The experience of transition economies is again illustrative of these adjustment problems. The price liberalization in the early 1990s led to dramatic changes in relative prices due to deep-rooted price distortions existing under central planning. Privatization of state assets was typically constrained by severe liquidity shortages. This together with the lack of managerial skills, questionable banking practices, corruption, poor financial supervision, under-capitalization of banks and bank balance sheets containing a high share of non-performing assets together with other market distortions produced economic results that at best can be judged as highly disruptive. The level of output dropped precipitously and well below the pre-1990 level and remained in many transition countries below that level a decade later. Unemployment reached levels unprecedented in these countries, and all of these countries struggled with dangerous bouts of inflation. It is, therefore, not surprising that many of these countries perceive the market disruptions as the major impediment to trade liberalization (See Box 3). Given the depth of recession, the size of unutilised resources and the collapse of all traditional foreign trade links, economic theory offers no solution as to the optimal conduct of trade policy under these circumstances.

BOX 3 – Market Disruptions in Moldova

"The government of Moldova has been deeply concerned about the future of its agricultural sector. The agricultural sector has been going through a radical restructuring process. The former collective agricultural enterprises are being transformed into thousands of small private farms with size ranging from between 1 to 3 hectares. The operation of these farms are far from optimal, with "new" farmers lacking a proper understanding of the basic concepts such as enterprise management, efficiency, price policy, product policy, development and new equipment implementation, competition, etc.

The restructuring process of the agricultural sector is being accompanied by a drastic fall in output. Overall agricultural output dropped to 3.01 billion lei in 1999, which is 55.5% less than in 1993. Due to the loss of subsidies by the former collective agricultural enterprises and the lack of resources of the newly privatised farmers less land is cultivated. The lack of inputs and of investment funds has also forced farmers to switch from high-value to low-value crops, even though in normal market conditions high value crops would be more competitive. The result has been a dramatic and unacceptable fall in rural income."

Source: Statement of Moldovan representative to TACIS-sponsored conference on the WTO accession, Moscow 2000.

The response of governments to changes in domestic market conditions critically depend on the impact of these changes on production, employment, price level and welfare. While in the long-run the scope for positive gains from trade is well understood, countries may face adjustment costs in

the short-run. We have not been able to collect full information on policy responses of governments in transition countries following or just preceding their WTO accession which would be beyond the scope of this paper.³⁵ It is clear, however, that the responses will vary. How governments respond in such situations will be determined by a variety of factors such as the depth of disruptions, availability of resources, legal provisions for government interventions (e.g. to provide assistance to ailing industries), etc.

A complicating factor for the assessment of government responses is the negative perception of some governments and observers about the value of WTO Agreements. The Agreements have been subject to two kinds of criticism. The first criticism concerns the effects of welfare and the distribution of benefits from the TRIPs and TRIMs among countries. The argument is that these agreements primarily serve the interests of developed countries and do not bring the corresponding benefits for developing and transition countries. On TRIPs, for example, Panagarya (1999) constructed a theoretical case to suggest that the Agreement is a welfare reducing instrument for developing countries as well as for the world as a whole.³⁶ Similarly, two World Bank economists Finger and Schuler (1998) argued that – in establishing the content of the obligations imposed by the WTO agreements on intellectual property rights (and customs valuation and SPS) – the developed countries have essentially imposed their standards. In their view, the TRIP agreement does not for this reason alone protect indigenous technology nor does it encourage innovation.³⁷

The criticism of the TRIMs Agreement is based on the perception that trade-related investment measures are useful as the second-best policy instrument to stem restrictive business practices of multinational enterprises or to offset distortions due to tariffs. The view is rejected by the critics of TRIMs who argue that these measures introduce new distortions which tend to increase the countries' import costs, worsen their balance-of-payments positions, fail to generate export earnings and to transfer modern technology to developing countries. In their view, the specific measures à la TRIMs that target any of the above distortions will be welfare reducing for the country imposing TRIMs. In brief, the critics dismiss TRIMs both on theoretical grounds - pointing to the inefficiencies of these instruments – and on empirical grounds demonstrating their general failure in countries in which were used.³⁸

³⁵ Economic liberalization has posed a variety of serious allocative problems in transition countries in the wake and following their accession to WTO. For a fuller and more detailed discussion, see Yang (1999).

³⁶ For a more comprehensive discussion of the issues see Maskus (1998).

³⁷ See, for example, Finger and Schuler (1998), p.23. The criticism of TRIPs is, however, much wider and it includes such issues as equitable sharing of benefits arising from the utilisation of genetic resources, transfer of technology, conservation and sustainable use of biological diversity.

³⁸ The popularity of TRIMs has been quite widely shared among politicians of developing countries even though they no longer attract much interest among economists. The literature on TRIMs and related

These views sharply contrast with the general assessments of gains to countries from their accession to the WTO. For example, in a recent econometric study based on a nine commodity by twelve regions version of the GTAP model, Yang (1999) estimated the welfare effects of the WTO accession by China, Taiwan and the countries of the former Soviet Union both on the acceding countries themselves as well as on different regions of the world. He found that the accession is likely to bring substantial welfare benefits for the acceding countries and other Asian countries. Welfare gains are found to be much more dubious for other regions and critically depend on the level of agricultural subsidies in the OECD countries. However, if all dynamic factors of globalization were to be included in the analysis, which could not be captured by the model itself, the overall welfare gains become even more widespread and evident.³⁹

In summary, WTO accession can lead to significant budgetary and other adjustment costs. Even though benefits of accession most likely far outweigh the costs in the long-run, the short-run costs are likely to be high enough to put governments in sensitive situations in which they will be expected to respond in order to ease the burden of implementation of WTO Agreements and the costs of adjustment.

F. IMPACT ON REGIONAL ARRANGEMENTS

Accession to the WTO may sometimes complicate the relations of countries with some of their existing trading partners. Problems have indeed arisen as a result of conflicts between obligations imposed by regional agreements on the one hand and the WTO on the other. Regional trade arrangements may in turn complicate the country's negotiations for accession to the WTO which specifies in Article XXIV of GATT the precise conditions under which preferential trade arrangements are acceptable in the WTO.

Several examples of conflicts between the regional and multilateral integration processes involving transition countries have been documented. As noted above, regional integration projects may affect the country's negotiated terms of accession. The prospect of joining the EU, for instance,

instruments is vast, and the debate was mainly conducted during the 1970s and 1980s in the context of the related subject – infant industry protection. See, for example, Rodrik (1987). The literature is briefly reviewed in Bora *et al.* (2000). Examples of more recent economic papers are Morrissey and Rai (1995) and by Balasubramanyan (1991) both of which take a strong pro-TRIMs position.

³⁹ The author recognized that his model excluded, for example, a treatment of better access to market for services, the effects of increased transparency, better protection of intellectual property rights, etc. See Yang (1999), p 526. His findings are broadly consistent with those of other researchers whose work is reviewed in his paper.

provides a strong incentive for a WTO acceding country to adopt a trade policy regime that is less open than that of the EU. The more open a country's trade policy and WTO commitments compared to that of the EU, the higher the compensation that the country concerned will have to pay to third countries upon the country's accession, and the higher the welfare cost of the adoption of the common external tariff to the new EU Member.⁴⁰ This is presumably one of the main reasons why Estonia set its applied tariffs at zero but its bound rates are higher because of its prospective accession to the EU.⁴¹ Upon its accession to the EU, Estonia will thus have to replace its current free trade regime by the EU's common foreign trade policy. This will lead to an increase in tariffs and thus to a welfare loss. Estonians expect, however, that these trade diversion costs will be limited because a large share of Estonia's trade is already with the EU. Moreover, the level of EU protection on raw materials, the main import from non-EU members, is relatively low. Estonia will have to implement the EU's contingent protection measures including its anti-dumping rules but these are WTO consistent. Another example of the conflicts between regional and multilateral commitments is Hungary's resignation from the Cairns group of agricultural exporters. One of the main reasons for this decision was the fear that the membership in the group may be incompatible with EU membership.

Another observation is that regional or bilateral liberalization may not necessarily spill-over to arrangements with non-preferential trading partners. The signing of Europe Agreements and similar bilateral agreements with other East European countries led to liberalization of trade and investment between parties without simultaneous alignment of MFN rates of the Central and East European countries. This observation has been made by Kaminski (1999) concerning four other Central European countries. He notes that while in view of the countries' interest to accede to the EU the best tariff policy action would have been an alignment of MFN applied duties on industrial products with the EU post-UR rates, not a single country has chosen to follow this path at the time. Similarly, the Baltic countries have also chosen to wait. Latvia, for example, has made no attempt to "converge" to the EU trade regime in advance of accession despite the fact that Latvia is openly committed to the full adoption of EU trade policy following its accession to the EU.⁴² It should be pointed out, however, that all of these transition countries will have to align their MFN rates to the EU as the condition of the accession. The case of Estonia is not representative in the sense that Estonia pursued a more liberal trade policy than the EU's.

⁴⁰ In its accession negotiations, Croatia faced conflicting demands from the EU and from other WTO Members on liberalization of audiovisual services. This was also the case of Latvia, Lithuania, Estonia, Moldova and Bulgaria.

⁴¹ Purju (2000), p.8

⁴² See Muravskaya et al. (2000).

The case of the Kyrgyz Republic illustrates how multilateral commitments can create tensions with trading partners, in particular if they are not WTO Members. Most Kyrgyz trading partners are still not members of the WTO. This significantly limits the immediate benefits from accession. On the other hand, its own WTO Membership allows Kyrgyzstan to participate in the Working Parties for the accessions of its trading partners. Kyrgyzstan's WTO commitments were also affected by its regional integration projects. The Kyrgyz Republic had introduced a flat 10 percent tariff on all products before its accession to the WTO but tariffs were not bound at this level possibly because of the customs union agreement signed with Belarus, Kazakhstan, and Russia in 1996. Following the Kyrgyz accession to the WTO, Russia and Kazakhstan have complained that the Kyrgyz Republic's WTO commitments violated its commitments to its customs union partners - despite the fact that, for the time being, a free trade arrangement rather than a customs union seems to be in place - and would cause a trade deflection, given the weak customs controls between Kazakhstan and the Kyrgyz Republic. Thus, in 1998 and 1999, first Kazakhstan and then Uzbekistan imposed significant impediments to Kyrgyz exports, including very high tariffs, quotas and other trade restrictions. In brief, the WTO disciplines do not shield the WTO Members from trade-restrictive measures if they are taken by non-members.

It must be emphasized that regional integration among transition countries does not necessarily conflict with the multilateral trading system. Various studies presented at the recent OECD's roundtable on "Ten years of trade liberalization in transition economies" provide interesting illustrations of the complementarity of the regional and multilateral trade liberalization approaches. On the one hand, countries on the accession track to the EU often see the WTO accession as a useful preparation. Purju (2000), for instance, suggests that maybe the most important benefit of the WTO accession for Estonia was the need to respond to the wide range of questions that were raised in the WTO negotiations and that prepared the government and the private sector for the negotiations with the European Union. During the negotiations, Estonia was able to address many issues that are likely to arise in the negotiations with the EU. On the other hand, the harmonization of rules and policies with the EU is helping the EU-candidate countries to more effectively implement their WTO commitments. For example, Tsvetkovska (2000) believes that Bulgaria's implementation of the WTO disciplines is facilitated by the fact that the economy has to harmonize its national legislation with that of the EU. Along the same line, Muravskaya et al. (2000) point out that the negotiations of the Baltic Free Trade Agreement and of the Europe Agreement have provided an opportunity to acquire experience and expertise in international trade policy-making.

G. BALANCE-OF-PAYMENTS MANAGEMENT

In Section D above, we have already discussed the effect of WTO Membership on countries' internal policies, policy instruments and institutions. Among these effects, perhaps the least familiar but equally important is the effect of the WTO disciplines on macroeconomic policy in the presence of balance-of-payments disequilibrium. To repeat, this issue is perhaps the most understated in the whole debate about the WTO and its impact on the Member countries. The reason for this understatement is partly historical given the perception of the GATT and the WTO as an exclusive domain of trade policy. However, as we shall argue below, trade policy is intermittently tied with domestic macroeconomic and structural policies.

The importance of the broader linkages of trade policy stem from the economic relationship between the current account in balance-of-payments and domestic aggregate variables for savings and investment. This relationship, which is known under the heading of "fundamental identity", links domestic investment expenditures (relative to savings) to net imports (or net exports). An excess of domestic spending over national savings can only happen if the excess is "funded" through imports and *vice versa*. An excess of national savings over domestic investment can only happen if the corresponding amount is withdrawn from the domestic economy in the form of net exports.

These linkages have been well understood by the original GATT negotiators. The GATT Articles XII and XVIII make special provisions for countries with balance-of-payments difficulties, and allow these countries to impose import restrictions to ease domestic adjustment and to facilitate the financing of current account deficits. One of the important provisions of these Articles is the temporary nature of the restrictions. The restrictions must not be imposed "permanently" which means that the long-term financing of current account deficits can only be achieved through domestic adjustment which in turn will call for appropriate changes in macroeconomic and structural policies. Another provision specifies that the restriction can only be taken in the form of a uniform import surcharge. Thus, the restrictions must not be selective and subject to different rates of surcharge. In other words, the restrictions must provide uniform protection from imports.⁴³

The critical effect of these provisions is to help *introduce a stronger discipline* into domestic policy-making – both on the macroeconomic and structural level. Another reason is to avoid frictions in international trade relations. For example, Members conducting inflationary policies which lead to

⁴³ Strictly speaking, the uniform rates of import surcharge do not necessarily provide uniform import protection. In theory, this will only happen if production functions are identical in each industry. Otherwise, the governments would have to apply uniform rates of effective tariffs or some other, more sophisticated measures of import restrictions.

current account deficits are most likely to run into difficulties with their trading partners if they seek aggressively to depreciate their currencies or restrict imports. While these policies may be seen by the countries that apply them as the first best policy, this is not the case when one takes into account the likely reactions of trade partners. Quite apart from the fact that tariffs are never the first-best policy to correct balance-of-payments disequilibria, both measures can be seen as the "beggar-thy-neighbour" policies. For this reason alone, the policies will be often resisted by the countries that are directly affected by them. The WTO Agreements have nothing to say about the former, but as we have seen above, they are quite explicit about the latter.

Transition countries provide interesting examples of the discipline that has been imposed by the WTO Agreements. During the period of 1995 – 2001 there were seven out of fourteen transition countries – WTO Members that invoked exemptions under Article XVIII of GATT – Bulgaria, the Czech Republic, Hungary, Poland, Slovak Republic, Romania and Yugoslavia (prior to 1995). In other words, the list has covered one half of all transition countries that were WTO Members at the end of the second half of the 1990s. What is particularly important in this respect is the fact that by mid-2001 there was no transition country still invoking the exemptions. All of these countries have taken measures to abandon their restrictive trade policies and met their WTO obligations.

The example of the Czech Republic is interesting for another reason – the country's use of a wrong policy instrument. When the Czech government decided to invoke the exemption on the grounds of a rapidly deteriorating balance-of-payments situation in 1996 it chose to restrict imports by requiring importers to make an advance foreign exchange deposit calculated as a percentage of the import bill. The measure was challenged by several trading partners as WTO illegal since the WTO requires that the restrictions can only be made in the form of a uniform import surcharge. The Czech government realized its mistake and shortly, after the notification, it withdrew the import deposit requirement.

The WTO disciplines help strengthen the balance-of-payments management of countries that run into balance-of-payments difficulties. This does not mean, however, that countries eliminate all origins of financial instability. The balance-of-payments difficulties may arise for a variety of reasons including, for example, unstable capital movements, deterioration in terms of trade, loss creditors' confidence, a sharp increase in foreign interest rates and so on. The temporary import restrictions address none of these factors and do not, therefore, eliminate the true origins of the balance-of-payments crisis. What they do provide, however, is the time necessary to take domestic measures to adjust to the changed international environment.

IV. CONCLUSIONS

Five main conclusions come out of our examination of the post-accession experience of the transition countries. *First*, there is no precise blueprint of conditions of accession for new acceding countries. The acceding countries are expected to sign on all WTO Agreements but the detailed conditions of accession may still vary from country to country as a result of negotiations. Thus, the terms and conditions of accession will critically depend on the outcome of the negotiations which, in turn, depend on the negotiating power of the country concerned, negotiating skills, and the country's readiness to agree to and implement the whole range of the WTO disciplines. *Second*, over the last decade most transition countries have made an exceptionally profound effort to liberalize their trade and investment regimes. Accession to the WTO has played an important albeit not exclusive role in this process of liberalization. The accession has been seen as critical for some countries such as China. In other countries, the autonomous measures taken by these countries have been more important in terms of the degree of liberalization. *Third*, the costs of the WTO Membership are not negligible. The Membership requires fairly large investment into the modernization and harmonization of various institutions directly involved in the conduct of foreign trade and investment. In addition, WTO commitments also imply for some transition countries significant changes in the conduct of foreign investment policies and in the protection of intellectual property rights. The "switch-over" from central planning to market-based policy instruments may be, therefore, painful but highly valuable as we have tried to document in this paper.

Fourth, WTO Membership brings several important benefits to the Members but there are limits how far and how much the Agreements can help. The Agreements can help in terms of a better market access and in terms of the recourse to better policy instruments and institutions. The Agreements cannot address problems originating in poor domestic supply response, terms of trade changes or exogenous shocks. The accession itself may not even open up new markets for the acceding countries because the incumbents are not expected to provide new concessions to them. In addition, the adjustment costs following the WTO accession, - the Membership "fee" - may also be fairly important but they should be more than offset by efficiency gains, growth of trade and inflow of foreign capital. *Fifth*, the WTO experience of transition countries must be seen by and large as positive. The Agreements significantly improve the stability of market access, they help eradicate corruption and improve governance without significant losses to government revenues. Moreover, the WTO has also played a positive role in strengthening domestic policies to better manage balance-of-payments crises.

The difficulties that arise as a result of WTO Membership lead to the logical question whether countries in transition should not receive a special treatment in their quest for WTO Membership. The answer to this question partially depends on the actual terms of accession, and these were not subject of this paper. As a general comment, however, one could say that there is a case to be made for allowing transition countries to fully benefit from the same treatment as countries with similar levels of per capita income. This would allow some of the transition countries to make the required investments over a longer period of time. The case is arguably more evident than the one which would call for a special and differential treatment based on the specifics of these countries as transition economies.

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Table 1: Bound and Applied Import Tariffs in Selected Transition Economies

	Simple Average Bound Tariff		Simple Average Applied Tariff	
	<i>Agricultural Products</i>	<i>Industrial Products</i>	<i>Agricultural Products</i>	<i>Industrial Products</i>
Albania	10.6	6.0	10.7 (01)	7.0 (01)
Bulgaria	46.7	23.8	27.2 (97)	15.5 (97)
			26.8 (98)	15.3 (98)
			23.6 (99)	12.6 (99)
			23.2 (00)	11.0 (00)
			21.9 (01)	10.0 (01)
Croatia	10.4	5.2	13.8 (01)	5.1 (01)
Czech Republic		4.3		5.6 (96)
				5.3 (97)
				5.0 (98)
				4.5 (00)
Estonia	21.2	7.1	0.0 (96)	0.1 (96)
			0.0 (97)	0.1 (97)
			0.0 (98)	0.0 (98)
			0.0 (99)	0.0 (99)
			13.8 (00)	0.0 (00)
			13.8 (01)	0.0 (01)
Hungary		7.4		8.7 (96)
				8.2 (97)
				7.8 (98)
				7.4 (99)
				7.3 (00)
				7.1 (01)
Latvia	33.3	9.4	16.4 (98)	2.7 (98)
			14.0 (99)	2.6 (99)
Poland		10.4		10.5 (00)
Romania		30.8		17.5 (99)

Sources: WTO Secretariat, based on Protocols of Accession.

Note: The figures in brackets refer to dates. The data in the first two columns may not be fully comparable due to different methodologies applied in the computations.

Table 2: Indices of Institutional Quality, 1997-1998

	Government Effectiveness	Regulatory Burden	Rule of Law	Graft	Institutional quality (narrow)	Voice and Accountability	Political Instability and Violence	Institutional quality (broad)
EU accession countries (excluding Baltics)								
Bulgaria	-8.1	5.2	-1.5	-5.6	-2.5	6	4.3	0.1
Czech Republic	5.9	5.7	5.4	3.8	5.2	12	8.1	6.8
Hungary	6.1	8.5	7.1	6.1	7.0	12	12.5	8.7
Poland	6.7	5.6	5.4	4.9	5.7	10.7	8.4	7
Romania	-5.7	2	-0.9	-4.6	-2.3	4.1	0.2	-0.8
Slovak Republic	-0.3	1.7	1.3	0.3	0.8	7.4	6.5	2.8
Slovenia	5.7	5.3	8.3	10.2	7.4	10.7	10.9	8.5
Baltic countries								
Estonia	2.6	7.4	5.1	5.9	5.3	7.9	7.9	6.1
Latvia	0.7	5.1	1.5	-2.6	1.2	6.2	4.6	2.6
Lithuania	1.3	0.9	1.8	0.3	1.1	7.7	3.5	2.6
Other southeastern European countries								
Albania	-6.5	-7	-9.2	-9.9	-8.2	-0.1	-10	-7.1
Bosnia and Herzegovina	-11.1	-12.6	-11.1	-3.5	-9.6	-9.7	-11.6	-9.9
Croatia	1.5	2.4	1.5	-4.6	0.2	-3.2	4.1	0.3
Macedonia, FYR	-5.8	-3.1	-2.6	-5.2	-4.2	0.9	-4	-3.3
Commonwealth of Independent States								
Armenia	-6.5	-5.7	-1.5	-8	-5.4	0.2	-4.5	-4.4
Azerbaijan	-8.3	-10	-5.6	-10	-8.5	-9.2	-3.6	-7.8
Belarus	-6.6	-14.7	-8.8	-6.5	-9.2	-5.2	-3.7	-7.6
Georgia	-5.1	-8.5	-4.9	-7.4	-6.5	-2.9	-7.6	-6.1
Kazakhstan	-8.2	-4	-5.9	-8.7	-6.7	-7.1	2.2	-5.3
Kyrgyz Republic	-5.8	-7.6	-4.7	-7.6	-6.4	-2.5	3.2	-4.2
Moldova	-4.6	-2.8	-0.2	-3.9	-2.9	1.6	-2	-2
Mongolia	0.2	1.7	0.4	-1.5	0.2	8.4	3.7	2.2
Russia	-5.9	-3	-7.2	-6.2	-5.6	-3.1	-6.9	-5.4
Tajikistan	-14.2	-15.2	-13.3	-13.2	-14.0	-15.6	-18.6	-15
Turkmenistan	-12.5	-19.3	-9.7	-12.9	-13.6	-14.5	0	-11.5
Ukraine	-8.9	-7.2	-7.1	-8.9	-8.0	-0.1	-2.4	-5.8
Uzbekistan	-13	-14	-8.7	-9.6	-11.3	-13.4	-3.3	-10.4
East Asia								
Cambodia	...	-0.4	-2.3	...		-9.1	...	-3.9
China	0.2	-0.7	-0.4	-2.9	-1.0	-13	4.8	-2
Lao People's Dem. Rep.	...	-18.2	-12	...		-10.5		-13.6
Viet Nam	-3	-4.6	-4.4	-3.3	-3.8	-14.2	6.5	-3.8

Source: Based on IMF (2000).

Table 3 - Indices of Corruption, 1999

	Corruption perception index¹ (1999)	Graft² (1999)³
EU accession countries (excl. Baltics)		
Bulgaria	3.3	-5.6
Czech Republic	4.6	3.8
Hungary	5.2	6.1
Poland	4.2	4.9
Romania	3.3	-4.6
Slovak Republic	3.7	0.3
Slovenia	6	10.2
Baltic countries		
Estonia	5.7	5.9
Latvia	3.4	-2.6
Lithuania	3.8	0.3
Other southeastern European countries		
Albania	2.3	-9.9
Bosnia and Herzegovina	n.a.	-3.5
Croatia	2.7	-4.6
Macedonia	3.3	-5.2
Commonwealth of Independent States		
Armenia	2.5	-8.0
Azerbaijan	1.7	-10
Belarus	3.4	-6.5
Georgia	2.3	-7.4
Kazakhstan	2.3	-8.7
Kyrgyz Republic	2.2	-7.6
Moldova	2.6	-3.9
Mongolia	n.a.	-1.5
Russia	2.4	-6.2
Tajikistan	n.a.	-13.2
Turkmenistan	n.a.	-12.9
Ukraine	2.6	-8.9
Uzbekistan	1.8	-9.6

¹ Source: Transparency International (1999). The index ranges from 0 (highly corrupted) to 10.

² Source: Kaufmann *et al.* (1999a) and (1999b). The index ranges from -25 to 25, with higher values corresponding to lower corruption.

³1998 for Mongolia.

Table 4 - Measures of Administrative Corruption

Country	Administrative Corruption	Standard error
Albania	4.0	(0.4)
Bulgaria	2.1	(0.4)
Croatia	1.1	(0.2)
Czech Republic	2.5	(0.4)
Estonia	1.6	(0.2)
Hungary	1.7	(0.3)
Latvia	1.4	(0.3)
Lithuania	2.8	(0.5)
Poland	1.6	(0.2)
Romania	3.2	(0.4)
Slovak Republic	2.5	(0.4)
Slovenia	1.4	(0.3)
Average CEE	2.2	
Armenia	4.6	(0.7)
Azerbaijan	5.7	(0.7)
Belarus	1.3	(0.4)
Georgia	4.3	(0.6)
Kazakhstan	3.1	(0.5)
Kyrgyzstan	5.3	(0.6)
Moldova	4.0	(0.6)
Russia	2.8	(0.2)
Ukraine	4.4	(0.4)
Uzbekistan	4.4	(0.6)
Average CIS	3.7	
Overall (unweighted average)	3.0	

Source: Hellman *et al.* (2000).

Note: Firms were asked, on average, what percent of revenues do firms like theirs typically pay per annum in unofficial payments to public officials and identify the percentage in the following ranges: 0% - less than 1%; 1 - 1.99%; 2 - 9.99%; 10 - 12%; 13 - 25%; Over 25%. The categories were imputed at M 1 %; M 6%; 11 %; 19%; 25% and the mean calculated.

The question was posed in terms of firm revenues rather than profits since estimates of revenues are more reliable. In addition the question was posed indirectly in terms of "firms like yours" to reassure respondents that their responses would not be attributable directly to their firm. The authors then take total payments as a proxy for administrative corruption since the available evidence suggests that the majority of bribe payments were for this purpose. This measure of administrative corruption differs from the "bribe tax" presented in EBRD (1999), although both were based on the same source. The measure used in Helman's paper includes the responses of all firms, whereas the measure presented in EBRD (1999) presents the average bribes as a share of revenues among firms that reported paying bribes.

Table 5 - Inward FDI Stocks in Transition Countries, 1995-1999
(as a percentage of GDP)

	1995	1999
EU accession countries (excl. Baltics)		
Bulgaria	3.4	19.9
Czech Republic	14.5	33.0
Hungary	22.4	39.9
Poland	6.6	17.2
Romania	3.2	16.1
Slovak Republic	7.3	14.6
Slovenia	9.4	13.0
Baltic countries		
Estonia	18.6	47.9
Latvia	13.8	26.9
Lithuania	5.8	19.7
Other southeastern European countries		
Albania	8.3	16.0
Croatia	2.6	20.2
Macedonia, FYR	1.6	6.1
Commonwealth of Independent States		
Armenia	1.2	23.1
Azerbaijan	14.6	81.4
Belarus	0.3	8.3
Georgia	1.1	7.0
Kazakhstan	14.6	51.9
Kyrgyz Republic	9.7	23.1
Moldova	6.6	28.8
Mongolia	3.9	14.1
Russia	1.6	4.4
Tajikistan	3.9	10.4
Turkmenistan	4.6	31.9
Ukraine	2.5	10.5
Uzbekistan	2.5	6.0
East Asia		
Cambodia	17.0	19.4
China	19.6	30.9
Lao People's Dem. Rep.	11.9	42.8
Viet Nam	31.1	55.6

Source: World Bank World Investment Report 2000.

Table 6 - Tariff Revenues in Transition Countries, 1991-1999
(in percentage of imports)

	1991	1992	1993	1994	1995	1996	1997	1998	1999
EU accession countries									
(excluding Baltics)									
Bulgaria	2.2	4.5	7.2	7.6	7.3	4.6	4.8	5.5	2.8
Czech Republic	n.a.	n.a.	3.5	3.5	2.6	2.6	1.7	1.5	1.2
Hungary	9.1	11.8	12.0	12.6	12.9	9.6	4.0	2.6	2.4
Poland	12.7	14.6	15.0	12.0	9.6	7.4	5.6	4.0	3.4
Romania	6.1	4.9	6.6	6.0	4.9	4.2	4.0	5.9	5.5
Slovak Republic	n.a.	2.6	2.3	3.4	3.3	2.9	3.3	2.6	2.7
Slovenia	11.0	6.7	7.3	7.0	7.1	6.2	4.0	2.9	2.6
Baltic countries									
Estonia	n.a.	n.a.	0.9	0.9	0.2	0.0	0.0	0.0	0.0
Latvia	n.a.	n.a.	2.9	3.2	1.8	1.5	1.4	1.1	0.9
Lithuania	n.a.	n.a.	1.1	3.2	1.4	1.2	1.3	1.1	n.a.
Other southeastern									
European countries									
Albania									
Bosnia & Herzegovina	n.a.	n.a.	n.a.	n.a.	n.a.	10.5	8.6	9.2	n.a.
Croatia	5.4	10.9	7.4	10.7	9.5	8.9	8.0	7.6	8.1
Macedonia, FYR	8.9	6.0	8.5	10.5	12.6	11.4	6.8	7.3	9.1
Commonwealth of									
Independent States									
Armenia	n.a.	0.2	6.1	0.7	1.0	1.9	2.7	2.8	3.0
Azerbaijan	0.0	0.1	1.4	1.1	1.6	1.9	4.3	4.4	5.4
Belarus	n.a.	n.a.	3.7	5.4	3.2	4.3	3.9	3.8	2.4
Georgia	n.a.	n.a.	n.a.	0.3	0.5	2.0	4.4	4.2	1.7
Kazakhstan	0.0	17.2	0.5	5.6	3.9	2.0	1.5	1.9	1.6
Kyrgyz Republic	n.a.	n.a.	n.a.	1.0	2.3	2.0	2.2	2.4	1.4
Moldova	n.a.	0.8	2.1	1.1	1.4	1.9	2.2	2.0	3.4
Mongolia				7.1	5.1	5.6	2.4	0.4	
Russia	n.a.	3.8	12.0	15.0	11.0	7.8	7.1	7.2	8.9
Tajikistan	n.a.	n.a.	0.9	4.0	1.2	0.6	2.6	6.1	2.1
Turkmenistan	n.a.	n.a.	n.a.	n.a.	0.3	0.3	0.4	0.3	0.5
Ukraine	n.a.	n.a.	n.a.	1.7	1.7	1.2	1.9	2.4	2.3
Uzbekistan	n.a.	1.3	2.4	2.5	2.6	1.6	1.6	1.9	0.7

Source: EBRD (2000).

Table 7: Share of International Trade Taxes in Total Government Revenues
(In percent)

	1991	1992	1993	1994	1995	1996	1997	1998	1999
EU accession countries (excluding Baltics)									
Bulgaria	2.0	5.2	8.1	7.1	6.7	6.8	6.8	5.5	2.9
Czech Republic			3.9	4.1	3.6	3.7	2.7	2.3	
Hungary	5.0	7.2	7.6	7.6	10.6	9.1	5.0	3.5	
Poland				8.5	7.7	6.5	4.1	3.1	
Romania	3.0	3.6	4.7	4.4	5.6	6.1	5.6		
Baltic countries									
Estonia			1.9	1.8	0.4	0.0	0.0	0.0	0.0
Latvia				4.5	2.7	2.2	2.0	1.6	
Lithuania	0.7		3.7	7.0	3.3	3.0	2.7	2.1	
Other southeastern European countries									
Albania					13.4	17.2	17.8	14.1	
Croatia	3.4	10.7	8.7	9.5	9.2	8.3	8.8	6.7	6.6
Commonwealth of Independent States									
Azerbaijan				50.8	33.4	21.0	8.2	8.9	8.4
Belarus		4.3	17.0	9.7	5.8	5.4	7.6	7.4	
Georgia							11.9	12.1	
Kazakhstan							2.7	3.5	
Kyrgyz Republic				3.0	5.0	5.0	5.0	6.0	4.0
Mongolia		16.7		11.9	8.8	11.4	5.1	0.8	
Russia				14.7	8.7				

Sources: IMF Government Finance Statistics and Staff Reports.

Table 8: Costs of World Bank Projects Related to the Implementation of Three WTO Agreements

Area of Implementation	Country	Nature of work	Cost (\$m)
<i>Customs Valuation</i>	10 Eastern European countries	7 yr. Institutional reform – customs modernization	108
	Tunisia	Customs reform component of a 5 yr. WB export development project	16
	Tanzania	3 yr. reform of customs procedures	8-10
	Lebanon	Customs reform component of a 7 yr. WB fiscal management program	4
	Armenia	4 yr. WB project involving drafting new laws, training staff, computerizing procedures	2
<i>Sanitary and Phytosanitary standards (all WB projects)</i>	Russia	3 yr. SPS implementation – disease control and improvement of food processing facilities	150
	Algeria	2 yr. locust control project	112
	Brazil	7 yr. livestock disease control project	108
	Argentina	5 yr. general agric. export reform project	83
	Poland	5 yr. SPS component of agric. exports development project	71
	Hungary	6 yr. Slaughter-house modernization project	41
<i>Intellectual Property Rights (all WB projects)</i>	Mexico	4 yr. project establishing agency to implement industrial property laws	32.1
	Indonesia	6 yr. project to improve IPR regulatory framework	15
	Brazil	5 yr. project to train staff administering IPR laws	4

Source: World Bank.

Annex Table 1 - WTO: Dates of Accession and Membership of Transition Countries

	Application	Membership		Application	Membership
EU accession countries (excluding Baltics)			Commonwealth of Independent States		
Bulgaria	09/1996	12/1996	Armenia	11/1993	
Czech Republic		04/1993 (GATT)	Azerbaijan	07/1997	
Hungary		09/1973 (GATT)	Belarus	09/1993	
Poland		10/1967 (GATT)	Georgia	07/1996	06/2000
Romania		11/1971 (GATT)	Kazakhstan	01/1996	
Slovak Republic		04/1993 (GATT)	Kyrgyz Republic	01/1996	12/1998
Slovenia		10/1994 (GATT)	Moldova	11/1993/	07/2001
Baltic countries			Mongolia	07/1991	01/1997
Estonia	03/1994	11/1999	Russian Federation	06/1993	
Latvia	11/1993	02/1999	Tajikistan	05/2001	
Lithuania	01/1994	05/2001	Turkmenistan		
Other southeastern European countries			Ukraine	11/1993	
Albania	11/1992	09/2000	Uzbekistan	12/1994	
Bosnia and Herzegovina	05/1999		East Asia		
Croatia	09/1993	11/2000	Cambodia	12/1994	
Macedonia, FYR	12/1994		China	07/1986	
Yugoslavia	01/2001		The Lao PDR	07/1997	
			Viet Nam	01/1995	

Source: WTO Secretariat.