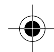


CHAPTER 2

WTO DISCIPLINES UNDER THE IMF PROGRAM: CONGRUENCE OR CONFLICT?

*Dukgeun Ahn**

I. STRUCTURE OF IMF PROGRAMS AND SOURCE OF PROBLEMS

The importance of interrelationship and linkage between globalized economies was forcefully illustrated during the recent financial crises of 1997-1998 that swept some Asian and Latin American countries. In addition to demonstrating interconnectivity of individual economies, the recovering process from such economic calamity has raised an interesting question from another dimension of international economic relations: coherence of international organizations, especially international financial institutions and international trade organization. The delicate issue of congruence between legal obligations under the WTO and policy measures adopted under the IMF program has become much more real, rather than theoretical, and imminent to be addressed as a series of trade disputes concerning such issue have been submitted to the WTO dispute settlement system.[1]

In principle, the answer for the question of how the WTO should treat policy measures adopted under the IMF programs is simple and clear. There is no exception to WTO obligations for policy measures

* Director, WTO & Trade Strategy Center; KDI School of Public Policy and Management, KOREA. I am very grateful to useful comments and insights on an earlier draft by James Durling, Debra Steger and participants at the 2003 Symposium on the WTO and East Asia. I also acknowledge excellent research assistance by Hyunjeong Kim.

[1] This issue was first raised by *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/R (adopted on Apr. 22, 1998; hereinafter '*Argentina – Footwear*'). Various measures adopted by the Korean government during the financial crisis of 1997-1998 have recently become a focal point for trade disputes with the United States and the European Communities. The consequent WTO cases include *Korea – Measures Affecting Trade in Commercial Vessels* (DS273), *US – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea* (DS/296), and *EC – Countervailing Measures on Dynamic Random Access Memory Chips from Korea* (DS/299).

regardless of whether they are employed as parts of adjustment measures or IMF conditionality.[2] This principle was basically affirmed by the Appellate Body in its ruling for the *Argentina – Footwear* case.[3] The Appellate Body clarified that nothing justified a conclusion that a Member's commitments to the IMF shall prevail over its obligations under GATT 1994.[4] In other words, any measure taken as a part of either IMF conditionality or overall adjustment measures should comply with pertinent WTO disciplines. In fact, IMF conditionality had rarely stipulated an implementation of trade policy measures that contradicted with WTO – or, previously GATT.

Although this principle may be conveniently enunciated, the actual application of it demands more complicated consideration. A country that receives financing under an IMF program typically undertakes three kinds of reform or adjustment policies, some of which are specifically mandated as IMF conditionality: financial restructuring measures, corporate restructuring measures and economic liberalization measures – especially, for foreign exchange and trade.

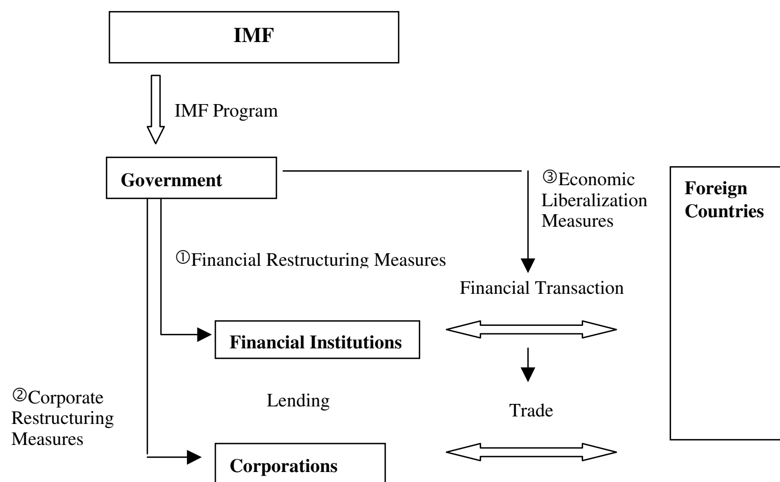


Figure 1. Structure of IMF Programs

[2] For a detailed account of distinction between IMF conditionality and adjustment measures committed by a government seeking the Fund financing, *see* Deborah Siegel, "Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements", 96 *American Journal of International Law* 561 (2002), 573-575.
[3] *See generally* Dukgeun Ahn, "Linkages between International Financial and Trade Institutions – IMF, World Bank and WTO", 34 *Journal of World Trade* 1 (2000), 23-25.
[4] WTO, WT/DS56/AB/R (adopted on Apr. 22, 1998), para.70. In fact, the Appellate Body ruling is more specific by focusing on Article VIII of the GATT 1994 as opposed to import surcharges of the Argentine government. But, the logic in that case can plausibly be applied to a broader context of IMF programs versus WTO obligations.

Since a standard condition for continued receipt of IMF financing requires countries to refrain from imposing import restrictions or to further import liberalization, trade policy measures taken as parts of formal IMF programs would rarely cause direct contradiction with WTO agreements.

More controversial problems, however, occur through seemingly incidental channel or nexus of financial institutions and corporations. Normally, financial institutions such as banks engage in divergent lending activities with corporations, which are considered to be governed by a market mechanism. When a government under an IMF program undertakes various adjustment measures or IMF conditionality, it typically embraces restructuring measures for not just financial sectors but also corporate sectors. These restructuring measures inevitably invite more active and visible roles of governments in both financial and corporate sectors. These increased roles of governments during the IMF program are now subject to considerably strengthened disciplines of the WTO Agreement on Subsidies and Countervailing Measures. Without considering such peculiar circumstances, substantial parts of governmental roles during the IMF program may be regarded as government 'directed' or even 'entrusted' activities that are inconsistent with subsidy disciplines, in case corporations are engaged in competition with imported products or at export markets. The possibility for WTO Members to raise such complaints, even more successfully, would rise as the degree of financial crisis gets more severe, because exports from countries under the IMF programs would increase more with larger exchange rate depreciation.[5] This structural part of problems concerning the IMF program deserves more attention and sensible resolution by the WTO Members to enhance congruence and coherence between two pillars of the world economic system. More specific examples based on the Korean experience will be discussed below.

II. TRADE LIBERALIZATION BY THE KOREAN GOVERNMENT UNDER THE IMF PROGRAM

Korea's economic liberalization policies undertaken pursuant to the mandates under the IMF program consist of mainly three parts: foreign

[5] The magnitude of the exchange rate volatility during the financial crisis is truly immense. For example, the Korean won was depreciated to an almost half value within a 4 month period from October 1997. *See* Dukgeun Ahn, "Korea in the GATT/WTO Dispute Settlement System: Legal Battle for Economic Development", 6 *Journal of International Economic Law* 597 (2003), 621.

exchange liberalization, capital account liberalization, and trade liberalization. Firstly, an exchange rate policy adopted freely flexible exchange rate systems by abolishing daily exchange rate bands. The Korean government implemented the first stage of foreign exchange liberalization on April 1, 1999 by liberalizing foreign currency transaction of companies and financial institutions. The second stage implementation was initiated on January 1, 2001 by permitting foreign currency transaction of individuals. Secondly, capital account liberalization policies include, *inter alia*, eliminating restriction for foreigners' access to domestic money market instruments and corporate bond markets, permitting foreign financial institutions to participate in mergers and acquisitions of domestic financial institutions, and increasing the ceilings on aggregate foreigners' ownership of listed Korean shares. Thirdly, trade policies adopted further liberalization measures such as termination of the Import Diversification Program and abolition of trade related subsidies.

Despite substantial difficulties to address precipitous reduction of foreign exchange reserve, the Korean government committed to continue trade liberalization under the IMF program. In that regard, the Korean government agreed not to make purchases under the Stand-By Arrangement with the IMF that would increase the IMF's holdings of Korea's currency subject to repurchase beyond 25% of quota, if Korea imposes or intensifies import restrictions for balance of payments reasons at any time during the period of the Stand-By Arrangement.[6]

Moreover, as a part of the comprehensive economic policy program for structural reforms, the Korean government agreed to set, at the time of the first full review, a timetable in line with WTO commitments to eliminate trade-related subsidies, restrictive import licensing and the import diversification program. It also committed to streamline and improve the transparency of the import certification procedures.[7] At the letter of intent dated December 24, 1997, the Korean government confirmed its intent to accelerate import liberalization and eliminate trade-related subsidies. To facilitate further liberalization, it categorized three types of trade measures: trade-related subsidies, import liberalization and financial services liberalization.

With regard to trade-related subsidies, the Korean government agreed to abolish three subsidies that were due to be terminated by the

[6] Stand-By Arrangement (dated Dec. 3, 1997), para. 3(e)(iv).
[7] Korea-Memorandum on the Economic Program (dated Dec. 3, 1997), para. 30.

end of 1998 under the purview of the WTO and delete one administrative subsidy program.

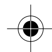
Abolition of Trade-Related Subsidies

The first subsidy repealed under the IMF program was tax concession for "Reserves for Export Losses" to compensate for the loss of export businesses under Article 16 of the Tax Exemption and Reduction Control Law.[8] The reserves set aside to compensate for its losses by a resident or a domestic corporation, running a business earning foreign currency, had been counted as a loss when calculating the taxable income within a certain limit (that of an amount equivalent to 1% of its foreign currency receipts or 50% of its income, whichever is less). The amount allocated to such reserves was added back to the resident's or corporation's gains in three-year instalments from the year after the year in which the reserves were counted as a loss, but in the case of export businesses, starting two years after the year in which the reserves were counted as a loss. This tax concession was granted since March 3, 1973. The second subsidy abolished was tax concession for "Reserves for Overseas Market Development" under Article 17 of the Tax Exemption and Reduction Control Law that aimed to promote the overseas market development of a business earning foreign currency. Reserves set aside for overseas market development had been treated as a loss when calculating the taxable income in the same manner as the reserves for export losses. This tax benefit was maintained since July 31, 1969. The third subsidy eliminated was tax concession for "Tax Credit for Investment in Facilities" to encourage investment in facilities for small and medium enterprises or for developing technology and manpower under the Tax Exemption and Reduction Control Law. Under this tax program, various tax credits were provided for investment in facilities for small and medium enterprises, facilities for technology and manpower, housing for employees. Also, tax credits were granted for businesses moving to a provincial area and business conversion or reorganization. This tax concession started from December 30, 1970 and subsequently expanded in 1976, 1985 and 1990. Another program was abolished by the approval of the National Assembly.

Import Liberalization: Termination of Import Diversification Program

Despite the accession to the GATT in 1967, the Korean government maintained various import restraints primarily due to its balance-of-

[8] WTO, G/SCMN/25/KOR (dated July 23, 1997).



payment problems. The chronic foreign debt problems aggravated by the heavy chemical industry promotion policy starting from 1973 and the first oil shock in 1974 in fact strengthened import restrictions. It was only in 1977 when the total value of exportation exceeded $10 billion that a serious effort to liberalize importation was undertaken.[9] In 1978, three major import liberalization measures were implemented in May, July and September.

In May 1978, as a safeguard mechanism for major import liberalization, the Korean government effectively applied the Import Diversification Program that was first introduced concerning 7 product items in 1977.[10] Subsequently, the Executive Order of the Trade Transaction Act was amended to include Article 21:3 that stipulated discretionary import restriction of products from countries with which Korea had trade deficits.[11] The legal foundation for the Import Diversification Program was later replaced with Article 19.2 of the Foreign Trade Act.[12] Article 35.5 of the Executive Order of the Foreign Trade Act provided a more specific legal support for the Programme that was employed to address country specific trade imbalance.[13]

The Import Diversification Program basically targeted the imports from Japan. After the liberation from colonial governance in 1945, Korea resumed economic relationship with Japan since 1965. Bilateral trade with Japan, however, caused huge trade deficits for Korea that often intensified political tension rooted on a former colonial history. The Import Diversification Program was, therefore, devised from the inception to address potentially too dependent trade structure on Japanese imports. When Korea experienced the largest trade deficit with Saudi Arabia in 1982, the Import Diversification Program was modified in 1983 to apply to the country with the largest trade surplus “in the past five years”. This amendment was solely to single out Japan as the potential target for the system. As a result, products from countries other than Japan had never been subject to the Import Diversification Program.

[9] The overall trade balance in 1977 was still in deficit at some $764 million.
[10] Public Notice by the Ministry of Commerce and Industry, No. 78-8.
[11] Executive Order of the Trade Transaction Act (Presidential Decree No.10057, Nov. 1, 1980), Art.21:3, para.2.4.
[12] Public Law No. 3895 (Enacted on Dec. 31, 1986; entered into force on July 1, 1987).
[13] Executive Order of the Foreign Trade Act (Presidential Decree No.12191, June 30, 1987).

Table 1. Number of Items Subject to the Import Diversification Program

Year	Number of Items			Liberalization Rate
	CCCN 4 level	CCCN 8 level	CCCN 10 level	
1980	195			69.3
1982	209	913		76.6
1984	168	590		84.9
1986	159	414		91.5
1988			344	94.8
1990			268	96.3
1991			258	97.2
1992			258	97.7
1993			258	98.1
1994			230	98.6
1995			204	99.0
1996			162	99.3
1997			127	99.9
1998			88	99.9

Source: Ministry of Commerce and Industry

Note: The increase of the number of the items subject to the Import Diversification Program is due to the amendment of HS code on January 1, 1990.

Although the Import Diversification Program began with 7 product items in 1977, it soon included 100 additional items by May 1978 and 107 more items by the end of 1978. But, the problem of the Import Diversification Program was already raised when the application to intermediary products and machinery harmed competitiveness of domestic production. Accordingly, the product coverage under the Import Diversification Program was focused on final consumer products, rather than intermediary products that were used in subsequent manufacturing process. The Korean Government allowed various exceptions to the Import Diversification Program. These have been granted for production facilities, parts and components in connection with the Foreign Investors Industrial Parks; sample products for domestic production; and materials for producing exports. In addition, the Import Diversification Program also covered divergent products for which import substitution policies were undertaken. This function of the Import Diversification Program, however, was not as crucial as the role to address unbalanced trade deficits.

The product coverage was continuously increased until 1981[14] and then gradually reduced to phase out by June 1999. The Import

[14] The product coverage in 1981 on the basis of the CCCN 8-digit reached about 924 items.

Diversification Program was formally terminated when the last 16 product items including VCR, mobile phones, colour televisions, automobiles, and camera were removed from the list.

The Japanese government had requested repeatedly to repeal the Import Diversification Program, alleging the violation of GATT obligation particularly, under Articles I, XI and XIII. Since the Korean government disinvoked Article XVIII:B for its import restrictive measures in 1990[15], the legitimacy of the Import Diversification Program under GATT obligations was indeed questionable. But, the Japanese government never brought a formal complaint on the Program to the GATT dispute settlement system. Instead, the Japanese government relied on a more political and diplomatic channel, for example, by raising the issue at the ministerial level.

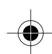
Table 2. Liberalization Schedule of the Import Diversification Program under the IMF Program

Items to Be Liberalized (113 Items as of Dec. 18, 1997)	Due Date
25	Dec. 30, 1997
40	July 31, 1998
32	Dec. 31, 1998
16	June 30, 1999

As an effort to improve bilateral economic relations and also to cope with a new trading system established by the Uruguay Round negotiation, the Korean government decided to reduce the product coverage of 258 items by half during the five year period beginning in 1994.[16] The long term plan for the Import Diversification Program prepared in December 1993 left open for future works the reform plan for 1999 and thereafter.

But, with the accession to the OECD in 1996, Korea agreed to eliminate the Import Diversification Program by the end of 1999. The OECD accession negotiation took place between November 1995 and July 1996 had seven evaluation sectors and four policy review areas. As one of policy review area, trade issue was discussed and the Import Diversification Program was scheduled to phase out by the end of 1999.

[15] Ahn, *supra* note 5, 603-606.
[16] MITI, 1999 Report on the WTO Consistency of Trade Policies by Major Trading Partners 55 (1999).



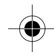
In addition, at the end of 1997 when the Korean government reached an agreement with the IMF on economic reform programs to receive financial supports, it committed to repeal the Import Diversification Program by the end of June 1999. After the Korean government reached a stand-by arrangement with the IMF in an effort to overcome a financial crisis on December 3, 1997, 11 "Letters of Intents" were exchanged to elaborate the structural reform programs in the course of restructuring and recovery process. By the Letter of Intent dated December 18, 1997, the Korean government committed to accelerate the phase-out of the Import Diversification Program by June 1999, six months earlier than the due date committed to the WTO. Pursuant to this agreement, the Korean government removed 25 items by the end of 1997, 40 items by the end of July 1998, 32 items by the end of 1998, and finally the remaining 16 items – primarily in industrial machinery, electrical and electronic equipment, and automotive sectors – by the end of June 1999. As part of a restructuring program committed to the IMF, the Korean government successfully implemented the scheduled liberalization, as indicated in Table 2, or the complete phase-out of the Import Diversification Program.

Financial Service Liberalization

The Korean government committed to bind under the WTO the liberalization of financial services as agreed with the OECD. This commitment was announced in the WTO Financial Services Committee on January 30, 1998. On January 19, 1999, The Korean government submitted the revised services offer consistent with the OECD commitments to the WTO.

III. Governmental Role in the Corporate Restructuring Program

Corporate restructuring program aimed to support economically viable but distressed companies reform their business operations and management, and financially restructure their liabilities to restore corporate financial sustainability. The fundamental objectives of corporate restructuring programs undertaken by the Korean government were established at the meeting on January 13, 1998 between the President-elect and the CEOs of top five *chaebols*. To achieve those objectives, the government focused on systemic reforms to facilitate corporate restructuring while actual restructuring was conducted on the basis of



voluntary agreements between companies and pertinent creditor financial institutions. The Korean government tried to ensure that all individual corporate restructuring was voluntary and market oriented, since the governmental intervention in such processes could aggravate distrust of the markets and relevant economic circumstances for the companies.

This corporate restructuring policy was in fact the adoption of the so-called "London Approach" under which corporate restructuring has been conducted by voluntary agreements between corporations and creditor financial institutions with active mediation of the Bank of England.[17] The corporate restructuring program implemented under the London Approach normally contains three elements: voluntary restructuring procedures led by creditor financial institutions on the basis of market oriented principles, loss sharing among interested parties not to unduly undermine particular parties' financial health, and utilization of corporate workout programs as a primary method of restructuring. Corporate workout programs had been implemented pursuant to the principles of loss minimization, fairness and justice, expeditiousness and cost minimization. The Korean government indeed encouraged banks to set up voluntary creditor committees to assess the need and modality of corporate debt restructuring. Subsequently, in order to provide an overall framework of principles and procedures for voluntary corporate workouts, the Financial Supervisory Corporation (FSC) provided guidelines on the Corporate Restructuring Agreement that was to set a structure for negotiations between creditors and debtors, and on creation and operation of the Corporate Restructuring Coordination Committee that was established to resolve inter-creditor disputes. The FSC monitored workouts conducted under the Corporate Restructuring Agreement to ascertain consistency with the issued guidelines.

The corporate restructuring programs were later more directly and concretely addressed by the Structural Adjustment Loan (SAL) of the World Bank.[18] Under the SAL, the Korean government agreed to extend policy support for corporate restructuring by, *inter alia*, curtailing emergency loans, facilitating use of debt/equity conversion to address excessive leverage among *chaebol* affiliates, reducing cross guarantees, removing tax disincentives for mergers and acquisitions, debt restructuring and asset dispositions as a means of corporate restructuring, improving procedures and coordination for court-supervised insolvency.

[17] For more detailed explanations on the London Approach, *see*, for example, Pen Kent, 'Corporate Workouts – A UK Perspective', *International Insolvency Review* (1997).
[18] Korea-World Bank SAL II, Policy Matrix on Corporate Restructuring (dated July 23, 1998).

Moreover, the Korean government accelerated implementation of corporate restructuring by pursuing inter-creditor agreements on corporations to be restructured, seeking a timely exit strategy for non-viable corporations, identifying additional non-viable corporations, initiating resolution of corporations that were not under corporate supervision but received emergency loans, expediting resolution of corporations under court supervision in which the Korean government was a major shareholder, developing an ability to anticipate corporate default or insolvency, promoting self-restructuring by the top five *chaebols*. These corporate restructuring policies were further elaborated by the Corporate and Financial Sector Restructuring Loan agreed between the Korean government and the World Bank on November 18, 1999. These series of corporate restructuring programs did accomplish substantial reforms for a Korean corporate sector, most notably dismantling the Daewoo group.

IV. Alternative Solutions

The exchange rate fluctuation during the financial crisis alone can cause trade disputes, particularly concerning antidumping measures.[19] By arbitrary segregation of investigation periods, price difference between normal values and export prices calculated in terms of dollar that is in turn transformed into antidumping duties may appear to be considerable. There is another risk of trade remedy actions based on governmental functions that should be inevitable and essential in the course of implementing IMF programs to overcome financial crises. Legitimate governmental roles in an economic emergency situation may be perceived as unjustified market intervention or interruption if considered entirely detached from the contextual economic circumstances. A more fundamental problem is that the risk of entailing trade disputes gets higher when the degree of a financial crisis is more severe because precipitous exchange rate depreciation tends to promote more exportation and trade liberalization policies embedded in the IMF program also induce more import competition.

What should then be the optimal solution for this inter-linkage problem? There may be three different approaches to this problem. Firstly, the WTO would not make any special consideration or exception to policy measures adopted, formally or informally, as parts of IMF programs. In

[19] For example, *United States - Anti-Dumping Measures on Stainless Steel Plate in Coils and Stainless Steel Sheet and Strip from Korea* (WT/DS179/R, adopted on Feb. 1, 2001).

other words, the WTO agreements may be applied in its entirety to a country or policy measures subject to IMF programs in the same manner as for other policy measures or WTO Members. This approach may, however, substantially undermine the effectiveness of policy measures under the IMF programs when trading partners counter with trade remedy actions. Moreover, such a bifurcated approach would cause unnecessarily adverse political repercussion against the IMF as well as the WTO.

Secondly, the IMF and the WTO can endeavor to enhance *ex ante* direct consultation so that they can ensure WTO consistency of policy measures proposed under the IMF programs. In fact, the Trade Policy Division of the Policy Development and Review Department in the IMF has conducted *ex ante* checking of WTO legality for IMF supported programs.[20] The WTO may also augment its institutional functions in this regard, for example by strengthening the Trade Policy Review Mechanism to review WTO consistency of any proposed policy measures under the IMF programs. This approach, however, is not free from structural problems, either. On the one hand, unlike the IMF conditionality that stipulates implementation *per se* of specific actions and no liability to consequential effects of those measures, WTO consistency of policy measures is typically determined by actual consequences of the implemented measures that depend on intricate market mechanisms. The WTO rules accommodating *de facto* standard, therefore, make such *ex ante* assessment of consistency or legality very vulnerable to future challenges. On the other hand, although the WTO may invoke its own institutional review procedure or a consultation process with the IMF, the nature of the WTO obligations seriously undermines the effectiveness of outcomes therefrom. This is because, under the WTO system, duties and obligations for a Member occur not against the WTO, but against other Members.[21] In other words, institutional cooperation between the IMF and the WTO would have an intrinsic limitation for fully resolving WTO inconsistency problems of IMF programs.

Thirdly, the WTO may provide a provisional and limited waiver of WTO obligations to a Member subject to an IMF program, at least during the period for which the IMF programs are enforced.[22] This waiver would be limited in that only certain trade remedy actions, especially antidumping and countervailing measures, and subsidy challenges to the

[20] Siegel, *supra* note 2, 575.

[21] It is contrasted with the IMF for which Member countries have specific legal duties for various actions. *See generally* Siegel, *supra* note 2.

[22] This approach was first proposed by Ahn, *supra* note 5, 24.

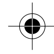
WTO are inhibited against a Member subject to an IMF program. Instead, safeguard actions may still be permitted for other Members that suffer from serious injury or threat thereof. Whereas there is too much risk of misplacing wrongdoings by exporters or exporting governments during the IMF program, it would not affect a safeguard mechanism that primarily hinges on domestic industry situations instead of actions by exporters or exporting governments. To the contrary, the concern by other Members on import surges from a country subject to IMF programs should be addressed by the WTO safeguard mechanisms that embraced elaborated disciplines such as compensation, retaliation and non-discriminatory application of measures.

V. Concluding Remarks

The economic impacts of the financial crisis to the Korean economy are truly tremendous. The Korean government played an important role under the IMF rescue program to overcome the unprecedented crisis in all aspects of economic policies. Although the crisis was triggered mainly by severe problems in the financial sector, the trade area was considerably affected by ensued volatile fluctuation of foreign exchange rate and also played a key role to deal with serious economic distress with the help of the IMF. The Korean government's strong policy commitment for persistent trade liberalization despite a markedly deteriorated foreign reserve situation would shed some light on policy consideration for WTO Members.

Corporate restructuring programs undertaken as parts of the IMF program might have an effect on international trade, as certain trading partners raised concerns especially in the context of the WTO Subsidy Agreement[23], since restructured corporations under the IMF program might subsequently be engaged in import or export competition. Most, if not all, parts of these economic policy measures were, however, devised to promote import liberalization or domestic market competition, rather than market operation. The governmental role was in fact vital, not to interfere but to improve market competition that, in turn, contributed to recover from the financial distress. It was meticulously prepared and monitored by the IMF to ensure proper implementation of the

[23] The United States had also closely monitored the Korean government's roles in financial and corporate restructuring programs. See, for example, USTR, *Subsidies Enforcement Annual Report to the Congress* (February 1999), 7-8.



commitments under the Stand-By Arrangement. From the outset of implementing the IMF program, the recipient governments are normally mindful of potential issues in the context of the WTO Agreements and emphasized voluntary and market-oriented nature of the policy measures. A categorical rejection of the legitimacy of the these governments' roles under the IMF program would, therefore, deserve a more careful scrutiny.