

Findings and Recommendations

A. Findings

56. The substantial swing in IMF involvement in trade policy during the evaluation period went too far on each side. The interventionist approach of the late 1990s, when the IMF played an uneven but at times aggressive role in trade policies through conditionality, gave way to substantial reluctance to state strong positions even on trade policies that have macroeconomic import. Several factors undoubtedly affected this swing: the establishment of the WTO, overall streamlining of the IMF and prioritization of financial issues, and, possibly, complacency stemming from a long period of high growth in world trade.

57. The establishment of the WTO changed the institutional landscape, but did not eliminate the need for an IMF role in trade policy. The IMF, with near-global membership, strong procedures for surveillance, and a mandate to promote macroeconomic stability in a globalized economy, has a key role to play in calling attention to systemic and macroeconomic implications of trade policy developments. Yet this is not the role the IMF has played of late. Rather, country officials see the IMF as sidelined on key trade policy issues (especially PTAs), and staff have increasingly demurred in expressing views beyond general endorsements of liberalism and multilateralism. This has left a worrisome gap. Without a strong IMF presence on these issues, the global debate misses a critical player.

58. Cooperation with other organizations on trade policy issues worked, though some potential synergies were or could be lost. Though a formal framework exists for cooperation and coherence in the work of the WTO and IMF, the scope for tensions (for example, between multilateral and unilateral approaches to liberalization or market-based and trade policy responses to balance of payments pressures) was evident during the evaluation period. Informal contacts between staff of the two institutions and the IMF's diminishing role in trade conditionality kept flare-ups at bay. But other potential tensions, especially with respect to possible charges of exchange rate manipulation for trade purposes, lie

below the surface. As for other institutions pursuing approaches to trade policy more similar to the IMF's, work with the World Bank was on occasion strong, but that with the OECD, UNCTAD, and regional development banks was unfortunately not frequent.

59. In charting a course for the IMF on trade policy issues, the Executive Board's guidance to staff was appropriately general in scope, but too vague. Because trade policy encompasses a wide range of issues, not all of which are relevant from a macroeconomic perspective in every country or region, the Board appropriately broadened the range of issues staff might address and asked for selectivity. But on some issues—particularly PTAs and trade in services stand out—the objectives and approach for IMF involvement were not made clear. Nor were the criteria for macro-criticality that were to guide staff decisions on when to become involved in trade policy issues. Without such clarity, staff are unlikely to be effective in looking out for trade policy-related threats to macroeconomic and financial stability.

60. The IMF has rightly scaled back its use of conditionality on trade liberalization. Conditionality on trade policy in IMF lending arrangements during the 1980s and early 1990s probably contributed to a beneficial reduction in very high and distorting trade barriers. But, particularly early in the evaluation period, trade conditionality exceeded a reasonable definition of macro-critical, went beyond staff's technical competence, and fell prey to political interference from large shareholders of the IMF.

61. Surveillance of trade policies had a mixed record. On some important trade issues, bilateral surveillance provided excellent analysis and a strong voice for changing policies that harmed global stability. Messages from Article IV reports were at times tough both on advanced countries (particularly on agricultural subsidies and contingent protection) and on developing countries (where high tariff and nontariff barriers were part of a web of features that raised business costs, fiscal revenue reforms needed to accompany trade liberalization, and preference erosion created uncertainties). Still, the record of IMF involvement was uneven across countries and

over time. Also, some important trade policies—from the perspective of spillovers and macroeconomic stability—were not addressed forcefully.

62. Two such issues stand out for not receiving the attention their macroeconomic and systemic importance merited. Much of the global action on trade policy in recent years has occurred through PTAs, an area in which IMF surveillance—bilateral, regional and multilateral—did not fully engage. When views on PTAs were expressed in staff reports they differed considerably across countries (some favorable, some cautionary, and some bland) with no apparent reason for the differences. And a fair amount of analytical and empirical work on PTAs undertaken by IMF staff frequently did not find voice in the IMF’s advice. In many countries, missions’ reluctance to engage on PTA issues meant that trade policy was effectively taken off the table in IMF surveillance discussions.

63. Even more serious from the perspective of the IMF’s core mandate is the meager attention to trade in financial services. Although the *GFSR* on occasion addressed the risks and benefits of liberalizing trade in financial services, bilateral surveillance was less thorough, tending indiscriminately to urge greater openness to foreign financial service providers with little direct assessment of risks. More explicit guidance on objectives of and approaches to surveillance of trade in financial services—as well as better use of tools for tracking openness to trade in financial services—would have facilitated work in this area.

64. Efforts to assess the effectiveness of IMF advice on trade policies did not yield strong conclusions. Trade policy conditionality was typically implemented (frequently with delays) but was often partially reversed later. Because trade policy advice in surveillance tended to be less precisely specified than conditionality and to have a medium-term focus, assessing its effectiveness would have required a counterfactual. Results from interviews and surveys are mixed but broadly do not refute the notion that IMF advice is effective at least in keeping trade policy issues on the table.

B. Recommendations

65. **Board guidance.** The Board should commit to periodic re-evaluation of its guidance on objectives of, approaches to, and modalities of staff work on trade policies. Regular reviews of guidance should be undertaken in the context of assessments of current global trends in trade and trade policy. This exercise should be much less ambitious than the 1994 Comprehensive Trade Paper, but it would serve a similar purpose—to keep staff and the Board up to date on developments in trade and trade policy important to the macroeconomic orientation of the IMF’s work

and to refresh Board guidance of the IMF’s role in trade policy issues.

66. **Trade policy in UFR.** Having scaled back conditionality on trade policy, the IMF must engage on the issues with borrowing countries through a strong advisory role. Countries will need not only to be supported in resisting protectionist pressures, but also to have plans for providing trade finance, influencing decisions within their PTAs, and reforming trade policies in ways that reduce the costs of doing business. Staff and the Board need to articulate what role the IMF should play to this end and how it should work with other institutions, especially the World Bank. Another important objective in scaling back conditionality is to eliminate the scope for political interference from member countries with global interests. All countries should commit to eschewing such interference.

67. **Surveillance over trade policies.** The IMF’s main role in trade policy issues in the future will likely be through surveillance. Four immediate initiatives are needed.

- The Board should establish guidance on the role and approach of the IMF in PTAs. The IMF is uniquely situated to advise countries on the macroeconomic implications of their PTAs and to call attention to the systemic effects of and vulnerabilities from PTAs. Activism in this role would involve no compromises in the IMF’s support for multilateral liberalization through reciprocal trade concessions, but it would inject IMF analysis into this fast-moving area of trade policy.
- The Board should establish guidance on the role and approach of the IMF in trade in financial services. The IMF needs to move beyond what has often been uncritical support for liberalization of trade in financial services—a position that has at times been inconsistent with the IMF’s more cautious approach to more general risks from inadequate financial supervision and prudential control. Surveillance should be actively involved in understanding and anticipating problems in financial services commitments through PTAs and the WTO.
- Trade policy—particularly involving PTAs—should be addressed periodically in multilateral and regional surveillance. Much of the value added that the IMF can bring to assessing trade policy developments comes from its ability to place them in a global context—an approach well suited to the *WEO* format. Assessments of PTA issues also lend themselves to *REOs*. Disseminating to the IMF’s bilateral missions views reached in such regional contexts would provide obvious economies of scale.

- The IMF should recommit to evenhandedness in its trade policy advice. Trade policy issues in large economies, which lately have not been given as much prominence as in the past, need to come back into the IMF's focus. This need not be to the detriment of financial sector analysis, insofar as trade policy, which can be slow to change, may be addressed only once every two to three years. Also, the IMF must re-engage more broadly in low- and middle-income countries, particularly those that have seen their share of world trade rise rapidly in recent years and have regional influence.

68. **Outreach.** The evaluation team often heard the view that the IMF could be more effective on trade issues if it attempted to provide fresh macroeconomic perspectives that would help persuade elected officials and the public of the merits of liberal trade. To be effective, IMF staff and the Board must consider ways to (i) improve outreach to officials inside and outside the ministries that are the IMF's traditional interlocutors and (ii) present trade policy issues in a rigorous and persuasive manner. This will require moving away from bland statements of general support for first-best policies and toward helping countries achieve the best outcomes possible within an increasingly regionalized trading system. On PTA issues in particular, the IMF's goal should not be simply to join the chorus of advisors on microeconomic aspects of PTAs, but rather to elevate perspectives on macroeconomic effects of PTAs and to consider implications of PTAs for exchange rate policies.

69. **Data, expertise, and organization.** Three orders of business are crucial for effective engagement in trade policy issues within the IMF's limited resources. (i) A minimum level of trade policy exper-

tise is needed. Particularly in light of recent departures of several trade economists from the IMF staff, a small but critical mass of trade policy expertise must be built to give the work on trade policies sufficient momentum. (ii) A division solely devoted to trade issues is needed to serve as the locus of inter-institutional cooperation on trade policy issues and a repository of trade expertise on which other staff can draw. (iii) Fund staff need data and measures of trade protection. The abandonment of the old TRI was reasonable, but a replacement should be considered. A good option would be to work with the World Bank to improve the timeliness of their TRI, a model-based measure to which the Bank is already committed. Also, IMF staff should work with other organizations to improve data and tools of analysis for assessing the effects of PTAs and restrictions on trade in financial services.

70. **Institutional cooperation.** As difficult as interinstitutional cooperation can be, there is no cost-effective alternative to making it work when it comes to trade policy. To spearhead such cooperation, management and a small number of senior staff need to commit to regular and formal meetings—for example, once a year—with counterparts in other key international organizations involved with trade. These meetings should cover the landscape of trade policy and trade flows so that institutions can have a common view and jointly consider how to respond to anticipated trade issues. IMF management should report to the Committee on Liaison with the World Bank and Other International Organizations and/or the Executive Board/International Monetary and Financial Committee on proceedings of the meetings and plans for staff-level coordination.