CHAPTER

I Introduction

1. The IMF's involvement in trade policy issues has been a source of controversy. In contrast to exchange rate, fiscal, or monetary policies, trade policy lies within the IMF's domain through at most a soft mandate. This leaves substantial scope for disagreement on whether the IMF has overstepped its proper role on trade policy or not done enough. Also, reflecting an orientation toward removing barriers to trade, the IMF's involvement in trade policy has stoked the debate on whether steps toward freer trade are always beneficial for a country or whether developmental objectives are better served by more gradual changes. Alongside this debate are charges that IMF advice has not been evenhanded and has pushed harder on developing countries (through lending arrangements) than on advanced countries to reduce protectionism. And with the increasing complexity of trade policy issues, questions have arisen about whether IMF staff have the expertise to address trade policies rigorously.

2. The evaluation asks what the role of the IMF in trade policy has been and how well it has been carried out. It examines these questions in the context of surveillance and conditionality on use of Fund resources (UFR). Trade-related technical assistance (TA), which is the subject of a soon-to-be completed evaluation by an external consultant to the Fund's Fiscal Affairs Department (FAD), is not systematically examined. The evaluation covers 1996–2007, the years since the establishment of the World Trade Organization (WTO) and during which IMF involvement in trade policy has continued to evolve. Box 1 has a brief retrospective on IMF involvement in trade policy prior to the evaluation period.

3. The definition of trade policy is somewhat arbitrary because myriad interlocking policies affect trade. Our definition is measures that directly and primarily aim to influence the quantity and/or value of a country's own or its trading partners' imports and exports of goods and services. It encompasses traditional instruments—tariffs, quotas, and export subsidies and taxes—customs administration, preferential trade agreements (PTAs) and domestic ("behind-the-border") policies that distort trade.[1] This delineation is not watertight as other policies also affect trade. Exchange rate policy, including exchange controls and multiple exchange rates, is noteworthy but is outside the scope of the evaluation (Box 2).

4. The evaluation considers five questions. What is the nature of the IMF's mandate to cover trade policy (addressed in Chapter 2)? Did the IMF work effectively with other international organizations on trade policy (Chapter 3)? Was clear guidance provided to staff on the IMF's role and approach to trade policy (Chapter 4)? How well did the IMF address trade policy issues through lending arrangements and surveillance (Chapter 5)? Was IMF advice effective (Chapter 6)? Chapter 7 offers findings and recommendations. Two annexes describe data sources for the evaluation and results of surveys of country officials and IMF staff.

[1] A PTA refers to an agreement between two or more countries to grant and/or receive more favorable trade conditions among themselves than vis-à-vis third countries. A PTA includes discriminatory preferences, be they unilateral (e.g., preference schemes) or reciprocal (e.g., free trade agreements and customs unions).

Box 1. IMF Involvement in Trade Policy: A History of Cycles

Until the mid-1970s, the IMF was involved in trade policy mainly as a record keeper. From a trade policy viewpoint, most countries fell into three groups: the 23 signatories of the General Agreement on Tariffs and Trade (GATT) undertook multilateral trade liberalization that spurred growth of world trade substantially faster than that of world GDP; most developing countries pursued an import substitution industrialization (ISI) strategy and were highly protectionist; and Soviet bloc countries operated in anything from barter systems to autarky. Yearly IMF Article VIII/XIV consultations recorded members' trade policy changes and gave some policy advice.

This rather passive role gave way to activism, mainly through conditionality in lending arrangements, in the 1970s, when shocks pummeled balance of payments positions, especially of developing countries. The difficulty of many countries in rebounding from these shocks, together with growing academic attention to harmful effects of protection, revealed the flaws of ISI strategies. Conditions on trade reform became prominent in IMF-supported adjustment programs during 1980–95, in efforts to improve supply conditions so as not to rely only on demand compression to reduce balance of payments imbalances. These policy changes were unilateral and outside of the GATT framework even as developing countries became GATT members.

By 1995, when the WTO was established, the trade policy landscape had changed massively. The GATT had 123 members (all became members of the WTO), and incentives for nonmembers to accede to the WTO were large. Five multilateral trade rounds during 1947–95 had reduced average tariff rates on manufactured imports in industrial countries from 40 percent to 3.5 percent. Though tariff reduction remained a goal of the WTO, it was also hoped that the new institution would be able to address impediments to trade in areas such as agriculture, textiles, services, intellectual property rights, and behind-the-border regulations, which had not yet been addressed or had proved thorny. But even as more trade policy issues were consolidated in one institution, the spread of preferential trade agreements meant that countries increasingly focused trade policy on these agreements. In this setting, the IMF began to curtail its role in trade policy issues at the turn of the century.

Box 2. Distinctions Between Exchange Rate Policy and Trade Policy from the IMF's Perspective

One purpose of the IMF, expressed in Article I(iii) of the Articles of Agreement, is "to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation." This responsibility implicitly reflects the view that exchange rate policy has profound implications for the expansion and balanced growth of international trade. In economic terms, therefore, exchange rate policy may share objectives and attributes of more narrowly defined trade policy. In two dimensions, this similarity can be particularly obvious. First, competitive depreciation can be considered a beggar-thy-neighbor trade policy similar to an across-the-board export subsidy plus import tariff. Second, substantial exchange rate volatility can have an adverse effect on trade volumes.

Nevertheless, there are good reasons, in the context of the IMF's mandate, to consider the IMF's role in trade policy separately from (though in tandem with) that in exchange rate policy. This is because of the fundamental distinction between exchange rate policy and more narrowly defined trade policy in the Articles of Agreement. Specifically, with respect to exchange rates, members undertake an obligation "to collaborate with the Fund and other members…to promote a stable system of exchange rates" and to "avoid manipulating exchange rates…to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members" (Article IV, Section 1). In turn, the Fund has the explicit responsibility "to exercise firm surveillance over the exchange rate policies of members" as it oversees "the compliance of each member with its obligations" (Article IV, Section 3). These provisions unambiguously place exchange rate policy and its implications for trade at the center of the Fund's mandate. In contrast, the mandate for the Fund's involvement in more narrowly defined trade policy is based on "soft" obligations, for example that each member shall "endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth" (Article IV, Section 1(i)). Thus, especially with the IEO having recently completed an evaluation of IMF advice on exchange rate policy and to help focus this evaluation on the IMF's role in the context of this softer mandate, this evaluation focuses on the IMF's role in providing advice on trade policy narrowly defined.