Background Document

I

The Legal Mandate[1]

A. Introduction

1. The legal mandate for the IMF's involvement in international trade policy issues is articulated in Article I(ii) of the Articles of Agreement, which specifies that a purpose of the IMF is:

> ...to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

2. This mandate is broad and less specific about the precise nature of the IMF's role in trade policy issues than about its role in exchange rate policy. The term "facilitate" in Article I(ii) encompasses any actions or policies that will encourage or ease the expansion of international trade.[2] And, unlike the IMF's mandate for exchange rate policy, this general mandate for the promotion of international trade is not spelled out in much more detail in other provisions of the Articles of Agreement.

3. Though the IMF has a broad mandate to facilitate the expansion of trade, it does not have regulatory jurisdiction over international trade.[3] Thus, though it can prohibit exchange restrictions on payments and transfers for current international transactions, the Fund cannot prohibit its members from imposing trade restrictions. As noted by Siegel (2002), "while a restriction on payments for particular imports is covered by Fund jurisdiction, an outright ban on the imports (i.e., the underlying transaction) is not. Fund members are obliged to avoid restrictions that are not maintained consistently with the Fund's Articles, but the Articles impose no such obligation with respect to trade restrictions."

4. Distinguishing between trade and exchange restrictions was central to delineating the jurisdiction of the IMF. The IMF has interpreted the concept of restrictions on payments and transfers for current international transactions, as set out in Article VIII, Section 2(a), using a technical criterion, rather than by considering the motive or economic effect of the restrictions.[4] By contrast, an interpretation that considered the authorities' motivation (such as for balance of payments reasons) would have encompassed trade restrictions. Likewise, since trade and exchange restrictions can have comparable effects on the balance of payments, an interpretation that considered their economic effect would have extended IMF jurisdiction to trade restrictions. In the event, the Fund has defined "restrictions" in Article VIII, Section 2(a) by a technical principle that applies to the financial aspect of "whether it [the restriction] involves a direct governmental limitation on the availability or use of exchange as such," making a clear distinction between the exchange and the underlying trade transaction.[5]

5. Despite acceptance inside and for the most part outside the IMF that the IMF has a mandate to engage in trade policy issues, some external critics have argued otherwise. Akyüz (2005) views the IMF's trade-facilitating role as relating to its function of promoting "a stable system of exchange rates and payments" as a means of ensuring "a predictable trading environment." He therefore argues that the IMF is "trespassing in trade policy" when it engages in trade policy issues, which are "a matter for multilateral

[1] This chapter has benefited from the insights in Annex I in IMF (2005). However, it reflects entirely the views of the IEO and not those of the Executive Board or Legal Department of the IMF.

[2] As noted by Gold (1986), "[t]he nuance of the word…'facilitate' in Article I expresses the idea of encouraging or easing and not controlling" the expansion of international trade as a purpose of the IMF.

[3] Regulatory jurisdiction or authority is "understood in the sense of requiring, proscribing, validating and invalidating practices" (Gold, 1986), "with the consequence that a member is in violation of its obligations if it applies a measure that the organization fails to approve or expressly disapproves" (Gold, 1975).

[4] Article VIII, Section 2(a), which gives the IMF regulatory jurisdiction over restrictions on payments and transfers of current international transactions, states that "…no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions."

[5] IMF (2006), Decision No. 1034 (60/27). Gold (1986) discusses the debate surrounding the interpretation of the restrictions on payments and transfers for current international transactions.

negotiations elsewhere in the global system." Woods (2006) and Saner and Guilherme (2007b) contend that trade liberalization is beyond the core legal mandate of the IMF.

6. The broad mandate for the IMF's role in trade policy issues has largely been interpreted within key modalities for specific activities of the IMF: Article IV, which governs surveillance; Article V, which requires that IMF financial support and technical assistance be consistent with its purposes as delineated in Article I; and Article X, which governs IMF cooperation with other international organizations.

B. Surveillance

7. The mandate for trade policy advice in surveillance is also quite general. Article IV (Obligations Regarding Exchange Arrangements) requires the IMF to oversee the international monetary system and monitor members' compliance with the general obligations specified in Article IV, Section 1. These obligations include that each member "direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability" and "seek to promote stability by fostering orderly economic and financial conditions." This comes alongside obligations related to exchange and exchange rate policies, also specified in Article IV.

8. From an economist's perspective, this mandate involves both a passive and an active role in the surveillance of trade policy issues. The passive role, suggested in the 1977 and 2007 Surveillance Decisions, is that the IMF should consider the implications of trade policies in assessing the appropriateness of a country's exchange rate regime and its macroeconomic and financial prospects.[6] The active role, suggested in Article IV, Sections I(i) and I(ii), involves inter alia the provision of advice on trade policies that will promote growth and external stability.[7]

9. Surveillance of trade policy in practice has also aimed to discourage actions that entail adverse cross-country spillovers. The Executive Board has called for surveillance of trade policies of systemically important countries if these policies have a global or regional impact, even if they do not hamper the country's own macroeconomic prospects. Article IV does not call for assessing such direct cross-country impacts of a country's trade policies; specifically, the Article does not specify obligations to conduct economic and financial policies in a manner that does not adversely impact another member's economy. (This contrasts with the Article IV obligations on exchange rate policies, where members have "a duty not to manipulate exchange rates in order to gain a competitive advantage" (IMF, 2004: Appendix I). However, Article XII, Section 8 and Article I(i) permit the IMF to discuss issues that are important for the IMF, but do not fall within the scope of surveillance. "Stated differently, while they [such spillover effects] are discussed in the context of an Article IV consultation, they are not the subject of surveillance under Article IV" (IMF, 2004).[8]

10. The IMF's interpretation of the mandate for surveillance of trade policy is not without its critics. Saner and Guilherme (2007a) argue that Article IV suggests a narrow role for IMF surveillance of trade policy issues. They note that IMF "surveillance activities ought to fall under the microcosm of exchange measures and policies taken by the Fund membership." Therefore, "generic trade measures,… unless specifically enacted for balance of payments reasons, fall totally outside of the scope of Article IV" and are "an objectionable legal amplification of the Fund's mandate under Article IV."

C. Conditionality

11. The mandate for applying conditionality to trade policies is somewhat more direct. Article V, Section 3 (Conditions Governing Use of the Fund's General Resources) empowers the IMF, consistent with the purposes outlined in Article I, to adopt policies on the use of its resources to help members resolve balance of payments difficulties. Article I(v) states that the IMF should make its resources temporarily available to members, subject to adequate safeguards, to provide them "with the opportunity to correct maladjustments in their balance of payments, without resorting to measures destructive of national

[6] The 1977 Decision on Surveillance Over Exchange Rate Policies and the 2007 Decision on Bilateral Surveillance over Members' Policies (which replaced the 1977 Decision in June 2007) note that "[i]n its surveillance...the Fund shall consider the following developments as among those which would require thorough review and might indicate the need for discussion with a member: [one such development is] the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments."

[7] As noted in Gold (1986), "'economic policies' and 'economic conditions' [for promoting growth and stability] in Article IV, Sections I(i) and I(ii) could be taken to imply concern with trade policies."

[8] This discussion of the mandate for IMF surveillance notes that the legal basis for the discussion of issues outside the scope of surveillance is Article I(i), which states that one of the purposes of the IMF is "to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems." Further, it notes that Article XII, Section 8 permits the IMF "to communicate its views informally to any member on any matter arising" under the Articles. Also see Annex I in IMF (2005).

or international prosperity.”[9] Some external commentators interpret these articles as mandating conditions to prevent the intensification of trade restrictions, but not conditions with other objectives.

12. The IMF, however, interprets this mandate as providing the basis for two types of trade policy conditionality: a continuous performance criterion prohibiting trade restrictions for balance of payments reasons and structural trade policy reforms. The IMF has noted that trade measures that are “destructive of national or international prosperity” are more likely to worsen maladjustments in the balance of payments and less likely to restore the external viability that is the objective of the IMF’s financial support. Such trade measures also make it more likely that the use of IMF resources will not be temporary (IMF, 2005). Gold (1986) states that “the IMF would not be observing the injunction to apply adequate safeguards if it concentrated exclusively on the measures and policies that were within its regulatory authority [such as exchange restrictions] and ignored other measures and policies [such as trade restrictions] that had comparable effects on the balance of payments.”

13. Some external commentators have criticized the IMF’s imposition of structural trade policy conditions as extending beyond its mandate. Buira (2003) argues that structural trade policy measures are outside the IMF’s core areas of competence and that the IMF should “keep itself within its original simplified mandate by giving advice and technical assistance within its areas of competence.” Saner and Guilherme (2007a, 2007b) assert that “the establishment of ‘adequate’ solvency safeguards does not bear the same meaning as a legal carte blanche to demand all-encompassing structural reforms from a Fund member” particularly those beyond its core legal mandate. Therefore, they contend that “adequate solvency safeguards to address balance of payments problems should not extend to trade policies” and that the “Fund usurps its legitimacy [when it] engage[s] in much broader reforms that include trade liberalization.”

[9] “These safeguards take various forms, such as limits on how much can be borrowed, conditions on the loans, measures to deal with misreporting or arrears, or ‘safeguards assessments’ of central banks” (IMF, 2008).

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