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IMF May Be on Collision Course with Trade Policy

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The International Monetary Fund (IMF) has officially endorsed an "institutional view" on the management of capital flows. Henceforth the IMF will advise nations, under certain circumstances, to deploy capital controls on inflows and outflows of capital. The IMF is aware that such advice may conflict with obligations that nations have under trade and investment treaties, and recommends that such treaties be reformed.

What the IMF Decided

On December 3, 2012 the International Monetary Fund made public an Executive-Board approved "institutional view" on capital account liberalization and the management of capital flows. In a nutshell, the IMF's new "institutional view" is that nations should eventually and sequentially open their capital accounts. This is indeed in contrast with its view in the 1990s that all nations should be uniformly required to open their capital accounts regardless of the strength of a nation's institutions. The IMF now recognizes that capital flows also bring risk, particularly in the form of capital inflow surges and sudden stops that can cause a great deal of financial instability. Under such conditions, and under a narrow set of circumstances, according to the new "institutional view" the IMF may recommend the use of capital controls to prevent or mitigate such instability in official country consultations or Article IV reports. In other words, the IMF now sanctions staff and management to recommend the use of capital controls to nations under certain circumstances.

IMF view and Trade and Investment Treaties

The IMF is aware of the fact that they may recommend capital controls to nations that do not have the policy space to deploy such instruments because they would be deemed actionable under a trade agreement or investment treaty. In the final report they say:

"As noted, the Fund's proposed institutional view would not (and legally could not) alter members' rights and obligations under other international agreements. Rather, conformity with obligations under other agreements would continue to be determined solely by the existing provisions of those agreements. Thus, for example, even **where the proposed Fund institutional view recognizes the use of inflow or outflow CFMs as an appropriate policy response, these measures could still violate a member's obligations under other international agreements if those agreements do not have temporary safeguard provisions compatible with the Fund's approach** (IMF, 2012b, 42)."

This echoes what the IMF stated in a board report earlier this year:

"The limited flexibility afforded by some bilateral and regional agreements in respect to liberalization obligations may create challenges for the management of capital flows. These challenges should be weighed against the agreements' potential benefits. In particular, such agreements could be a step toward broader liberalization. However, **these agreements in many cases do not provide appropriate safeguards or proper sequencing of liberalization**, and could thus benefit from reform to include these protections(IMF 2012a, 8)."

Indeed, the IMF suggests that the new IMF institutional view could help guide future trade treaties and that the IMF could serve as a forum for such discussions.

"In particular, the proposed institutional view could help foster a more consistent approach to the design of policy space for CFMs under bilateral and regional agreements. Recognizing the macroeconomic, IMS, and global stability goals that underpin the institutional view**, members drafting such agreements in the future, as well as the various international bodies that promote these agreements, could take into account this view in designing the circumstances under which both inflows and outflows CFMs may be imposed within the scope of their agreements. Similarly—and depending on the stages of development of the relevant signatories—the sequenced approach to liberalization under the integrated approach could be taken into account to guide the pace and sequencing of liberalization obligations, and the re-imposition of CFMs due to institutional considerations** (IMF, 2012b, 33)."

Which Nations will be the most affected?

A number of analyses of the relationship between trade and investment treaties and the ability to deploy capital controls have been published in the past few years. At the World Trade Organization under the General Agreement on Trade In Services and under United States' trade and investment treaties nations must to some degree liberalize their capital account. Nations must partially do so in order to allow trade in financial services under their GATS commitments (though many countries have not made commitments for financial services) and absolutely allow all transfers of investments to occur "freely and without delay" in US treaties. So for each case the use of capital controls would be actionable. The question is whether these treaties have ample safeguards for the prudential use of capital controls. There is unanimity that US trade and investment treaties have limited or nonexistent safeguards. There is also significant concern that the WTO's General Agreement on Trade in Services also constrains the ability of nations to deploy controls if those nations have made commitments in financial services (for a review see Gallagher and Stanley, 2012). The IMF has taken a step forward on this matter. Unfortunately that step forward is into a web of inconsistent international rules and incentives that go the other way.

References

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