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How the International Monetary Fund and World Trade Organization Can Promote Fair Trade

by Meg Lundsager

SUMMARY

Exchange rates affect international trade, and they can be skewed by countries that are capable of buying and selling large amounts of currency to counter market trends. The International Monetary Fund and the World Trade Organization are charged with curbing such trade-distorting practices, but they could increase their effectiveness by improving communication and collaboration.

Currency exchange rates affect all internationally traded goods and services. If a country's exchange rate policies resist market signals and keep its currency undervalued, then its goods appear cheaper, the country develops wide trade and current account surpluses, and its trading partners lose competitiveness.

Two global institutions are tasked with preventing such practices: the International Monetary Fund (IMF) sets rules for exchange rate policies and the World Trade Organization (WTO) sets rules for fair trade. They should be closely linked, yet in practice they talk past each other regarding how exchange rates affect trade. Their deeper cooperation could lead to more fair and transparent exchange rates.

Exchange rates and foreign currency reserves

Over the years, heightened IMF and trading partner scrutiny has led more countries to adopt market-determined exchange rates or at least set a goal of moving to a flexible, market system. Nonetheless, some countries intervene in their currency markets, buying foreign currencies in exchange for their domestic currency in order to lower the international value of their own currency and gain competitive advantage for their exports.

Exchange rate movements are watched closely by ordinary citizens, manufacturers and services providers, and policymakers around the world. Changes in foreign currency reserves, however, which can reflect government or official foreign exchange market intervention, are less accessible, and intervention is often reported belatedly if at all. Promptly disseminating information on changes in currency reserves would focus attention on countries that are undertaking excessive intervention and could increase peer pressure on them to desist. If large economies stop artificially depreciating their own currencies, smaller ones will as well.

The IMF's role

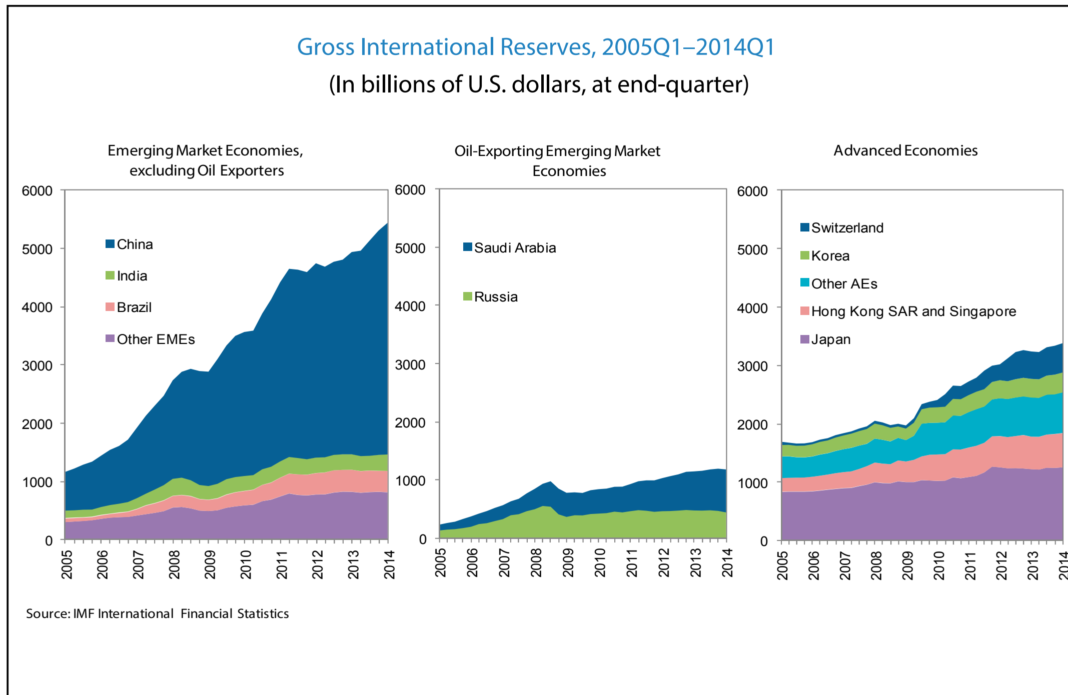
The IMF periodically reviews its members' economic policies, including their exchange rate systems. Its annual *External Sector Report* (ESR) describes the 28 countries with the largest economies, plus the Eurozone, in terms of exchange rate systems, trade and investment flows, and foreign exchange reserves accumulation, and gives a bottom-line assessment of the exchange rate.[1] The ESR highlights how some countries continue to intervene in foreign exchange markets, preventing adjustment in their exchange rates and trade accounts. Because one country's exports are another's imports, these interventions sustain the imbalances in their partners' trade and current accounts.

Of course, not all official foreign exchange intervention is bad. The IMF condones "smoothing" operations to counter market volatility, and countries with very low foreign currency reserves may need to build up a minimum cushion in order to handle volatility. Yet the IMF criticizes persistent intervention that prevents exchange rates from adjusting to reduce imbalances in trade and payments.

Although the IMF does not have an effective enforcement mechanism to stop excessive foreign exchange intervention, it has a powerful voice for setting global standards of behavior for exchange rate policies, intervention, and overall macroeconomic policies. Twice a year, it scrutinizes macroeconomic policies in the *World Economic Outlook* (WEO), *Global Financial Stability Report* (GFSR), and *Fiscal Monitor* (with two additional WEO updates). The ESR, by contrast, is published just once a year with little publicity.

[1] See the *IMF Multilateral Policy Issues Report: 2014 Pilot External Sector Report*, July 29, 2014 (www.imf.org/external/np/pp/eng/2014/062614.pdf) and corresponding individual economy assessments (www.imf.org/external/np/pp/eng/2014/062614a.pdf).

More frequent public release of IMF assessments of current accounts, exchange rate movements, and changes in reserves—including changes due to interventions—would enable finance/treasury and central bank officials to discuss developments at IMF or G-20 meetings. A country that had been intervening in a lopsided manner would be expected to explain its actions and respond to the frustrations of those losing competitiveness.



Toward better IMF and WTO cooperation

The WTO's operational procedures differ from those of the IMF, but they share the same objectives to promote trade, create jobs, and generate growth worldwide. Although the WTO charter defers to the IMF on assessing exchange rates, the WTO promotes fair trade by setting global trade rules, particularly through the enforcement mechanism known as the dispute settlement system.

Because exchange rates affect trade, the WTO, its governing council, and its ambassadors in Geneva should all understand currency policies better. The IMF could help promote better understanding by preparing quarterly updates of its ESR with country assessments and briefing WTO officials on them in Geneva; simplifying its website presentations of data and assessments; and facilitating links from the WTO website to enhance accessibility for WTO officials, including dispute settlement panels.

Furthermore, the WTO offers special opportunities for smaller countries to put pressure on larger ones. As a consensus organization, the WTO offers forums for both large and small participants to voice concerns. Smaller partners' complaints about currency policies of their larger competitors would communicate the dangers of "currency wars" and broaden peer pressure to stigmatize intervention in currency markets.

The IMF also monitors monetary and fiscal policies that affect trade and investment flows. A country or region that is pursuing an expansionary monetary policy and causing currency depreciation should be prepared to show how that policy increases domestic demand and growth, boosting demand for its trading partners' exports. Officials responsible for trade, finance, and monetary policy should better understand all these linkages.

In sum, the IMF and WTO could greatly enhance their effectiveness if they shared their expertise and knowledge, promoting increased global trade and more widely shared economic growth.

- The IMF should prepare and publish the ESR twice a year, update it as part of the two other WEO updates, and present the ESR publicly along with the WEO and GFSR.
- Finance ministers and central bank governors should discuss the ESR and share country experiences to complement their discussion of the effects of their monetary and fiscal policies on their economic growth and external accounts.
- The WTO, including the ambassadors in Geneva and the trade ministers at their meetings, should have routine briefings on exchange rate developments such as currency intervention and reserves accumulation. IMF data and assessments should be more easily accessible.

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