

Disciplines on capital flows in trade and investment agreements: a disservice for global economic governance

Dr Gabriel Gari
Queen Mary, University of London

Questions

- To what extent trade and investment agreements limit contracting parties' discretion to manage capital flows into and outside their territories?
- What are the implications of having disciplines on capital flows in trade and investment agreements for the governance of international economic relations in an increasingly interconnected and interdependent global market?

- From a global economic governance perspective, the main problem with disciplines on capital flows in trade and investment agreements is the lack of adequate bridges between legal regimes with overlapping jurisdiction on measures affecting international economic relations in a progressively interconnected and interdependent global market, and, at the same time, in a less certain economic policy environment. In other words, the main issue is not deciding what contracting parties to trade and investment agreements can or cannot do, but who monitors their behaviour and how they do it.

capital flows

- Current transactions (Article XXX IMF AA)
 - Payments for imports / proceeds from exports
 - Payments for services / proceeds from services
 - Payments / proceeds due in connection with normal short-term banking and credit facilities
 - Payments /proceeds due as interests on loans
 - Payments / proceeds due as net income from other investments
 - Payments / proceeds of moderate amount for amortization of loans or for depreciation of direct investments
 - Moderate remittance for family living expenses / proceeds from moderate remittance
- capital transactions

Capital Controls

- “include measures affecting international capital movements that involve official action by members and impose limitations on capital account transactions or on payments and transfers related to them” (Caruana, 2007)
- describes regulations influencing both inward and outward capital flows. The concept of controls on capital transactions is interpreted broadly. Thus, controls on capital transactions include prohibitions, need for prior approval, authorisation and notification, dual and multiple exchange rates, discriminatory taxes and reserve requirements or interest penalties imposed by the authorities that regulate the conclusion or execution of transactions or transfers; or the holding of assets at home by non-residents and abroad by residents. The coverage of the regulations applies to receipts as well as to payments and to actions initiated by non-residents and residents (IMF AREAER)

Type of capital controls

- On capital outflows / on capital inflows
- On residents / on non-residents
- On the underlying transaction / on associated payments and transfers
- For economic reasons / for non-economic reasons
- Restrictions / non-restrictive controls

Type of capital controls (cont')

- Countries facing external financial difficulties
- Countries facing excessive inflows of capital
- Countries facing recovery challenges in the aftermath of financial crises

Trade (in services) agreements

- Purpose: eliminate trade restrictions
- Scope: broad! ("trade in services", "measures", "affecting" test, "financial services")
- Disciplines on trade in services reach any measures affecting trade in services, including restrictions on capital flows.
- Enforcement (GATS): state to state dispute settlement system / single forum for resolving disputes/ appellate body
- Agreements (WTO, May 2011)
 - GATS
 - PTAs: 380 counting goods and services together, of which 202 are currently in force

GATS Disciplines

Article XI Payments and Transfers

- “XI.1. Except under the circumstances envisaged in Article XII, a Member shall not apply restrictions on international transfers and payments for **current transactions** relating to its specific commitments.
- XI.2 Nothing in this Agreement shall affect the rights and obligations of the members of the IMF under the Articles of Agreement of the Fund, including the use of exchange actions which are in conformity with the Articles of Agreement, provided that a Member shall not impose restrictions on any **capital transactions** inconsistently with its specific commitments regarding such transactions, except under Article XII or at the request of the Fund.”

Footnote 8

- If a Member undertakes a market access commitment on the cross-border supply of a service and the cross-border movement of capital is an essential part of the service itself, the Member must allow the associated movement of capital
- If a Member undertakes a market-access commitment in relation to the supply of a service through commercial presence, it is thereby committed to allow related transfers of capital into its territory

Other disciplines

Disciplines / Exceptions

Disciplines	Exceptions
Disciplines on payments and transfers for current transactions	Rights and obligations of Members of the IMF under the Articles of Agreement Restrictions to safeguard BofP General Treaty Exceptions
Disciplines on capital flows	Fund Request Restrictions to safeguard BofP General Treaty Exceptions
Other disciplines -MFN -NT -Domestic Regulation -Understanding on commitments in Financial Services	General Treaty Exceptions - General Exceptions - Security Exceptions - Prudential carve out

Findings (provisional)

GATS

- Disciplines on “trade” in services limit contracting parties’ discretion to control capital flows
- Provides policy room for the adoption of controls on capital outflows for Balance of Payment reasons or at the request of the Fund, but not for the adoption of controls on inflows.
- GATS and IMF give rise to conflicting rights and obligations over the same measures
- Broad scope of GATS magnifies risk of inconsistencies
- An increase in the level of specific commitments will also increase tensions
- Room for improving coordination between trade and monetary authorities

PTAs

- GATS plus disciplines
- Sector specific commitments: negative list approach or GATS plus commitments
- No exception safeguarding contracting parties’ right to adopt restrictions for BoP reasons
- No reference to Members’ rights and obligations under the IMF Articles of Agreements
- No duty of adjudicative bodies to consult with the IMF when dealing with problems concerning monetary reserves, balance of payments or foreign exchange arrangements

Investment Agreements

- Purpose: promotion and protection of foreign investment
- Scope: definition of ‘investment’ / interpretation of ‘investment’
- Disciplines prescribe standards of treatment owed by host countries to foreign investors, including the obligation to protect investors’ right to transfer funds into and outside the host country’s territory
- Enforcement: investor/state dispute settlement system based on arbitration, no single forum
- Agreements (UNCTAD, end 2009)
 - 2,750 BITs
 - 295 other IIAs

Disciplines/Exceptions

Disciplines (US BIT Model 2004)	Exceptions (US BIT Model 2004)
<p>Transfer provision</p> <p>1. Each Party shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory. Such transfers include:</p> <p>(a) contributions to capital;</p> <p>(b) profits, dividends, capital gains, and proceeds from the sale/liquidation of investmt;</p> <p>(c) interest, royalty payments, management fees, and technical assistance and other fees;</p> <p>(d) payments made under a contract;</p> <p>(e) payments made pursuant to expropriation and compensation; and</p> <p>(f) payments arising out of a dispute.”</p> <p>2. Each Party shall permit transfers relating to a covered investment to be made in a freely usable currency at the market rate of exchange prevailing at the time of transfer.</p> <p>Duty to accord NT and MFN to the establishment of investments</p>	<p>No exception to accommodate contracting parties’ rights and obligations under the IMF Articles of Agreement</p> <p>No exception for restrictions adopted to safeguard BoP</p> <p>Prudential carve out does not affect transfer obligations</p> <p>Exception for the adoption of measures that a Party considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of intl’ peace or security, or the protection of its own essential security interests (but no reference to the maintenance of public order)</p>

Other BITs

- **Preamble:** express recognition of public policy issues such as the protection of health, safety, the environment, consumer protection, labour rights (US-URU BIT 2005)
- **Admission** conditional to approval by host state authorities (Baharian-Thailand BIT 2002)
- **Definition of investment:** exclusion of certain transactions that do not entail a real acquisition of interests by an investor in the territory of the host country such as short term debt instruments, claims arising out of commercial contracts (e.g. Colom-Belg-Lux 2009)
- **Transfers:** right to limit transfers by financial institutions for prudential reasons (Canada BIT Model) / carve out host country’s laws on exchange controls (Canada –Colom FTA, China-Germany BIT)
- **Enforcement:** cooling off periods for claims against restrictions on payments and transfers / limits on compensation for loss or damages arising from restrictive measures on capital inflows (US-Chile FTA) / prohibition to submit to arbitration claims grounded on the breach of NT/MFN owed to financial institutions (US-URU BIT 2005)

Findings (provisional)

- BITs disciplines limit contracting parties' discretion to control capital flows, in particular, transfer provisions
- Significant variations among BITs with respect to contracting parties' policy space for the adoption of controls on capital flows, yet almost no BIT includes exceptions for the adoption of restrictions for Balance of Payment reasons or in cases of serious economic and financial disturbance.
- Some arbitration awards confirmed that the scope of "essential security" exceptions may cover emergency measures taken in times of economic crises, but discrepancies remain with respect to the standards that must be met for invoking such exception. Likewise, recent annulment awards have recognised the right of the defendant to rely on the customary law of necessity to justify BIT violations (*Sempra v Argentina / Enron v Argentina*) although other awards held a different view (*Suez and Vivendi v Argentina*)
- BITs and IMF AA give rise to conflicting rights and obligations over the same measures, yet BITs do not include provisions to preserve contracting parties' rights and obligations under the IMF AA or any duty to consult the IMF on problems concerning monetary reserves, balance of payments or foreign exchange arrangements

Findings (provisional)

- Concerns about the adequacy of BITs enforcement mechanisms for balancing the obligation to protect foreign investors against the need to adopt measures necessary for prudential or macroeconomic reasons
 - Lack of expertise
 - Lack of transparency
 - No single forum for hearing claims, pervasive discrepancies and inconsistencies among known awards
 - Lack of political consensus about economic benefits of capital controls (reflected in significant variations on BITs rules on the matter in question)
 - Absence of decision making bodies capable of counterbalance an extremely powerful, investor-led enforcement mechanism

Food for thought

- Need to revisit the role played by an investor-led, confidential, atomised and isolated adjudicative system in the governance of an international investment regime that impinges on contracting parties policy space to prevent/mitigate financial crises?
- **Possible lines of reform**
- Adopting treaty exceptions that provide more generous flexibility to regulate for prudential or macroeconomic reasons and, at the same time, introduce transparency and good governance type of disciplines
- Creation of political bodies with decision-making, monitoring and even enforcement power (OECD Codes experience)
- Scale down role of adjudicative bodies by
 - Compulsory intervention of contracting parties' financial authorities prior to the initiation of adjudicative proceedings
 - Duty to consult IMF on problems concerning monetary reserves, balance of payments or exchange arrangements
 - Limiting locus standi on claims against capital controls for state parties only, or even, carve out such type claims altogether from adjudication