



Negotiating Group on the Multilateral Agreement on Investment (MAI)

Expert Group No.5 on “Financial Services Matters”

REPORT TO THE NEGOTIATING GROUP

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1. In accordance with its Mandate, Expert Group No. 5 met on 27-29 January 1997 to finalise advice to Drafting Group No. 3 with regard to the definition of investment and to consider the need for general safeguard provisions, particularly with respect to the balance of payments, taking account of the role of the International Monetary Fund (IMF).
2. Regarding the definition of investment, EG5 (with three delegations reserving their position) considered that the item “financial assets” should be deleted from the negative list. The majority of delegations favoured deleting the item “derivatives” as well. For some delegations, these deletions are subject to agreement on adequate safeguards. The Group considered, however, that further work on the treatment of “public debt” in the MAI is needed by EG5.
3. On the assumption that the MAI contains a broad definition of investment, EG5 reached agreement that a balance of payments safeguards clause is appropriate. Some delegations felt that the balance-of-payments clause would be necessary regardless of the scope of the definition of investment. The Group also identified many of the elements to be included in such a provision, including a key role for the IMF.
4. The Group also considered proposals for provisions dealing with monetary and exchange rate policies and the actions of monetary authorities and other proprietary actions of government, but these matters need further consideration.
5. The Group agreed that no other safeguard provisions need to be considered, bearing in mind that the MAI will contain a carve-out provision for prudential measures.
6. The Group also advanced its consideration of various financial services issues with a view to concluding on these issues at the March meeting.
7. Looking forward to its March meeting, the Group is ready to prepare text on the question of appropriate safeguards and to finalise its recommendations on financial services matters. The Group is also willing to prepare an opinion on the treatment of public debt in the MAI and to propose text for paragraph 4.6 of the transfers article of the MAI.

Chair

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I. Definition of Investment

1. The Group considered three items on the negative list of the definition of investment and prepared the following advice for DG3.

2. The broad item “financial assets” should be deleted from the negative list*. The Group confirmed the general opinion given in its December Report to the Negotiating Group [DAFFE/MAI/EG5(96)5] that it would be very difficult to make distinctions between different kinds of financial assets with respect to their intrinsic value or motivation. Some delegations indicated that they could accept the resulting broad definition of investment in the MAI provided adequate general safeguard provisions are included. Other delegations are ready to accept safeguards provisions only on the basis of agreement on this broad definition of investment.

3. With respect to “derivatives”, the majority of delegations favoured deletion of any reference to derivatives from the negative list. These delegations found no rationale for distinguishing derivatives from other financial assets. For some delegations, this deletion is subject to agreement on adequate safeguards. One delegation preferred to retain derivatives on the negative list with the current drafting so that derivatives would be excluded from the definition of investment to the extent to which their underlying assets were excluded. It considered that this approach would avoid circumvention of the exclusion of the underlying assets and ensure orderly markets. A few delegations preferred to exclude all derivatives from the MAI as they regard such assets as principally short-term operations open to speculation.

4. The Group held a first discussion of the treatment of “public debt” in the definition of investment. Different views were held on whether public debt should be excluded entirely or in part. Issues raised included the relationship of the MAI to “workouts” regarding sovereign debt (including in particular the Paris Club), the sovereign right of countries to manage their debt, debt of state-owned enterprises, and the extent to which National Treatment and MFN obligations might remain relevant even if public debt were excluded from the definition of investment. One delegation circulated a paper on some aspects of this subject [DAFFE/MAI/EG5/RD(97)1] and is ready to co-ordinate preparatory work on this subject before the March meeting. Some delegations suggested that solutions outside the definition of investment might be more appropriate. The various questions regarding treatment of public debt in the MAI require further work.

* Two delegations reserved on this point. Another delegation wishes to give further consideration to this matter in light of the possible safeguard clauses.

II. Balance of Payments Clause and Role of the IMF

1. The Group agreed that, given the broad definition of investment envisaged for the MAI, a balance-of-payments (b.o.p) clause permitting temporary departure from the disciplines of the MAI would be appropriate. Some delegations felt that the b.o.p. clause would be necessary regardless of the scope of the definition of investment.

2. The Group agreed that the provisions of the GATS provide a useful starting point for such a b.o.p. clause.

3. Without developing text, the Group agreed that a b.o.p. clause of the MAI should contain the following elements:

- a. it should cover only situations of exceptional balance-of-payments difficulties (“crisis” situations) or the threat of such situations developing;
- b. the restrictions should not be discriminatory;
- c. they should be temporary and phased out progressively;
- d. they should not be more severe than necessary;
- e. they should be consistent with the Articles of the Agreement of the IMF;
- f. the clause should include provisions to ensure an early return to the disciplines of the MAI.

4. The Group agreed that the IMF should play a key role in determining whether recourse to the b.o.p. clause would be justified under the MAI. For example:

- a. Restrictions falling under the jurisdiction of the IMF would be justified under the MAI b.o.p. clause based on whether they are maintained consistently with the Articles of the Agreement of the IMF*
- b. Regarding restrictions which do not fall under the jurisdiction of the IMF, two options were considered:
 - 1) the IMF would be asked to provide a factual assessment of the situation of the country invoking the derogation clause, which will be relied upon by the MAI Parties Group in making its final determination as to whether the invocation is justified; or
 - 2) the IMF would be asked to make a determination as to whether the invocation is justified, on the understanding that the MAI Parties Group would automatically endorse the IMF opinion. The Parties Group would provide a forum for discussion and follow-up once the measure has been approved by the IMF.

* The broader issue of consistency of the MAI with the Articles of the Agreement of the IMF would remain for consideration in an appropriate Group.

5. The Group also considered the scope of a b.o.p. clause in the MAI.
 - a. It agreed that a b.o.p. clause should cover both transfers and underlying transactions. Some delegations wished to reflect further on this matter.
 - b. The Group agreed that the b.o.p. clause should cover capital outflows. A number of delegations considered that it should also cover capital inflows, while other delegations reserved their position on this matter. The Group agreed that further consideration to this matter is needed.
 - c. Most delegations were of the opinion that compensation from expropriation should not be excluded from the scope of the b.o.p. clause to avoid preferential treatment of certain categories of investors. Some delegations, however, felt that compensation from expropriation should be protected from the b.o.p. clause.
6. The Group agreed that, if the GATS provisions were to be used as a model for a b.o.p. clause of the MAI, the text of the GATS will have to be adapted to the characteristics of an investment agreement. In addition, delegations questioned the need to retain, in the MAI, provisions along the lines of Article XII (3) of the GATS.
7. The Group agreed that the dispute settlement provision of the MAI should not apply to measures which have been approved under the b.o.p. clause (whether by the IMF or the Parties Group). The application of the measures, however, would be subject to the normal dispute settlement provisions, both state-to-state and investor-to-state. Some delegations considered that further consideration of this matter is needed.

III. Monetary and Exchange Rate Policies and Role of Monetary Authorities

1. Many delegations felt that, in addition to the balance-of-payments clause, the MAI should contain a safeguard or carve-out provision covering the actions of central banks and other monetary authorities in carrying out monetary policy and exchange rate policy as well as other proprietary actions of government. Furthermore, these delegations do not wish such actions to be subject to MAI dispute settlement procedures.
2. Other delegations cautioned against unduly weakening the coverage of the MAI. Further consideration is needed before determining whether special provisions for actions of monetary authorities in carrying out their policy responsibility are needed in the MAI.
3. A few delegations also considered that a derogation provision is needed to address situations of large capital inflows where capital controls may be necessary in order to preserve the effectiveness of monetary policy and counter exchange rate instability. One approach to this issue would be to enlarge the scope of balance of payments derogation clause. Some other delegations, however, felt that such an approach may unduly weaken the MAI disciplines.
4. All these matters need further consideration in light of the provisions of the MAI as a whole and the treatment of similar issues in existing agreements. One delegation is ready to take the lead in preparing for a further discussion on this matter at the Group's March meeting.