



Negotiating Group on the Multilateral Agreement on Investment (MAI)

MAI AND THE IMF ARTICLES OF AGREEMENT

(Note by the Chairman)

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1. This paper considers the relationship of the MAI with the Articles of Agreement of the International Monetary Fund and the Fund's role with regard to transfers.
2. The MAI will have a provision granting a general right of free transfer for all payments relating to a covered investment in its territory and specific provision granting a right of free transfer of compensation for expropriation and for requisition or unnecessary destruction in time of strife. Free transfer is a traditional and core investor protection generally found in investment treaties.
3. Under Article VIII of the IMF's Articles of Agreement, members are prohibited from imposing restrictions on the making of payments and transfers for current international transactions without the approval of the IMF. Under the IMF's policies, such restrictions will only be approved if the IMF determines that they are non-discriminatory, imposed for balance of payments reasons, and are temporary. Before recommending approval by the Executive Board, the Fund staff makes a comprehensive assessment of a member's policies and of the member's ability to eliminate the restriction within a reasonable period¹.
4. It should be noted that, under the IMF Articles, current payments and transfers are defined broadly and encompass many investment-related flows, including net income on investment and, with respect to debt instruments, all interest as well as moderate amounts of amortisation of principal. Fund jurisdiction does not cover capital transactions nor sovereign payments.
5. While IMF members are not prohibited from imposing controls on capital movements, the IMF generally discourages members from resorting to such controls as a means of resolving their balance of payments problems, stressing that capital controls are not a substitute for appropriate adjustment policies and, in many cases, will only serve to exacerbate the underlying difficulties². Nevertheless, it considers that, in exceptional circumstances, controls on capital payments and transfers may be unavoidable for a temporary period while appropriate policies are implemented. In these circumstances, the Fund attempts to ensure that such controls are imposed in an orderly fashion and, to the extent possible, do not interrupt the servicing of the member's existing financial obligations.
6. In recognition of the general benefits of capital movements, the Fund has begun to consider an amendment to its Articles of Agreement that would also give it jurisdiction over capital payments and transfers. Although discussion of the amendment is still at a very early stage, such an amendment would presumably grandfather existing capital restrictions under specified conditions and empower the Fund to approve the imposition of new capital restrictions under exceptional circumstances for a temporary period.

1 This general obligation is limited by the transitional arrangements under Article XIV of the IMF's Articles, which permits members to maintain restrictions that were already in place when the country became a member of the IMF. These "grandfathered" restrictions may be maintained until the member's balance of payments position becomes sufficiently strong that reliance on them is no longer warranted. Moreover, even during the period when a member avails itself of the provisions of Article XIV, it is prohibited by Article VIII from imposing new restrictions. Among the IMF's members (including all OECD countries) there are 132 that no longer maintain grandfathered restrictions.

2 Article VI permits the Fund to request a member to impose controls on capital transfers to prevent the Fund's general resources from being used to meet large or sustained outflows of capital. However, no such request has ever been made.

If the Fund's Articles were amended in this way, and if the definition of investment in the MAI were a broad one, the overlap between the Fund's Articles and the MAI would increase.

7. The obligations of parties under MAI transfer provisions would not seem to be in legal conflict with their obligations under the IMF Articles of Agreement. However, IMF members have rights as well as obligations which are important to achieving the Fund's objectives. The IMF may approve current transfer restrictions, and could request capital movement controls in the context of the overall management of financial difficulties of Fund members. The IMF representative has argued that limitations on the freedom of countries to take actions necessary to deal with balance of payments difficulties could undermine the effectiveness of Fund programmes and possibly impair the country's ability to repay the Fund. [DAFFE/MAI/RD(95)19].

8. If it is considered that free transfer obligations under the MAI could, in certain circumstances, be incompatible with sound management of such a crisis within the IMF framework, a temporary derogation to the MAI free transfer provisions could be warranted. It might also facilitate accession to the MAI by certain non-member countries.

9. The Negotiating Group considered the question of a temporary balance of payment exception at its meeting held on 6-8 December 1995³ and decided to defer it until further progress was made on the major substantive elements of the MAI, in particular the definition of investment. It also noted that the Group could consider whether the issue of a balance of payments derogation could be addressed in defining the modalities of accession of non-member countries.⁴

10. Balance of payments exceptions are not in the model BITs of most OECD countries, but some of their bilateral investment treaties have limited balance of payments derogations⁵. The World Bank Guidelines for BITs contain a limited derogation.⁶ The Energy Charter Treaty has broad transfer rights and no such derogation provision.

11. The GATS allows derogation for payments and transfers for both current and capital transactions, in the event of balance of payments need, subject to safeguards, and in the case of capital movements if the Fund so requests. This derogation is made in the context of a provision that preserves the rights and obligations of IMF members with certain limitations (see attached). NAFTA also contains a broad balance of payments derogation clause, with safeguards similar to those in the GATS. The IMF staff believes that the GATS provides a useful model for reaching an accommodation between the IMF and the MAI because it includes both a temporary balance of payments derogation (Article XII of the GATS) and a more general provision which explicitly ensures consistency of rights and obligations under

3 It had before it paragraphs 18-22 of the Chairman's note on "General Exceptions, Country Specific Reservations, Temporary Derogations," DAFTE/MAI(95)6. It also heard a presentation by the representative of the IMF, DAFTE/MAI/RD(95)19, and had available an earlier presentation to DG1 by an IMF representative, DAFTE/MAI/DG1/RD(95)1.

4 Summary Record, paragraph 4c, DAFTE/MAI/M(95)3.

5 For example, the United States has included balance of payments exceptions in its BITs with Bangladesh, Egypt, Turkey and Zaire.

6 The World Bank Guidelines provide for free transfer rights for listed purposes, such as net revenues realised and sums necessary for discharge of contractual obligations; they allow time-limited restrictions in periods of exceptional foreign exchange stringency for transfer of the net proceeds of liquidation or sale of an investment and expropriation compensation.

the two treaties (Article XI of the GATS)⁷. The IMF staff has stressed that it is not requesting exclusive jurisdiction over transfers, but rather that any concurrent jurisdiction be consistent.

12. The OECD Codes of Liberalisation, which cover virtually all payments and transfers of current and capital account nature, contains a derogation clause (Article 7) which can be invoked in specified circumstances, including balance of payments difficulties. Whether the derogation clause has been properly invoked is assessed by the OECD Committee on Capital Movements and International Transactions (CMIT) in which the IMF representative participates as an observer. It is also specified that nothing in the Codes shall detract from the obligations of OECD Members (there is no mention of their rights) under the Fund Agreement.

13. The need for compatibility between the MAI transfer provisions and the functioning of the Fund calls for close co-operation between a MAI Parties Group and the International Monetary Fund. Accordingly, a two-stage process could be envisaged in which the Fund would first give its agreement (by approval or request) for transfer restrictions under normal Fund procedures and, in a second stage, a decision would be taken by the MAI Parties Group on whether those restrictions should apply in derogation from the transfer provisions of the MAI.

14. These procedures would provide the Fund with authority to pursue its objectives, which are largely compatible with those of the MAI. At the same time, it would ensure that investment interests were specifically considered before authorising payment restrictions otherwise incompatible with the MAI.

15. Recourse to the derogation provisions could also be made subject to safeguards such as those in GATS and NAFTA, e.g. non-discrimination, avoidance of unnecessary damage to the interests of other parties, not exceeding what is necessary to meet the balance of payments problem. Moreover, certain transfers, such as for compensation in the event of expropriation, could be excluded altogether from the right to derogate.

Questions:

- a. *How should compatibility between the MAI and the IMF Agreement be best achieved? Do existing agreements, such as the GATS, provide a useful model or should other solutions be considered?*
- b. *Should the MAI provide a derogation for transfer restrictions under a two-stage process whereby the IMF would authorise (requests or approves) the restrictions under its normal procedures and a MAI Parties Group would decide whether to allow a derogation to the MAI transfer provisions?*
- c. *Where derogation is permitted, should safeguards be specified (e.g. non-discrimination, avoidance of unnecessary damage to the interests of other parties, not exceeding what is necessary to meet the balance of payments problem)?*
- d. *Should recourse to the derogation provision be excluded for certain transfers, such as transfers of compensation for expropriation?*

⁷ The IMF staff's specific proposal will be included in a written statement, which will be circulated before the September meeting of the Negotiating Group.

Annex

Extract from the GATS

Article XI

Payments and Transfers

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.
2. Nothing in this Agreement shall affect the rights and obligations of the members of the International Monetary Fund 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.

Article XII

Restrictions to Safeguard the Balance of Payments

1. In the event of serious balance-of-payments and external financial difficulties or threat thereof, a Member may adopt or maintain restrictions on trade in services on which it has undertaken specific commitments, including on payments or transfers for transactions related to such commitments. It is recognised that particular pressures on the balance of payments of a Member in the process of economic development or economic transition may necessitate the use of restrictions to ensure, *inter alia*, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development or economic transition.
2. The restrictions referred to in paragraph 1:
 - (a) shall not discriminate among Members;
 - (b) shall be consistent with the Articles of Agreement of the International Monetary Fund;
 - (c) shall avoid unnecessary damage to the commercial, economic and financial interests of any other Member;
 - (d) shall not exceed those necessary to deal with the circumstances described in paragraph 1;
 - (e) shall be temporary and be phased out progressively as the situation specified in paragraph 1 improves.
3. In determining the incidence of such restrictions, Members may give priority to the supply of services which are more essential to their economic or development programmes. However, such restrictions shall not be adopted or maintained for the purpose of protecting a particular service sector.

4. Any restrictions adopted or maintained under paragraph 1, or any changes therein, shall be promptly notified to the General Council.

5. (a) Members applying the provisions of this Article shall consult promptly with the Committee on Balance-of-Payments Restrictions on restrictions adopted under this Article.

(b) The Ministerial Conference shall establish procedures⁸ for periodic consultations with the objective of enabling such recommendations to be made to the Member concerned as it may deem appropriate.

(c) Such consultations shall assess the balance-of-payment situation of the Member concerned and the restrictions adopted or maintained under this Article, taking into account, *inter alia*, such factors as:

- (i) the nature and extent of the balance-of-payments and the external financial difficulties;
- (ii) the external economic and trading environment of the consulting Member;
- (iii) alternative corrective measures which may be available.

(d) The consultations shall address the compliance of any restrictions with paragraph 2, in particular the progressive phaseout of restrictions in accordance with paragraph 2(e).

(e) In such consultations, all findings of statistical and other facts presented by the International Monetary Fund relating to foreign exchange, monetary reserves and balance of payments, shall be accepted and conclusions shall be based on the assessment by the Fund of the balance-of-payments and the external financial situation of the consulting Member.

6. If a Member which is not a member of the International Monetary Fund wishes to apply the provisions of this Article, the Ministerial Conference shall establish a review procedure and any other procedures necessary.

8 It is understood that the procedures under paragraph 5 shall be the same as the GATT 1994 procedures.