I. INTRODUCTION

The United States recently signed separate Free Trade Agreements (FTA’s) with Singapore and Chile. The agreements contain similar chapters on investment rules. These chapters seek to increase investment between the signatories through the articulation of strong disciplines, including by providing for free transfers of funds related to covered investments. This is a laudable goal insofar as increased trade and investment flows can be beneficial and clear rules on transfers prevent arbitrary administration of exchange transactions. Nonetheless, the FTA’s blanket prohibitions on capital restrictions, even in the context of an economic and financial crisis, raises concerns about the ability of signatories to manage macroeconomic imbalances and consistency with the work of the International Monetary Fund (IMF). Furthermore, the “cooling off” provisions of the dispute resolution provisions—while innovative—are not a substitute for clear legal rules on a balance of payments safeguard and consistency within the IMF Articles of Agreement. This note discusses how the rules of these investment chapters overlap with the law and work of the IMF, particularly in the context of managing economic and financial crises that affect its membership and the international community writ large.1

II. INCREASED PROMINENCE OF INVESTMENT AGREEMENTS

While the investment rules covered in these FTA's are similar in many respects to the disciplines contained in Bilateral Investment Agreements (BIT's), it is significant that they are not stand-alone BIT's. The FTA's in which they are included necessarily cover a range of commercial transactions that is broader than BIT's. Indeed, in order to be consistent with the most favored nation requirement of the WTO Agreements, the FTA's are required to cover "substantially all trade" (General Agreement on Tariffs and Trade (GATT), Article XXIV.) Thus, these agreements are likely to have significantly more impact in increasing commercial activity between the parties than would a stand-alone BIT.

Use of investment agreements for a wide range of transactions has already begun to expand. Traditional BIT's include a broad definition of investment that allows for evolving coverage of new instruments even though they originally focused in practice on foreign direct investment and (somewhat later) financial instruments associated with an enterprise. Depending on the text of the agreements, investors in "hot money" transactions (e.g., high yield overnight deposits and other derivative financial products) could seek protections of the investment rules. Two features of the recent FTA's accentuate this phenomenon—their public notoriety and their explicit coverage of various financial products as investments. It is possible that this visibility will attract speculative capital flows more than under a traditional BIT, as well as legal action under the investor-state arbitration rules should recourse to capital controls or other measures arise in the context of economic or financial sector crises.

An increasing number of regional or bilateral agreements are including chapters with investment rules. The United States has stated, moreover, that it intends to "raise the bar" in terms of scope and level of commitment in such agreements. Still, recent experience has highlighted the unexpected nature of economic and financial crises. Thus, even for relatively stable countries like Singapore and Chile, the potential liability associated with the prohibition on any exchange controls, even temporary controls in the context of a crisis, is worrisome. To the extent that these provisions serve as models for future agreements with higher risk countries, this concern is more pronounced and could potentially interfere with the support that the international community expects from the IMF.

III. IMF MANDATE ON RELATED MATTERS

The rules in investment agreements overlap with the mandate of the IMF in several ways. Although the Fund is best known for its financing function, it also has important regulatory powers. The purposes of the IMF include promoting international monetary cooperation and assisting in the establishment
of a multilateral system of payments in respect of current international transactions (IMF Articles of Agreement, Article I, paragraphs (i) and (iv)). To this end, members are prohibited from imposing restrictions on the making of payments and transfers for current international transactions without the approval of the IMF (Article VIII, Section 2(a)), with a limited exception related to restrictions existing at the time the country joined the IMF (Article XIV). This area of the IMF’s mandate constitutes the IMF’s jurisdiction; refraining from such restrictions constitutes an obligation of members, for which they could be subject to sanctions from the IMF. The Fund may also ask a member to restrict capital transfers.

The overlap between the investment chapters’ and the Fund’s jurisdiction extends beyond the FTA’s coverage of current account payments and transfers (e.g., interest and dividends). The definition in the IMF Articles of “current international transactions” is not limited to the prevalent concept of payments and transfers for trade in goods and services, but extends to transactions covered in the investment agreements that would be considered “capital” in other contexts. Such transactions include moderate amounts for amortization of principal on debt instruments and for depreciation of direct investments (Article XXX(d)).

The IMF Articles authorize the IMF to “approve” restrictions on payments and transfers for current international transactions that are subject to its jurisdiction when these restrictions are needed for balance of payments reasons. This power in the Articles reflects the recognition of the membership that it may be necessary to impose restrictions in times of severe balance of payments crisis. The IMF has established policies on criteria for approval of restrictions which require, besides that these restrictions be necessary for balance of payments reasons, that they refrain from discriminating among IMF members and be temporary; approval is usually for one year. Restrictions imposed for national security reasons are subject to a separate approval procedure (Decision 144-(52/51)).

Management of the capital account and the control of the outflow of foreign exchange is, of course, also important in the IMF’s financing function. Another purpose of the IMF is to make available temporary balance of payments financing in times of balance of payments difficulties and in support of programs of macroeconomic stabilization and structural reform (Article I, paragraph (v)). The availability of IMF resources normally plays a catalytic role for financing from the rest of the international community.

Financing alone is rarely a solution, however, and indeed may not stop the hemorrhaging associated with an economic and financial crisis. Thus, in cases of severe balance of payments crisis, it may be necessary for the country to impose exchange restrictions on a temporary basis to safeguard its balance of payments. Nonetheless, the IMF’s discussions with the member will focus on
the fact that the circumstances giving rise to the crisis will normally require the member to adjust its underlying economic policies over the medium or long term. This understanding will be reflected in the conditionality associated with the IMF's financial support. However, even if adjustment measures are undertaken immediately (and others will take time to implement) they are unlikely to have their intended effect right away. Thus, should a circumstance arise where it is appropriate for the member to impose exchange restrictions, the key point is the temporary nature of such restrictions, as prolonged reliance on restrictions will both delay recovery and make the implementation of the necessary reforms more painful.

There are three key provisions in the IMF Articles relevant to the potential for temporary restrictions on foreign exchange outflows. The first is Article VIII, Section 2(a) which, as noted above, contemplates approval for restrictions on payments and transfers for current international transactions (as defined under Article XXX(d)). The approval function under Article VIII, Section 2(a) is not limited to countries receiving Fund financing and serves as an exception to the obligation to refrain from such restrictions.

The other two provisions related to the possible imposition of restrictions on foreign exchange outflows are contained in Article VI of the IMF Articles of Agreement. Under Section 3, restrictions imposed on capital transactions do not require the IMF's approval. However, according to Section 1 of that Article, under a provision designed to safeguard its resources, the IMF may "request" that a member using IMF resources impose capital controls to prevent a large or sustained outflow of capital. The scope of this latter provision is broad in the sense that it applies to any capital outflow; in other words, it is not limited to the payments and transfers for capital transactions defined as "current" in Article XXX(d). The legal status of the request is not an obligation. The member is not required to impose the restrictions or be faced with breach of obligation; rather the request is a condition for Fund financing, in that failure to comply could lead to a declaration of ineligibility to use Fund resources.

The IMF's surveillance function also comprises the review of a member's capital account policies. Under Article IV of its Articles, the IMF exercises surveillance over members' economic, financial, and exchange rate policies. Conducting surveillance is an obligation of the Fund, as well as of the member. Surveillance involves comprehensive discussions of each member's economic policies as well as member's exchange and payments system, especially with a view to the effect on its exchange rate. IMF surveillance has given increasing attention to capital account issues, as capital flows are increasingly important means of allocating savings, promoting growth, and facilitating balance of payments adjustment. Capital account restrictions may also feature surveillance in any case where a country's use of capital restrictions is directed at attempting to support inappropriate exchange rate policies.
IV. PROBLEMS WITH INCONSISTENT APPROACHES

The absence in either of the two FTA's of a balance of payments safeguard or a reference to consistency with the IMF's Articles raises important concerns with respect to the work of the Fund.

First, from a jurisdictional perspective, the FTA's could give rise to inconsistent rights and obligations vis-à-vis the IMF Articles of Agreement. To the extent that an FTA covers transactions that would be defined as "current" payments and transfers under the IMF's Articles (Article XXX(d)), they overlap with IMF jurisdiction under Article VIII, Section 2(a). For example, the FTA's require the signatories to permit transfers comprising dividends, interest, royalty payments, management and other fees, payments made under a contract entered into by the investor or the covered investor, including payments (e.g., amortization) made pursuant to a loan agreement, which would all be subject to the IMF's jurisdiction.

In the event of a financial crisis in which the signatory may be forced to impose restrictions, it may consider restrictions on countries that are not FTA signatories, in order to avoid acting inconsistently with the FTA prohibitions. But, restrictions on payments and transfers for current international transactions are subject to approval by the IMF and one condition for such approval is nondiscrimination among members of the Fund. Because a restriction by an FTA country against non-FTA countries would discriminate among the Fund's membership, it could not be approved under the IMF's policies and would therefore be inconsistent with the member's obligations under Article VIII, Section 2(a).

Conversely, the parties to the FTA agreement could be subject to inconsistent treaty provisions if a restriction were approved by the IMF but were not permitted under the FTA agreement. This could happen if the FTA does not permit an IMF member to exercise its right to impose a restriction that is consistent with the Fund's Articles (e.g., one approved under Article VIII, Section 2(a) or maintained under Article XIV). This inconsistency could be avoided in treaty drafting. For example, when the work of the World Trade Organization was expanded to include service transactions, the General Agreement on Trade in Services (GATS), was drafted to include exceptions to the transfer obligation for measures imposed consistently with the IMF's Articles.

Second, the absence of a balance of payments safeguard is particularly striking in view of the IMF's financing function. Because of Article VI, Section 1 of the Fund's Articles described above, the FTA's create a risk that in complying with its obligations under the FTA, a member could be rendered ineligible to use the Fund's resources under the Fund's Articles. Chile and
Singapore are relatively mature markets with a solid record of macroeconomic and financial sector management and, given the availability of more sophisticated and less costly policy tools, are unlikely to resort to capital control measures. Nonetheless, despite improvements in crisis prevention analysis, a risk remains that economic and financial crises may emerge in countries where they are not anticipated. Moreover, given that these provisions are likely to serve as models for future agreements, the implications are different for other emerging and developing countries with limited capacity to absorb balance of payments or financial system shocks.

A precedent for including a balance of payments safeguard in an FTA is found in the North American Free Trade Agreement (NAFTA, among the United States, Canada, and Mexico), and in the investment context specifically, in the draft Multilateral Agreement on Investment negotiated (but not concluded) under the aegis of the OECD. The GATT and the GATS also include safeguard provisions calling for consultation with the IMF. While employing different styles, these agreements address the problem by balancing authority to impose controls in appropriate circumstances with disciplines on their duration and rules such as nondiscrimination. Furthermore, in order to ensure consistency between those treaties and the work of the IMF, the GATS (Article XI) acknowledges the authority of the IMF to make a request for a member to impose capital controls, although the Fund has never found it necessary to do so in practice. The GATS rules providing for unrestricted payments and transfers related to the covered services were written to expressly exclude controls imposed at the “request” of the IMF—a reference to Article VI, Section 1 of the IMF’s Articles.

Third, the pressure on an FTA signatory to accept the draconian provisions in the style of the Chile and Singapore investment chapters in order to conclude the FTA may also be counterproductive in the context of the IMF’s surveillance function. Surveillance serves as a key instrument in the IMF’s ongoing dialog with members in the evolution of their macroeconomic and exchange rate policies and may include the pace and sequencing of liberalization of the economy. These comprehensive consultations serve an important role in crisis prevention analysis. Importantly, this discussion takes place in the context of the member’s overall macroeconomic environment rather than the more limited market opening perspective that tends to drive bilateral trade and investment agreements.

Another speaker at this conference proffered the “cooling off” period provided in the dispute settlement provisions of the two FTA’s in response to these potential inconsistencies. While a detailed discussion of the dispute settlement rules are beyond the scope of this article, the key point is that a signatory country could still be held liable to investors for even temporary restrictions that were imposed in connection with resolution of an economic and
financial crises. The "cooling off" period delays when a claim may be initiated, but the treaty continues to hold the signatory liable if a panel determines that any restrictions imposed "substantially impede transfers" and the liability applies retroactively even if the restrictions have subsequently been removed. A helpful, but not dispositive, discussion of this standard is contained in a letter from United States Under Secretary for International Affairs, John B. Taylor to the Managing Director of Singapore's Monetary Authority, Köh Yong Guan (reportedly available on the USTR website). This letter articulates the United States government's agreement to a "rebuttable presumption" that certain forms and effects of restrictions "will be deemed not to substantially impede transfers" including, for example, that the controls be nondiscriminatory. Nonetheless, this letter does not bind panels, is likely to be ignored by investors bringing claims under the investor-state arbitration, and does not fully address the point that restrictions may indeed need to have substantial effects in order to serve their purpose.

V. CONCLUSIONS

The provisions in the United States-Chile and United States-Singapore FTA's that disregard potential need for a temporary safeguard and the related role of the IMF are unnecessarily severe in that the contrary approach would not detract from the goals of these investment agreements. When the potential for exchange restrictions arises, the IMF does not treat the restrictions as a solution to the problem; rather, it is based on the recognition that the restrictions may be necessary as a temporary matter while adjustment measures have a chance to have their intended effect. Indeed, the general obligations under IMF jurisdiction are to refrain from exchange restrictions and to the extent that such restrictions are approved, IMF policy requires them to be temporary and nondiscriminatory. As reflected in conditionality accompanying its financial support, the IMF policies recognize that over the longer term, the external environment that necessitated restricting the outflow of foreign exchange will usually require the member to adapt by introducing corrective macroeconomic and, in some cases, structural reforms, rather than relying on exchange controls.

Other international treaties serve as useful models of agreements that take these issues into account. Both the GATT and the GATS contain a balance of payments safeguard in similar form as well as a deference to IMF jurisdiction (GATT, Articles XII, XV, and XVIII; GATS, Articles XI and XII). The draft MAI did so at the time that negotiations were terminated for other reasons (Draft MAI, Section IV). These provisions were accepted by the United States. An alternative approach is represented by NAFTA, which, like the FTA's, is not a multilateral agreement. Given the increased prominence of investment agreements and their inclusion in FTA's, as well as the importance of the issues
to the international community, a meaningful dialog with the IMF and its staff should be encouraged in order to ensure consideration of the issues in a broader context than bilateral market access negotiations.