

**COMMUNICATION FROM THE EUROPEAN COMMUNITY  
AND ITS MEMBER STATES**

The following communication, dated 27 November 2002, has been received from the Permanent Delegation of the European Commission.

**CONCEPT PAPER ON BALANCE-OF-PAYMENTS SAFEGUARDS**

*This concept paper is intended as a contribution for discussion of the balance-of-payments safeguards that could be included in an Investment for Development Framework. The general proposals it contains should not be read as a text proposal.*

**I. INTRODUCTION**

1. Paragraph 22 of the Doha Ministerial Declaration mentions “exceptions and balance of payments safeguards” among the issues to be clarified by the Working Group on the Relationship between Trade and Investment (WGTI), in the period until the Fifth Ministerial Conference. Specific discussions on these topics have started at the last meeting of the WGTI on 16-18 September. As a further contribution to these discussions, this paper will focus on Balance of Payments safeguards. We have already dealt with the possible exceptions of an Investment for Development Framework (IDF) in our previous documents WT/WGTI/W/110 on transparency provisions, WT/WGTI/W/122 on non-discrimination and WT/WGTI/W/140 on development provisions.

2. As in the GATT and in the GATS, the EC considers that a future IDF should include the possibility for members to take safeguard measures in case of BOP crises. This kind of safeguard clause is particularly important for developing countries, whose financial system may be more fragile and exposed to instability. In our view any safeguard measure should be taken in exceptional circumstances, in a non-discriminatory manner, in full compliance with the Articles of Agreement of the IMF, for a limited period of time and must not go beyond what is necessary to address the BOP crisis. They should also be notified to the WTO, and subject to effective, multilateral review, to be carried out in co-ordination between the WTO and the IMF.

3. A limitation on the inflow of capital does not necessarily lead to a direct improvement in the BOP situation of the country that adopts such a measure. Indeed, inflows of foreign capital may often make a positive contribution to the BOP situation in a country. This paper will focus on the BOP safeguard measures that could be allowed in an IDF.

## II. WHAT IS A BOP CRISIS?

4. An unsustainable BOP situation in a given country may arise for a number of reasons and risks becoming a BOP crisis<sup>1</sup>. One example of an unsustainable current account position is when the current account is in deficit, and the net imports of goods and services cannot be financed with a sufficient inflow of foreign capital or a reduction in foreign reserves. This may lead to an unsustainable BOP situation. The policy options available to the affected country include improving the current account, for instance by expanding exports or restricting imports (provided these restrictions are compatible with its international obligations and preferably not counterproductive in terms of future developmental objectives), or improving the capital account by encouraging capital inflows. The latter may be achieved by attracting more FDI or portfolio inflows. Borrowing, if sustainable in terms of future interest and capital repayments, from foreign banks, governments or international institutions is another policy option. Countries may also need to consider adjustments to their monetary and exchange rate policies.

5. In seeking to avoid serious BOP difficulties governments have sometimes taken restrictive measures on current transfers as well as on capital movements. However, such mechanisms involve costs and can introduce distortions for the country imposing them. Their adoption, or even threats of their adoption, can also provoke capital flight if investors want to “get out while they can”. A future IDF covering FDI would necessarily have to preserve a possibility for safeguards although within well-defined and internationally accepted criteria.

## III. RELEVANT PROVISIONS IN THE TREATY OF THE EUROPEAN COMMUNITY

6. The relevant Treaty provisions governing the freedom of payments and capital movements are enshrined in Articles 56 to 60 (formerly Articles 73b to 73h of the EC Treaty). In particular, Article 56 provides that all restrictions on the movement of capital and on payments between Member States and between Member States and third countries shall be prohibited.

7. Restrictive measures can only be taken in exceptional circumstances, such as serious difficulties for the operation of the monetary union (Article 59)<sup>2</sup> or balance of payments difficulties (Articles 119, 120)<sup>3</sup>.

---

<sup>1</sup> A key issue is to seek to understand what has led to the unsustainable position and to assess whether the relevant factors are temporary or permanent phenomena.

<sup>2</sup> Article 59

Where, in exceptional circumstances, movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of economic and monetary union, the Council, acting by a qualified majority on a proposal from the Commission and after consulting the ECB, may take safeguard measures with regard to third countries for a period not exceeding six months if such measures are strictly necessary.

<sup>3</sup>Article 119

1. Where a Member State is in difficulties or is seriously threatened with difficulties as regards its balance of payments either as a result of an overall disequilibrium in its balance of payments, or as a result of the type of currency at its disposal, and where such difficulties are liable in particular to jeopardise the functioning of the common market or the progressive implementation of the common commercial policy, the Commission shall immediately investigate the position of the State in question and the action which, making use of all the means at its disposal, that State has taken or may take in accordance with the provisions of this Treaty. The Commission shall state what measures it recommends the State concerned to take.

If the action taken by a Member State and the measures suggested by the Commission do not prove sufficient to overcome the difficulties which have arisen or which threaten, the Commission shall, after consulting the Committee referred to in Article 114, recommend to the Council the granting of mutual assistance and appropriate methods therefore. (...)

2. The Council, acting by a qualified majority, shall grant such mutual assistance; it shall adopt directives or decisions laying down the conditions and details of such assistance, which may take such forms as:

#### IV. FREEDOM OF TRANSFERS IN INTERNATIONAL INVESTMENT AGREEMENTS

8. Most international investment agreements include provisions that guarantee the freedom of the current payments (profits, dividends, etc.) and capital movements related to the investment covered by the agreement. This reflects the importance for foreign investors of being able to transfer from the host country the income produced by their investment as well as, in case of liquidation of their undertaking, the value of their investment. This essential guarantee is generally included in most Bilateral Treaties on protection and promotion of Investment (i.e. BITs) as well as in those Free Trade Agreements that include provisions on services and investment.

9. As discussions in this working group have often confirmed, most BITs do not include binding obligations on the admission of investments. They mainly protect investments already made in accordance with the laws of the host country. Thus, the transfer obligations included in these agreements often do not cover those transactions that are necessary to make new investments, but only those transactions necessary for the repatriation of profits (including returns, dividends, royalties, etc.), for the development of an existing investment and for the liquidation of the capital related to existing investments.

10. Beyond providing for the free transfer of current payments, other agreements which include rules on the admission of investment also require the parties, explicitly or implicitly, to ensure the capital transfers necessary for the making of new investments. For instance, GATS Article XI:1 requires members to ensure current payments relating to their specific commitments, and GATS Article XVI footnote 8 provides that when a member takes a market access commitment on mode 3 (commercial presence, i.e. FDI) it shall also ensure the related transfer of capital into its territory. The OECD Codes<sup>4</sup> also require members to allow the free transfer of current payments (profits, dividends, etc) related to a covered investment as well as the capital movements needed for the making, the development and the liquidation of the investment.

11. Although the IMF Articles of Agreement are not an investment agreement as such, they regulate an important component associated with international investment flows. As a general rule every IMF member is required to allow all international current payments and transactions to non-residents<sup>5</sup>. This includes the repatriation in convertible currency of all income arising from foreign investments. However, the IMF may allow a member “to maintain and adapt to changing circumstances the restrictions on payments and transfers for current international transactions that were in effect on the date on which it became a member”<sup>6</sup>.

- 
- (a) a concerted approach to or within any other international organisations to which Member States may have recourse;
  - (b) measures needed to avoid deflection of trade where the State which is in difficulties maintains or reintroduces quantitative restrictions against third countries;
  - (c) the granting of limited credits by other Member States, subject to their agreement. (...)

#### Article 120

1. Where a sudden crisis in the balance of payments occurs and a decision within the meaning of Article 119(2) is not immediately taken, the Member State concerned may, as a precaution, take the necessary protective measures. Such measures must cause the least possible disturbance in the functioning of the common market and must not be wider in scope than is strictly necessary to remedy the sudden difficulties which have arisen. (...)

<sup>4</sup> OECD Code of liberalisation of capital movements and the Code of liberalisation of current invisible operations.

<sup>5</sup> Article VIII.

<sup>6</sup> Article XIV section 2.

## V. EXISTING BOP SAFEGUARDS IN INTERNATIONAL AGREEMENTS

12. It has been noted that most BITs do not include explicit BOP safeguards. However, some recent bilateral and regional agreements, such as the NAFTA, allow restrictions on capital movements in cases where a Party “experiences serious balance of payments difficulties, or the threat thereof...”<sup>7</sup>.

13. The OECD Codes, Article 7 (c), provide that members may temporarily suspend their measures of liberalisation “if the overall balance of payments of a member develops adversely at a rate and in circumstances, including the state of its monetary reserves, which it considers serious...”.

14. GATS Article XII also allows members to adopt or maintain restrictions on payments or transfers for transactions related to its commitments “in the event of serious balance-of-payments and external financial difficulties or threat thereof”. The GATS also takes account of the need of members in the process of economic development and economies in transition to maintain a level of financial reserves adequate for the implementation of economic development programmes.

15. The common features of most BOP safeguards is that restrictions should: be taken in a non-discriminatory manner; be applied for a limited period of time; and be consistent with the IMF provisions.

16. Under the IMF Articles of Agreement, beyond the requirement for members to obtain approval to maintain existing restrictions on current payments and transfers, members may be allowed to take special exchange measures, including restrictions on current transactions for BOP reasons. These measures are usually included in the framework of actions aimed at providing “temporary financial assistance to countries under adequate safeguards to help ease balance of payments adjustment”<sup>8</sup>.

## VI. CONCLUSION

17. In light of the existing provisions discussed above, on transfers and BOP safeguards, a future IDF in our view should provide:

- as a general rule, that members allow: all current and capital transfers related to established investments, and; as far as the making of new investments is concerned, all current and capital transfers related to those investments covered by the countries’ sectoral list of commitments.
- as an exception, a safeguard clause to preserve members in case of serious BOP difficulties. This provision should allow temporary restrictions on the outflows of current and capital transfers related to those investments covered in the IDF.

18. As explained in the Note by the WTO Secretariat on Development Provisions<sup>9</sup>, a safeguard provision allowing the imposition of investment restrictions for BOP reasons is an example of “escape

---

<sup>7</sup> Article 2104.

<sup>8</sup> “A main function of the IMF is to provide loans to countries experiencing balance-of-payments problems so that they can restore conditions for sustainable economic growth. The financial assistance provided by the IMF enables countries to rebuild their international reserves, stabilize their currencies, and continue paying for imports without having to impose trade restrictions or capital controls”.

*Stand-By Arrangements (SBA)*. The SBA is designed to address short-term balance-of-payments problems and is the most widely used facility of the IMF. The length of a SBA is typically 12–18 months.

*Extended Fund Facility (EFF)*. This facility was established in 1974 to help countries address more protracted balance-of-payments problems with roots in the structure of the economy. Arrangements under the EFF are thus longer (3 years).

<http://www.imf.org>.

<sup>9</sup> WT/WGTI/W/119, paragraph 48.

clause” particularly relevant for developing countries. In any case, a BOP safeguard clause, which allows members to take restrictive measures should only be allowed under exceptional circumstances, it should be clearly defined and include strict criteria. For instance, in our view, restrictions should:

- be non-discriminatory;
- be consistent with other relevant international provisions;
- be limited in time and phased out progressively;
- be applied in a way that does not exceed what is necessary to deal with the sudden difficulties;
- avoid unnecessary damages to the interests of other members;
- not be used to justify measures adopted to protect specific industries or sectors.

19. As in the GATT and in the GATS, specific procedures should be included concerning notification, review and consultations within the WTO and with other fora as appropriate.

20. We look forward to hearing other members’ views on these and other possible options available to address the question of BOP safeguards in the context of an Investment for Development Framework.

---