

# Capital Account Regulations and the Trading System

**Kevin P. Gallagher**

Global Economic Governance Initiative

Boston University

[kpg@bu.edu](mailto:kpg@bu.edu)

[www.bu.edu/gegi](http://www.bu.edu/gegi)

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PARDEE CENTER TASK FORCE REPORT

**BOSTON  
UNIVERSITY**

Boston University The Frederick S. Pardee Center  
for the Study of the Longer-Range Future

Regulating Global  
Capital Flows for  
Long-Run Development

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Capital Account Regulations  
and the Trading System:  
A Compatibility Review

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# Four Points

- Regulating capital flows is justified now more than ever.
- WTO commitments legally make it harder to regulate, but there are safeguards and an implicit 'peace clause.'
- Fundamental incompatibility between many FTAs and BITS with the ability to regulate capital flows: no safeguards, and no 'peace clause'.
- Urgent need of reform of FTAs and BITS.

# Reasons to Regulate Capital Flows

- Manage the ‘trilemma’ (Mundell-Fleming)
- Mobilize domestic finance (Lewis-Prebisch; **China, Vietnam**)
- Transition/sequence ‘capital account liberalization’ (IMF, **India, China**)
- Regulate inflows to stem ‘financial amplification effects’ of surges in short-term inflows (Ocampo, French-Davis, Stiglitz, **Korinek, Rey**, IMF, G-20, **Brazil, South Korea, Indonesia, Uruguay, Taiwan, Thailand**)
- Regulate outflows to stem ‘sudden stops’ and balance-of-payments problems (Calvo, IMF, G-20, **Malaysia, Iceland, Ukraine, India**)

# Do you know where your trade minister is?

## Policy Space for Managing Capital Flows in the Trade Regime

	<u>WTO*</u>	<u>US FTAs-BITS</u>
Trilemma	no	no
Resource mobilization	no	no
Capital Account Sequencing	no	no
Surges/Dilemma	maybe	no
BOP problem	yes	no

\*if a country has 'listed' the liberalization of cross-border financial services

# Comparing WTO and US Treaties

## WTO-GATS

- Covers only 'financial services'
- Positive 'list'
- Prudential safeguards
- BOP safeguard
- State-to-State dispute settlement
- *'peace clause'?*

## US FTAs and BITS

- Covers **all** cross-border transfers and investment
- **Negative** 'list'
- **Restricted** Prudential exception
- **No** BOP safeguard
- **Investor**-state dispute settlement

# GATS and Cross-Border Financial Regulation

- (Article XVI: footnote 8 GATS): WTO members must allow cross-border (inward and outward) movements of capital if these are an essential part of a service for which they have made commitments.

## Most Vulnerable to Actions Against Regulating Capital Flows Under GATS

Argentina	Japan	Panama
Australia	Kuwait	Philippines
Bahrain	Kyrgyz Republic	Qatar
Canada	Latvia	Romania
Ecuador	Macau	Sierra Leone
Estonia	Malawi	Singapore
Gabon	Mauritius	Solomon Islands
Gambia	Mongolia	South Africa
Hong Kong	Mozambique	Switzerland
Hungary	New Zealand	Tunisia
Iceland	Nigeria	Turkey
Indonesia	Norway	United Arab Emirates
		USA

## Nations with Most Policy Space to Regulate Capital Flows - WTO

Afghanistan	Guinea-Bissau	Papua New Guinea
Algeria	Guyana	Paraguay
Angola	Haiti	Russian Federation
Antigua and Barbuda	India	Rwanda
Bahamas	Iran, Islamic Republic of	St. Kitts and Nevis
Barbados	Iraq	St. Lucia
Belarus	Kenya	St. Vincent and the Grenadines
Belize	Kiribati	Samoa
Benin	Kosovo	San Marino
Bhutan	Lao People's Democratic Republic	São Tomé and Príncipe
Bosnia and Herzegovina	Lebanon	Saudi Arabia
Botswana	Lesotho	Serbia
Brazil	Liberia	Seychelles
Brunei Darussalam	Libyan Arab Jamahiriya	Slovenia
Burkina Faso	Macedonia	Somalia
Burundi	Madagascar	Sudan
Cambodia	Malaysia	Suriname
Cape Verde	Maldives	Swaziland
Central African Republic	Mali	Syrian Arab Republic
Chad	Malta	Tajikistan
China	Marshall Islands	Tanzania
Comoros	Mauritania	Thailand
Côte d'Ivoire	Micronesia	Timor-Leste
Cyprus	Montenegro	Togo
Djibouti	Myanmar	Tonga
Dominica	Namibia	Turkmenistan
Equatorial Guinea	Nepal	Uganda
Eritrea	Niger	Uzbekistan
Ethiopia	Pakistan	Vanuatu
Fiji	Palau	Venezuela,
Gabon		Vietnam
Ghana		Yemen, Republic of
Guinea		Zambia
		Zimbabwe

# US FTAs and BITs

- Covers all cross-border transfers and investment
- Negative 'list'
- Restricted Prudential exception\*
- No BOP safeguard
- Investor-state dispute settlement

# Most Vulnerable to Actions Related to Regulating Border Finance US FTA-BITS

## Ratified

## Pending

## TIFA (Selected)

Chile  
Colombia  
Costa Rica  
Dominican Republic  
El Salvador  
Guatemala  
Honduras  
Jordan  
Mexico  
Morocco  
Nicaragua  
Oman  
Panama  
Peru  
Singapore  
Uruguay

Brunei  
Malaysia  
Vietnam  
India  
China

Angola  
Algeria  
Bahrain  
Brazil  
Georgia  
Indonesia  
Iceland  
Kuwait  
Liberia  
Mauritius  
Mozambique  
Nepal  
Pakistan  
Sri Lanka  
Thailand  
South Africa

# US Prudential Exception

- 1. Notwithstanding any other provision of this Chapter or Chapter Ten (Investment), Fourteen (Telecommunications), or Fifteen (Electronic Commerce), including specifically Articles 14.16 (Relationship to Other Chapters), and 11.1 (Scope and Coverage) with respect to the supply of financial services in the territory of a Party by a covered investment, a Party shall not be prevented from adopting or maintaining measures for **prudential reasons**,\* including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service supplier, or to ensure the integrity and stability of the financial system. *Where such measures do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party's commitments or obligations under such provisions.*
- \*It is understood that the term “**prudential reasons**” includes the maintenance of the safety, soundness, integrity, or financial responsibility of **individual** financial institutions or cross-border financial service suppliers.

# IMF on Capital Controls and Trading System

- **these agreements in many cases do not provide appropriate safeguards or proper sequencing of liberalization**, and could thus **benefit from reform** to include these protections (IMF 2012a, 8).”

- “In particular, the proposed institutional view could help foster a more consistent approach to the design of policy space for CFMs under bilateral and regional agreements. Recognizing the macroeconomic, IMS, and global stability goals that underpin the institutional view, **members drafting such agreements in the future, as well as the various international bodies that promote these agreements, could take into account this view in designing the circumstances under which both inflows and outflows CFMs may be imposed within the scope of their agreements (IMF 2012b, 33).**

*International Monetary Fund (2012a), Liberalizing Capital Flows and Managing Outflows, Washington, IMF.*

*International Monetary Fund (2012b), The Liberalization and Management of Capital Flows: An Institutional View, Washington, IMF.*

# Policy Issues

- Policies to sequence liberalization, and prevent and mitigate financial crises are forbidden in large parts of trading system.
- Creates incentives to circumvent controls through US and EU banks.
- Problems with overlapping regimes and jurisdictions—IMF vs. trading commitments.
- No ‘diplomatic screen’ because of investor-state dispute resolution.

# Reform

- Refrain from taking on new commitments in regimes incompatible with the ability to regulate (Brazil).
- Withdraw from existing commitments (South Africa, Ecuador)
- Adopt ‘interpretations’ of existing treaty language (Ecuador-WTO), US Congress-FTAs-BITs).
- Amend existing treaties to reconcile current incompatibilities (EU).
- Design new rules for future treaties (Chile/Malaysia, US Congress).
- India? China?

**THANK YOU!**

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# GATS-BOP Exception

## 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 recognized 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.

# GATS: Annex on Financial Services

- **Article 2 (a)**: Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for **prudential reasons**, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system.  
*Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.*

# 'Cooling Off': Special Dispute Settlement Provisions

1. Where a claimant submits a claim to arbitration alleging that a Party other than the United States has breached an obligation under Section A, other than Article 10.3 or 10.4, through the imposition of a restrictive measure with regard to payments and transfers, Section B shall apply, except as follows:

(a) The claimant **may not submit any such claim to arbitration until one year after the events** that give rise to the claim .

(b) Loss or damages arising from the restrictive measure on capital inflows shall be limited to the reduction in value of the transfers and shall exclude loss of profits or business and any similar consequential or incidental damages.

(d) If the measure restricts **outward** payments or transfers:

(i) it shall not prevent investors from earning a **market rate of return** in the territory of the Party imposing the measure on any restricted assets;

(ii) the Party imposing the measure shall afford investors a **reasonable opportunity to mitigate any losses** arising from such measure ; and