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#### COMMUNICATION FROM KOREA

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# BALANCE-OF-PAYMENT SAFEGUARD PROVISIONS IN INVESTMENT AGREEMENTS

#### I. INTRODUCTION

- 1. The two main purposes of international investment agreements (IIAs) are to liberalize and to protect foreign investment. However, without the guaranteed free transfer of funds associated with foreign investment, the liberalization of foreign investment would be meaningless. The guarantee of free transfer of funds is also closely related to the protection of investment assets. Restrictions imposed on the transfer of profits or proceeds connected with established investment could frustrate the purpose of investment protection.
- 2. On the other hand, it is important for an IIA to strike a balance between a home country's desire to obtain guarantees on the free transfer of investment-related payments and the concerns of a host country about the impact of a sudden repatriation of funds on its balance-of-payments. In this regard, BOP safeguard provisions in IIAs, just like safeguard clauses on trade in goods, function as a buffer in the application of an agreement.
- 3. The BOP safeguard provisions included in IIAs are designed as exemptions from the obligation of allowing the free transfer of payments. In addition, unlike general exceptions arising from such causes as public interest, BOP safeguard provisions are applied on a temporary basis in exceptional situations for BOP purposes. Hence, it would be more appropriate to regard these types of provisions as temporary derogations rather than as exceptions.
- 4. In this context, this submission examines the implications of BOP safeguard provisions in connection with FDI that will contribute to the expansion of trade.

## II. PROVISIONS ON THE FREE TRANSFER OF PAYMENTS

5. The free transfer of payments is not among the seven topics that are listed in Paragraph 22 of the Doha Ministerial Declaration. However, provisions on the free transfer of payments are core elements that must be included in a multilateral investment agreement. From the perspective of a foreign investor, an investment can hardly be considered protected unless the host country has committed itself to permit the free transfer of payments related to the investment in question.

6. Although varying according to IIAs, the provisions generally stipulate that all payments into and out of the host countries related to an investment may be freely transferred without delay at the market rate of exchange prevailing on the date of transfer. Normally included is a list of examples of what types of payments fall under this provision (e.g. the initial capital to make investment, returns, payments of compensation, proceeds from the sale or liquidation of the investment, earnings and other remuneration of personnel, or payments arising out of the settlement of a dispute). In addition, they regulate that transfers can be made in a currency that may be freely used or converted.

#### III. CAPITAL CONTROLS AND FDI

- 7. Capital controls in a BOP crisis include control over the inflow of foreign investment, but more generally, they focus on restrictions placed on the outflow of capital in exceptional circumstances.
- 8. At present when cross-border capital movement, particularly, that of speculative short-term capital, is rapidly increasing, there are circumstances in which temporary reliance on restrictions may be necessary. In this regard, capital controls can provide temporary breathing space to allow a host country to implement required adjustment policies.
- 9. Nevertheless, the effectiveness of capital controls as a policy alternative in case of a BOP crisis remains unclear. A prevailing view is sceptical about their effectiveness, warning of their negative impact on the host country's economy in the long run.
  - Even with the enforcement of capital controls, it would be difficult to completely shield the domestic financial market from the international financial market, given that the private sector, through rapidly developing financial engineering techniques, can find means to circumvent them. In addition, capital controls may be seen as an obstacle that delays the economic restructuring necessary for BOP adjustments, and thus slows overall economic recovery.
  - Moreover, capital controls may also damage market confidence, negatively affecting the host country's economy in the long run.
- 10. A major risk related to capital controls is the possibility that certain negative effects on FDI inflows may occur in the long run due to decreased international confidence in the host country's economy. It is a well-known fact that the inducement of FDI is a critical path to a country facing a BOP crisis as FDI can contribute to rapid economic recovery as well as resumption of development. Meanwhile, capital controls, as a means of responding to a BOP crises, are risky in that they may at worst damage chances of future economic growth.

### IV. BOP SAFEGUARDS IN INTERNATIONAL INVESTMENT AGREEMENTS

- 11. Some IIAs have various forms of exceptional provisions on the free transfer of payments to deal with difficulties in the balance-of-payments or in the level of foreign exchange reserves.
- 12. However, these exception provisions are not found in most BITs. UNCTAD notes that only a very small proportion of the nearly 1,800 bilateral investment treaties in existence specifically allow for temporary BOP derogations. It points out that the absence of balance-of-payments derogation provisions in most bilateral agreements raises the question of whether such provisions are, in fact, entirely inconsistent with the principle of investor protection, which is the main objective of many of these agreements. It can also be explained by the above-stated disadvantages of capital controls, including their lack of effectiveness and negative impact on the host country's economy in the long term.

- 13. Some BITs can be distinguished according to their treatment of various types of payments. There are: (1) The case in which proceeds from the sale or liquidation of FDI which fall outside the IMF's definition of current transactions are included in the list of exceptions to the obligation of free transfer in case of a BOP crisis, but current returns on investment, such as income, profits, dividends and interests, are excluded from the list of exceptions; (2) The case in which proceeds from the sale or liquidation of FDI are differentiated according to the value of transfer, and also; (3) The case in which proceeds from the sale or liquidation of an investment are acknowledged to be limitedly exceptional, for which payments are allowed to be made in instalments or over a period during the course of the BOP crisis.
- 14. As stated in the Secretariat Note (W/137), among the regional investment agreements that are similar in scope and content to BITs, only a small number of RTAs, for example NAFTA, contain safeguard clauses for BOP problems.
- 15. In this regard, it is notable that stronger protection is provided for current transactions, which include investment-related payments, than for capital transactions. Investment-related payments are relatively small, in value terms, in comparison to proceeds from the sale or liquidation of an investment. Moreover, the Articles of Agreement of the International Monetary Fund stipulate that the imposition of restrictions is allowed on payments and transfers for international capital transactions but not on those for international current transactions, unless authorized by the IMF. The role of the IMF in the context of BOP restrictions is addressed in the GATT and the GATS, as illustrated in the Secretariat Note (W/137). In short, the GATT and the GATS stipulate that their provisions should be consistent with the IMF agreement in regard to the use of BOP safeguards.
- 16. The Guidelines on the Treatment of Foreign Direct Investment, which the World Bank enacted in 1992, also provide provisions that approve of limited exceptions for proceeds from the sale or liquidation of an investment in exceptional circumstances such as foreign currency stringencies. (see Annex).

#### V. CONCLUDING REMARKS

- 17. Multilateral investment agreements aim to facilitate investment, in particular FDI, through creating a stable, transparent and predictable international environment. They require the convergence of relevant policies among participating countries in order to achieve their policy objectives. These agreements should also be flexible to address the various interests and potential concerns of participants. BOP safeguard provisions, in this context, offer some policy flexibility to safeguard countries' economic interests.
- 18. It should be noted, however, that the provisions are designed to apply only in exceptional circumstances and are subject to strict conditions, notably that they must be maintained only on a temporary basis and be phased out as the BOP situation improves, and that they not exceed what is necessary to address the BOP problems. Care should also be taken to prevent damage from any possible abuse.
- 19. Korea wishes to highlights that many BITs with BOP safeguard provisions generally give special consideration to FDI-related current transactions. Korea also takes note of the stipulation of the IMF Articles that payments and transfers for current transactions related to FDI be excluded from the scope of BOP-related exceptions, unless approved by the IMF.
- 20. In conclusion, Korea wishes to suggest that BOP safeguard provisions in a multilateral investment framework be constituted, taking into consideration the above-stated points and the fact that the WTO has recognized the special role of the IMF with respect to BOP-related matters.

#### **ANNEX**

## World Bank Guidelines on the Treatment of Foreign Direct Investment

- 6. (1) Each State will, with respect to private investment in its territory by nationals of the other state:
  - (a) freely allow regular periodic transfer of a reasonable part of the salaries and wages of foreign personnel; and, on liquidation of the investment or earlier termination of the employment, allow immediate transfer of all savings from such salaries and wages;
  - (b) freely allow transfer of the net revenues realized from the investment;
  - (c) allow the transfer of such sums as may be necessary for the payment of debts contracted, or the discharge of other contractual obligations incurred in connection with the investment as they fall due;
  - (d) on liquidation or sale of the investment (whether covering the investment as a whole or a part thereof), allow the repatriation and transfer of the net proceeds of such liquidation or sale and all accretions thereto all at once; in the exceptional case where the state faces foreign exchange stringencies, such transfers may as an exception be made in instalments within a period which will be as short as possible and will not in any case exceed five years from the date of liquidation or sale, subject to interests as provided for in Section 6 (3) of this Guideline, and;
  - (e) allow the transfer of any other amounts to which the investor is entitled such as those which become due under the conditions provided for in Guidelines IV and V.