Confluence or Contradictory: Understanding & Managing the Conflicting Standards of the IMF, WTO & IIAs on Capital Controls

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The Changing Landscape

• The IMF – Capital controls, from taboo to acceptance
• The WTO – GATS and its relationship with the IMF
• BITs/FTAs – a blocking move?
The Liberalisation of Capital Flows

• Capital flows have grown significantly over the last two decades in both size and volatility

• Capital flows to emerging economies are mainly FDI, but portfolio and ‘other investment’ have increased substantially since 2003

• Capital flows are the ‘connective tissue of the international financial system’

• Worldwide embrace of open capital flows – bringing immense benefits but also significant risks
The IMF and Capital Flows

• Historical aversion to capital controls
  – Prior to 2007, generally discouraged CFMs and did not include in loan programs
  – Recognised importance of ‘sequencing’ capital account liberalization in line with developmental status of the host nation’s financial sector
  – Since 2008, recommended CFMs (together with prudent macroeconomic policies) – Tanzania (2008) and Iceland (2009)
  – The big break occurred in the publication of a new ‘institutional view’ on FCMs in 2012
IMF ‘institutional view’ (2012)

• A broad range of policies in both recipient and source countries influence capital flows ... include macroeconomic and structural policies, supervisory and regulatory frameworks, and measures that are specifically designed to limit capital flows...referred to as (CFMs)...’

• ‘Liberalization does not rule out the temporary re-imposition of [CFMs] under certain circumstances. It also does not rule out the maintenance of prudential measures that, while CFMs, are needed for financial system stability or measures that members may maintain for reasons of national security’

• ‘...in certain circumstances, (CFMs) can be useful.'
IMF

• Article VI, S. 3 – ‘Members may exercise such controls as are necessary to regulate international capital movements’ (emphasis added).

• Does the IMF now allow for or constrain the use of CFMs?
  – Does Article VI grants members an absolute right to regulate capital movements?
  – Effect of Article VIII, S. 2(a)) and holistic interpretation of Article VI
  – Financing/surveillance and stabilization/structural reform programs under Articles V and VI
  – Revision to Article IV
  – What is necessary?
WTO/FTAs

• Where capital account liberalisation commitment is made
  – If made, GATS Article XVI (FN 8) guarantees market access where cross-border movement of capital is an ‘essential part’ of the service (i.e. financial services sector)

• Exceptions
  – Request from the IMF (Article XI:2)
  – BOP difficulties (Article XII)
  – Prudential measures (Article 2(a) of the Annex on Financial Services)
IIAs

• Short-term capital covered in definition of ‘investment’

• Safeguards are limited (similar to WTO), and not included in the majority of IIAs
  – Limited to times of crisis
  – Negative list agreements use GATS-like ‘specific commitments’ language
  – Application of CFMs excluding FTA partners would conflict with non-discrimination rules of IMF
Potential for conflict...

- IMF, 2012: ‘The limited flexibility afforded by some [FTAs and IIAs] in respect to liberalization obligations may create challenges for the management of capital flows’ ... institutions and members should ‘take [the Fund’s] view into account’ when drafting new agreements
Conclusion

• Conflict between IMF and WTO possible
• Conflict between IMF and FTAs and IIAs highly probable
• Solution can be drafted into future agreements, but lingering agreements cannot be ignored