

**Working Group on the Relationship
between Trade and Investment**

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COMMUNICATION FROM CANADA

The following communication, dated 13 September 2002, has been received from the Permanent Mission of Canada.

EXCEPTIONS AND BALANCE-OF-PAYMENTS SAFEGUARDS

I. INTRODUCTION

1. This paper is submitted to the WGTI on the same basis as previous recent submissions by Canada, as outlined in paras. 1-3 of WT/WGTI/W/130.¹

2. Consistent with Canada's previous submissions, our approach to subjects singled out for particular attention by Ministers in para. 22 of the Doha Declaration is to investigate how possible elements of a prospective international investment agreement would interact with each other, as well as with other provisions within the WTO system that have a bearing on international investment. How we address these architectural considerations will assist in demonstrating to Ministers that we have considered not only specific issues but holistic aspects of a prospective WTO investment agreement which may arise.

¹ This may be summarised as follows: Canada believes that work in the WGTI benefits from focussing on a *general approach* to issues that Ministers asked us to consider at Doha. This helps us to continue clarifying specific concepts with a view to providing a basis for a decision on the modalities of negotiations, without pre-judging outcomes. Our work must also be consistent with other aspects of the Doha mandate, including with respect to the importance of balancing "the interests of home and host countries, and to take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest" as indicated in para. 22 of the Doha Declaration.

In addition, in order for our work to be effectively anchored and as relevant as possible to the rapidly evolving international economy, Canada believes that our work should: (a) support the principles and objectives of the WTO as outlined in the Doha Declaration and at Marrakesh; (b) reflect business realities and assist in the development of a multilateral rules-based framework for evolving relationships between the state on the one hand and investors and investments on the other; and (c) provide for "flexibility" in the scope of any prospective agreement, including with respect to the development needs of members.

Finally, underpinning our approach is a belief in the utility of a prospective investment agreement in the WTO. Ultimately, such an agreement must be consistent with a legally and administratively enhanced trade and investment framework, and thereby be a positive contribution to the activities of investors and governments, and be seen to be so by the interested public.

II. PRELIMINARY CONCEPTUAL CONSIDERATIONS

3. Canada considers balance-of-payments safeguards to be an important element in any discussion of possible exceptions in a prospective WTO investment agreement. The following comments briefly on key considerations, without prejudice to further work on more focused balance-of-payments and related matters.

4. As WGTI work has evolved, it is interesting to note the interplay among the concepts singled out for attention by Ministers at Doha. The inclusion of a balance-of-payments (BOPs) clause, for instance, is linked to the scope of the prospective agreement, as well as the definition of concepts, and the type of foreign investment covered by the agreement.

5. Canada would note that any exceptions would be fully consistent with – and contribute to – the flexibility advocated by Canada and others in designing a comprehensive investment agreement in the WTO. As Section V of the Secretariat paper (WT/WGTI/W/137) points out, exceptions facilitating temporary balance-of-payments safeguards exist in many trade and investment agreements. In Canada's view, exceptions, whether for balance-of-payments or other purposes, are an integral component of international investment agreements. They can also complement reservations to provisions of the agreement as outlined by Canada with respect to modalities for commitments in such an agreement (WT/WGTI/W/130).

6. Even when they are not explicitly articulated it is commonly understood that rights accorded under international trade and investment arrangements should not serve to unduly destabilize a country's balance of international payments, nor international monetary obligations under the IMF Articles of Agreement. Canada would propose that the specifics of a BOPs provision be addressed separately as our discussions progress. At that time, it will be necessary to ask financial services and international monetary experts to contribute to the discussion.

III. EXCEPTIONS, FLEXIBILITY, AND THE STRUCTURE OF A PROSPECTIVE INVESTMENT AGREEMENT IN THE WTO

7. As noted in Canada's submission on "Scope and Definition", the scope of an agreement is shaped by the inter-relationship among three interconnected conceptual elements: a scope article, definitions of terms in the agreement, as well as any restrictions on the "reach" of the provisions as outlined in reservations and exceptions. Exceptions effectively serve to limit the scope of the agreement by accommodating sectors, issue areas, or circumstances where provisions of the agreement would not apply.² Canada believes that exceptions combined with reservations (including with respect to unspecified future measures) could provide much of the flexibility Ministers indicated would be necessary in any comprehensive investment agreement in the WTO. Developing country priorities may be expected to figure among them.

8. In its examination of IIAs, para. 29 of the Secretariat paper identified exceptions in the investment chapter of the NAFTA that are also addressed in the GATT and GATS. However these are by no means the only exceptions that feature in Canadian international agreements negotiated with our trade and investment partners. In the Canada-Chile FTA, for example, article G-08 (Reservations and Exceptions) facilitates Annexes A (existing measures) and B (future measures) reservations.³

² Reservations, on the other hand, usually refer to individual country measures to which certain negotiated provisions of the agreement do not apply. Importantly, in sensitive sectors where it may be difficult to define precisely the measures that may be necessary to effectively limit the scope of the agreement, reservations may also be negotiated with respect to *future* measures.

³ For the text of the investment chapter of the Canada-Chile Free Trade Agreement, see: <http://www.dfait-maeci.gc.ca/tna-nac/cda-chile/chap-g26.asp>. Like the NAFTA, the Canada-Chile FTA illustrates how a trade agreement can encompass an investment agreement. Crosswalks between trade- and

Among other things, this article allows for the non-application of a number of provisions with respect to the TRIPs agreement, as well as procurement or subsidies by a Party or state enterprise in certain circumstances. In addition, a provision allows for exceptions to MFN in specified sectors, including aviation, fisheries, maritime matters, and certain telecoms sub-sectors not covered in the telecoms chapter of the agreement, as well as foreign aid programmes promoting economic development.

9. In addition to exceptions and reservations provided for in investment agreements, Canada's comprehensive trade agreements also include exceptions that do not apply solely to the investment provisions of the agreement.⁴ These are often contained in a separate chapter devoted to exceptions to the whole agreement. Again, using the Canada-Chile FTA as an example, the chapter on exceptions begins with an article on "general exceptions" that includes a provision deferring to Article XX of the GATT with respect to trade in goods. There are also six additional articles, five of which to a greater or lesser degree provide exceptions for the following issues: national security, taxation, balance-of-payments, disclosure of information, and cultural industries.⁵ The balance-of-payments article in the Canada-Chile FTA is reproduced in the annex below.

10. The precise content of such exceptions varies according to the needs of the parties to each agreement. For our purposes in the WGTI, it is premature to examine the prospective contents of each exception until an agreement begins to take shape. Nonetheless it is useful to illustrate that exceptions are an integral component of many countries' international trade and investment agreements. They assist in providing the policy space for conduct that could otherwise be considered as contravening commitments in the agreement.

IV. SCOPE, INVESTMENT PROTECTION, AND BALANCE-OF-PAYMENTS SAFEGUARDS

11. An exception respecting BOPs measures in certain circumstances is only one example of the exceptions, reservations and derogations that are typically found in IIAs. Briefly, exceptions are usually – but not always – understood to be of general application to all signatories, reservations can apply to individual signatories with respect to existing *or future* measures, and derogations, where they occur, are understood to facilitate behaviour that would not normally be in accordance with treaty obligations but are allowed as long as they are temporary, usually with a time limit or transitional period.

12. At this juncture, two broad observations may be made with respect to how a balance-of-payments provision in an investment agreement is dealt with. Both are with respect to how such provisions would interact with other provisions in an international investment agreement.

investment-related provisions are noted in these agreements, and would have to be echoed in the WTO in the event a comprehensive IIA was incorporated in the WTO system. (See also the Canadian submission on "Non-discrimination and Modalities for Pre-establishment Commitments Based on a GATS-type, Positive List Approach" WT/WGTI/W/130).

⁴ The "Exceptions" chapter to the Canada-Chile Free Trade Agreement is at: <http://www.dfait-maeci.gc.ca/tna-nac/cda-chile/chap-o26.asp>.

⁵ The seventh and final article of the exceptions chapter to the Canada-Chile FTA is on definitions. The wording of the balance of payments article is included in an Annex, below. Note, too, that in the NAFTA the Balance of Payments exception is complemented by a provision in the financial services chapter (chapter 14) on exceptions (Article 1410) that among other things provides for the adoption or maintenance of reasonable measures for prudential measures connected with the integrity and stability of a Party's financial system. In the Canada-Chile FTA Annex G-09.1 includes a Chilean exception dealing with the stability of its currency. In addition to a relevant Annex I reservation, Canada also enjoys a dispute settlement exception with respect to decisions under the Investment Canada Act.

13. First of all, as noted in Canada's paper on "scope and definitions", a broad, asset based definition of investment which Canada believes would be best suited to anchor any meaningful international WTO investment agreement would be consistent with balance-of-payments safeguards. WGTI discussion has revealed that capital flows associated with international equity investments are among the most stable forms of capital flows.⁶ In addition, it may be observed that the evolution of constituent elements of what is now understood to be FDI has expanded to gradually encompass flows that could have been considered portfolio or other flows in the past.⁷

14. Second, it should also be noted that BOPs safeguards are most relevant to a discussion of investment agreements in conjunction with investment protection provisions. In Canada's view, there would need to be compatibility between an international investment agreement and the Articles of Agreement of the IMF, given that a country should be able to carry out an IMF adjustment plan without being in conflict with its obligations under any such agreement.

15. In this regard, the WTO in both GATT (Article XV:9(a)) and GATS (Article XII) defers to the IMF's jurisdiction with respect to BOPs matters, exchange restrictions, and exchange controls. In IIAs, it is with respect to investment protection provisions (e.g. transfers, expropriation, and dispute settlement) that facilitation of capital movements linked to an investment, and complementary restrictions on these movements *in extremis* (i.e. BOPs safeguards) are most justified.

V. CONCLUSION

16. Exceptions would need to feature in any prospective investment agreement in the WTO; indeed a precedent already exists in the GATS with respect to MFN exceptions under Article II. One of the principles behind exceptions is that they are usually (but not always) generic and apply to all parties.

17. Exceptions may be incorporated in different ways to an international trade and/or investment agreement: they may be incorporated as a provision itself, in a separate chapter, or in an annex with respect to an individual chapter or the agreement as a whole. Flexibility – whether it be with respect to the structure of exceptions or the broader question of how to encompass differing country priorities, including with respect to development – is thus implicitly embodied in the manner in which exceptions could be addressed in an investment agreement in the WTO. The specific conditions that apply to exceptions will be part of the discussion on the specifics of each, whether it be for BOPs,

⁶ See the Korean submission (WG/WGTI/W/69) on the stable characteristics of FDI in a currency crisis; also fn. 7, below. Other relevant WGTI discussion is contained in (WT/WGTI/W/95).

⁷ A broad, asset-based – but closed – definition of investment means that it would include equity investments, reinvested earnings, and intercompany debt flows, plus what is increasingly understood as other assets invested abroad for the purposes of economic benefit or other business purposes. Robert Lipsey confirms that direct investment flows have been the least volatile source of international investment for most countries, particularly developing countries. (See Robert E. Lipsey, "The Role of Foreign Direct Investment in International Capital Flows", in Martin Feldstein (ed.), *International Capital Flows*, Chicago: University of Chicago Press, 1999; also published as NBER Working Paper no. w7094, June 2000 (this version cited here).) Lipsey makes two points relevant to this debate: firstly, that "the definition of direct investment, and therefore its measurement, have changed considerably over time", with the more nebulous concept of "lasting interest" replacing that of "control" (pp. 5-7). Secondly, Lipsey also notes that portfolio investment may be included as direct investment: "Portfolio investment includes equity securities, debt securities in the form of bonds, money market instruments, and financial derivatives, such as options, *all excluding any of these included in direct investment or reserve assets*" (p. 13; emphasis added). Finally, as para. 56 of the Secretariat paper [WT/WGTI/W/137] observes, "In the case of foreign portfolio investment, in general equity investments appear from the empirical evidence to pose less of a potential problem for a host country's balance of payments".

taxation, national security, or other purposes. But exceptions, like reservations, are a fundamentally important concept that essentially defines the scope of any international agreement.

ANNEX

Excerpt from the Canada-Chile Free Trade Agreement –
Exceptions (Chapter ‘O’)

Balance-of-Payments Article

Article O-04: Balance-of-Payments

1. Nothing in this Agreement shall be construed to prevent a Party from adopting or maintaining measures that restrict transfers where the Party experiences serious balance-of-payments difficulties, or the threat thereof, and such restrictions are consistent with this Article.
 2. As soon as practicable after a Party imposes a measure under this Article, the Party shall:
 - (a) submit any current account exchange restrictions to the IMF for review under Article VIII of the Articles of Agreement of the IMF;
 - (b) enter into good faith consultations with the IMF on economic adjustment measures to address the fundamental underlying economic problems causing the difficulties; and
 - (c) adopt or maintain economic policies consistent with such consultations.
 3. A measure adopted or maintained under this Article shall:
 - (a) avoid unnecessary damage to the commercial, economic or financial interests of the other Party;
 - (b) not be more burdensome than necessary to deal with the balance-of-payments difficulties or threat thereof;
 - (c) be temporary and be phased out progressively as the balance-of-payments situation improves;
 - (d) be consistent with paragraph 2(c) and with the Articles of Agreement of the IMF; and
 - (e) be applied on a national treatment or most-favoured-nation treatment basis, whichever is better.
 4. A Party may adopt or maintain a measure under this Article that gives priority to services that are essential to its economic program, provided that a Party may not impose a measure for the purpose of protecting a specific industry or sector unless the measure is consistent with paragraph 2(c) and with Article VIII(3) of the Articles of Agreement of the IMF.
 5. Restrictions imposed on transfers:
 - (a) where imposed on payments for current international transactions, shall be consistent with Article VIII(3) of the Articles of Agreement of the IMF;
 - (b) where imposed on international capital transactions, shall be consistent with Article VI of the Articles of Agreement of the IMF and be imposed only in conjunction with measures imposed on current international transactions under paragraph 2(a);
 - (c) where imposed on transfers covered by Article G-09 (Investment -Transfers) and transfers related to trade in goods, may not substantially impede transfers from being made in a freely usable currency at a market rate of exchange; and
 - (d) may not take the form of tariff surcharges, quotas, licences or similar measures.
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