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To: Members of the Executive Board

From: The Secretary

Subject: **Legal Aspects of Capital Movements Under an Amendment of the  
Articles—Relationship with Articles XI and XII of the GATS**

Attached for consideration by the Executive Directors is a supplement to the paper on further considerations of the legal aspects of capital movements under an amendment of the Articles, which is tentatively scheduled for Tuesday, August 26, 1997.

Mr. Gianviti (ext. 38329) or Mr. Hagan (ext. 37715) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

**Legal Aspects of Capital Movements Under an Amendment of the Articles:  
Relationship with Articles XI and XII of the GATS**

Prepared by the Legal Department

(In consultation with Monetary and Exchange Affairs and  
Policy and Development and Review Departments  
and the Office in Geneva)

Approved by François Gianviti

August 19, 1997

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## INTRODUCTION

1. Section 4 of "Legal Aspects of Capital Movements Under an Amendment of the Articles - Further Considerations"<sup>1</sup> contains a general discussion of the implications of the proposed amendment of the Fund's Articles on other international agreements. As noted in that section, it is assumed that members do not intend for the amendment to modify automatically the terms of existing agreements in circumstances where the rights and obligations under the amendment diverge from those already established under these agreements. It is recognized, however, that signatories of some, but not all, agreements may wish to modify the terms of these treaties so as to ensure harmonization with the amended Articles, particularly in circumstances where the provisions in question provide for consistency with the Fund's Articles, but were drafted in the context of the existing Articles. As has been noted, Articles XI and XII of the General Agreement on Trade and Services (the GATS) are the most important examples of such provisions. This supplement discusses the implications of the proposed amendment on these provisions, the text of which is attached.

### I. ARTICLES XI AND XII AND THE FUND'S EXISTING ARTICLES

2. *Article XI* of the GATS generally prohibits GATS signatories from applying restrictions on international transfers and payments for current transactions relating to their specific commitments. Article XI provides, however, that nothing in the GATS will "affect the rights and obligations" of Fund members under the Articles, including the use of exchange actions which are "in conformity" with the Articles of Agreement. Deference to members' rights and obligations under the Articles is qualified by an important proviso: Article XI provides that GATS signatories may not impose restrictions on any capital transactions inconsistently with their specific commitments regarding such transactions, except under Article XII of the GATS or "at the request of the Fund".

3. *Article XII* of the GATS sets forth a number of conditions under which a signatory can impose restrictions in the "event of serious balance-of-payments and external financial difficulties or threat thereof". One of the conditions set forth in this Article is that the restrictions "be consistent with" the Fund's Articles.

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<sup>1</sup> SM/97/209 (8/12/97).

4. The relationship between Article XI and XII of the GATS and the existing Articles has been described extensively in previous staff papers.<sup>2</sup> The essential elements can be briefly summarized as follows.

5. Regarding *restrictions on current payments and transfers*, Article XI ensures that the exercise by a member of its rights under the Articles to impose or maintain such restrictions (either because they have been approved for temporary balance of payments reasons or because their maintenance is authorized under the Fund's transitional provisions) will not give rise to a breach of a signatory's obligations under the GATS. Conversely, the GATS is precluded from permitting a signatory to impose a restriction on a current payment relating to a commitment under the GATS if the restriction is not consistent with the Articles because, for example, it has not been approved by the Fund.

6. Regarding *restrictions on capital movements*, as a general rule, these restrictions will only be permitted if they meet all of the conditions set forth in Article XII of the GATS (see attached). The exception to this general rule would be restrictions imposed "at the request" of the Fund. The only provision of the existing Articles that explicitly gives the Fund the authority to request the imposition of restrictions is Article VI, Section 1, which authorizes the Fund to request their imposition as a means of protecting the Fund's resources from being used to finance large or sustained capital outflows. These restrictions do not need to meet the additional conditions set forth in Article XII.

## II. ARTICLES XI AND XII AND THE PROPOSED AMENDMENT

7. The adoption of an amendment of the Articles that would give the Fund jurisdiction over capital movements would raise a number of issues regarding Articles XI and XII, the resolution of which will require interpretations of these provisions.

8. With respect to *Article XI*, at least two issues arise. First, would restrictions on capital movements imposed "at the request" of the Fund be interpreted as including restrictions imposed at the request of the Fund in accordance with the authority granted under the proposed amendment? As has been discussed in staff papers, the amendment will need to give the Fund the authority to make such requests if it is decided that the Fund should have the authority to make the imposition of capital restrictions a component of its conditionality.<sup>3</sup> Second, would restrictions on capital movements that have been approved by the Fund under its new jurisdiction need to meet the additional conditions of Article XII or,

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<sup>2</sup> See "The Relationship of the World Trade Organization With the Fund - Legal Aspects" SM/94/303 (12/20/94); see also "The Relationship between the Multilateral Agreement on Investment and the International Monetary Fund" (EBD/96/113)(8/30/96).

<sup>3</sup> See SM/97/209(8/12/97), pp. 10-11; see also, SM/97/173(7/1/97), p.24.

alternatively, would such approval be treated under Article XI as automatically bringing these measures into conformity with signatories' obligations, i.e., would capital restrictions approved by the Fund be treated in the same way by the GATS as current restrictions approved by the Fund? For instance, would it be possible to interpret restrictions imposed "at the request of the Fund" as including restrictions that have been approved by the Fund?

9. Regarding *Article XII*, the question arises as to whether the term "consistency with" the Fund's Articles will be interpreted on the basis of the provisions of the Articles that existed when the GATS entered into force (i.e., the existing Articles) or whether, alternatively, it will be interpreted as taking into consideration subsequent amendments to the Articles. If the first interpretation is followed, restrictions on capital movements imposed by signatories of the GATS could meet the conditions of the safeguard provisions of Article XII of the GATS, even in circumstances where these restrictions had not been approved by the Fund under the amendment. If the second interpretation is followed, Fund approval of such restrictions would be required (unless the restrictions are maintained under the transitional provisions), as is presently the case for restrictions on current payments and transfers.

10. Another issue relates to the existing scope of Article XII. If it is determined that, absent an amendment of the GATS, capital restrictions approved by the Fund will still need to meet all the conditions of Article XII, would this Article be broad enough to cover not only restrictions on capital outflows but also restrictions on capital inflows? Based on the staff's understanding, no authoritative interpretation has been rendered as to whether Article XII covers restrictions on both outflows and inflows.

11. Although the Fund staff has expressed its views on the above issues on previous occasions, it needs to be emphasized that the resolution of these questions will require interpretations of the GATS in accordance with the provisions of that agreement. Under Article IX:2 of the Agreement establishing the World Trade Organization, the WTO Ministerial Conference and General Council have the exclusive authority to adopt authoritative interpretations of the GATS. In addition, dispute settlement panels established by the Dispute Settlement Body of the WTO may interpret relevant provisions of the GATS in the context of specific disputes, although such interpretations are not binding in subsequent cases.

12. A related issue is whether a finding by the Fund that a measure is "consistent with" the Fund's Articles for purposes of these GATS provisions (either prior or subsequent to an amendment) will be treated as conclusive by all organs of the WTO. Under the terms of the decision adopted by the General Council of the WTO when it approved the Agreement between the Fund and the WTO, "views" of the Fund "submitted" to the Chairman of the

Dispute Settlement Body on a question of whether a measure is consistent with the Articles are not required to be treated as authoritative by the relevant dispute settlement panel.<sup>4</sup>

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<sup>4</sup> This issue is discussed in EBD/96/145 (11/7/96) and EBD/96/149 (11/19/96).

EXTRACTS FROM THE GATS

*Article XI*

*Payments and Transfers*

1. Except under the circumstances envisaged in Article XII, a Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments.
2. Nothing in this Agreement shall affect the rights and obligations of the members of the International Monetary Fund under the Articles of Agreement of the Fund, including the use of exchange actions which are in conformity with the Articles of Agreement, provided that a Member shall not impose restrictions on any capital transactions inconsistently with its specific commitments regarding such transactions, except under Article XII or at the request of the Fund.

*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.
2. The restrictions referred to in paragraph 1:
  - (a) shall not discriminate among Members;
  - (b) shall be consistent with the Articles of Agreement of the International Monetary Fund;
  - (c) shall avoid unnecessary damage to the commercial, economic and financial interests of any other Member;
  - (d) shall not exceed those necessary to deal with the circumstances described in paragraph 1;
  - (e) shall be temporary and be phased out progressively as the situation specified in paragraph 1 improves.

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3. In determining the incidence of such restrictions, Members may give priority to the supply of services which are more essential to their economic or development programmes. However, such restrictions shall not be adopted or maintained for the purpose of protecting a particular service sector.

4. Any restrictions adopted or maintained under paragraph 1, or any changes therein, shall be promptly notified to the General Council.

5. (a) Members applying the provisions of this Article shall consult promptly with the Committee on Balance-of-Payments Restrictions on restrictions adopted under this Article.

(b) The Ministerial Conference shall establish procedures<sup>4</sup> for periodic consultations with the objective of enabling such recommendations to be made to the Member concerned as it may deem appropriate.

(c) Such consultations shall assess the balance-of-payment situation of the Member concerned and the restrictions adopted or maintained under this Article, taking into account, *inter alia*, such factors as:

- (i) the nature and extent of the balance-of-payments and the external financial difficulties;
- (ii) the external economic and trading environment of the consulting Member;
- (iii) alternative corrective measures which may be available.

(d) The consultations shall address the compliance of any restrictions with paragraph 2, in particular the progressive phaseout of restrictions in accordance with paragraph 2(e).

(e) In such consultations, all findings of statistical and other facts presented by the International Monetary Fund relating to foreign exchange, monetary reserves and balance of payments, shall be accepted and conclusions shall be based on the assessment by the Fund of the balance-of-payments and the external financial situation of the consulting Member.

6. If a Member which is not a member of the International Monetary Fund wishes to apply the provisions of this Article, the Ministerial Conference shall establish a review procedure and any other procedures necessary.

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<sup>4</sup> It is understood that the procedures under paragraph 5 shall be the same as the GATT 1994 procedures.

