

**PURSUING SUSTAINABLE DEVELOPMENT STRATEGIES:
The case of the balance of payment rules in the WTO¹**

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Introduction: Equity and Coherence

In Section III of the Millennium Declaration entitled “Development and Poverty Reduction,” UN Member States committed themselves to “to create an environment - at the national and global levels alike - which is conducive to development and to the elimination of poverty.” This depends on “good governance within each country” and on “good governance at the international level, and on transparency in the financial, monetary and trading systems.” Hence, they “are committed to an open, equitable, rule-based, predictable and non-discriminatory multilateral trading and financial system.” In 2002 the Monterrey Consensus also reaffirmed the UN members’ commitment to trade liberalization, but noted that developing countries need “appropriate institutions and policies” to benefit fully from trade.

The concept of equity in international trade and financial rules and institutions has not been explicitly defined and is the subject of debate and speculation among philosophers and political theorists. Economists are often skeptical of whether the trade and financial systems should be understood at all in terms of justice rather than as instruments of economic policy coordination. Nevertheless, it will be observed that the actual rules often do depend, explicitly or implicitly, on a concept of fairness. For instance, one of the rules that will be discussed in this paper, contained in Art. IV of the IMF Articles of Agreement required that IMF Members not “manipulate exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an *unfair* competitive advantage over other members.”(emphasis added) In the trading system, the WTO rules on subsidies suppose a conception of fair competition; as the WTO Appellate Body noted in one case, there are situations where market-based benchmarks for fairness will be inapplicable given the pervasive interconnection of public policies and market structures. The WTO rules on anti-dumping require a *fair* comparison of prices between exported products and like products sold in the home market of the producer.

The concept of equity is then inescapable in the interpretation and application of the law of the international trade and financial systems. The question is whether there are legal and policy sources that allow us to give a definite meaning to this concept as we apply it to particular rules and disputes in the trade and financial systems. Once one looks for these sources, they appear more various and more instructive than what one might have originally imagined.

One ingredient of equity that is widely reflected in international instruments concerning trade, finance and development (for example, the Doha Declaration and its references to Special and Differential Treatment) is the notion that that rules should be

adjusted to the different situations of different states, in terms of their development needs. Thus, there is widespread agreement that formal legal equality, treating everyone the same regardless of their particular situation, is *not* equitable. At the same time, there is disagreement among states on how much differential treatment is justified in a given situation. The WTO Uruguay Round Agreements on TRIPs, services, and Sanitary and Phytosanitary Measures contain elements of differential treatment for developing countries, and provisions that make the application of the rules relative, more generally, to the context and specific situations faced by particular WTO Members. However, many developing countries, as well as academic observers, believe that these Agreements have not proven flexible enough and embody formal legal equality to an unjustifiable degree.

There is an interesting parallelism between the conception of equity as treating “unlikes” *differently* and the recognition, in recent economic literature, that—contrary to what was implied in the Washington Consensus formula—there is not a single formula or pathway to development that will work for all countries².

Another dimension of equity that is reflected in international human rights instruments is that of voice and participation. These instruments suggest that people not have a vision of development forced on them or decided by others. The Declaration on the Right to Development stipulates that the Right to Development includes “free and meaningful participation in development.”

Further, there is a concept of equity implicit in the Millennium poverty reduction goals. Acceptance of these goals implies that existing inequalities of wealth, to the extent that they leave billions in dire poverty, are unacceptable. The focus on reducing *poverty* not just increasing *growth*, implies that increased wealth does not necessarily lead to an acceptably just or equitable distribution of wealth without positive redistributive measures.

Closely related to this notion of equity is the concept of social and economic justice or equity expressed in the United Nations Covenant on Social and Economic and Cultural Rights. Article 11 of the Covenant provides: “1. The States Parties to the present Covenant recognize the right of everyone to an adequate standard of living for himself and his family, including adequate food, clothing and housing, and to the continuous improvement of living conditions. The States Parties will take appropriate steps to ensure the realization of this right, recognizing to this effect the essential importance of international co-operation based on free consent.” While not all states - most notably the United States - have embraced the rights in the Covenant as treaty or customary international law, even the US has participated in the Declaration on the Right to Development, which incorporates to a large extent and affirms these rights. It is important to note that the Covenant does require a specific notion of redistribution between countries as a means of realization of the rights in question. The primary obligation is of states to their own peoples. However, a concrete implication of this

² D. Rodrik, *The Global Governance of Trade as if Development Really Mattered*, United Nations Development Programme, 2001.

notion of equity is that the rules of the international trade and financial system at a minimum should not *undermine* and ideally should *facilitate* the ability of states to discharge their obligations under the Covenant to implement social and economic rights.³ In this respect, the UN Human Rights organs have correctly grasped that they have a mandate to evaluate the rules of the trade and financial system against their impact on the ability of states, individually and collectively, to fulfill their obligations under the Covenant.⁴

Finally, equity has been considered by UN Members to imply a fair global distribution of burdens and benefits from the operations of the international trade and financial system. This goes beyond a notion that the system(s) should enable states to achieve social and economic justice within their borders to a conception of global solidarity. Thus, according to the Millennium Declaration, solidarity requires that “global challenges must be managed in a way that distributes the costs and burdens fairly in accordance with basic principles of equity and social justice. Those who suffer most, or who benefit least, deserve help from those who benefit most.”⁵

In examining the WTO rules and jurisprudence as they relate to balance-of-payments related matters, this paper will draw on all the dimensions of equity articulated above, all of which, as suggested have a foundation in the existing legal and policy instruments of the international system, especially those of the United Nations.

The WTO Agreement defines the goal of the multilateral trading system in terms of the principle that “relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world’s resources in accordance with the objective of sustainable development . . .” Clearly, the goals of raising standards of living and ensuring full employment are closely linked to the conception of social and economic justice in the UN Covenant on Social Economic and Cultural Rights. The imperative that these goals be achieved while “allowing for the optimal use of the world’s resources in accordance with the objective of sustainable development” implies that mere increases in growth or wealth are not necessarily consistent with the aims of the trading system unless they further sustainable

³ See Robert Howse and Ruti Teitel, “Beyond the Divide: The Covenant on Economic Social and Cultural Rights and the World Trade Organization,” Friedrich Ebert Stiftung, 2007, Geneva.

⁴ See for example Liberalization of trade in services and human rights, Report of the High Commissioner for Human Rights (E/CN.4/Sub.2/2002/9). Globalization and its impact on the full enjoyment of human rights; Report of the High Commissioner for Human Rights (E/CN.4/2002/54). The report considers the WTO’s Agreement on Agriculture; The Human rights, trade and investment, Report of the High Commissioner for Human Rights, (E/CN.4/Sub.2/2003/9). impact of the TRIPS Agreement on the Enjoyment of all Human Rights, report of the High Commissioner for Human Rights, (E/CN.4/Sub.2/2001/13).

⁵ See also Americo Beviglia Zampetti, “Progressing Towards a Just Future Through the MDGs: What is the Role of an “Equitable” Multilateral Trading System?” Draft, October 2005, p. 12.

development. And this in turn brings us back to the conception of “development” in the human rights instruments, especially as articulated in the UN Declaration on the Right to Development.

Coherence

Coherence seems a logical implication of the recognition of equity as a fundamental ingredient of the international trade and financial system; while as noted there are rules and policies in the system that are *expressions* of equity mostly those rules and policies leave unarticulated—and in some sense presuppose—relevant conceptions or articulations of equity. These are found, as we have seen, in the instruments and institutions primarily of the United Nations that address human rights and development. Coherence, then, means in the first instance coherence between the rules and policies of the institutions where equity is articulated and defined normatively and the rules and policies of the international trading system. But there is a further aspect to the relationship between equity and coherence: inequity may result from *uncoordinated rules as between* the trading system and the financial system.

For example, the IMF may ask a country to improve its balance of payments and the trading system may prevent the use of certain instruments for doing so, such as import surcharges or concessional export financing. Furthermore, there may be strong reasons why these policy options have been constrained by the international trading system. However, without greater sensitivity by the IMF for the constraints imposed by that system *and their underlying policy reasons* and a broader and more palatable range of policy options, developed to accommodate the trading system while achieving the IMF’s goals for a given client state, such States may well feel those policy options are their only viable choices. If these options remain foreclosed without the provision of other viable trading system friendly options, states may then be forced to have recourse to policy instruments that threaten social equity, and result in poverty and unemployment if they are to obey the prescriptions of the financial system as well as respect the rules of the trading system.

An early explicit attempt to address coherence at the WTO is the Uruguay Round *Declaration on the Contribution of the World Trade Organization to Greater Coherence in Global Economic Policymaking*.

Paragraph 2 of the *Declaration* reads, in relevant part,

“Trade liberalization forms an increasingly important component in the success of the adjustment programmes that many countries are undertaking, often involving significant transitional social costs. In this connection, Ministers note the role of the World Bank and the IMF in supporting adjustment to trade liberalization, including support to net food-importing developing countries facing short-term costs arising from agricultural trade reforms.”

The most important text in the Declaration is arguably to be found in Paragraph 5:

“The interlinkages between the different aspects of economic policy require that the international institutions with responsibilities in each of these areas follow consistent and mutually supportive policies. The World Trade Organization should therefore pursue and develop cooperation with the international organizations responsible for monetary and financial matters, while respecting the mandate, the confidentiality requirements and the necessary autonomy in decision-making procedures of each institution, and avoiding the imposition on governments of cross-conditionality or additional conditions. Ministers further invite the Director-General of the WTO to review with the Managing Director of the International Monetary Fund and the President of the World Bank, the implications of the WTO's responsibilities for its cooperation with the Bretton Woods institutions, as well as the forms such cooperation might take, with a view to achieving greater coherence in global economic policymaking.”

It is to be noted that, while Paragraph 2, for example, mentions the important social costs of trade liberalization and economic reform and singles out the situations of developing countries, the Declaration does not extend the idea of coherence to cooperation with those international institutions whose mandate is development policy such as UNCTAD and UNDP nor those concerned with social equity and justice in particular, such as the UN Human Rights institutions. Instead, the need for coherence is limited to those international institutions “responsible for monetary and financial matters, . . .” Nevertheless, Paragraph 5 does state the imperative of avoiding “cross-conditionality,” a situation where a government is forced to pursue a harmful policy or set of policies or even inconsistent policies because otherwise it will fall afoul of uncoordinated conditions or strictures imposed by different international economic institutions.

In 1996, the WTO entered into a cooperation agreement with the IMF: this agreement provides for consultations between the WTO and the IMF and the exchange of information. Paragraph 10 of that agreement provides:

“The Fund’s staff shall consult with the WTO Secretariat on issues of possible inconsistency between measures under discussion with a common member and that member’s obligations under the WTO Agreement. The WTO Secretariat shall consult with the Fund’s staff on issues of possible inconsistency between measures under discussion with a common member and that member’s obligations under the Fund’s Articles of Agreement.”

This provision would appear to be of very great importance for coherence; it appears to both strengthen and implement Paragraph 5 of the Uruguay Round *Declaration on Coherence* by requiring (the obligatory “shall” is used here) discussions about possible inconsistency while measures are “under discussion,” i.e. to avoid a conflict in the first place. As we shall see, however, in at least one prominent WTO dispute it became clear that this consultation requirement had not been followed and unfortunately the Appellate Body of the WTO did not attach much importance to it.

The WTO Doha Declaration provided for the establishment of a new Working Group on Trade, Debt and Finance: “36. We agree to an examination, in a Working Group under the auspices of the General Council, of the relationship between trade, debt and finance, and of any possible recommendations on steps that might be taken within the mandate and competence of the WTO to enhance the capacity of the multilateral trading system to contribute to a durable solution to the problem of external indebtedness of developing and least-developed countries, and to strengthen the coherence of international trade and financial policies, with a view to safeguarding the multilateral trading system from the effects of financial and monetary instability. The General Council shall report to the Fifth Session of the Ministerial Conference on progress in the examination.”

The Working Group has examined a number of the issues that will be discussed below in this paper but has been unable to make any concrete recommendations. Its latest report, released this month,⁶ summarizes the views of individual Members of the Working Group but concludes only with the recommendation that the Group continue its activities into the future.

Exchange Controls and Convertibility

1. The GATT

The GATT rules on exchange controls and convertibility reflect the international financial and monetary system designed at Bretton Woods at the end of World War II. The post-war Bretton Woods arrangements contemplated a system of fixed exchange rates tied to the gold standard. Under this system, a country would in theory be required to hold sufficient reserves of gold to back the quantity of its currency in circulation. Where a temporary imbalance of payments occurred (i.e. where a country could not meet payments for imports with its receipts of foreign currency from export sales without selling gold for foreign currency), this would be financed by a country borrowing from the International Monetary Fund. In the case of a structural or persistent imbalance, a country would devalue its currency under the supervision of the IMF, which might recommend domestic policy adjustments to ensure that further devaluations were not required in order to maintain the balance of payments. While it had already been under tension for some time, the Bretton Woods system broke down in the 1970s when the US unilaterally opted out of the system by refusing to back the dollar with gold reserves. The result is well-summarized in a recent UNCTAD document: “Unfortunately, after the breakdown of the Bretton Woods system at the beginning of the 1970s, the world monetary system slipped back into the kind of “monetary chaos” that had characterised the pre-war period and its dismal economic and political outcomes. Nevertheless, the liberalisation of the trading system, even after the end of the Bretton Woods system, was pushed forward by policy makers as if a consistent approach on the monetary side, i.e. a coherent monetary order, would have existed. Only recently, with the Asian crisis as well as with the Latin American currency turmoil, have the shortcomings of the

⁶ WT/WGTDF/4, October 1, 2005.

"monetary chaos" and its repercussions on the trading system been acknowledged, even by mainstream economic theory and the WTO. The inherent instability of the system of multiple exchange-rate systems, ranging from free floating to absolutely fixing, has led many observers to ask for a global approach in monetary affairs or, at least, for improved regional co-operation. But instability is only part of the story. . . . If exchange rate movements follow a random walk, i.e. if changes in the international value of money are in no way related to the fundamentals of countries with open markets for goods and capital, traditional trade theories quickly lose their grasp on reality and trade liberalisation loses much of its alleged justification."⁷

In the case of developing countries, rapid progress towards convertibility and the removal of exchange controls became the economic orthodoxy in the 1980s and 1990s. Such reforms were thought to have the effect of encouraging foreign investment and creating domestic financial systems as well as access to global financial networks that would underwrite growth and development. The Asian and Latin American financial crises of the 1990s led to considerable rethinking of this story. Some economists, such as Jagdish Bhagwati of Columbia University believe that too rapid financial liberalization contributed to the crises, which led to widespread human misery in a number of countries. According to Bhagwati, "Per capita incomes tumbled to almost one-third their 1996 level in Indonesia, with the other crisis-stricken Asian countries showing declines ranging from a quarter to nearly half of the 1996 levels. . . . This crisis, precipitated by panic-fueled outflows of capital, was a product of hasty and imprudent financial liberalization, almost always under foreign pressure, allowing free international flows of short-term capital without adequate attention to the potentially potent downside of such globalization."⁸ Nobel Prize-winning economist Joseph Stiglitz takes a similar view, and when he was at the World Bank he resisted the IMF-led orthodoxy of rapid financial liberalization, largely predicting the kind of consequences discussed by Bhagwati.⁹ Both Stiglitz and Bhagwati, economists of the first rank who disagree on many issues, nevertheless see capital controls as a valuable instrument in stemming a panic flight of short-term capital and thereby preventing the kind of financial collapse that sent millions back into poverty in the late 1990s.

At the same time, more recently, the United States has placed considerable pressure on China to either revalue or "float" its currency, the Renminbi, on the theory that the exchange rate was "unfair," rigged somehow to keep Chinese exports artificially cheap. The implication is that a "fair" exchange rate would be one based upon the currency markets. Certainly, in a world of floating exchange rates, where there is no objective standard such as gold reserves, the concept of a "correct" exchange rate is an illusive one. Economists have attempted various estimates of the "correct" exchange rate between the Renminbi and the US Dollar, but these estimates vary considerably depending on the methodology used. Unless China moves to a market-base, floating

⁷ "Economic Policy Challenges in an Open Economy: Coherence Between Trade and Finance," Communication of UNCTAD to the WTO Working Group on Trade, Debt and Finance, WT/WGTDF/W/27, November 24, 2004.

⁸ J. Bhagwati, *In Defense of Globalization* (Oxford: Oxford University Press, 2004), pp. 199-200.

⁹ J. Stiglitz *Globalization and Its Discontents* (New York: W. W. Norton, 2002).

exchange rate it will be thus always vulnerable to criticisms that, according to some methodology, its exchange rate is not “correct,” or unfair to US trading interests. Bhagwati has, however, suggested that China’s fixed exchange rate with the dollar and cautious approach to financial liberalization contributed positively to its development strategy, providing needed stability in a dynamic economy, and sustaining policies that led to millions being brought out of poverty: “It is noteworthy that both India and China escaped the Asian financial crisis; they did not have capital account convertibility.”¹⁰

The GATT rules concerning exchange measures and convertibility are contained in Article XV of the General Agreement. Art. XV:4 states that “Contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement, nor by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund.” According to the Interpretative Note Ad Article XV: “The word ‘frustrate’ is intended to indicate, for example, that infringements of the letter of any Article of this Agreement by exchange action shall not be regarded as a violation of that Article if, in practice, there is no appreciable departure from the intent of the Article. Thus, a contracting party which, as part of its exchange control operated in accordance with the Articles of Agreement of the International Monetary Fund, required payment to be received for its exports in its own currency or in the currency of one or more members of the International Monetary Fund will not thereby be deemed to contravene Article XI or Article XIII [of the GATT on quantitative restrictions]. Another example would be that of a contracting party which specifies on an import license the country from which the goods may be imported, for the purpose not of introducing any additional element of discrimination in its import licensing system but of enforcing permissible exchange controls.” Article XV:9 of the GATT further provides: “Nothing in this Agreement shall preclude: (a) the use by a contracting party of exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund or with that contracting party’s special exchange agreement with the CONTRACTING PARTIES, or (b) the use by a contracting party of restrictions or controls on imports or exports the sole effect of which, additional to the effects permitted under Articles XI, XII, XIII and XIV, is to make effective such exchange controls or exchange restrictions.” According to Article XVI:2 of the GATT, there shall be deference to “the determination of the Fund as to whether action by a contracting party in exchange matters in accordance with the Articles of Agreement of the International Monetary Fund, . . .”

These provisions suggest that, where measures have been taken with respect to exchange controls or restrictions, even if such measures would otherwise be considered trade restrictions because of their effect on import and export transactions, *the intent of the GATT is not to impose disciplines beyond those required by the IMF*. Nevertheless, it is inaccurate to view these provisions, as some commentators have, essentially *ceding jurisdiction* to the IMF. The reason is that, where an exchange measure is not consistent with the IMF Articles then the “safe haven” of Article XV disappears and the measure may well then fall afoul of a provision of the GATT, such as Article XI. Thus, where a country disagrees with the Fund on the best course for solving a financial crisis, including in a manner that does not worsen the plight of the least advantaged, the GATT allows for

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that country to be “punished” through being found in violation of GATT rules; in other words, added to the punishment that the IMF can dish out, is the punishment that can be dished out through possible retaliatory sanctions for a violation of the GATT. In other words, the GATT/WTO sets itself up as a residual enforcer for the IMF.

I do not believe this to have been the intent of the GATT framers. First of all, prior to the WTO as we know the GATT dispute settlement system contained many diplomatic safety valves. Secondly, the original IMF Articles were premised on a world of largely fixed exchange rates adjusted through IMF supervision and as against an objective standard (gold reserves). The world that the IMF represents today is a very different one, where because of speculation-driven currency markets and the widespread liberalization of capital controls, which IMF economists have generally wholeheartedly endorsed, there is no agreed international standard against which a currency can be viewed as over- or under-valued, thus triggering a reasonable obligation to adjust economic fundamentals through means that do not impose unreasonable costs on other countries.

Let us take the example of Malaysia, which decided to defy the IMF’s advice, and impose selective capital controls in order to resolve its financial crisis, as well as establishing a fixed exchange rate. Kaplan and Rodrik conclude that, in comparison with other countries that follows IMF prescriptions, and taking into account differences in those countries’ situations, “the Malaysian policy was more successful in accomplishing an immediate reduction in interest rates, stabilizing the currency, and stemming financial panic. This eased, for the short term at least, worries that the banking system would go under and that there would be a devaluation spiral. The turnaround in market confidence was correspondingly more rapid. In addition, fiscal policy was on balance more expansionary. All these in turn spurred consumption and economic activity.”¹¹ From an equity perspective, the observation of Kaplan and Rodrik that the Malaysian approach may have resulted in employment and incomes falling less than in Korea (which took the IMF-orthodox route) is particularly relevant.

If we turn to the original IMF Articles of Agreement, which the drafters of the GATT had in mind when they linked the safe haven for exchange measures, Malaysia’s capital controls would not, on their face, have violated the Articles of Agreement, since only current account restrictions are clear violations of the Articles, whereas IMF Members retain the right to maintain controls on capital account transactions. As Upakbi explains: “When read together, . . . [Art. VII:3(b) and Art. XIV:2 of the IMF Articles of Agreement] suggest . . . [w]hereas, in respect of what is regarded as current international transactions (current account transactions), restrictions are ab initio disallowed (subject to limited exceptions); in respect of the capital account, the reverse is the case—restrictions are maintainable (again, subject to limited exceptions). Given this difference in the treatment of the two accounts, a distinction between what falls within their respective ambits appears crucial. . . In part, [current transactions, according to Art. XXX of the

¹¹ E. Kaplan and D. Rodrik, “Did the Malaysian Capital Controls Work?” NBER Working Paper, 2001, p. 27.

IMF Articles of Agreement] envisage ‘all payments due in connection with foreign trade.’”¹²

These provisions assume a clear cut distinction between capital and current account controls. They do not strictly speaking address current account, trade-related measures aimed at preventing circumvention of capital controls, such as artificial or over-invoiced trade transactions within multinational enterprises.

With respect to exchange rates, the IMF Articles of Agreement provide that an IMF Member shall not “manipulate exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.” (IMF Agreement Article IV, Section 1(iii)). Currency manipulation as such is defined in the surveillance provisions of the IMF Articles as “protracted large-scale intervention in one direction in the exchange market.”

However, the concept of an “*unfair*” competitive advantage is not defined. Thus, the international community is here required to supply a relevant conception of “equity.” Is China’s purchase of dollars with Renminbi aimed at maintaining an exchange rate that constitutes an “unfair” competitive advantage? Arguably, under an approach to fairness influenced by conceptions of sustainable development and the right to development, one essential aspect of the question would be whether China’s exchange rate policy represents a legitimate exercise of its right to development, and thus the way in which the policy figures in its development needs and strategies. For example, as Erik Denters argues, pegging the Renminbi to the dollar may well have encouraged foreign investment, a crucial part of China’s development strategy.¹³ At the same time, one would have to ask if China’s exchange rate actions undermine the development policies of other WTO Members.

In GATT/WTO practice and jurisprudence, the justifiability of measures under Article XV has been considered on a number of occasions. According to the GATT Analytical Index, “During the Review Session in 1954-55, Italy brought a complaint concerning action by Turkey providing export bonuses for certain agricultural products and levying special import taxes on certain goods deemed less essential in order to provide the necessary funds for the bonuses. Italy stated that the export subsidies had not been notified as required by Article XVI:1 and that the import taxes were inconsistent with Article II:1(b). Turkey stated that as part of a reform of its foreign exchange system, it had established an Equalization Fund which was financed by the sale of import permits, and that this system had been approved by the International Monetary Fund. A representative of the Fund confirmed that the practices under question were multiple currency practices under the Fund Articles of Agreement and that in a Decision

¹² U.C. Ukpabi, “Juridical Substance or Myth Over Balance-of-Payments: Developing Countries and the Role of the International Monetary Fund in the World Trade Organization” 26 *Michigan Journal of International Law* 701, p. 710.

¹³ E. Denters, “Manipulation of Exchange Rates in International Law: The Chinese Yuan”, *ASIL Insights*, November 2003.

concerning Turkey the Fund had stated that it did not object to the temporary continuance of these practices and would remain in consultation with Turkey on these practices.”¹⁴

Around the same time, a separate GATT panel considered a tax levied by Greece on certain imports. The issue before the panel was whether the measure in question was a discriminatory internal tax that violated Art. III:2 of the GATT (National Treatment with respect to taxation or an additional charge on imports in violation of GATT Article II, or on the other hand, as the Greek Government claimed, an foreign exchange measure aimed at stabilizing Greece’s currency, the Drachma. The panel refused to decide the question, instead referring to the IMF the question of whether the measure in question was an exchange measure and whether it was consistent with the IMF Articles.¹⁵ It is to be noted that here the panel suggested a degree of deference to the Fund beyond what is required in Art. XV:2, which requires deference to the Fund’s assessment of consistency with the Articles of Agreement but *does not* require deference to the Fund in the classification of a measure as an exchange measure that falls outside provisions of the GATT such as Art. III, which the measure might otherwise be found to violate. The approach of the panel gives the IMF far more power than it is conferred under Art. XV:2. Under XV:2, while statistical and other purely factual findings of the IMF are binding, the only normative conclusion of the IMF that is determinative concerns whether there is a violation of the Articles of Agreement. If the IMF can also make a determinative judgment about whether in fact a WTO Member’s measure is a genuine or appropriate exchange measure, it can effectively take away a WTO Member’s “safe harbor” under Art. XV just because it does not like the measure, i.e. it does not think the measure is an appropriate exchange policy, even though the measure is consistent with the *law* of IMF Articles of Agreement.

Fast-forwarding to the WTO era, in the *Argentina-Textiles and Apparel* case, Argentina argued that a 3 per-cent ad valorem tax that it collected was for purposes of funding the collection of accurate statistical data on import and export transactions as part of its overall understanding with the IMF on stabilization and adjustment. The panel held that there was no exception under the GATT that would, for these reasons, limit Argentina’s obligations under Art. VIII with regard to customs fees. The panel did not consider whether, given that Argentina was maintaining the tax in the context of its arrangements with the IMF, the tax could be deemed to be an exchange measure within the meaning of XV:9 of the GATT. The fact that the tax applied to all imports indicates that it was not intended as a protectionist measure to shelter Argentine industries from competition while lending plausibility to its connection to Argentina’s exchange arrangements. The Appellate Body upheld the panel’s approach.¹⁶ Argentina had argued that the Declaration on Coherence and the subsequent Agreement between the IMF and the WTO, discussed in section [1996 agreement, on page 7 of this paper, also referred to in footnote 4 on same page] above, were “legislative developments” in the WTO which

¹⁴ *Guide to GATT Law and Practice*, Vol. I (Geneva: WTO, 1995), p. 439.

¹⁵ *Special Import Taxes Instituted by Greece*, Report Adopted by the CONTRACTING PARTIES on 3 November 1952, G25-1S48, paras. 9-11.

¹⁶ *Argentina-Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, Report of the Appellate Body, WT/DS56/AB/R (adopted 22 April 1998), paras. 69-74)

had the effect of creating a meta-norm of avoidance of “cross-conditionalities,” such that its relations with the IMF would require a state to engage in conduct that would violate WTO law. The Appellate Body first of all observed that Argentina had not shown to the panel’s satisfaction that the tax had been requested of it by the IMF or there was a conflict of *legal obligation*, i.e. that Argentina had a legally binding agreement with the IMF that would be violated if it did not impose the tax.

These findings of the Appellate Body suggest a far too narrow and formalistic view of the problem of coherence and conflicting conditionalities. In many cases the IMF’s requirements are of a general nature, and linked to the achievement of certain results. The IMF leaves the specific instrumentalities up to the state in question. The fact that the IMF has not requested “x” policy does *not mean* that “x” policy does not result from requirements imposed by the IMF—the policy in question may be one of the only feasible ways of satisfying the IMF demands at reasonable social cost, for example. The notion of legal conflict suggested by the Appellate Body is equally problematic. It reduces the challenge of coherence to a notion of avoiding conflicting treaty requirements. However, international law is not the only or even the primary lever that the IMF uses to “enforce” conditionality; rather, the IMF will simply not disburse further funds to a state that does not meet its conditions, regardless of whether those conditions are formalized as legal requirements or expressed as is typically the case in “memoranda” or “letters of intent” from the state in question.¹⁷

The Appellate Body placed considerable emphasis on the notion that neither the Declaration on Coherence nor the subsequent Cooperation Agreement between the WTO and the IMF added to or diminished the rights and obligations contained in the WTO Agreements. The Appellate Body noted that the effect of cross-conditionalities or possible conflicts between measures that might result from IMF programs and WTO obligations was specified as “consultation” between the Fund and the WTO. Yet when it considered whether the panel’s failure to consult with the Fund constituted a violation of its obligation to make an objective assessment of the matter, the Appellate Body *ignored* the consultation requirement as set out in the Paragraph 10 of the Agreement between the IMF and the WTO. While the consultation requirement in Paragraph 10 applies, as a *sui generis* obligation, to discussions between IMF staff and the WTO Secretariat in cases of a possible situation of cross-conditionalities and does not as such demand consultations between a dispute settlement panel and the IMF staff, the Appellate Body failed to consider that this requirement might have relevance for the *interpretation* of Art. XV of the GATT and also for the meaning of the obligation “to make an objective assessment of

¹⁷ See O. Eldar, “Reform of IMF Conditionality; a Proposal for Self-Imposed Conditionality,” IILJ Working paper 2005/10, New York University Law School, Centre Global Administrative Law Series; D. Siegel, “Legal Aspects of the IMF/WTO Relationship: The Fund’s Articles of Agreement and the WTO Agreements,” 96 *American Journal of International Law* 561 (2002), p. 581: “even those measures that constitute Fund conditionality do not entail legal obligations to implement the policies in the program. As a legal matter, failure to complete those measures results solely in the non-fulfillment of a condition for the use of Fund resources. Political ramifications may stem from this failure, but the legal consequences are limited to the suspension of financing absent further action by the Executive Board; they do not give rise to a breach of obligation or the possibility of sanctions.”

the facts” under Article 11 of the WTO DSU. Briefly put, the thrust of the Declaration on Coherence and the subsequent Agreement between the IMF and the WTO is that issues that arise from possible inconsistencies between measures taken in relation to Fund programs on the one hand and WTO obligations on the other ought, at least in the first instance, to be addressed through consultations and cooperation between the WTO Secretariat and the Fund. Arguably, in light of the Agreement between the IMF and the WTO, Article XV:9 could be *interpreted* so as to encompass any measure related to the fulfillment of an IMF program to restore payments and exchange rate stability that would otherwise be WTO-inconsistent; the Agreement gives meaning to the exception in Article XV by specifying *ex ante* consultations between the WTO Secretariat and the IMF rather than *ex post* dispute settlement, as the means by which possible inconsistencies between IMF measures and WTO measures are resolved. This would explain why, as the Appellate Body observed, the Agreement between the IMF and WTO does not contain any “rules” for resolving conflicts; the Agreement specifies policy coordination not rule-application through dispute settlement as the manner in which such measures are to be addressed.

In the *Dominican Republic-Cigarettes* case, the Dominican Republic argued that a foreign exchange fee charged on certain import transactions was an exchange measure within Art. XV:9(a) of the GATT and thus justified even if otherwise inconsistent with GATT Art. II, because “it is prescribed by monetary authorities, not by trade or customs authorities; it applies to exchange actions, not to import transactions as such; and it is a charge on foreign exchange transactions imposed through the banking system, not a charge on import transactions levied by customs authorities.”(para. 7.124).

The panel rejected the Dominican Republic’s defense under Art. XV:9 on the grounds that “since Article XV:9 of the GATT exempts exchange restrictions measures that are applied in accordance with the Fund Articles, from obligations under other Articles of the GATT, the guiding principle that the IMF prescribed as the criterion for the determination of what constitutes an “exchange restriction” should be respected by this Panel.”(para. 7.132). This is the same non-sequitur evident in the panel ruling on the Greek import charge in the 1950s—the leap from the textual requirement of the GATT that a measure justified under XV:9 be consistent with the IMF Articles, the constitutional treaty of the IMF, to the conclusion that the IMF and its policies should be determinative *in other respects* of whether the measure falls into Art. XV.

In jumping to various IMF documents to assess whether the Dominican Republic’s measure was an “exchange restriction” within the meaning of those documents, the panel failed to consider the meaning of the text of Art. XV, especially the language, “exchange restrictions,” in light of the purpose and object of the WTO agreements. It looked at Art. XV:9 as if it simply ceded jurisdiction or deferred to the IMF, rather than being intended to fulfill goals of the WTO itself, such as the achievement of full employment and improving standards of living, through allowing a country to safeguard the stability of its currency and payments as a sovereign matter, and not on account of the authority of the IMF. Thus, the panel asked the IMF for a legal opinion as to whether the Dominican Republic measure was an “exchange restriction”

and the Fund replied that in its current form, as a fee charged on importation rather than all foreign currency transactions, the measure was not an “exchange restriction.” The panel simply deferred to this judgment of the Fund even though, as already noted, the legal meaning of an “exchange restriction” is not a matter listed in what is drafted in XV:2 as an exhaustive list of the matters where a panel must obtain and defer to the views of the IMF.

The rejection of the Dominican Republic’s Art. XV:9(a) defense in this manner was all the more egregious, given that the Fund, having given an opinion on a matter where according to GATT XV:2 it has no particular mandate, the interpretation of language in the GATT treaty (in this case the expression “exchange restriction”) *then* stated that it would not go on to give an opinion on the matter where it *is* given a mandate, namely the consistency of the Dominican Republic’s measures with the IMF Articles. (Para. 7.150).

Through a logic so twisted that it is almost impossible to fathom, in light of the IMF’s failure to indicate whether the measure was consistent with the IMF Articles, the panel held that the Dominican Republic had not discharged its burden of proof to show that the measure was consistent with the IMF Articles. But how *could* such a burden of proof be reasonably imposed on the Dominican Republic? Art. XV:2 states that whether action in exchange matters by a Contracting Parties is in accord with the IMF Articles is a matter for determination by the Fund, thus if, as here the Fund refuses to make that determination, by the very language of XV:2 there is no alternative route open to the Dominican Republic to *prove* consistency with the IMF Articles.

In sum, as interpreted by in the WTO dispute settlement system¹⁸, the WTO rules on exchange actions are likely to be permissive on any macroeconomic policy intervention that has the explicit blessing of, or is specifically required by the IMF; however, where a WTO Member takes an action that the Fund is not prepared to endorse, or that it has not required, and such an action falls generally with the kind of exchange measures covered by Art. XV there is something close to a presumption that the WTO rules have been *violated*.

Trade Restrictions for Balance-of-Payments Purposes¹⁹

Articles XII to XIV of the GATT elaborate a complex code designed to govern and discipline the use of trade restrictions for balance of payments purposes. Article XII:1 states the basic right of any Contracting Party to impose quantitative restrictions in derogation from Article XI ‘in order to safeguard its external financial position and its balance of payments’. Article XII:2 establishes that such restrictions shall be limited to what is ‘necessary: (i) to forestall the imminent threat of, or to stop, a serious decline in

¹⁸ While there was an appeal to the Appellate Body in *Cigarettes*, the Dominican Republic did not, unfortunately, appeal the panel’s findings on Art. XV.

¹⁹ The following draws from Michael J. Trebilcock and Robert Howse, *The Regulation of International Trade*, Third Edition (London and New York: Routledge, 2005), ch. 5 “Trade, Exchange Rates and the Balance of Payments.”

monetary reserves, or (ii) in the case of a Contracting Party with very low monetary reserves to achieve a reasonable rate of increase in its reserves'. As well, such restrictions must be progressively relaxed as the balance of payments improves.

Furthermore, Contracting Parties 'undertake, in carrying out their domestic policies, to pay due regard to the need for maintaining or restoring equilibrium in their balance of payments on a sound and lasting basis' (XII:3). At the same time, no Contracting Party is obligated to take domestic balance of payments measures that would threaten the objective of full employment (i.e. contracting the domestic money supply to dampen demand for imports, XII:3(d)). A process of consultations is envisaged with the GATT Council concerning any new restrictions or increase in restrictions, with periodic review of the necessity of the trade measures and their consistency with Articles XII–XIV. In addition, Article XII contains provisions on dispute settlement, including the authorization of retaliation where a Party persists in trade restrictions that have been found by the Contracting Parties to violate the GATT.

Articles XIII and XIV contain, respectively, the requirement that measures taken pursuant to Article XII:1 be implemented on a non-discriminatory basis and certain narrow exceptions to this non-discrimination requirement, e.g. where discriminatory exchange controls have been authorized by the IMF (see the discussion of substitutability below).

In the case of developing countries, there is a much broader exemption for balance of payments-based trade restrictions. Hence, Article XVII:2(b) states the principle that developing countries should have additional flexibility 'to apply quantitative restrictions for balance of payments purposes in a manner which takes full account of the continued high level of demand for imports likely to be generated by their programmes of economic development'.

What this suggests is that even though a developing country could address its balance of payments difficulties through exchange rate adjustments or tighter macroeconomic policies, it should not be expected to do so given the harm to development that may come from the resultant decline in needed imports. It is recognized that quantitative restrictions will allow a developing country to conserve its limited foreign currency resources for purchases of imports necessary for development – whereas an exchange rate devaluation would result in *all* imports becoming more expensive. In this connection, it bears emphasis that balance of payments restrictions in general may be discriminatory with respect to products although not with respect to countries. Indeed, it is explicitly stated that 'the contracting party may determine (the) incidence (of restrictions) on imports of different products or classes of products in such a way as to give priority to the importation of those products which are more essential in the light of its policy of economic development' (XVIII B(10)).

In 1979 the Contracting Parties, without formally amending the General Agreement, made the 'Declaration on Trade Measures taken for Balance-of-Payments Purposes',^{14]} which expanded the ambit of Articles XII–XIV and XVIII beyond quantitative restrictions to include 'all import measures taken for balance of payments

purposes'. The Declaration also imposes an obligation on Contracting Parties taking such measures to 'give preference to the measure least restrictive of trade.'

The Understanding on the Balance of Payments Provisions of the General Agreement on Tariffs and Trade 1994, incorporated in the Uruguay Round Final Act, is aimed at improving GATT/WTO discipline of trade measures taken for balance of payments purposes. Members commit themselves to publish, as soon as possible, time-schedules for the removal of such trade measures. Such schedules may, however, be modified 'to take into account changes in the balance-of-payments situation' (Article 1). Furthermore (and perhaps the most important modification of the existing GATT regime), Members commit themselves to give preference to trade measures of a price-based nature, such as tariff surcharges, and to only resort to new quantitative restrictions where 'because of a critical balance-of-payments situation, price-based measures cannot arrest a sharp deterioration in the external payments position' (Articles 2, 3). The Understanding further sets out an elaborate set of procedures for review by the Committee for Balance-of-Payments Restrictions of both the time-schedules for elimination of existing restrictions and notifications of any new restrictions. The overall intent appears to be that of placing balance of payments trade restrictions under ongoing scrutiny, with a view to their elimination as soon as possible. This is consistent with the original GATT regime, where such restrictions are envisaged as temporary, and not an appropriate longer-term solution to payments imbalances. It is also, however, something of a retreat from the more permissive approach to such restrictions reflected in the Tokyo Round declaration.

Pursuant to the Understanding, on 31 January 1995, the WTO General Council established the WTO Committee on Balance-of-Payments Restrictions. From its inception through 2003, the Committee has conducted consultations with numerous Members concerning the existence and possible reduction and phase-out of their balance of payments restrictions, including Brazil, South Africa, Slovakia, Poland, Sri Lanka, India, Egypt, Turkey, Tunisia, Hungary, Nigeria, Bangladesh, the Philippines, the Czech Republic, Bulgaria and Pakistan. In most cases, Members made commitments to eliminate or reduce the restrictions in question, which satisfied the Committee. In some instances, with respect for example to India and Tunisia, there was some controversy within the Committee itself as to how rapidly the balance of payments situation of the country would reasonably permit the removal of measures.

Dissatisfied with the lack of consensus on India's use of balance-of-payments based trade restrictions, the United States challenged India's continued use of balance of payments-based trade restrictions in dispute settlement, claiming violations of the GATT and the BOP Understanding. A key threshold issue was the relationship between the mandate of the BOP Committee and the jurisdiction of the WTO dispute settlement organs; India argued that, given the explicit role of the Committee in the surveillance of the challenged measures, the dispute panel should defer to that process. The panel below found that the competence of the BOP Committee and that of the panel were not mutually exclusive in these matters. India appealed this finding.

The Appellate Body (AB) first observed, in disposing of this appeal that, according to Article 1.1 of the Dispute Settlement Understanding (DSU), the dispute settlement procedures in the DSU apply generally to disputes brought under the dispute settlement provisions of the covered agreements (in this case Article XXIII of the 1994 GATT), and that furthermore the DSU rules and procedures are subject only to special or additional rules identified in agreements as listed in Appendix 2 of the DSU. The AB noted that ‘Appendix 2 does not identify any special or additional rules or procedures relating to balance of payments restrictions’ (para. 86). In particular, it did not mention Article XVIII:B of the GATT, which calls for review by the CONTRACTING PARTIES of balance of payments restrictions maintained on the basis of developmental considerations set out in XVIII:B. Thus, one could not infer any limitation on the rights of access to dispute settlement under the DSU, or on the competence of panels to interpret and apply the balance of payments provisions of the GATT, from the grant of competence to review XVIII:B justifications for such restrictions to the CONTRACTING PARTIES. India, however, also argued that GATT practice with respect to Article XXIII precluded access to dispute settlement for balance of payments purposes. Since Article XXIII is the very basis on which DSU procedures may be invoked in the case of the GATT, practice with respect to Article XXIII of the GATT is relevant to the ultimate scope and limits of authority of panels and the AB when they are applying the GATT. Here, however, whatever pre-existing GATT practice existed in this matter was codified and perhaps also modified by the BOP Understanding negotiated in the Uruguay Round. The second sentence of footnote 1 to the BOP Understanding reads: ‘[t]he provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of restrictive import measures taken for balance-of-payments purposes’. Here, India argued that the expression ‘application’ somehow limited the competence of the dispute settlement organs in balance of payments disputes, in favour of that of the Membership, sitting as the BOP Committee. The distinction that India drew was between disputes about the ‘application’ of balance of payments measures and those that concerned the substantive justification of the measures.

The AB, however, held that the use of the word ‘application’ merely reflected ‘traditional GATT doctrine that, with the exception of mandatory rules, only measures that are effectively applied can be the subject of dispute settlement proceedings’ (para. 93). But, at first glance, this very interpretation would seem to risk reducing the word to complete inutility – as *that* much, the AB is saying, has already been established by GATT practice. However, the BOP Understanding is intended to ‘clarify’ Articles XII and XVIII:B of the GATT. Such clarifications provide greater legal certainty and security, but will amount in large measure to restatements of what a sound treaty interpreter would already find to exist in the *status quo*. The assumption in treaty interpretation developed in *Reformulated Gasoline* and subsequent cases that each treaty provision should be assumed to have a discrete, non-redundant legal meaning may have to be modified in cases where the text being interpreted is an understanding that clarifies and largely affirms other, existing legal provisions.

The problem with the AB's reading is with the semantic structure of the footnote. The footnote first asserts that '[n]othing in this Understanding is intended to modify the rights and obligations of Members under Articles XII or XVIII:B of GATT 1994'. The footnote then goes on to express the situation with respect to Articles XX and XXIII of the GATT in terms of the right to invoke these procedures in matters arising from the application of balance of payments measures. Now if, as the AB suggests, the effect is simply to confirm existing rights under Article XXIII, then why was Article XXIII not added to the list of GATT provisions containing rights and obligations that the BOP Understanding is not intended to modify?

The AB's interpretation of the word 'application' is also undermined by the structure of Article XVIII:B of the GATT itself. XVIII:B (9) contains the criteria for justification of balance of payments measures under XVIII:B, while XVIII:B (10) states certain conditions that a Member must adhere to in the application of its balance of payments measures, even if they are justified under XVIII:B (9). Thus, the relationship between XVIII:B (9) and XVIII:B (10) is not dissimilar to the relationship between the various lettered paragraphs of Article XX and the *chapeau*. Thus, the most obvious interpretation of 'application' in the footnote is that the BOP Understanding modifies rights and obligations under Article XXIII of the GATT to the extent that it limits dispute settlement action under XXIII to claims that the *application* of balance of payments measures is inconsistent with the criteria for such application contained in XVIII:B (10), which would be consistent with exclusive competence for the BOP Committee with respect to review of justification of such measures under XVIII:B (9).

Despite all this, there may be good legal reasons why the AB came to the conclusion that footnote 1, second sentence, of the BOP Understanding does not oust the jurisdiction of the dispute settlement organs to consider complaints related to the justification of balance of payments measures under XVIII:B (9). As the AB noted, the DSU itself purports to provide transparency with respect to any special procedures that might apply so as to modify or supplement DSU procedures in the case of particular covered agreements, and the BOP Agreement is not on the list.

In the *India-Balance of Payments* case, the exception relied on by India required that balance of payments restrictions be removed as soon as the crisis conditions to which they were addressed had passed, unless the removal were likely to provoke the return of those conditions. However, a further proviso was that, in any case, a developing country should not be required to remove balance-of-payments import restrictions, if doing so could require a change in that country's development policies.²⁰ India's reliance on this provision required the Appellate Body to determine what is a development policy and whether if India were to remove its balance-of-payments restrictions it would be required to change its policies.

²⁰ The following draws on R. Howse, "Mainstreaming the Right to Development into International Trade Law and Policy at the World Trade Organization", E/CN.4/Sub.2/2004/17, 3-20. Geneva: United Nations, 2004.

What the Appellate Body did was to rely entirely on a judgment of the IMF that India did not need to change its development policies because it could address the consequences of removing its balance-of-payments-based import restrictions through “macroeconomic” policies.

Had the Appellate Body considered development policy informed by a conception of equity that includes the notion that development policy is a matter in the first instance for participation of those who are affected, it would have analyzed the legal issue quite differently.

First of all, the Appellate Body would not have accepted that one institution, and particularly, the technocrats in that institution have “ownership” of the meaning of a “development” policy. Secondly, the Appellate Body would not have embraced the stark contrast between “development policy” and macroeconomic policy. This implies that development policy is restricted to a series of techniques that “experts” view as formulae for “development,” rather than including all those policies that people—in this case, at a minimum, India and Indians—see as affecting the fulfillment of their approach to development. From the perspective of equity, as informed by the social and economic rights recognized in the UN Covenant on Social, Economic and Cultural Rights, it would be obvious that macroeconomic policies, which affect revenues available for government programmes to fulfill social and economic rights, as well as the cost of imported goods and services needed to fulfill such rights and the reserves of currency with which to pay for them, are “development policies.”

Thirdly, on the question of whether India would be required to change its development policy in order to be able to remove the balance of payments restrictions without a return to the crisis conditions that led to their imposition, the Appellate Body and the panel ought to have, for purposes of equity and coherence, considered and indeed solicited the views of a broader range of institutions and social actors—at a minimum the international organizations with express mandates on development, such as UNCTAD and the UNDP.

Finally, the Appellate Body might have considered that the provision in question is largely a matter of self-declaration—that it empowers India and above all Indians to chart their own course in development policy, and therefore that the provision is not intended to invite the dispute settlement organs to examine *de novo* India’s judgment that if it removed the restrictions, it would have to change its development policy.

In sum, even *if* the overall orthodox economic preference for macroeconomic measures over trade restrictions is correct, in the realm of the second best, trade restrictions at least of a temporary nature may be a desirable alternative to a macroeconomic policy move that leaves very severe social and economic consequences.

Trade Financing and Equity

Increasing exports is a means of addressing indebtedness and balance of payments difficulties that, instead of reducing employment with the corresponding effect of increasing poverty in many cases, actually has the prospect of bringing more people out of poverty. Yet trade financing—at least short term financing—is crucial to many export transactions and the very economic conditions that export receipts are needed to address may make access to such financing on the market, particularly in developing countries that have suffered financial crises, very difficult. This issue is broached in the 2005 Report to the WTO General Council of the Working Group on Trade, Debt and Finance.²¹ In a study of the WTO Secretariat in the late nineties, Finger and Shukrecht explain the importance of government export credit agencies in trade financing: “the commercial and political risk of international trade transactions is often much larger than for domestic transactions, because companies lack information about their foreign trading partners, the legal framework may not be well-developed and war, crisis and the sudden implementation of payment restrictions can undermine the proper completion of trade transactions . . . well-functioning ECAs [Export Credit Agencies] are probably even more important for developing country exporters [than for industrial country exporters in developed countries]. [Developing country exporters] (and their banks) are often relatively small and, therefore, less able to generate their own information on commercial and political risk abroad. They are also often likely to obtain less favourable financing terms because of mistrust by importers from other countries. This implies that developing country traders have to pay earlier for imports (possibly even cash on order) but they receive payment later (possibly only after delivery), and hence their trade financing needs are greater than for similar exporters from industrialized countries.”²²

The WTO rules, however, are not concerned with facilitating developing country exportation through export financing, but rather with disciplining or curbing such financing to the extent it is viewed as an export subsidy. The relevant provisions are paragraphs (j) and (k) of Annex I to the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement), which is titled “Illustrative List of Export Subsidies.” Paragraph (j) states that the following would be examples of prohibited export subsidies: “The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increased in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.” Further examples are to be found in paragraph (k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms. Provided, however, that if a Member is a party to an international undertaking on official

²¹ WT/WGTDF/4, 10 October 2005.

²² K.M. Finger and L. Schulknecht, *Trade, Finance and Financial Crises*, World Trade Organization Special Studies (Geneva: WTO, 1999), pp. 9-10.

export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provision shall not be considered an export subsidy prohibited by this Agreement.” The international undertaking referred to in paragraph (k) is the OECD Export Credit Arrangement. By incorporating this Arrangement in to paragraph (k) the WTO SCM Agreement essentially draws a line between prohibited and permissible forms of export financing based on an Agreement negotiated by and for developed countries in a developed country forum, the OECD. The assumed benchmarks are based on mature capital markets and sophisticated risk-spreading and allocation-vehicles typical of fully developed economies. Are these fair or reasonable benchmarks for developing countries, especially ones that have had access to private capital severely limited due to debt and/or other financial crises? The Center for International Environmental Law notes concerning the OECD Arrangement: The *Arrangement* can be understood as a cartel-like, price-fixing mechanism, where the largest lenders of export credits establish limits on competition, in terms of the interest and premia fees, to prevent running substantial losses, and thus to avoid risking intensified scrutiny by their own national parliaments or governments. It is an agreement by the richest countries in the world, and therefore its provisions are tailored for their needs.”²³

In the *Brazil-Aircraft* case, where the context was the sale for export of commuter jets that was supported by export credits by both Brazil and Brazil’s competitor Canada, Brazil argued that “due to the high level of risk perceived by international markets with respect to Brazilian borrowers, the cost to EMBRAER and to Brazilian financial institutions of raising funds to finance exports of Brazilian regional aircraft is higher than the cost to Bombardier and Canadian financial institutions of raising funds to finance exports of Canadian regional aircraft. Because PROEX payments merely offset in part that higher cost of funds, allowing export credit financing for Brazilian regional aircraft on terms that are closer to, but still less favourable than, those available for competing Canadian regional aircraft, those payments are not in Brazil’s view used to secure a material advantage in the field of export credit terms.” In other words, Brazil was arguing that the particular financing barriers faced in developing countries should be used in determining the baseline against which an export credit is assessed to determine if it is an unfair export subsidy.(Para 7.21) The panel curtly and almost scornfully rejected Brazil’s approach. Most disturbingly, the panel suggested that Brazil’s attempt to suggest that the baseline of the “marketplace” in paragraph (k) be adjusted to the circumstances and needs of developing countries had to be rejected because the paragraph was not on its face a provision concerning special and differential treatment. (Para. 7.32) It should be noted that Article 27 of the SCM Agreement does provide some time- (and otherwise) limited relaxation of export subsidies disciplines for developing countries. The interpretative approach of the panel suggests that where special and differential treatment exists in a WTO Agreement the other provisions should be interpreted in a manner that is blind as to the equities as between developed and developing country members. However, Art. 27.1 states a general principle that is much broader than the specific

²³ CIEL, “Export Credit Agencies and the World Trade Organization,” Draft Issue Brief, 2003, pp. 4-5.

exceptions and limitations in Art. 27.2ff.: “Members recognize that subsidies may play an important role in economic development programmes of developing country Members.” This principle should inform the interpretation of the SCM Agreement—there is certainly no textual indication that it is exhausted by 27.2ff. Moreover, the panel tentatively characterized Brazil’s approach to the meaning of “used to secure a material advantage” in para. (k) as a “general lowering” of SCM disciplines, which might be harmful to developing countries as a whole; but, of course, Brazil’s notion was not an across-the-board lowering of disciplines, but rather to take into account the difference in financial market conditions of a particular developing country credit-provider in relation to those conditions of its actual developed country competitors to determine whether the developing country producer is really being given a leg up or compensated for structural disadvantage and inequity. It is hard to see how such an approach could be harmful to other developing countries, many of which face much more serious structural disadvantages in terms of access to capital than Brazil. The Appellate Body compounded the indifference to developing country concerns and challenges that was shown by the panel. Although paragraph (k) refers only to the OECD Arrangement as a “safe haven” in terms of the disciplines of that paragraph, the Appellate Body used the benchmarks of the Arrangement—as noted above, negotiated by and for developed country governments in a process where developing countries lack virtually all voice—as the appropriate methodology for determining, in Brazil’s case whether the rate of interest attached to its export credits were such as to conclude that they “are used to secure a material advantage.

In the aftermath of this decision, some developing countries have, rightly, put paragraph (k) on the negotiating table in the present Doha Round of negotiations.²⁴

The General Agreement on Trade and Services (GATS), balance of payments and debt sustainability

The regulation of banks and other financial institutions is critical to management of debt and financial crises, especially from an equity perspective. The collapse of financial intermediaries can destroy the savings, as well as the jobs, of ordinary citizens. Thus, the WTO has a special set of rules that apply to liberalization of financial services within the general context of GATS. These rules limit and shape in various ways the capacity of governments to regulate the financial sector with a view to stability and equity in the management of debt and financial crises.

Before considering these special rules, it is important to understand the implications of the general framework for services liberalization, the GATS, for the management of debt and financial crises, in particular through the control of capital flows. The GATS applies to trade in services in four modes, 1) cross-border delivery (e.g. a lawyer in one WTO Member state sends a memo to a client in another by email; 2) presence of the consumer in the territory of the vendor (e.g. tourism, education, healthcare); 3) commercial presence of the vendor in the consumer state; 4)

²⁴ CIEL, *supra*. n. 20.

transboundary movement of workers engaged in providing services. Certain obligations in the GATS apply to all services trade in these four modes. For example, the MFN obligation; in some cases, limited reservations may be taken to these obligations by individual WTO Members, and as well there are general exceptions, including in relation to balance-of-payments measures, which we shall examine shortly. At the same time, many of the most important obligations in GATS, such as the National Treatment obligation as well the “market access” rules (prohibiting quantitative restrictions) apply *only* where the particular service sector in question is listed in a particular WTO Member’s schedule of specific commitments.

Article XI:1 of GATS creates a general rule, only, however, applicable to sectors where a Member has made specific commitments, that “a Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments.” Article XI:2 states: “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 [of GATS] or at the request of the Fund.”

The language of XI:2 indicates an extremely important difference between GATT and GATS. However narrowly or restrictively interpreted, the relevant provisions of the GATT, as we have seen, contain only disciplines on *current account* measures. Under GATS, a Member’s specific commitments may prevent it from instituting *capital account* controls that economists such as Bhagwati and Rodrik have argued may be desirable or necessary to either forestall or address a financial crisis in a manner consistent with the development and general social needs of the country concerned. To understand the flexibility that may exist under the GATS to enact such capital controls it is therefore necessary to look carefully at Article XII, the balance-of-payments exception. This exception can only be utilized after satisfying a very complex and long series of conditions. The text of Article XII is as follows:

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 improves.

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 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.

A number of important features of Article XII are worth noting. First of all, XII:1 gives WTO Members with developing or transitional economies a clear right to take measures that provide a level of financial reserves “adequate” for that particular Member’s programme of economic transition or development. Thus, Art. XII:1 affirms that development goals are the legitimate basis for a WTO Member determining the kinds of balance of payments measures it needs. Whereas the measures must “not exceed those necessary” to deal with “serious balance-of-payments and external financial difficulties or threat thereof,” Art. XII:3 affirms that a Member “may give priority to the supply of services which are more essential to their economic or development programmes.” More generally, the concept of “necessity” ought to be interpreted in the context of Art. XII as a whole, which gives considerable emphasis to an individual Member’s approach

to development. There is ample room to read Art. XII so as not to require a Member to use alternative policy measures, even if less restrictive of services trade, where those measures undermine the concept of equity implicit or explicit in that Member's development program.

Unlike the case with the GATT, deference to the IMF under Article XII extends *only* to statistics and facts and conclusions drawn from such statistics and facts; therefore, a judgment about the consistency of the measures with the IMF Articles may be made independently at the WTO.

Article XII envisages consultations on balance-of-payments measures in the Committee on Balance of Payments Restrictions. However, following the logic of the *India-Balance of Payments* case, discussed above, since the GATS provides no exception from dispute settlement for Articles XI and XII of the GATS, the existence of the Committee on Balance of Payments forum would not lead to a removal or restriction of panel and Appellate Body jurisdiction.

Finally, it is important to appreciate the extent to which GATS specific commitments may imply limits to the ability to impose capital account controls. Footnote 8 of Article XVI:1 reads: "If a Member undertakes a market-access commitment in relation to the supply of a service through [mode 1] and if the cross-border movement of capital is an essential part of the service itself, that Member is thereby committed to allow such movement of capital. If a Member undertakes a market-access commitment in relation to the supply of a service through [mode 3], it is thereby committed to allow related transfers of capital into its territory." Situations where "movement of capital is an essential part of the service itself" would apply most obviously to certain kinds of financial services (for example, mutual funds), but the other kind of situation mentioned in Footnote 8 is much broader, applying to *all* cases where the service is being supplied through a commercial presence in the other WTO Member. Nevertheless, in such circumstances, the requirement of liberalization seems limited to *inward* movement of capital.

At the same time, some kinds of (outbound) capital controls might be viewed as *conditions* on who can supply services (number of service suppliers) in violation of XVI:2(a), or as "limitations on the total value of service transactions or assets" in violation of XVI:2 (b) or "total number of service operations or the total quantity of service output" in violation of XVI:2(c). This possibility arises from the extremely broad interpretation of XVI:2(a) and (c) by the Appellate Body in the *US-Gambling* case. Essentially, the Appellate Body suggested that to violate either provision, measures need not take the explicit *forms* described in those provisions provided they have comparable *effects* on restricting market access and are quantitative in nature. (Report of the Appellate Body, paras. 232, 247). Since capital account controls are clearly measures that are quantitative in nature they may well have effects on the number of service suppliers, the total value of services transactions or assets under Art. XVI.

With respect to financial services, commitments in this sector are governed by the Annex on Financial Services. The Annex contains the following provision:

2. *Domestic Regulation*

(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.

The first sentence of this provision appears to allow any measure “to ensure the integrity and stability of the financial system” without the need to show that the measure is necessary or least restrictive of trade in services. The second sentence, however, seems drafted in a manner to undermine the regulatory flexibility granted in the first sentence, in that it qualifies the use of the provision as an *exception* to GATS commitments and obligations. Thus, where a measure is not in conformity with GATS, it “shall not be used as a means of avoiding the Member’s commitments or obligations under the Agreement.” It is difficult to discern the exact implication of this qualifying or conditional language. One reading would be that it imports an intent requirement into 2(a), namely the notion that the measures must be genuinely intended to “ensure the integrity and stability of the financial system” rather than to protect domestic financial industries. Such an intent requirement might be difficult to apply in the case of a financial crisis, where ensuring the survival of domestic financial institutions may well be part and parcel of ensuring the “integrity and stability of the financial system” itself.

The GATS financial services arrangements²⁵ do not contain any specific standards defining what is appropriate prudential regulation and efforts in the WTO Committee on Financial Services to define further the meaning of prudential regulation have gone nowhere.²⁶ Under these circumstances, there is a significant debate among academic commentators as to whether and what extent the meaning of prudential regulation for purposes of the GATS carve-out should be determined by the standards of the Basel Committee on Banking Supervision. The Basel Committee, a “club” of the central bankers of the G-10, has promulgated a set of non-binding capital adequacy standards for banks engaged in international transactions. In addition, the Basel Committee has developed 25 “Core Principles for Effective Banking Supervision.” Basel II, the more recent version of the capital adequacy standards, leaves domestic regulators with a menu of options for implementation of the standards in their domestic regulatory systems, including the possibility of self-regulation, where the banks in question have the capacity make sophisticated judgments about the risk rating of various classes of their loans. Commentators have raised serious legitimacy concerns about the G-10-dominated

²⁵ The following draws from Robert Howse, “Importing Regulatory Standards and Principles into WTO Dispute Settlement: the Challenge of Interpreting the GATS Regulations on Financial Services and Telecommunications,” paper presented at the NYU-CPR Conference on Global Administrative Law, New Delhi, January 5, 2008.

²⁶ Lazaros E. Panourgias, *Banking Regulation and World Trade Law: GATS, EU and “Prudential” Institution Building* (Hart: Oxford, 2006), p. 106-107.

Basel process, and questioned whether, in a multilateral regime such as the WTO with a large developing country membership, it is appropriate for the WTO adjudicator to use the Basel standards as benchmark or baseline by which to assess regulatory measures that a WTO Member is seeking to justify under the prudential carve-out. According to Alexander, Dhumale, and Eatwell, “Although non-G10 countries can make comments to the Basel Committee, the Committee has not obligation to recognize them. The standard-setting process remains dominated by the G-10. The standard-setting process remains dominated by the G-10, even though, These standards are increasingly being applied on a global basis.”²⁷ Panourgias suggests that incorporation of the Basel standards into the WTO framework, especially through dispute settlement but even through amendment to GATS would raise the “democracy-related problem of legalization at the multilateral level of international norms, which have been developed by an international forum without the safeguards and transparency of treaty making.”²⁸ Grynberg and Silva complain of “lack of representation [for small states]” as well as “non-transparency.”²⁹

Barr and Miller on the other hand, conclude in their study of the Basel Committee in light of the Global Administrative Law approach: “The Basel Committee has increased the transparency of its processes and broadened the circle of the Basel Club. It has improved opportunities for public participation. These measures serve to increase the accountability and legitimacy of the Basel Committee’s global rule-making.” Even they, however, “would like to see greater transparency and wider participation.”³⁰ Trachtman’s concern, on the other hand, is not the Basel standards inadequately reflect the social and development concerns of small and developing countries, i.e. no economic values, but rather that they are indifferent, hostile, or insufficiently oriented to trade liberalization as a value.³¹

A number of issues arise as to the way in which the Basel standards could properly be used to interpret the prudential exception in the GATS. One view would be that where domestic regulation that is more trade restrictive than that endorsed or required by the Basel standards, it should be presumed to be unjustifiable under the prudential exception. This presumption would be reversible, but the onus can in effect be put on the WTO Member seeking to justify its prudential measures to explain *why* it needs to go beyond the international norm, i.e. the *legitimate* rationale for this, given the prudential objective.

However, from the Basel perspective, the standards have been self-consciously understood as minimum standards, and this community certainly would not discourage stricter or greater regulation, depending on the particular strengths and vulnerabilities of a country’s financial system and financial services markets and institutions. Thus, arguably for the purpose of identifying a baseline against which one can subject to special

²⁷ K. Alexander, R. Dhumale, and J. Eatwell, *Global Governance of Financial Systems: The International Regulation of Systemic Risk* (Oxford: Oxford University Press, 2006), p.

²⁸ Panourgias, *supra* n. ?, p. 114.

²⁹ R. Grynberg and S. Silva, “Harmonization without Representaton: Small States, the Basel Committee, and the WTO,” 34 *World Development* 7 (2006), p. 1224.

³⁰ Michael Barr and Geoffrey Miller, “Global Administrative Law: the View from Basel,” 17 *EJIL* 1 (2006), p. 45.

³¹ Joel Trachtman, “Addressing Regulatory Divergence through International Standards: Financial Services,” in A. Mattoo and P. Sauve eds. *Domestic Regulation & Services Trade Liberalization* (World Bank, Washington DC, 2005), pp. 34-35.

scrutiny non-conforming regulations, one would need to look to the practice of states in implementing the Basel standards in their domestic regulations, and not to take the standards themselves as evidence of some kind of common or widespread understanding of the maximum necessary level of prudential regulation.

Further, there may be some areas of prudential regulation where Basel does not engage the relevant values, interests or constituencies in the GATS. As Barr and Miller explain, the rationale for Basel is very much connected to the collective action problems and externalities involved in the globalization of financial markets, where financial instability or the collapse of major financial institutions in one jurisdiction can impose significant negative externalities on others for example, or where capital can easily escape stricter regulations in one jurisdiction by moving to another with laxer standards (“race to the bottom” effects). But there are other important values and interests at stake in prudential regulation than these (and the Basel epistemic community would not likely deny this). Such regulation for instance is closely related to deposit insurance, which may play important redistributive functions, protecting vulnerable groups that face considerable inequalities of bargaining power and information asymmetries in dealing with financial institutions, as well as systemic stability functions.

As a general matter, exchange rate stabilization, and indeed devaluation or revaluation, may be part of a desirable macroeconomic policy response to a financial crisis; but, in the absence of capital controls, at least controls on the capital account, such policies may be unsustainable. The ambit or scope of the various exceptions or limitations in the GATS may therefore be quite important in determining the range of permissible macroeconomic policy responses.

Conclusions/Recommendations

- The WTO rules on exchange actions and balance of payments justifications for trade restrictions clearly reflect a conception of equity that takes into account the particular needs and situations of developing countries. In certain, very precisely defined matters, the WTO rules entail deference to judgments of the IMF. In dispute settlement, however, those elements in the rules that reflect equity in particular as concerns developing countries have been minimized or ignored; moreover, the dispute settlement organs have gone well beyond the explicit limits of deference to the IMF such that they have deferred to the IMF even in such a matter as the meaning of a country’s “development policy” (the *India-Balance of Payments* case). From the perspective of equity as participation in decision-making concerning development, these tendencies of the dispute settlement organs are of considerable concern, since developing countries have limited and unequal representation and voice in the IMF.
- More generally, the concept of coherence reflected in the relevant WTO instruments and activities as concerns balance of payments and exchange matters is too narrowly focused on relations between the IMF and the WTO and does not include cooperation with those international institutions concerned with equity in

- development. The concept of coherence should be revised to reflect the relationship between equity and coherence as implied in the Millennium Declaration and related instruments.
- ❑ At the same time, it appears that even within the narrow conception of coherence embraced in the WTO, the agreed mechanism for avoiding cross-conditionality, namely obligatory consultations between the WTO Secretariat and the IMF prior to either taking decisions that could result in cross-conditionality, has not been closely followed. A comprehensive review should be done of the situations where and where not these consultations have occurred and whether they have been effective in the avoidance of cross-conditionality.
 - ❑ In the case of the General Agreement on Trade in Services (GATS), there is a real possibility that a WTO Member's specific commitments combined with general obligations in the GATS could result in a GATS violation if the Member adopts capital controls, which may be necessary to address a financial crisis in a manner consistent with social and economic justice. However, there are a number of exceptions and limitations provisions in the GATS that could conceivably justify such measures. International institutions with a mandate related to equity in development should endeavor to produce guidelines for the taking into account of equity in the trade and financial system in the interpretation of such limits and exceptions.
 - ❑ Especially as interpreted in dispute settlement (the *Brazil-Aircraft* case), the rules on export subsidies in the WTO Agreement on Subsidies and Countervailing Measures appear to limit the capacity of developing countries (subject to certain temporal exceptions) to provide trade financing for export transactions, based on market benchmarks devised for and by developed countries in the OECD Arrangement. Consideration should be given to an alternative approach, which would take into account, in an equitable manner, the structural differences of financial markets in developing countries as well as the special challenges of countries that have faced financial and/or debt crises in depending on private capital markets for the financing of export transactions.