Investor Protection vs Host State Regulatory Autonomy during Economic Crisis: Treatment of Capital Transfers and Restrictions under Modern Investment Treaties

Abba KOLO *

INTRODUCTION

There is a debate amongst economists over whether foreign exchange restrictions—a form of capital control—drive away foreign investors, or whether they can be used to stem the damaging effects of the flow of "hot money"; why do countries impose capital restrictions and whether such restrictions are the best available options to countries facing economic crises. For international investment lawyers, the main questions are: to what extent is a host state under legal duty to comply with the capital repatriation obligations of an investment treaty in the face of economic or financial crisis or threat thereof? Who should bear the risk of such economic turmoil and measures taken by the state to ameliorate the situation; should it be the private investor or the public in whose interest the restrictions were imposed? Should a determination by the national authorities on the appropriateness to impose restrictions be self-judging or subjected to an international scrutiny under relevant investment treaties and instruments such as the Articles of Agreement of the IMF, GATT and GATS rules? What margin of appreciation should be afforded a host state in an analysis of the rights of the foreign investor to repatriate capital on the one hand, and the regulatory autonomy of the host state on the other? In this article, we will explore these questions in the context of investor-state relationship under

---

* Lecturer in Energy/International Investment Law, Centre for Energy, Petroleum and Mineral Law & Policy, University of Dundee. I am grateful to Thomas Wälde (for suggesting the topic) and Stephan Schill for their comments and helpful suggestions. All errors remain mine. The author may be reached at: aabakolo@yahoo.com.

1 There is no clear distinction between exchange "control" on one hand and "restriction" on the other. Instead, any distinction is usually made on a case by case basis. H. Aufricht, Exchange Restrictions under the Fund Agreement, 2 J INTL (1968) 297, 298. According to Joseph Gold, exchange restrictions may be "described as the governmental control of payments and transfers that affect the country's balance of payments, or as the governmental control of the means used to make, or of the means resulting from, such payments and transfers." J. Gold, Exchange Control: Act of State, Public Policy, The IMF's Articles of Agreement, and other Complications, 7 Souls J.I.L. (1984) 13, 22; K. Els, The Effects of Capital Controls on Foreign Direct Investment Decisions under Country Risk with Intangible Assets, IMF Working Paper, WP/07/79 (2007), available at: www.imf.org/publications at p. 3 (noting that: "Capital controls are administrative measures initiated by governments to alter the composition or size of foreign investments and also to restrict capital outflows of the economy.") C. Proctor, Mann on the Legal Aspect of Money (6th ed. Oup, 2005) 357.

According to Fawcett, "[a]ll exchange restrictions are a form of control; but not all exchange control is restrictive of international payments." For instance, "the requirement that exchange transactions be carried out through authorised dealers, or the checking of the purposes for which foreign currency is needed, or the requirement that foreign currency obtained from export sales be surrendered for legal currency, are all forms of exchange control, which are not in themselves restrictions upon the payments made." J. Fawcett, The International...
modern investment treaties and in light of state practice and judicial and arbitral jurisprudence. The discussion of the issue is pertinent in view of current liberalisation of capital movements in tune with globalisation and the susceptibility of countries to experience financial crisis or suffer from its “contagion” effects. The issue is more interesting in view of the different conclusions reached by arbitral tribunals sitting over disputes arising from the Argentine economic crisis and the legal consequences of such crisis on the country’s responsibility to foreign investors who suffered economic harm as a result of measures adopted by the Argentine government to tackle the problems.

Section one examines the economic and political rationale for capital restrictions and the historical development of liberalisation of capital movements in developed and developing countries with a view to demonstrating the commonality in perception and use of capital controls by all countries at one time or another. It notes that whilst recognising the right of member states to impose capital controls, the IMF Articles of

Monetary Fund and International Law, 40 BYIL (1964) 32, 42. However, “although a licensing or similar procedure is not in itself a restriction, it would be regarded as one if it unduly delayed the making of payments or transfers.” J. Gold, The International Monetary Fund and Private Business Transactions, IMF Pamphlet Series (1965) p. 8 quoted by M. Schuster, The Public International Law of Money (OUP, 1973) 143; Thus, “an exchange control measure may constitute an impermissible ‘restriction’ if it involves a direct governmental limitation on the availability or use of exchange as such. The more direct, and the greater the practical obstacle to the acquisition of foreign exchange, the greater the likelihood that the measure will be viewed by the IMF as constituting a ‘restriction’.” See S. Zamora, Exchange Control in Mexico: A Case Study in the Application of IMF Rules, 7 Hous. J. Int’l L. (1984) 103, 108–109.


Although jurisprudentially, exchange restrictions and control are different—the former constituting a “real interference” with international financial transaction and so prohibited under the IMF Agreement, as opposed to the latter which is a “mere nuisance” on such transactions but allowable under the IMF Agreement—nevertheless, both could have the same practical effect, which is to limit capital transfer and probably impose hardship on private commercial and economic activities—hence the terms being used interchangeably. Gold, (1984), ibid, 52; Schuster, ibid, 31–34, 140–144.

7 C. Lichtenstein, International Jurisdiction over International Capital Flows and the Role of the IMF: Plus ça Change ..., in M. Giovannoli (ed), International Monetary Law: Issues for the New Millennium (OUP, 2000) 61 at 77; S. Fisher, Economic Crises and the Financial Sector, 1998, available at: www.imf.org; F. Gianviti, The Prevention and Resolution of International Financial Crises: A perspective from the International Monetary Fund, in Giovannoli (ed), 97; B. Steil, The End of National Currency, Foreign Affairs, May/June 2007, p. 83; contrast with J. Bhagwati, The Capital Myth: The Difference between Trade in Widgets and Dollars, Foreign Affairs, May 1998. The difference in opinion is recognised by international tribunals. However, these are policy questions for political leaders to decide and not for international tribunals to second guess those decisions. Instead, the role of the tribunal is to decide “whether the requirements for the preclusion of wrongfulness have or have not been met” by the host state which seeks to invoke the legal defence of necessity under customary international law or the exceptions to free transfer of capital under the relevant investment treaty. See CMS v. Argentina, award of 12 May 2005, para. 323; Enron v. Argentina, award of 22 May 2007, para. 309, both available at: www.investmentclaimcomp.com.

3 “Recent financial crises have put capital controls in the focus of renewed investigation...” See Elo (2007) supra (n.1). The imperative for the investigation is not only from the economic and policy perspective but also, from the international investment law angle as will be demonstrated in this article.