Leaked TPP Draft Text On Investment Reveals Debate On Capital Controls

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The draft text of the investment chapter in the Trans-Pacific Partnership (TPP) talks, which was leaked this week by a civil society group called Citizens Trade Campaign, reveals disagreement between TPP members on the key issue of whether countries should be allowed to restrict capital flows in the event of a financial crisis.

Along with the issue of indirect expropriation (see related story), capital controls is one area where key provisions remain in bracketed text, indicating a lack of agreement. Overall, however, the draft investment chapter hews fairly closely to the current U.S. model bilateral investment treaty (BIT) and past U.S. bilateral trade deals.

While much of the text is bracketed, TPP countries appear to have reached agreement on several core investor rights, including with regards to national treatment, most-favored nation treatment and minimum standard of treatment. Those investor rights are described in Section A of the text in language that reflects the current U.S. model BIT.

The draft text also confirms that Australia is seeking to exclude itself from the TPP's binding investor-state dispute settlement mechanism, which is covered under Section B of the chapter.

In particular, the leaked negotiating text includes a bracketed footnote to Section B stating that this mechanism "does not apply to Australia or an investor of Australia," and that Australia "does not consent to the submission of a claim to arbitration under this [s]ection."

*On capital flows, TPP countries have agreed to language from the U.S. model BIT* that generally commits them to ensure investors can make transfers "freely and without delay" into and out of their territory, but some countries have proposed additional text that would preserve their right to impose
controls on capital flows in certain circumstances.

Generally speaking, new provisions specific to capital controls make U.S. business representatives nervous. One representative this week argued that language in past U.S. FTAs -- which states that parties shall not be prevented from adopting or maintaining measures for "prudential" reasons, including to ensure the stability and integrity of their financial systems -- is already sufficient to cover any good faith measures related to capital controls.

This language has generally appeared in the "general exceptions" section of past U.S. FTAs, meaning its absence from the leaked investment text does not mean the U.S. is not proposing it in the TPP talks. However, two new proposals specific to capital controls are included in the leaked investment chapter itself.

The first is included in an annex to Chapter 12 on investment, although it is listed as Article XX.3, which observers said could mean it too is ultimately intended to be a part of a later chapter on general exceptions.

This bracketed proposal essentially would explicitly allow TPP countries to adopt or maintain "temporary safeguard measures" with regard to payments or capital transfers "in the event of serious balance of payments or external financial difficulties or threat thereof."

By contrast, the "prudential" exception included in past U.S. FTAs is less explicit, and critics charge that it does not allow countries to use capital controls because of a footnote clarifying it only applies to measures taken by individual financial institutions, as opposed to macroeconomic steps taken by governments to address system-wide risks (/Inside U.S. Trade/, June 1).

However, a U.S. business source this week argued that all legitimate measures that governments may have to impose when it comes to capital controls are covered under the prudential measures exception, and that there is no need to introduce new language on capital controls in a TPP deal.

Either way, the proposed article also imposes disciplines on implementing capital controls. For instance, it requires that they be applied on a non-discriminatory basis and would have to be notified to other TPP countries.

Several observers pointed out that this bracketed language introduces uncertainty because it does not tightly define what would constitute "serious balance of payments or external financial difficulties." One civil society source said it nonetheless represented an improvement over the "prudential" exception language, but argued it does not go far enough because it would only allow for "temporary" safeguards, not permanent measures.

But Kevin Gallagher, a professor of international relations at Boston University who favors giving countries greater flexibility to use capital controls, rejected that notion in an interview. He said the
leaked proposal would amount to a major step forward from the current U.S. investment model, and should be supported.

Gallagher stressed that although laws on capital controls can be viewed as permanent, the capital controls associated with them are generally employed in a temporary manner. He also pointed out that "temporary" is not defined in the proposed Article XX.3, which only states that such measures shall "not exceed those necessary to deal with the circumstances" of serious balance of payments or external financial difficulties.

Gallagher also said the proposed Article XX.3 is basically the same as language in Article XII of the General Agreement on Trade in Services (GATS), which allows members to adopt or maintain restrictions on trade in services covered under their GATS commitments, including on payments or transfers for transactions related to such commitments, "in the event of serious balance-of-payments and external financial difficulties or threat thereof."

GATS Article XII contains a list of requirements that those measures must meet that is nearly identical to the disciplines included in the proposed TPP Article XX.3.

But Gallagher pointed out that this commitment is different in the GATS because it only applies to service sectors that countries have explicitly covered under the agreement. And unlike U.S. BITs and investment chapters, the GATS and other WTO agreements do not contain a commitment by countries to ensure investors can make transfers "freely and without delay" into and out of their territory.

In a June 13 blog post on the leaked text, Gallagher speculated that countries such as Australia, New Zealand and Singapore would likely support the proposed Article XX.3 because it is "almost identical" to one found in the pending Australia-Malaysia FTA, as well as Australian FTAs with New Zealand and Singapore.

"This is a great step in the right direction and would obviously have support among Australia, New Zealand and Malaysia at least -- given that they have already agreed to these terms in their own agreement," he wrote.

*The second proposal on capital controls, which appears in brackets as Annex 12-I, applies only to Chile*. It states that Chile would not be prevented from establishing measures such as restrictions on capital movements or reserve requirements that are in accordance with Chile’s capital controls law.

Chile tried to obtain greater flexibility to impose capital controls during its negotiations for a bilateral FTA with the U.S., but was only able to obtain special dispute settlement procedures that include an additional six-month "cooling off" period before investors can file a case over capital controls.

By contrast, South Korea was able to win some flexibility to employ capital controls in accordance with its domestic law in the U.S.-Korea FTA, according to Gallagher. Annex 11-G of that trade deal allows
Korea to apply its law as long as doing so meets certain requirements. For instance, implementation must be consistent with South Korea's national treatment and most-favored nation obligations.

In an analysis of the leaked text dated June 13, consumer group Public Citizen said the U.S. has not supported either of the two TPP proposals providing countries with greater flexibility to implement capital controls. Public Citizen said it has viewed a copy of the text that indicates where each TPP party stands on various proposals.

Civil society groups, academics and lawmakers such as Reps. Barney Frank (D-MA) and Sander Levin (D-MI) have argued that the current U.S. investment model does not provide countries with enough flexibility to impose capital controls at the macroeconomic level, despite a growing consensus that capital controls are legitimate prudential financial measures that can be used to prevent or mitigate economic crises (/Inside U.S. Trade/, June 1).

For instance, a March 13 report on liberalizing capital flows by the International Monetary Fund noted that the "limited flexibility afforded by some bilateral and regional agreements in respect to liberalization obligations may create challenges for the management of capital flows." These agreements "in many cases do not provide appropriate safeguards or proper sequencing of liberalization," according to the report.

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