February 28, 2012

Hon. Craig Emerson, Trade Minister
Department of Foreign Affairs and Trade of Australia

H.R.H. Prince Mohamed Bolkiah, Minister
Ministry of Foreign Affairs and Trade of Brunei Darussalam

Hon. Alfredo Moreno Charme, Minister
Ministry of Foreign Affairs of Chile

Yb. Dato' Sri Mustapa Bin Mohamed, Minister
Ministry of International Trade and Industry, Malaysia

Hon. Tim Groser, Trade Minister
Ministry of Foreign Affairs and Trade of New Zealand

Hon. Eduardo Ferreyros, Minister
Ministry of Foreign Trade and Tourism of Peru

Hon. Lim Hng Kiang, Minister
Ministry of Trade and Industry of Singapore

Amb. Ronald Kirk, Trade Representative
Office of the United States Trade Representative

Hon. Vu Huy Hoang, Minister
Ministry of Industry and Trade, Vietnam

Re: Promoting financial stability in the Trans-Pacific Partnership Agreement

Dear Trade Ministers,

We, the undersigned economists, write to you regarding the capital transfers provisions in the proposed Trans-Pacific Partnership Agreement (TPPA). We are concerned that if recent U.S. treaties are used as the model for the TPPA, the agreement will unduly limit the authority of participating parties to prevent and mitigate financial crises.

Nearly all U.S. free trade agreements (FTAs) and bilateral investment treaties (BITs) strictly limit the ability of trading partners to deploy capital controls – with no safeguards for times of crisis. A few recent U.S. trade agreements put some limits on the amount of damages foreign investors may receive as compensation for certain capital control measures. They also extend the "cooling off" period before investors may file claims in international tribunals.[1] However, these minor reforms do not go far enough to ensure that governments have the authority to use such legitimate policy tools.

Authoritative research published by the National Bureau of Economic Research, the International Monetary Fund, and other institutions has found that limits on short-term capital flows can stem the development of dangerous asset bubbles and currency appreciations, grant nations more autonomy in monetary policy-making, and protect nations from the dangers of abrupt capital flight.[2]

The U.S. government's rigid opposition to capital controls does not reflect the global norm. According to an IMF report, "Most BITs and FTAs either provide temporary safeguards on capital inflows and outflows to prevent or mitigate financial crises, or defer that matter to the host country's legislation. However, BITs and FTAs to which the United States is a party (with the exception of NAFTA) do not permit restrictions on either capital inflows or outflows." [3] Indeed, other TPP countries typically allow more flexibility in their trade and investment treaties.[4]

While capital controls and other capital management techniques are no panacea for financial instability, there is an emerging consensus that they are an important part of the macro-economic toolkit. Indeed, all G-20 leaders endorsed the following statement at the 2011 Cannes Summit:

> "Capital flow management measures may constitute part of a broader approach to protect economies from shocks. In circumstances of high and volatile capital flows, capital flow management measures can complement and be employed alongside, rather than substitute for, appropriate monetary, exchange rate, foreign reserve management and prudential policies."[5]

Increased financial stability is in the interest of businesses, working people, and consumers in all TPPA parties. When one country falls into crisis, its trading partners lose export markets. When one country cannot control financial bubbles that drive up currency values, consumers in trading partner countries may be hurt by rising prices on imported goods. When exchange rates are unstable, long-term investors and businesses engaged in exporting or importing face uncertainty.

Thus, we recommend that the TPPA permit governments to deploy capital controls without being subject to investor lawsuits, as part of a broader menu of policy options to prevent and mitigate financial crises.

We look forward to discussing these issues further. Please direct inquiries to:

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Sincerely,

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102. Oscar Ugarteche, Investigador titular B, Instituto de Investigaciones Económicas, Universidad Nacional Autonoma de Mexico, Peru

[1] See, for example, Annex 10-E of the U.S.-Peru FTA and Annex 10-C of the U.S.-Chile FTA.

[2] For some of the most important recent studies see: Ostry JD, Ghosh AR, Habermeier K, Chamon M, Qureshi MS and Reinhardt DBS (2010). Capital Inflows. The Role of Controls. IMF Staff Position Note, SPN/10/04. Washington, DC, International Monetary Fund. Magud N, Reinhart CM (2011). Capital Controls: Myth and Reality - A Portfolio Balance Approach. Cambridge, MA, National Bureau of Economic Research. Korinek, Anton (2011), The New Economics of Prudential Capital Controls: A Research Agenda, IMF Economic Review, 59: 523-561. Further studies are available upon request.

[3] Jonathan D. Ostry, Atish R. Ghosh, Karl Habermeier, Luc Laeven, Marcos Chamon, Mahvash S. Qureshi, and Annamaria Kokenyne, "Managing Capital Inflows: What Tools to Use?" IMF Staff Discussion Note SDN/11/06, April 5, 2011. http://www.imf.org/external/pubs/ft/sdn/2011/sdn1106.pdf

[4] Sarah Anderson, "Capital Controls and the Trans-Pacific Partnership," Institute for Policy Studies, Sept. 10, 2011. http://www.ips-dc.org/reports/capital_controls_and_the_trans-pacific_partnership

[5] G20 Coherent Conclusions for the Management of Capital Flows Drawing on Country Experiences, as endorsed by G20 Heads of State and Government, November 3-4, 2011. http://www.g20-g8.com/g8-g20/root/bank_objects/0000005999-Coherent_Conclusions_on_CFMs_postCannes.pdf