Congress of the United States
House of Representatives
Washington, D.C. 20515

July 20, 2015

Ambassador Michael Froman
Office of the United States Trade Representative
600 17th Street, NW
Washington, D.C., 20508

Dear Ambassador Froman:

We write to express serious concern about the longstanding U.S. position in trade negotiations that insists upon the mobility of capital across borders, generally unencumbered by national or international regulation. Policies promoting full and free movement of capital -- without any controls on, for instance, volatile short-term speculative capital -- have contributed to a series of financial crises within countries, with devastating economic and human costs, and major disruptions in the international financial system over the past quarter century.

Press reports have suggested that a number of TPP parties have pushed to include a provision that would allow countries to adopt capital controls in order to prevent or mitigate financial crises. Unfortunately, press reports also suggest that the United States has strongly opposed the safeguard and is pushing to significantly weaken it.

We strongly urge the Administration to work to adopt a strong, clear Safeguard that will not only give governments the flexibility to impose temporary controls on capital flight to prevent or mitigate a balance-of-payment crisis, but also to use controls to prevent or mitigate massive inflows of short-term speculative capital from flooding into their economy, causing rapid currency appreciation, and pushing their external accounts into deficit, while at the same time contributing to the creation of asset bubbles -- all of which in the past have led to crises in affected economies.

These inflows also expose economies to sudden changes in market sentiment, which can result in a rapid, sudden reversal of flows out of the country, creating even greater financial instability domestically and to the international financial system as well.

In the late 1990s, the East Asian financial crisis showed the devastating effect that unregulated short-term speculative capital flows can have on economies. Massive floods of foreign volatile capital surged into East Asian countries, and then abruptly reversed at a moment's notice, plunging once-successful economies into deep recession.

Since then, a growing number of leading international economists and international institutions -- including the International Monetary Fund (IMF, or, the Fund), the United Nations, and the Asian

Development Bank -- have recognized that measures to control the inflow and outflow of short-term capital are legitimate policy tools that can help prevent and mitigate financial instability.
In 2012, the IMF Board of Directors adopted a new institutional view that formally endorsed the use of capital controls, under certain circumstances, to help calm volatile capital flows that can give rise to macroeconomic and financial instability. This decision was based in part on IMF research that found controls on cross-border financial flows can not only be desirable, but also effective. Countries that used capital controls in the run up to 2007-2008 financial crisis, IMF's economists concluded, avoided some of the worst growth outcomes associated with financial fragility, with GDPs falling less sharply.

In response to questions raised by members of Congress and prominent economists, Administration officials have maintained the view that the risks of volatile capital flows are best managed through a mix of fiscal and monetary policy measures, exchange rate adjustment, accumulation of reserves, and non-discriminatory prudential measures, such as bank reserves or capital requirements. A 2010 IMF report, however, outlined the shortcomings associated with each of these policy responses and concluded that capital controls may still be necessary in some cases. Indeed, a number of nations introduced some form of capital controls in the wake of the 2008 crisis, including Brazil, Indonesia, South Korea, Taiwan, and Thailand.

It's important to note that when the IMF changed its position on capital controls in 2012, it raised a specific concern that the Fund's endorsement of the use of capital controls could put a country in conflict with its international obligations under free trade agreements, many of which prohibit their use. According to the Fund's Articles of Agreement, under a provision designed to safeguard its resources, the Fund has the right to request that a country in crisis adopt capital controls to avoid the use of the Fund's resources to finance capital flight. This creates the risk that in complying with its obligations, for example, under a U.S. trade agreement, a member country could be rendered ineligible to use the Fund's resources in a time of crisis.

We strongly urge the Administration to work to strengthen the Safeguard proposal, with priority changes that include the following:

1. **Explicitly allow regulation of both capital inflows and outflows.** Outflows controls can be useful to stem capital flight during a balance-of-payment crisis, while inflows controls have proven useful in some circumstances to prevent rapid currency appreciation and asset bubbles.

2. **Close the loophole for equities investments.** An exception for this form of investment would render the safeguard ineffective, as many investors could avoid the controls by quickly converting their positions into equities.

3. **Allow sufficient time for crisis prevention and mitigation**. Once the use of capital controls is accepted as a legitimate macroprudential tool, it makes little sense to arbitrarily cut them off

after one year. In some circumstances, instability can last longer. For example, the IMF has insisted that Iceland maintain its regulations on capital outflows through 2015, despite being put in place under an IMF program in 2009.

4. **Do not require capital controls to be price-based in all cases.** While price-based controls are generally preferred, certain financial crises might require quantitative restrictions. Thus, the provision on price-based capital controls should be suggested, but not required (similar to the manner the price-based issue was handled in KORUS).

We know that those who forget the past are bound to relive it. With what we know today about the dangers of volatile, short-term capital movements, we hope the Administration will avoid showing the world that there are times when those who *remember* the past are also bound to relive it, especially when it is likely to come at enormous economic and human cost.

Along these lines, we look forward to working with you on this and the other outstanding issues in the TPP investment chapter, such as the minimum standard of treatment, May 10th preambular language, and a diplomatic screening mechanism.

Maxine Waters
Ranking Member
House Financial Services Committee

Sander M. Levin
Ranking Member
House Ways & Means Committee

Gwen Moore
Ranking Member
House Financial Services Subcommittee on Monetary Policy and Trade

Charles B. Rangel
Ranking Member
House Ways & Means Subcommittee on Trade