



## **TPP Financial Stability Threats Unveiled: It's Worse than We Thought** *First U.S. Pact Negotiated Since Global Financial Crisis Fails to Remedy Past Pacts' Deregulatory Terms and Grants Firms New Rights to Challenge Financial Policies*

Although the Trans-Pacific Partnership (TPP) is the first U.S. trade deal to be negotiated since the 2008 financial crisis that spurred a global recession, it would impose on TPP signatory countries the pre-crisis model of extreme financial deregulation that is widely understood to have spurred the crisis. After nearly six years of negotiations under conditions of extreme secrecy, the Obama administration has only now released the text of the controversial deal after it has been finalized and it is too late to make any needed changes. The TPP financial services and investment chapters provide stark warnings about the dangers of “trade” negotiations occurring without press, public or policymaker oversight.

- **Unlike past pacts, the TPP would empower financial firms to use extrajudicial tribunals to challenge financial stability measures that do not conform to their “expectations.”** The TPP’s Financial Services chapter “reads in” Investment Chapter provisions that would grant multinational banks and other foreign financial service firms expansive new substantive and procedural rights and privileges not available to U.S. firms under domestic law to attack our financial stability measures. For the first time in any U.S. trade pact, the TPP would grant foreign firms new rights to attack U.S. financial regulatory policies in extrajudicial investor-state dispute settlement (ISDS) tribunals using the broadest claim: the guaranteed “minimum standard of treatment” (MST) for foreign investors. MST is the basis for almost all successful ISDS challenges of government policies under existing pacts. Past U.S. trade pacts allowed ISDS challenges of financial regulatory policies, but limited the substantive investor rights that applied to the Financial Services Chapter, and thus the basis for such attacks. The TPP explicitly grants foreign investors new rights (Article 11.2.2) to launch attacks on financial policies using the extremely elastic MST standard that ISDS tribunals regularly interpret to require compensation if a change in policy undermines an investors’ expectations.
- **Despite the pivotal role that new financial products, such as toxic derivatives, played in fueling the financial crisis, the TPP would impose obligations on TPP countries to allow new financial products and services to enter their economies if permitted in other TPP countries (Article 11.7).**
- **The TPP constrains signatory governments’ ability to ban risky financial products, including those not yet invented, via rules designating a regulatory ban to be a “zero quota” limiting market access and thus prohibited (Article 11.5).** TPP rules also would jeopardize efforts to keep banks from becoming too big to fail and to firewall the spread of risk between types of financial activities.
- **The TPP would be the first U.S. pact to empower some of the world’s largest financial firms to launch ISDS claims against U.S. financial policies. The TPP would greatly expand U.S. liability for ISDS attacks because currently these firms cannot resort to extrajudicial tribunals to demand taxpayer compensation for U.S. financial regulations.** Among the top banks in the world based in TPP countries are: Mitsubishi UFJ, Mizuho, ANZ, Commonwealth Australia, West Pac, National Australia Bank, Bank of Tokyo, Sumitomo, Royal Bank of Canada and Toronto Dominion. These

multinational firms own dozens of subsidiaries across the United States, any one of which could serve as the basis for an ISDS challenge against U.S. financial regulations if the TPP were to take effect. Under current U.S. pacts, none of the world's 30 largest banks may bypass domestic courts, go before extrajudicial tribunals of three private lawyers, and demand taxpayer compensation for U.S. financial policies. The TPP would allow foreign firms to challenge policies that apply to domestic and foreign firms alike and that have been reviewed and affirmed by U.S. courts. And not only foreign financial firms but foreign subsidiaries of U.S. firms operating in TPP nations could demand taxpayer compensation for financial regulations and government regulatory actions. Meanwhile, the TPP would newly empower U.S. banks, four of which rank among the world's 30 largest, to launch ISDS claims against domestic financial regulations in TPP countries that do not already have an ISDS-enforced pact with the United States (Australia, Brunei, Japan, Malaysia, New Zealand and Vietnam).

- **A provision touted as a “prudential filter” would fail to effectively safeguard financial policies from ISDS challenges under the TPP.** The provision (Article 11.11.1) states that if a foreign investor uses ISDS to challenge a government's financial measure, and if the government invokes a highly-contested provision for defending prudential measures, financial authorities from the challenged government and from the firm's home government, rather than the ISDS tribunal, will aim to determine whether the prudential defense applies (Article 11.22). *But if those officials cannot agree within 120 days, meaning officials from the challenging corporation's home country opt not to shut down their investor's claims, the decision goes back to the ISDS tribunal.*
- **The use of capital controls and other macro-prudential financial policies that regulate capital flows to promote financial stability are forbidden and subject to compensation demands by foreign corporations.** Like past U.S. free trade agreements (FTAs), the TPP text requires that governments “shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory” (Article 9.8). This obligation restricts the use of capital controls or financial transaction taxes, even as the International Monetary Fund (IMF), many prominent economists and world leaders have shifted from opposing capital controls to endorsing them as a tool for preventing or mitigating financial crises. Strong concerns about the TPP's ban on the use of such policies resulted in the inclusion of a new “temporary safeguard” provision (Article 29.3) in the TPP despite years of U.S. opposition. But unfortunately, the provision that was ultimately agreed upon would not adequately protect governments' ability to regulate speculative, destabilizing capital flows. The safeguard is subject to a litany of constraining conditions, largely replicating the narrow Article XII “Restrictions to Safeguard the Balance of Payments” terms of the World Trade Organization (WTO) General Agreement on Trade in Services (GATS). But, the TPP provision adds two *further* constraints: Capital controls are subject to ISDS challenges as indirect expropriations. Thus, while the temporary safeguard may permit a TPP country to enact a capital control for a limited amount of time, the country may also be required to compensate a foreign investor if doing so results in a significant reduction in the value of an investment. There is no comparable obligation to compensate private investors in the GATS. And, in TPP capital controls “shall not apply to payments or transfers relating to foreign direct investment,” a significant limitation. As a result, Chile, which has in place policies that allow long term limits on capital flows, had to negotiate for a separate carve-out of its policies so as to be able to preserve them.
- **The United States, unlike most other TPP countries, has chosen to subject sovereign debt restructuring to ISDS challenges.** An annex in the Investment Chapter seeks to ensure that disputes related to sovereign debt and sovereign debt restructuring are not subject to the full range of Investment Chapter disciplines (Annex 9-G). But a footnote states that the partial safeguards for sovereign debt restructuring “do not apply to Singapore or the United States.” That is, were Singapore or the United

States to negotiate a restructuring of its sovereign debt that applied equally to domestic and foreign investors, foreign investors alone would be empowered under the TPP to challenge the non-discriminatory restructuring before an ISDS tribunal, claiming violations of any of the broad substantive foreign investor rights provided by the TPP Investment Chapter.

These deregulatory rules were written under the advisement of Wall Street firms before the financial crisis. Some are included in one of the most extreme WTO agreements *to which most TPP nations are not signatories*. Rather than update these terms to reflect the post-crisis consensus on the importance of robust financial regulation, the TPP would expose an even wider array of financial stability measures to challenge as violations of the 1990s-era rules. With few exceptions, TPP governments have bound existing and future financial policies to these deregulatory rules, curtailing their policy space to respond to emerging financial products and risks if the deal takes effect. Any TPP government that would fail to conform its financial policies to TPP rules could face indefinite trade sanctions, authorized by an extrajudicial tribunal, until it brought its domestic measures into conformity. And, the TPP would expand the basis for financial firms to directly attack domestic regulation and demand compensation through ISDS tribunals. Compensation orders could be based on the “expected future profits” a tribunal surmises that a foreign investor would have earned in the absence of the financial policy it is attacking as violating the substantive foreign investor rights granted by the TPP. The tribunals would be staffed by private sector lawyers unaccountable to any electorate, system of precedent or substantive appeal. Many of the tribunalists involved in ISDS cases under existing pacts rotate between acting as “judges” and as advocates for the investors launching cases against governments. Such dual roles would be deemed unethical in most legal systems. (*For more information, see [Public Citizen’s analysis of the TPP’s investment chapter.](#)*)

### *Detailed Textual Analysis*

**The TPP would be the first U.S. trade agreement to empower foreign financial firms to challenge domestic financial policies using the broadest and most successful basis for ISDS claims – the guaranteed minimum standard of treatment for investors – which allows for compensation because an investor’s expectations were undermined.**

The most successful (and controversial) basis for investors’ challenges of government policies in past agreements is alleged violations of the guaranteed “minimum standard of treatment” for investors or the closely linked “fair and equitable treatment” (FET) provision. The TPP would be the first U.S. FTA to empower foreign financial firms to use the open-ended MST and FET provisions to challenge domestic financial regulations before ISDS tribunals (Article 11.2.2). The TPP text largely replicates the language found in previous ISDS agreements on which tribunals have relied to issue some of the most alarming ISDS rulings to date (Chapter 9, Section A). Tribunals have often broadly interpreted these terms, effectively fabricating new obligations for governments that do not exist in the actual text of ISDS agreements. Of the 29 known ISDS cases under U.S. trade and investment agreements in which the foreign investor has “won,” 76 percent (22) have found MST or FET violations. (In contrast, only seven have found national treatment violations, five have found expropriation violations and three have found performance requirement violations. Some cases found violations of multiple rules.)

Previous U.S. FTAs have shielded financial policies from these most-used and most-abused of investor claims. For example, the Korea FTA’s Financial Services chapter makes clear that firms can only bring ISDS claims against a government’s financial measures on the basis of alleged violations of the pact’s expropriation and transfers provisions (Article 13.1). ISDS claims on the basis of alleged MST or FET violations are not permissible for challenges to financial policies under any past U.S. FTA. Given that the TPP is the first U.S. trade pact to be negotiated since the global financial crisis, it is perverse that it is also the first U.S. trade pact to allow foreign financial firms to use these broad rights to attack financial policies.

While some FET violations in existing ISDS cases have involved “denials of justice” as that term has long been understood under customary international law (e.g. lack of due process), some tribunals have found FET violations for government regulatory actions that simply contradicted what investors’ argued were their “reasonable expectations.” For instance, in an *Occidental Exploration and Production Co. v. Ecuador* case under the U.S.-Ecuador Bilateral Investment Treaty (BIT), a tribunal ruled that the reasonable expectations requirement means that “there is certainly an obligation not to alter the legal and business environment in which the investment has been made.” In defending itself against an ISDS challenge that tried to invoke this sweeping interpretation, the U.S. government argued, “[I]f States were prohibited from regulating in any manner that frustrated expectations – or had to compensate for any diminution in profit – they would lose the power to regulate.” There is no right to compensation in U.S. law merely because a government policy changes after the establishment of an investment in a way that may affect a business operating here. But under the TPP, foreign financial firms with U.S. investments could claim this expansive right to challenge forthcoming policies enacted to protect against emerging financial risks.

The TPP includes nothing to forestall these extreme MST and FET interpretations. Instead, the text merely includes an annex *also contained in recent past U.S. FTAs* that states that the relevant standard under customary international law that is intended for the MST provision is one that “results from a general and consistent practice of States that they follow from a sense of legal obligation” (Annex 9-A). This circular language, which the administration touts as a new TPP remedy to the MST overreach problem, has in fact failed to fix the problem. The idea was to add a requirement that tribunals examine the *actual* practice of nations. But although this annex was first included in the Central America Free Trade Agreement (CAFTA), in two of the first ISDS cases brought under CAFTA – *Railroad Development Corporation (RDC) v. Guatemala* and *TECO Guatemala Holdings v. Guatemala* – the tribunals simply ignored the annex’s terms and the signatory nations’ attempt to narrow the definition of minimum standard of treatment. Instead, the *RDC* and *TECO* tribunals both relied on an expansive interpretation of the MST standard concocted by a previous ISDS tribunal in a NAFTA case, which included an obligation to honor investors’ expectations. On that basis, both tribunals ruled that Guatemala had violated the MST obligation, and ordered the government to pay millions. The TPP fails to remedy this severe flaw, leaving uncertainty and unpredictability that invites foreign firms to launch ISDS attacks against financial measures.

**ISDS tribunals in non-U.S. FTAs have repeatedly ruled against financial stability measures on the basis of the broad foreign investor privilege that the TPP would now grant to foreign financial firms.**

The threat that MST/FET claims pose to financial policies is unfortunately not hypothetical, as ISDS tribunals already have used expansive interpretations of MST/FET to rule against emergency financial stability measures under existing non-U.S. pacts and U.S. BITs. In one such case, Saluka Investments, a Netherlands investment company, launched an ISDS claim in 2001 under the Netherlands-Czech Republic BIT against the Czech government for choosing not to bail out a bank during the country’s banking crisis. Investicni a Postovni Banka (IPB), the first large bank to be fully privatized in the Czech Republic, along with three large banks in which the government retained significant ownership, had been suffering from significant debt and borderline insolvency, threatening the Czech banking sector. Consequently, the government placed IPB into forced administration in 2000 and then sold the bank for one crown to another bank. Saluka, a *minority* shareholder in IPB, claimed the Czech government violated its FET obligation under the BIT by not giving IPB the same degree of assistance as it gave to the banks in which the government possessed a large stake. The government argued that rectifying IPB’s debt problems was the responsibility of private shareholders, while the problems of the large banks in which the government had a major shareholding interest were the government’s responsibility. In its ruling, an ISDS tribunal crafted a broad interpretation of the FET obligation that included protection of Saluka’s “reasonable expectations.” The tribunal decided that the government’s decision not to bail out a private bank breached this

interpretation of the FET obligation by frustrating the foreign minority shareholder's expectation of consistency. The tribunal ordered the government to pay Saluka \$236 million.

In another ISDS case, CMS Gas Transmission Company, a U.S. energy firm, demanded compensation from Argentina under the U.S.-Argentina BIT for financial rebalancing policies enacted in response to a 2001 economic meltdown spurring social and political unrest. The case, launched in 2001, particularly targeted the government's limitations on gas utility rate increases – an effort, as part of Argentina's Economic Emergency Law, to stem runaway inflation. While utility rates were frozen, the international value of the Argentine peso, which had been pegged to the dollar, dropped precipitously. CMS claimed large revenue losses and argued that the freezing of consumers' rates violated the BIT's FET obligation. The Argentine government contended that the reforms were non-discriminatory since domestic investors also had to face economic losses as a result of the emergency measures. Argentina further argued that, given the national crisis, the measures were protected by a BIT clause allowing measures "necessary for the maintenance of public order." An ISDS tribunal decided that that the economic crisis in Argentina was not sufficiently severe for Argentina to be able to use this defense. (In contrast, a different tribunal in another ISDS case shortly thereafter ruled that the defense was valid because Argentina "faced an extremely serious threat to its existence".) In offering its interpretation of the FET obligation, the tribunal plainly stated, "fair and equitable treatment is inseparable from stability and predictability." Deeming Argentina's emergency financial stability measures unpredictable, the tribunal ruled that Argentina had violated the FET obligation and ordered payment to the foreign firm of \$133 million, plus interest.

### **A provision touted as a "prudential filter" would fail to effectively safeguard financial policies from ISDS challenges under the TPP.**

When presented with the new ISDS threats that the TPP would pose to domestic financial measures, proponents of the deal often express hope that a provision claimed as a "prudential filter" would be sufficient to protect financial regulations (Article 11.11.1). The provision states that if a foreign investor uses ISDS to challenge a government's financial measure, and if the government invokes a highly-contested provision for defending prudential measures, financial authorities from the challenged government and from the firm's home government, rather than the ISDS tribunal, will aim to determine whether the prudential defense applies (Article 11.22). *But if those officials cannot agree within 120 days, meaning officials from the challenging corporation's home country opt not to shut down their investor's claims, the decision goes back to the ISDS tribunal.*

First, the prudential defense itself is hardly sufficient to protect legitimate financial measures, as it does not apply to all such polices and includes a contradictory clause that undermines the efficacy of the defense (see below for an analysis of the inadequacy of the prudential defense). Second, the "filter" leaves open a large loophole by requiring government authorities to decide within 120 days if the prudential defense applies (Article 11.22). If they do not, the tribunal of ISDS lawyers – who are not regulators and who typically are not experts in regulatory policy – would have full authority to determine whether a challenged policy was protected under the prudential defense. This is particularly concerning given ISDS tribunals' track record of using investor-friendly interpretations to rule against governments. Under the TPP provision, the financial firm that brought the ISDS case could take advantage of the filter mechanism's time limit by pressuring its own government to either refuse to agree that the defense is applicable or to simply not respond in the time allotted, putting the decision back in the hands of the ISDS tribunal.

In addition, the TPP's "filter" provision omits any mention of an array of independent U.S. financial regulatory and consumer protection agencies, allowing for the possibility that these agencies could be excluded or sidelined in determining whether the prudential defense would apply to a challenged financial measure. Why would the Federal Reserve, charged with "maintaining the stability of the financial system," not be part of deciding whether a challenged financial regulation exists for legitimate financial stability

purposes? And why would the Federal Deposit Insurance Corporation not be designated as a key actor in determining whether challenged policies are designed to protect depositors? Similar questions apply to the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, the Commodity Futures Trading Commission, and the Securities and Exchange Commission.

The TPP's prudential filter does make one change relative to past agreements. A new footnote reads that, "For greater certainty, if a measure challenged under [investment rules] is determined to have been adopted or maintained by a Party for prudential reasons in accordance with [tribunal rules applicable to financial services disputes], a tribunal shall find that the measure is not inconsistent with the Party's obligations in the Agreement and accordingly shall not award any damages with respect to that measure" (Article 11.11.1, fn 11). However, what is or is not "prudential" in the first place is decided on a case-by-case basis, leaving the panelists with the discretion to decide.

### **Obligation to Allow Financial Products Not Yet Invented**

Despite the pivotal role that new, complex financial products played in spurring the 2008 financial crisis (e.g. collateralized debt obligations, credit default swaps), the TPP's financial services chapter would require each signatory government to allow foreign-owned firms to sell in their territory any new financial products and services that do not exist on the domestic market, but do exist in any of the other 11 TPP countries (Article 11.7). This obligation is not limited to financial products and services currently in existence, meaning that each TPP country would be indefinitely bound, with limited caveats, to allow financial products not yet invented to enter their economies, so long as another TPP country allows the products first. This obligation is compounded by another TPP rule (described below) that forbids regulatory bans on financial services and products – deemed a prohibited "zero quota" – meaning the TPP rules would make it very difficult for any one TPP government to forbid establishment of new financial products, even those posing risks to financial stability, paving the way for their introduction in all TPP countries.

For a majority of TPP countries, this broad obligation to accept new financial services and products would be an entirely new limit on their ability to enact domestic policies to preserve financial stability. The obligation goes beyond those included in the GATS that applies to all TPP members. Five of the TPP's developed countries are already bound to a "new financial services" obligation under an agreement called the Understanding on Commitments in Financial Services (Article B(7)). For the other seven TPP countries – Brunei, Chile, Malaysia, Mexico, Peru, Singapore and Vietnam – this TPP obligation would present an unprecedented hindrance to the government's ability to restrict risky financial products. While each government was permitted to shield certain financial policies from the obligation, each was under pressure not to do so, and all bowed to that pressure. No governments named financial policies as "non-conforming measures" exempt from the "new financial services" rule.

The text includes few, narrow limitations on the broad requirement that TPP governments "shall permit" foreign-owned firms to introduce any new financial product or service. One is that the requirement is not applicable if it requires new legislation (Article 11.7). This caveat is unlikely to exclude many new financial products from the sweeping rule, as the introduction of a new product often does not require the creation of a new law or the modification of existing ones. The complex financial products at the heart of the financial crisis did not require changes to U.S. statute to be sold in the United States.

The TPP provision also allows governments to deny authorization of new financial services "only for prudential reasons" (Article 11.7). But unless a government could preemptively prove that a new, potentially risky financial service or product may one day threaten financial stability – an unrealistic requirement – this exception would seem to not apply, meaning the government would have to accept the new product or service. For example, it would have been difficult to prove the prudential threat posed by "collateralized debt obligations" when the complex products were first introduced in the United States in

1987, despite the significant role they played two decades later in spurring the financial crisis. The “prudential reasons” caveat also fails to safeguard governments’ prerogative to deny authorization of new financial services for legitimate reasons beyond “prudential” ones, such as consumer protection. For example, a foreign firm could open the first payday lending service in a TPP country that had no payday lenders even though the service was technically legal, intending to profit via predatory loans to consumers. Since the protection of those consumers would not likely pass for “prudential,” this TPP obligation could bar the government from preventing the introduction of payday lending in its territory.

### **Restrictions on Even-handed Policies Needed to Prevent another Financial Crisis**

Despite the stark lessons of the global financial crisis, the TPP’s financial services chapter includes sweeping “market access” rules that forbid the use of commonsense financial regulations that apply equally to foreign and domestic firms. These deregulatory rules were written under the advisement of Wall Street banks before the financial crisis and included in the WTO’s GATS (Article XVI). While GATS defenders claim that the provisions are focused on liberalizing trade in financial services, they actually conflate liberalization and deregulation, simply forbidding TPP countries from applying certain common forms of regulation. Rather than revamp the rules to reflect the post-crisis consensus on the importance of robust financial regulations, the TPP would replicate the pre-crisis GATS rules. Indeed, the deal goes beyond the GATS in that all financial services of all TPP countries are subject to these constraints while in the GATS context countries had to affirmatively list those financial services they agreed would meet these terms. Thus, the TPP would require an even wider array of signatory governments’ domestic laws to conform to the now-rejected model of extreme deregulation that led to global recession.

One set of TPP “market access” rules virtually copied from GATS would expose governments to legal challenges, under threat of trade sanctions, for banning risky financial services or products, such as the complex derivatives that fueled the financial crisis (Article 11.5(a)). In the wake of the crisis, analysts, policymakers and activists alike called for toxic, purely speculative derivatives such as “naked” credit default swaps to be banned. In November 2012, the European Union banned “naked” credit default swaps based on sovereign debt, prompting new calls for such bans in the United States. However, the TPP rules bar quantitative limits on the supply of any financial services (except those specific services that the government has explicitly named as exempt from the rules). A WTO tribunal has already established that a ban of a service violates these rules: The U.S. Internet gambling ban – which prohibited *both* U.S. and foreign gambling companies from offering online gambling to U.S. consumers – was found to be a “zero quota” that violates the parallel GATS “market access” requirements.

These same TPP rules also threaten proposals to limit the size of banks so that they do not become “too big to fail.” One clear lesson of the financial crisis was that oversized banks, aware of their own systemic importance, can take undue risks with the expectation that the government would bail them out if doing so resulted in financial collapse. However, proposals to restrict the size of financial firms contradict TPP “market access” rules prohibiting limitations on the total value of financial assets or number of financial service operations (Article 11.5(a)).

Another TPP “market access” rule would undermine efforts to “firewall” different financial services to prevent the spread of risk (Article 11.5(a)). For example, Republican and Democratic leaders in the U.S. Congress seek to reinstate a version of the Glass-Steagall Act, which helped eliminate U.S. banking crises for four decades by preventing the banks that keep our savings accounts from taking hedge-fund-style bets on high-risk securities. But the TPP would imperil such reform, as it includes a prohibition against policies that “restrict or require specific types of legal entity...through which a financial institution may supply a service.” A policy that bars deposit-taking commercial banks from supplying higher-risk financial services, as Glass-Steagall did, could be challenged as a violation of this pre-crisis obligation revived via the TPP.

While TPP governments are already bound to these anachronistic “market access” requirements under the GATS, the TPP would vastly expand these obligations, not only to more existing financial services, but also to financial services not yet invented. The TPP goes beyond the GATS in requiring governments to subject all financial regulations in all financial sectors to the pre-crisis rules, unless otherwise specified as a “non-conforming measure” (Article 11.10). In contrast, the GATS only bound governments to “market access” rules for sectors they specifically named. The TPP’s so-called “negative list” approach imposed on TPP negotiators the nearly impossible burden of anticipating today all possible financial regulations – including future regulations for financial services not yet invented – that may one day run afoul of the TPP’s deregulatory rules. Were the TPP to take effect, any such regulation that a TPP government has failed to predict and preemptively exempt from TPP “market access” rules could later be challenged as a violation of those rules, exposing the country to possible trade sanctions. Despite this sweeping default application of the TPP’s rules, TPP negotiators named surprisingly few existing or potential regulations as “non-conforming measures.” By broadly committing to indefinitely avoid policies that could contradict the TPP’s 1990s-era deregulatory rules, U.S. negotiators have hamstrung future generations of financial regulations that will be needed to respond to emerging financial products and risks.

### **Foreign corporations could demand compensation for capital controls and other macro-prudential financial regulations that promote financial stability**

Like past U.S. FTAs, the TPP text requires that governments “shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory” (Article 9.8). This obligation restricts the use of capital controls or financial transaction taxes, even as the IMF, many prominent economists and world leaders have shifted from opposing capital controls to officially endorsing them as a legitimate policy tool for preventing or mitigating financial crises.

In July 2015, the four Democrats in the House of Representatives with the highest authority on matters of trade and finance – the ranking members of the House Financial Services Committee, the House Ways and Means Committee and the trade subcommittees of both – sent a letter to the Obama administration to warn against the TPP’s threat to capital controls. They concluded, “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.” In a December 2014 letter to the administration, Senator Elizabeth Warren (D-Mass.), member of the Senate Banking Committee, and Sens. Tammy Baldwin (D-Wis.) and Edward Markey (D-Mass.) urged the administration to not replicate in the TPP terms from past U.S. FTAs “that could limit the ability of the government to use capital controls.” In another letter that same month led by Congresswoman Maxine Waters (D-Calif.), the ranking member of the House Financial Services Committee, leading House Democrats made clear to the administration their opposition to the inclusion of such restrictions on capital controls in pending trade deals.

In February of that year, U.S. Federal Reserve economists backed capital controls in a study finding they “can lead to a significant welfare improvement.” And in a February 2012 letter signed by more than 100 prominent economists, including Columbia University’s Jagdish Bhagwati and former IMF officials Olivier Jeanne of Johns Hopkins University and Arvind Subramanian (formerly of the Peterson Institute for International Economics, now chief economic adviser to India’s government), demanded such provisions be excluded from the TPP: “The U.S. government’s rigid opposition to capital controls does not reflect the global norm.” This followed a January 2011 letter signed by more than 250 economists, including Nobel laureate Joseph Stiglitz, Harvard economics professors Ricardo Hausmann and Dani Rodrik (formerly at Harvard University, now at the Institute for Advanced Study), and José Antonio Ocampo (former executive secretary of the UN Economic Commission on Latin America and the Caribbean, and Colombia’s former Minister of Finance), noting that past U.S. FTAs and BITs “strictly limit the ability of our trading partners



to deploy capital controls.” Yet, the final TPP text would replicate the past U.S. template, defying the post-financial crisis consensus that policy space for capital controls must be preserved.

Broad-based concerns about the TPP’s ban on capital controls resulted in the inclusion of a new “temporary safeguard” provision (Article 29.3) despite years of U.S. opposition. But the provision in the final text of the TPP’s General Exceptions Chapter would not adequately protect governments’ ability to regulate speculative, destabilizing capital flows. The safeguard is subject to a litany of constraining conditions, largely replicating the GATS Article XII “Restrictions to Safeguard the Balance of Payments” terms.

Both the GATS and TPP language apply to “serious balance-of-payments and external financial difficulties or threat thereof” (GATS Article XII-1, TPP Article 29.3.1). The TPP adds two further constraints. First, such measures are subject to ISDS challenges as indirect expropriations. So, while the safeguard may permit a TPP country to enact a capital control, it may also be required to compensate a foreign investor if doing so results in a significant reduction in the value of that investor’s investment. There is no comparable obligation to compensate private investors in the GATS. And, in the TPP capital controls “shall not apply to payments or transfers relating to foreign direct investment.”

Both the TPP and GATS terms require capital controls to be consistent with the Articles of Agreement of the IMF; avoid unnecessary damage to the commercial, economic and financial interests of any other Party; not exceed those necessary to deal with the circumstances and not be used to avoid necessary macroeconomic adjustment. Thus, the safeguard would only apply to those capital controls that an ISDS tribunal – not a government’s central bank – deemed “necessary.” Governments, not ISDS tribunals, should have the authority to decide when capital management measures are needed and how they should be implemented. And such measures are to be temporary and phased out progressively. Under the TPP provision, even capital controls used to *respond* to balance-of-payments and other macroeconomic problems (rather than to prevent them) could run afoul of the provision’s requirement, if they last longer than 18 months. Use beyond this time period is subject to majority approval of the other TPP parties. This restriction would preclude the use of capital controls for longer-lasting financial crises. The provision would have failed to safeguard, for example, Malaysia’s capital controls implemented in 1997 in response to the Asian financial crisis, which were phased out slowly *over a decade*. Indeed, the overarching requirement that such policies be temporary means the “safeguard” does not provide policy space for capital controls of a more permanent nature, such as those relating to capital inflows that are designed to *avoid* balance-of-payments and other macroeconomic problems. For example, the capital management policies of Chile, a TPP party, involve standing laws of general application that were not implemented in response to a specific crisis, but to avoid the conditions that could cause one. A separate TPP annex would allow Chile alone to maintain or enact capital controls that are consistent with its own domestic laws to ensure financial stability (Annex 9-E). No such protection is available for other TPP nations.

**The United States, unlike most other TPP countries, has chosen to subject sovereign debt restructuring to ISDS challenges.**

An annex in the investment chapter seeks to ensure that disputes related to sovereign debt and sovereign debt restructuring are not subject to the full range of investment chapter disciplines (Annex 9-G). But a footnote states that the partial safeguards for sovereign debt restructuring “do not apply to Singapore or the United States.” That is, were Singapore or the United States to negotiate a restructuring of its sovereign debt that applied equally to domestic and foreign investors, foreign investors alone would be empowered under the TPP to challenge the non-discriminatory restructuring before an ISDS tribunal, claiming violations of any of the broad substantive foreign investor rights provided by the TPP investment chapter.

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