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Alone and Confused:
U.S. Trade Officials Defy Post-Crisis Consensus Backing Capital Controls

Congressional leaders, prominent economists and the International Monetary Fund (IMF) all agree: capital controls – regulations to stem destabilizing flows of speculative "hot money" into or out of a country – are legitimate, common-sense policy tools for preventing or mitigating financial crises. Though the lessons of the 2007-2008 global financial crisis have spurred this emergent consensus of support for capital controls, U.S. trade officials are moving in precisely the opposite direction. **Clinging to a pre-crisis position endorsed by Wall Street, the Office of the U.S. Trade Representative (USTR) continues to push binding "trade" deals that ban the use of capital controls.** U.S. negotiators have proposed this anachronistic ban in the Trans-Pacific Partnership (TPP), the controversial pact that President Obama wants to sign this year with 11 Pacific Rim nations.

U.S. "Trade" Pacts: Capital Controls Are Prohibited

According to an IMF report, "Most [Bilateral Investment Treaties] BITs and [Free Trade Agreements] 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…do not permit restrictions on either capital inflows or outflows."** A leaked draft TPP chapter on investment revealed that the deal would empower foreign banks to circumvent domestic courts, drag sovereign governments before extrajudicial tribunals, and demand taxpayer compensation for the use of capital controls.

Why Governments Use Capital Controls

- To ensure economic stability in the face of balance-of-payment crises
- To prevent asset bubbles
- To avoid rapid currency appreciation or depreciation
- To effectively use monetary policy to create jobs and stem inflation
- To eliminate rent-seeking activities
- To ensure a stable climate for long-term domestic investment

Economists, the IMF, the Fed, Congress, World Leaders: Capital Controls Are Common Sense

The IMF, which urged countries to abandon capital controls in the 1990s, officially endorsed a new, post-crisis policy position on capital controls in November 2012, stating, "In certain circumstances, introducing [Capital Flow Management Measures] CFMs can be **useful for supporting macroeconomic policy adjustment and safeguarding financial system stability**."

U.S. Federal Reserve economists backed capital controls in a February 2014 study finding they "**can lead to a significant welfare improvement**." The authors concluded, "there may be a role for capital controls to exist side-by-side with conventional monetary tools as an instrument of monetary policy."

In February 2012, more than 100 prominent economists signed a letter to TPP negotiators, stating, "We are concerned that if recent U.S. treaties are used as the model for the TPP, the agreement will unduly

limit the authority of participating parties to prevent and mitigate financial crises…**The U.S. government's rigid opposition to capital controls does not reflect the global norm.**" This followed a 2011 letter, signed by over 250 economists from around the world, to inform USTR of "authoritative research" that capital controls "**can stem the development of dangerous asset bubbles and currency appreciations** and generally grant nations more autonomy in monetary policy-making…"

In May 2012, Representatives Barney Frank and Sander Levin (then-Ranking Members of the House committees on Financial Services and Ways and Means, respectively) sent a letter to Treasury Secretary Timothy Geithner, stating, "**US free trade agreements and bilateral investment treaties are widely viewed as prohibiting governments from using capital controls to prevent and mitigate financial crises without being subject to investor claims and penalties that serve as an overwhelming disincentive to their use.**" The congressional leaders asked the Obama administration to provide "an official written statement of US policy" that capital controls used by the United States or its trading partners would not violate U.S. FTAs. No such statement was produced.

Leaders from all G-20 nations endorsed a statement supporting capital controls at their 2011 summit in Cannes: "**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."

TPP Ban on Capital Controls Defies Studies from Harvard, Columbia, Peterson Institute, Etc.

After conducting a comprehensive review of academic studies on capital flows, economists with the pro-"free-trade" Peterson Institute for International Economics concluded in 2012, "the international community should not seek to promote totally free trade in assets – even over the long run – **because…free capital mobility seems to have little benefit in terms of long-run growth and because there is a good case to be made for prudential and other nondistortive capital controls.**" In contrast, they note, "many free trade agreements recently signed by the United States – with Chile and Singapore, for example – prohibit the imposition of capital controls even for prudential reasons."

A historical study by Harvard economists Kenneth Rogoff and Carmen Reinhart found in 2009 that **in more than 60 percent of countries, large inflows of foreign capital increased the likelihood of banking crises**. Columbia University economists Joseph Stiglitz, José Antonio Ocampo and Shari Spiegel endorsed capital controls on the basis of a similar conclusion in a 2008 book: "It has become clear that pro-cyclical capital flows – particularly (but not only) short-term speculative flows – have been at the heart of many of the crises in the developing world since the 1980s."

Recent studies have found that unmanaged capital flows not only pose concerns for developing countries, but for developed nations like the United States. A 2013 IMF study analyzed the impact of dismantling capital controls on income inequality in 17 advanced economies, concluding, "The evidence is that, on average, **capital account liberalization is followed by a significant and persistent increase in inequality**."

Other recent studies have explicitly focused on the TPP's threats to capital controls. An October 2013 paper by U.S., Malaysian and Chilean economists concluded that Malaysia and Chile – **two TPP negotiating countries – "have successfully deployed cross-border financial regulations," including capital controls. The authors warn, "However, such policy space would be jeopardized if the TPP conformed to the US model…"**