Congress of the United States
Washington, DC 20515

May 23, 2012

The Honorable Timothy Geithner
Secretary of the Treasury
Department of Treasury
Washington, DC 20229

Dear Mr. Secretary,

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.

Rep. Frank has spoken with Under Secretary Brainard about this, and her response was to tell him that in the view of the Administration, our treaties do allow for capital controls in general to be applied, as long as they are not done for purposes of trade discrimination. But we are still troubled because the plain language of the treaties does not by itself seem to support that interpretation. And our concern on this is one that is shared both within the United States and internationally.

For example, an IMF staff note on managing capital inflows noted that most bilateral investment treaties and free trade agreements "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."

Also, in January 2011, 250 economists from across the globe called on the US to recognize the growing consensus on capital controls as legitimate prudential financial measures to prevent and mitigate crises that should not be subject to investor claims under US trade and investment treaties:

> We also write to express our concern that many U.S. free trade agreements and bilateral investment treaties contain provisions that strictly limit the ability of our trading partners to deploy capital controls. The "capital transfers" provisions of such agreements require governments to permit all transfers relating to a covered investment to be made "freely and without delay into and out of its territory."
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> Under these agreements, private foreign investors have the power to effectively sue governments in international tribunals over alleged violations of these provisions.
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> We recommend that future U.S. FTAs and BITs permit governments to deploy capital controls without being subject to investor claims, as part of a broader menu of policy options to prevent and mitigate financial crises.

Similarly, last February a group of 100 economists signed a letter to the ministers negotiating the Trans-Pacific Partnership (TPP), expressing their concerns that "if recent US 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 letter recommends 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."

And as we noted, this view does seem to us to get support from the language itself. Here is the language from the U.S.-Korea trade agreement:

ARTICLE 13.10: EXCEPTIONS

1. Notwithstanding any other provision of this Chapter or Chapter Eleven (Investment), Fourteen (Telecommunications), including specifically Article 14.23 (Relation to Other Chapters), or Fifteen (Electronic Commerce), and, in addition, Article 12.1.3 (Scope and Coverage) with respect to the supply of financial services in the territory of a Party by a covered investment, a Party shall not be prevented from adopting or maintaining measures for prudential reasons[5] ,including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party's commitments or obligations under such provisions.

[5] It is understood that the term "prudential reasons" includes the maintenance of the safety, soundness, integrity, or financial responsibility of individual financial institutions or cross-border financial service suppliers.

On its face, capital controls do not seem permissible under this exception. This is because the term "prudential reasons" is interpreted in a much narrower fashion, pertaining to individual financial institutions, as described in footnote 5, and so would not allow governments to respond to system-wide risks to ensure the safety and soundness of the entire financial system. And the last sentence undoes the first part of the clause.

The prudential exception is followed in the Korea text by an exception for monetary policy that reads as follows:

2. Nothing in this Chapter or Chapter Eleven (Investment), Fourteen (Telecommunications), including specifically Article 14.23 (Relation to Other Chapters), or Fifteen (Electronic Commerce), and, in addition, Article 12.1.3 (Scope and Coverage) with respect to the supply of financial services in the territory of a Party by a covered investment, applies to non-discriminatory measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange rate policies. This paragraph shall not affect a Party's obligations under Article 11.8 (Performance Requirements) with respect to measures covered by Chapter Eleven or under Article 11.7 (Transfers) or 12.10 (Payments and Transfers).

This second exception could be seen as granting nations the flexibility to pursue necessary monetary and exchange rate policy, yet the last sentence in that paragraph specifically excludes transfers.

Our concern is heightened by our reading of your letter of April 12, 2011 to Ricardo Hausmann of the Harvard University Center for International Development, a copy of which we have attached. In it, you say that "we believe those risks (of large swings in capital flows) are best managed through a mix of fiscal and monetary policy measures, exchange rate adjustment and carefully designed non-discriminatory prudential measures, such as bank reserve or capital requirements and limitations on exposure to exchange rate risk." This language appears to reinforce the footnote cited above which says that the reference there is essentially to micro-prudential policies, and not to macroeconomic concerns with capital flows such as capital controls.

Rep. Frank has received oral assurances from Secretary Brainard and USTR Kirk that despite the standard "Transfers" language included in our free trade agreements, these pacts' provisions interpreted in the context of various standard FTA exception clauses do not limit countries' use of capital controls and similar macro-prudential mechanisms.

Given the importance of this issue, and the widespread view that the language is excessively restrictive, we request an official written statement of U.S. policy on the Administration's interpretation that the scope and coverage of the "prudential exception" in US free trade agreements and bilateral investment treaties grants parties the ability to deploy capital controls on the inflow or outflow of capital without being challenged by private investors.

In recent conversations with Under Secretary Brainard, she raised a concern that any change in the texts of our agreements going forward would cast doubt on the view that the existing language embedded in treaties that are now in effect was flexible enough to allow capital controls. That is a reasonable point, and we understand it as an argument against having very different language in new treaties, but there is a way to resolve this. The official interpretations that we are asking the Administration to offer should make it clear that this is not a new view, but rather is the Administration's binding interpretation of what the existing language means, both for future treaties and for existing treaties. That is, this would in no way cast doubt on what the existing language means, but would in fact clarify it in a way that we think is important.

We specifically believe it is important that the Obama administration make public an official written statement of US policy that:

- U.S. FTA signatory countries would not be in violation of their FTA obligations and could not be challenged by an investor-state claim if they apply capital controls on either inflows or outflows to manage volatility in capital flows, including long-term capital controls adopted on a prophylactic basis.

- The scope of coverage of the standard Prudential Exception in U.S. FTAs includes the Transfers provisions, such that this exception can be used by a country as a defense to maintain a policy that would otherwise conflict with the Transfers provision obligations not to limit capital movements.

In addition, we are requesting a written statement of policy with respect to the U.S. government's interpretation of the meaning of the second sentence of the standard Prudential Exception. ("*Where such measures do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party's commitments or obligations under such provisions.*")

Absent these interpretative clarifications, we believe there will be continued doubt about the ability of our trading partners to use capital controls, and we would not support that.

Barney Frank

REP. BARNEY FRANK

Sander Levin

REP. SANDER M. LEVIN