Safeguarding financial stability in the TPP

By Kevin Gallagher
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Chilean and Peruvian officials will meet with their counterparts later this month in what may be one of the final stages in the negotiation of the Trans-Pacific Partnership (TPP). If completed the TPP will bring together 12 key Pacific-rim countries into the largest regional trade bloc on the planet.

One of the hurdles in the negotiations is the extent to which the treaty will permit national safeguards to prevent and mitigate financial instability triggered by cross-border financial flows through bonds, stocks and derivatives. Such safeguards are particularly important to many of the developing nations involved in the negotiations, having experienced wrenching financial crises in the not-too-distant past.

The fall out from those crises and the success of regulations in preventing or mitigating others is precisely why the negotiators meeting this month should hold the line in not trading away national regulations to combat financial instability.

The main obstacle to protecting these regulations in the treaty has been the Obama Administration. Meanwhile Chile, Malaysia and ranking members of the United States Congress—members of the administration's own party Sander Levin, Charles Rangel, Gwen Moore, and Maxine Waters—and to some extent the International Monetary Fund have been pressing the Obama Administration to ensure that nations have the flexibility to regulate their financial sectors.

Latin American and East Asian nations alike have learned the hard way that unregulated capital flows of the sort currently on the table in the TPP discussions can cause financial instability. Financial flows tend to surge into a country when things are going well and then rush out the door on a whim. During a surge, exchange rates appreciate and credit expands and in the rush to exit exchange rates depreciate and debt balloons. Such cycles are among the key causes of the financial crises that wracked both regions in the 1990s.

TPP nations such as Chile and Malaysia have both been praised for successfully managing foreign capital flows to prevent and mitigate those financial crises in the 1990s. Chile famously regulated the inflow of capital during a surge —thereby heading off a crisis—and Malaysia regulated the outflow of capital during a crisis itself—preventing it from becoming worse.

Based on these examples and others, in 2012 the International Monetary Fund (IMF) issued an "institutional view" recognizing the risks of capital flows, particularly in the form of capital inflow surges and flights, which can provoke financial instability. When financial flows get too volatile the IMF now recommends that nations regulate financial flows. The IMF decision also expresses concern that "[trade] agreements in many cases do not provide appropriate safeguards" to regulate financial flows.

Within the TPP, the United States is trying to mandate that all forms of finance move freely across borders and without delay, without any safeguards for regulation. Indeed, Chile was forced to accept such a condition in the 2003 U.S.-Chile Free Trade Agreement—despite Chile's trade pacts with Canada and the European Union which permitted such safeguards. On the other side of the Pacific, Malaysia has always maintained financial regulations in its treaties, but now faces resistance from the U.S. in this mega-deal.

TPP negotiations are notoriously held in secret so we don't know what the nature of the

discussions has been on this topic. But reportedly the Obama Administration has shown more willingness to negotiate on these matters. That said, even with the administration's supposed flexibility, it has not shown much of a willingness to grant countries broad scope to regulate financial flows and the risk that comes with them.

This week, members of key Congressional committees—Ways and Means and Financial Services– urged the President to ensure that the TPP gives nations a broad set of tools to regulate financial flows. The members wrote: "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."

Trading away financial stability should not be a requirement for participation in the TPP. A TPP that is friendly to financial stability would allow member countries the ability to do whatever it takes to regulate the inflow and outflow of financial flows to prevent and mitigate instability.

In 2008 the United States learned what Latin Americans have known for decades—that financial instability anywhere can lead to instability everywhere. Now, as it is about to enter into the largest trade pact in history, the U.S. needs to recognize that the lessons from seven years ago also apply to its future free-trade partners.

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