Financial Services under WTO: Disciplining governments and freeing business*

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Though overshadowed by the deep differences over agricultural subsidies and food security and on the rules governing trade in industrial goods, services were an important bone of contention at WTO's Nairobi Ministerial Conference over 15-18 December, 2015. Developed countries had achieved a major victory in the Uruguay Round of trade negotiations, when they managed to bring trade in services, defined broadly as occurring under four modes (cross-border supply, consumption abroad, commercial presence and movement of natural persons), onto the negotiating table through the General Agreement on Trade in Services (GATS). That began a process of liberalisation of trade in services, which was crucial for the developed countries because they accounted for a rising share of output and employment in the developed countries, and because while these countries had been losing their competitiveness in the production of goods, they had retained significant competitive advantages in high-end services.

However, while the Uruguay Round (UR) established a framework with four modes for examining and discussing the services trade and delivered GATS, it provided little by way of actual commitments and only a cumbersome "request and offer" regime to proceed with liberalisation. This made substantial gains in the services area an important objective in the ensuing and currently ongoing Doha Round for advocates of liberalisation. Among those services, financial services, dominated by agents operating in developed country financial centres such as London, New York and Frankfurt, are among those where the pressures to put in place a far more liberal multilateral investment and trading regime have been intense.

Liberalisation in services in general, and the financial area in particular has two important elements among its many features. First, increased market access to firms from other member nations, which involves easing the conditions for cross-border flow of capital and cross-border movement of the carriers of that capital, viz., financial firms, or dilution of capital controls. And second, more "transparent" and reduced domestic regulation, or dilution of the conditions, limitations and qualifications imposed on foreign service providers. The difficulty here was that developing country experience and the Saving and Loans and banking crises in the United States in the1980s, the periodic currency and financial crises in developing countries, the Southeast Asian financial crisis of 1997 and, more recently, the global financial crisis of 2008 had all made clear that deregulation of these kinds lead to loss of sovereignty in macroeconomic policy, currency instability and balance of payments difficulties.

But the strength of finance capital had ensure that, even under the UR, financial services received undue emphasis with a special annexe to GATS dealing with the subject and a separate protocol titled Understanding on Commitments in Financial Services, which was not part of GATS but appended to the Final Act of the Uruguay Round. The Annexe was a concession to those who recognised that financial markets, contracts and instruments have their specificities, were important instruments facilitating broad-based growth, and were far more prone to disruption with damaging systemic effects. Besides identifying specific areas of financial services that could be

brought under new disciplines, it provided for the 'prudential carve out' needed "for the protection of investors, depositors and insurance policy holders" and excluded from the ambit of the agreement government provided services that were important for economic management such as measures adopted in pursuit of monetary or exchange rate objectives. The Understanding on the other hand sought to define "an optional and alternative approach to making specific commitments on financial services" that provided the basis for a GATS-plus framework in the financial area.

Part III of GATS sets out the contours of the commitments a country can make, when it chooses to do so in any area of services as part of the 'request and offer' process. It needs to specify in its schedule of offer (applied without discrimination to all members on a most favoured nation—MFN—basis) the areas in which it plans to provide market access, and the limitations to that access, if any, in terms of modes of supply, number of suppliers, nature of the legal entity, level of foreign ownership in case of commercial presence, value of service transactions, or number of natural persons that can be employed. It also needs to indicate whether or not national treatment is being provided to foreign providers with clear specification of how it is providing 'formally identical' or 'formally different' treatment to similar, domestic services suppliers.

This initial call for 'voluntary' liberalisation in all services through the GATS framework has, in the case of financial services, sought to be extended by the 'alternative approach' to liberalisation specified in the Understanding on Commitments in Financial Services to be adopted by willing members. The starting point of this approach is a "standstill" clause in which the minimum level of liberalisation in the formal offer must be such that conditions, limitations and qualifications in areas in which commitments are being made do not involve any increase in the range or intensity of non-conforming measures or any roll-back of the extent of liberalisation implicit in the status quo.

The Understanding also provides for a minimum set of commitments that all agreeing to implement it must adopt. These involve, inter alia, listing and seeking to eliminate or reduce monopoly rights (including those of public entities); permitting commercial presence, including through acquisition; offering foreign suppliers with a commercial presence "most-favoured-nation treatment and national treatment as regards the purchase or acquisition of financial services by public entities"; permitting foreign entry in areas such as insurance for maritime shipping and civil aviation, reinsurance and provision and transfer of financial information; and reducing restraints on consumption abroad.

In sum, the idea is to create a subset of countries that set new "standards" for the extent of liberalisation of trade in financial services. This was facilitated by the creation of so-called "friends groups", including the "Friends of Financial Services". There is an explicit strategy here for advancing liberalisation in the area. The standards set under the alternative approach provide the template to be accepted in time by other members of the WTO leading to full multilateralisation of the intended financial liberalisation.

This strategy is proving powerful because of the growing importance of off-WTO trade and investment negotiations with Doha-plus ambitions with regard to financial services. Of special importance here are the secret negotiations under the Trade in

Services Agreement or TISA launched by a set of countries calling themselves "The Really Good Friends of Services" and a host of bilateral and mega-regional trade agreements, including the recently concluded Trans-Pacific Partnership Agreement (TPPA), which have incorporated in their texts substantial liberalisation of trade and investment rules relating to financial services. Since the extent of liberalisation in these off-WTO treaties between selected countries is far more than provided for in the Understanding on Financial Services, the ambition in the templates for liberalisation in the financial services area being pushed by the developed countries under the Doha Round is even greater. Of particular importance here are the standstill clauses that prevent reversal of liberalisation measures once they have been committed to and the incorporation of investor-state dispute settlement mechanisms that allow private financial entities to drag governments to extra-judicial tribunals for violation of treaty clauses.

There is a view though that this trend set by old and new trade and investment treaties in general and WTO negotiations in particular is not of much consequence because actual liberalisation in the financial services area in the developing countries has been far more than prescribed under multilateral or bilateral agreements. One reason is that external liberalisation, especially in the form of dilution of capital controls and internal liberalisation with regard to entry and liberalised conditions of operation for foreign financial players has been promoted by the multilateral institutions through means such as Financial Sector Adjustment Programmes. But an equally important reason is that, when the huge accumulation of liquidity in the international financial system after the 1970s forced private sector financial institutions from the metropolitan countries to drop their reticence to lend to or invest in the developing countries, most developing countries chose to exploit the "opportunity" and open themselves to the hugely enhanced cross-border flow of capital. Attracting such capital requires attracting the carriers of capital in the form of foreign financial institutions of various kinds. This requires suitably adjusting the regulatory regime as well. As a result, over the last few decades, finance is an area where liberalisation has proceeded apace.

If global and domestic forces outside the WTO are ensuring the liberalisation of finance, it is argued, interested nations would not turn to the cumbersome WTO negotiating process to realise that objective. So financial services are not seen as a real issue in the Doha Round. This argument misses out on important differences in having liberalisation mandated through a WTO treaty and "voluntarily" adopted by developing countries. First, the legitimacy associated with sanction from a multilateral institution in which each nation exercises a vote and decisions are arrived at in practice by consensus is immense. Given the evidence that financial deregulation has resulted in periodic crises in developing countries and underlies the global financial crisis of 2008, such legitimacy has much value. Second, standstill clauses, if incorporated, introduce a substantial degree of "irreversibility" to the liberalisation process, protecting financial interests in ways that bind governments. And, finally, if those interests, represented by developed country governments, manage to gain treaty sanction for a non-governmental, extra-judicial, investor-state dispute settlement process, developing country governments would be forced into submission.

This is not to say that success on this front in the Doha Round is inevitable. But "failure" would not be the result of the absence of desire on the part of the developed countries to push for financial services liberalisation. Liberalisation may be stalled

only because, as services negotiators at WTO, such as those from 33 member countries who met informally in June 2015, have always recognised, “the level of ambition in services could not be higher” than in agriculture and industrial goods. And in the absence of progress in the latter, not much could be achieved in the services area.

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