CURRENT DEVELOPMENTS REGARDING THE WTO FINANCIAL SERVICES AGREEMENT

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I. The WTO GATS Agreement

A. In General

The General Agreement on Trade in Services (GATS) was the first international agreement to set rules for international trade in services. It was negotiated during the Uruguay Round and entered into force on January 1, 1995. The GATS provides a framework of obligations and a forum for future negotiations aimed at greater market access and lessened discrimination against imported services.

GATS broadly covers all "measures affecting trade in services" (Article I:1) provided through any of four "modes" – cross-border, consumption abroad, commercial presence and presence of natural persons. GATS was patterned after the General Agreement on Tariffs and Trade (GATT). It requires publications of all laws, regulations and other government measures of general application ("transparency") (Article III:1) and administration of all measures of general application in a reasonable, objective and impartial manner (Article VI:1). The GATS permits regional liberalization in services trade through customs unions and free trade areas, as does the GATT (Article XIV). It permits monopolies and exclusive providers, but requires that they act in a manner consistent with the Member's services commitments (Article VIII), similar to the obligation in GATT Article XVII. GATS also contains general exceptions and security exceptions modeled after the GATT (Articles XIV and XIV *bis*).

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However, the GATS is weaker than the GATT with respect to all major substantive obligations. The MFN and national treatment obligations, as well as liberalization of market access limitations, are voluntary. Article II:2 permits WTO Members to provide non-MFN treatment, as long as they record the exceptions in their WTO schedule of services commitments. Such exceptions "normally" expire after ten years and expressly are "subject to negotiation" in future rounds of multilateral trade negotiations (paragraph 5 of Annex on Article II Exemptions).

Similarly, a Member is not obligated to provide national treatment, as under GATT. Rather, it provides national treatment only for those service categories that it chooses and only to the extent recorded in its schedule of WTO services commitments (Article XVII). Agreements to eliminate or reduce limitations to market access (such as limits on the number of service suppliers or value of transactions or restrictions on type of legal entity or percentage of foreign capital participation) also are voluntary, applying only to those service categories included in a Member's schedule and only to the extent specified therein (Article XVI).

Given the voluntary nature of these key obligations, it is unsurprising that few Members actually reduced existing access barriers or discriminatory treatment to any significant extent. Rather, most Members were selective about the service categories as to which they undertook any obligations, and the "commitments" they did schedule often reflected the degree of openness and of limitations and discrimination then existing in their market.

B. Financial Services

The negotiations regarding financial services were not completed by the end of the Uruguay Round and the entry into force of the WTO. Subsequent efforts were successful,

though, and 104 WTO Members made commitments (some only a few, though most made many), which came into effect on March 1, 1999.[1]

The most contentious issue was "prudential measures" – designed to ensure the integrity and stability of the financial system. There was significant debate, and no ultimate shared view, concerning the dividing line between necessary and appropriate prudential measures and unnecessary limitations on market access and measures impermissibly discriminating against foreign financial service providers. As will be seen, this debate continues.

II. Current Developments

There are two major current developments regarding financial services in the WTO: (1) commitments undertaken by China; and (2) proposals for changes in the financial services framework now being discussed as part of the Doha Development Agenda. Each will be discussed.

A. China's Financial Services Commitments

1. Banking

Prior to China's WTO accession, there were severe restrictions on where foreign banks could operate. They could not conduct local currency business with Chinese enterprises or persons except in Pudong and Shenzhen, and conditions for approval of new representative offices and branches were stringent and not uniform.

Several of China's general WTO accession commitments will have important consequences for financial services:

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[1] Although financial services also includes insurance, this presentation will address only banking and securities.

1. Uniform, impartial and reasonable administration of laws, regulations and other government measures – applicable at the local and sub-national levels as well as to the central government;[2]

2. Publication in an official journal of all laws, regulations and other government measures affecting trade in services;[3]

3. Annual notification to the WTO Secretariat of all laws, regulations, administrative guidelines and other government measures relating to trade in services;[4]

4. Establishment of an enquiry point to provide information and respond to WTO-related questions;[5]

5. Judicial review available for all administrative actions regarding implementation of all WTO-related laws, regulations and other government measures;[6] and

6. Regulators separate from and not accountable to those regulated.[7]

With regard to specific commitments relating to financial services, China made no commitments regarding cross-border supply, except with respect to provision and transfer of financial information, data processing and related software; and advisory, intermediation and other auxiliary financial services.

China lifted all geographic restrictions regarding foreign currency business as of the date of accession (11 December 2001). Restrictions regarding local currency business will be phased out over five years, with all geographic restrictions removed by 11 December 2006.

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2 Protocol on the Accession of the People's Republic of China, paras. 2(A)2 and 3, WTO Document WT/L/432 (23 November 2001).

3 *Id.*, para. 2(C)2.

4 *Id.*, Annex 1A, Section V.

5 *Id.*, para. 2(C)3.

6 *Id.*, para. 2(D)1.

7 Report of the Working Party on the Accession of China, para. 309, WTO Document WT/MIN(01)/3 (10 November 2001).

As for client restrictions, restrictions on foreign currency business ceased as of the date of accession. With regard to local currency business, China committed to permit it with Chinese enterprises by 11 December 2003 and with Chinese individuals by 11 December 2006. Foreign institutions licensed for local currency business in one region may service clients in any other region not subject to geographic restrictions. However, to be licensed to engage in local currency business, foreign institutions must have operated in China for three years and been profitable for the two consecutive years prior to license application.

China committed that the criteria for authorization to receive a license to provide banking services would be solely prudential. No economic needs test would be applied, and there would be no quantitative limits on licenses. Existing non-prudential measures restricting ownership, operation and judicial form (including on internal branching and licenses) would be eliminated by 11 December 2006. (The major effect will be elimination of the limitation on domestic currency business to 50 percent of foreign currency business.)

China has maintained hefty capital requirements. To be entitled to establish a subsidiary, a foreign bank or finance company must have total assets of more than US$10 billion. To be entitled to establish a branch, a foreign bank must have total assets of more than US$20 billion (Foreign finance companies cannot establish branches.) To be entitled to establish a Chinese-foreign joint venture bank or finance company, the foreign institution must have total assets of more than US$10 billion and the joint venture must have registered capital of at least CNY1 billion (US$121 million) – 600 million in yuan and 400 million in foreign currency (this is by regulation of the People's Bank of China).

With regard to national treatment, once an activity is permitted, China commits that foreign financial service providers will receive the same treatment as Chinese enterprises.

2. Securities

Prior to China's accession, foreign securities firms were not permitted to operate in China, and foreign banks could not underwrite domestic or foreign-currency-denominated securities.

China made no commitments with respect to cross-border supply, except that foreign securities institutions can engage directly (without a Chinese intermediary) in B share business.

Representative offices of foreign securities firms became eligible to become "Special Members" of all Chinese stock exchanges as of the date of accession.

Joint ventures could be established to conduct domestic securities investment management, with foreign investment up to 33 percent as of the date of accession and with foreign investment up to 49 percent by 11 December 2004.

By 11 December 2004, joint ventures, with foreign investment up to 33 percent, can be established to engage directly (without a Chinese intermediary) in underwriting A shares (trading would not be authorized), underwriting and trading of B and H shares and of government and corporate debt instruments, and establishing mutual funds.

As with banking, China committed that the criteria for authorization to do business would be solely prudential. No economic needs test would be applied and there would be no quantitative limits on licenses.

B. The Doha Negotiations

The Doha Ministerial Declaration[8] provided that the services negotiations should ". . . aim to achieve progressively higher levels of liberalization . . . with a view to promoting the interests of all participants on a mutually advantageous basis . . .." It added that "[t]he process of

[8] WTO Document WT/MIN(01)/DEC/1 (14 November 2001).

liberalization shall take place with due respect for national policy objectives, the level of development and the size of economies of individual Members . . .."

1. Fall-out from the Asian Financial Crisis

The negotiations are still in a very early stage. Members' requests for specific liberalization commitments from other Members are not due until 30 June this year, and Members' initial offers are not due until 31 March 2003. Further, most Members have not yet tabled their positions regarding the nature and scope of the financial services negotiations.

However, it is already apparent that the major issue will be what are the lessons of the Asian financial crisis and how they should be reflected in revisions to GATS provisions relating to financial services. The five developed country Members that have submitted negotiating proposals (the U.S., EC, Canada, Australia and Switzerland) share the view expressed by the WTO Secretariat in 1997 – trade liberalization in the financial services sector does not cause financial crises. The key causes are unsound macroeconomic policies, inadequate prudential regulation and government supervision, and inappropriate government intervention in financial markets (such as government-directed lending). Trade liberalization can exacerbate problems, though, so there should be "careful preparation" prior to liberalizing.[9]

The United States stresses the benefits of financial services liberalization – it strengthens market efficiency, bolsters stability in the sector, stimulates innovation, and provides consumers the broadest range of services at the lowest cost.[10] The EC declares that liberalization leads to stronger institutions, greater efficiency and more manageable capital flows, which ". . . are, in turn, likely to increase financial sector stability." However, the EC recognizes that ". . . it must

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[9] WTO Secretariat, "Opening Markets in Financial Services and the Role of the GATS," p. 23 (22 September 1997).

[10] WTO Document S/CSS/W/27, para. 4 (18 December 2000).

still be possible for Members to take the appropriate temporary measures, as required and in accordance with the relevant provisions of the GATS, to control capital movements."[11] Canada asserts that liberalization enhances the functioning of the financial services sector, which contributes to enhanced stability in the sector. It then declares that appropriate prudential regulation is necessary to protect investors and the soundness of the financial system.[12] Switzerland shares Canada's views – "liberalization of trade in financial services must not be confused with deregulation. On the contrary, the liberalization of financial flows calls for a strict framework to protect consumers, preserve financial stability and manage systemic risks."[13]

The three developing countries that have already submitted negotiating proposals (Korea, Colombia and Cuba), on the other hand, stress the dangers of "imprudent" liberalization. Korea states that "[i]ll-prepared liberalization of financial services lacking sound financial infrastructure and strong supervisory system actually weakened financial system and eventually resulted in [the 1997 Asian] financial crisis."[14] Therefore, Korea says that the negotiations ". . . should aim at achieving more orderly and sequenced liberalization in accordance with the levels of developments of financial market and supervisory system of member countries."[15] Colombia declares that the pace of liberalization must take into account the Member's level of economic and institutional development.[16] Cuba is even more blunt:

> The current negotiations must take Members' individual levels of development into account. Many developing countries have fragile financial systems, and therefore need to implement

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11 WTO Document S/CSS/W/39, para. 2 (22 December 2000).

12 WTO Document S/CSS/W/50, paras. 3-5 (14 March 2001).

13 WTO Document S/CSS/W/71, para. 4 (4 May 2001).

14 WTO Document S/CSS/W/86, para. 3 (11 May 2001).

15 *Id.*, para. 5.

16 WTO Document S/CSS/W/96, para. 4 (9 July 2001).

> regulatory measures to protect themselves from speculative capital and asymmetrical competition from transnational corporations.[17]

The U.S., EC and Korea made several additional significant proposals. They are discussed in the following sections.

2. U.S. Proposal

The most contentious U.S. proposal is that all Members should eliminate restrictions on cross-border provision of those financial services where that is possible (principally in the insurance sector).[18] The EC,[19] Canada[20] and Switzerland[21] support the proposal, but Korea[22] and Colombia[23] strongly oppose it, arguing that cross-border supply would be difficult to regulate and would increase the volatility of financial systems.

Also certain to be contentious, though not countered by the three developing countries submitting proposals to date, is the U.S. proposal to strengthen commitments relating to provision of financial services through temporary entry of natural persons.[24] This proposal, supported by the EC[25] and Australia,[26] is limited to temporary movement of key personnel to provide specific services. India, and doubtless many other developing countries, are certain to

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17 WTO Document S/CSS/W/143, para. 6 (22 March 2002).

18 WTO Document S/CSS/W/27, para. 14 (18 December 2000).

19 WTO Document S/CSS/W/39, para. 14 (22 December 2000).

20 WTO Document S/CSS/W/50, para. 9 (14 March 2001).

21 WTO Document S/CSS/W/71, para. 14 (4 May 2001).

22 WTO Document S/CSS/W/86, para. 13 (11 May 2001).

23 WTO Document S/CSS/W/96, para. 5 (9 July 2001).

24 WTO Document S/CSS/W/27, para. 16 (18 December 2000).

25 WTO Document S/CSS/W/39, para. 19 (22 December 2000).

26 WTO Document S/CSS/W/66, para. 9 (28 March 2001).

propose instead that barriers to relocation by all natural persons wishing to provide services should be removed.

The U.S. proposal to eliminate restrictions on the number of service suppliers – in the form of quotas or an economic needs test – also is highly contentious.[27] It is supported by the EC,[28] Australia[29] and Switzerland,[30] but it is strongly opposed by Colombia[31] and Cuba,[32] which argue that an economic needs test is necessary for some Members since "[a] surfeit of banking institutions or uncontrolled competition in the financial services sector can bring in their wake . . . systemic risks which can eventually become destabilizing."[33]

The United States also proposes that Members should be prohibited from restricting a financial service provider's form of commercial presence and level of equity participation.[34] This proposal is supported by the EC,[35] Australia[36] and Switzerland.[37]

In addition, the United States makes a number of proposals to increase transparency during the development and application of financial services regulations.[38] It also advocates full

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27 WTO Document S/CSS/W/27, para. 15 (18 December 2000).

28 WTO Document S/CSS/W/39, para. 10 (22 December 2000).

29 WTO Document S/CSS/W/66, para. 9 (28 March 2001).

30 WTO Document S/CSS/W/71, para. 13 (4 May 2001).

31 WTO Document S/CSS/W/96, para. 6 (9 July 2001).

32 WTO Document S/CSS/W/143, para. 9 (22 March 2002).

33 WTO Document S/CSS/W/96, para. 6 (9 July 2001).

34 WTO Document S/CSS/W/27, para. 13 (18 December 2000).

35 WTO Document S/CSS/W/39, para. 16 (22 December 2000).

36 WTO Document S/CSS/W/66, para. 9 (28 March 2001).

37 WTO Document S/CSS/W/71, para. 13 (4 May 2001).

38 WTO Document S/CSS/W/27, para. 23 (18 December 2000).

transparency in the licensing process – including publication of all activities for which a license is required and of all procedures and criteria to obtain or renew a license.[39]

3. EC Proposal

The EC's most controversial proposal is that the Understanding on Commitments in Financial Services should be used by all Members as the basis for scheduling their financial service commitments.[40] The Understanding inverts the normal basis for scheduling – providing that Members accept the listed commitments unless they specifically take an exception. Switzerland supports this proposal,[41] but Korea opposes it.[42]

The EC declares that prudential measures are important to ensure the integrity and stability of the financial system, but that the negotiation should seek to develop ways to ensure that such measures are not used as a means of avoiding commitments.[43] Switzerland[44] and Korea[45] agree.

The EC,[46] supported by Canada[47] and Australia,[48] also proposes negotiations aimed at reducing restrictions on consumption abroad of financial services.

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39 *Id.*

40 WTO Document S/CSS/W/39, paras. 11-12 (22 December 2000).

41 WTO Document S/CSS/W/71, para. 12 (4 May 2001).

42 WTO Document S/CSS/W/86, para. 7 (11 May 2001).

43 WTO Document S/CSS/W/39, para. 21 (22 December 2000).

44 WTO Document S/CSS/W/71, para. 18 (4 May 2001).

45 WTO Document S/CSS/W/86, para. 16 (11 May 2001).

46 WTO Document S/CSS/W/39, para. 14 (22 December 2000).

47 WTO Document S/CSS/W/50, para. 9 (14 March 2001).

48 WTO Document S/CSS/W/66, para. 14 (28 March 2001).

4. Korea's Proposals

Korea proposes that the negotiations seek to reduce the number of MFN exemptions and address the problem of different limitations applied by sub-central governments.[49] This latter proposal – directed at situations such as the differing standards in order to be licensed as an attorney in the states of the U.S. – is certain to draw strong opposition from the United States and other Members with federal systems.

Equally certain to attract strong opposition is Korea's proposal to prohibit Members from making liberalization commitments only for those Members who offer similar liberalization.[50] Colombia supports this proposal,[51] but the United States – the principal user of the so-called reciprocity test – will strenuously oppose it.

5. Conclusions

Although the Doha negotiations are still very young, it already is clear that the financial services negotiations will be complex and difficult. The ghost of the Asian financial crisis will loom large. Most developing countries will argue that it demonstrates the necessity of what the Koreans call "orderly and sequenced liberalization," while most developed countries will argue that erroneous domestic policies, not trade liberalization, are the culprit. How this debate plays out will be a major determinant in the outcome of the negotiations.

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49 WTO Document S/CSS/W/86, paras. 11-12 (11 May 2001).

50 *Id.*, para. 11.

51 WTO Document S/CSS/W/96, para. 7 (9 July 2001).