

Trade Agreements Cannot be Allowed to Undermine Needed Financial Service-Sector Reregulation

To Rescue Main Street, We Need to Curb the WTO

Foreclosed homes. Lost jobs. Collapsing banks. The greatest government involvement in the economy in generations. While these headlines dominate the news, a root cause of this crisis has largely been ignored: over the last several decades, the U.S. government and corporations have pushed extreme financial deregulation worldwide using “trade” agreements and international agencies.

Starting in the late 1970s, the U.S. government and corporations pushed to redefine “finance” from a service that supports the real economy to a tradable commodity whose flow across borders should be uninhibited. Starting in the late 1980s, they successfully pushed for financial services to be included in “trade” negotiations, including those establishing the World Trade Organization (WTO). “The sector was truly unique in that respect, and there is little doubt within the trade policy community that financial sector support in the European Union and the United States was a determining force in concluding the FSA [WTO Financial Services Agreement]” notes a study posted on the WTO’s own website “Financial Services and the WTO: What Next?”

The WTO rules require deregulation – and lock-in – of financial services that countries “liberalize” under these terms.

This includes simply banning many common forms of financial regulation, even if such policies were to apply to domestic and foreign firms. U.S. government and corporate efforts in trade negotiations complemented the domestic lobbying to weaken and eventually repeal the New Deal’s system of banking regulation. For instance, the Glass-Steagall Act created a firewall between commercial and investment banks to prevent the former from speculating with consumers’ savings. But

the U.S.’ 1997 FSA commitments noted an intent to change Glass-Steagall to conform with WTO rules. The Gramm-Leach-Bliley Act, which did so, passed in 1999 – the year the FSA went into effect.

Stiglitz UN Commission Calls for Reform of WTO’s Regulatory Ceiling

The United Nations Commission of Experts, chaired by Nobel Prize winning economist Joseph Stiglitz, noted that: “The framework for financial market liberalization under the Financial Services Agreement of the General Agreement on Trade in Services (GATS) under the WTO and, even more, similar provisions in bilateral trade agreements may restrict the ability of governments to change the regulatory structure in ways which support financial stability, economic growth, and the welfare of vulnerable consumers and investors.”

Many people still assume trade pacts are about traditional matters, such as tariff cuts. In fact, the WTO requires its members – including the United States – to conform domestic policies to a broad *non-trade* deregulatory agenda. Few in Congress read the legislation that implemented the WTO in 1994, much less the pact’s actual 900-page text. Congress didn’t even get a vote on the expanded U.S. financial service deregulation commitments contained in the subsequent WTO FSA. But if any country’s laws fail to comply to WTO rules, these can be challenged before foreign tribunals and the country subjected to indefinite trade sanctions until policies are changed to meet WTO dictates.

Now, while Congress works to reregulate banks and other financial firms, it must confront how the WTO locks in domestically and exports internationally the model of extreme deregulation that caused the global economic crisis. In other words, **we must change the WTO rules to fix our current economic crisis.**

The Problem: Overreaching “Trade” Agreement Rules

So-called “trade” agreements – both existing and proposed – limit the domestic-policy options lawmakers can pursue in areas that are not trade related. The WTO enforces 17 different agreements, only a handful of which relate to tariffs and quotas – the traditional terrain of “trade policy.” Others limit subsidies governments can provide to green industries, forbid domestic economic stimulus funds from being directed to domestic workers and firms, set parameters for how our health-care system is managed, and even constrain how our federal and state governments can expend our tax dollars in government procurement. (The North American Free Trade Agreement and similar pacts contain analogous provisions, and also empower foreign investors to sue governments directly for violating certain rules.)

One of the most controversial WTO agreements is the General Agreement on Trade in Services (GATS), which sets out rules for how countries can regulate their economies’ “service sectors.” What’s a service? Basically anything you can’t drop on your foot, from banking to energy, education to healthcare. The WTO Secretariat was unusually direct in describing the GATS’ implications: *“Governments are free in principle to pursue any national policy objectives **provided the relevant measures are compatible with the GATS.**”*

One of the most controversial service sectors covered by the GATS is finance. When many countries initially rejected the extreme banking, securities and insurance deregulation pushed by U.S. and European governments and corporations, additional negotiations were launched after the WTO was established to push for deeper commitments. In all, over 100 countries have WTO financial services commitments.

The United States and other rich countries also committed to even greater deregulation by adopting an additional WTO agreement, called the “Understanding on Commitments in Financial Services.” When all was said and done, the United States was bound to extremely broad WTO obligations to stay out of regulation of “banking,” “other financial services,” and “insurance.” Consider just one sector that has been a focus of considerable attention as a source of the financial meltdown. In the expansive WTO category called “Trading of Securities and Derivative Products and Services Related Thereto,” the only specific carve-out listed by the United States regarding the regulation of derivatives is for onion futures – really.

Taken as a whole, the WTO’s limits on financial service sector regulation are expansive. These rules not only guarantee foreign financial firms and their products access to U.S. markets, but also include numerous additional rules that limit how our domestic governments may regulate foreign firms operating here:

No new regulation: The United States agreed to a “standstill provision” which requires that we not create new regulations (or reverse liberalization) for the list of financial services bound to comply with WTO rules. Translated out of GATSese, this means that the United States has bound itself not to do what Congress, regulators and scholars deem necessary – create new financial service regulations.

Certain forms of regulation banned outright: The United States agreed that it would not set limits on the size of financial firms, the types of financial service one entity may provide or the types of legal entities through which a financial service may be provided in the broad array of financial services signed up to the WTO. These WTO rules conflict with countries’ efforts to put size limitations on banks (so that they do not become “too big too fail”) and to “firewall” different financial services (a policy tool used to limit the spread of risk across sectors).

Treating foreign and domestic firms alike is not sufficient: The GATS Market Access limits on U.S. domestic regulation apply in absolute terms. In other words, even if a policy applies to domestic and foreign firms alike, if it goes beyond what WTO rules permit, it is forbidden. And, forms of regulation not outright banned by these rules must not inadvertently “modify the conditions of competition in favor of

services or service suppliers” of the United States, even if they apply identically to foreign and domestic firms. Might aspects of the Wall Street bailout eventually “change the conditions of competition” in favor of U.S. firms? Other WTO members have begun reviewing just this question.

No bans on new financial service “products”:

The United States is also required to allow all foreign financial firms operating here “to offer in its territory any new financial service,” a conflict with proposals to limit various risky investment instruments, such as types of derivatives.

Other non-discriminatory domestic regulations also subject to review: GATS subjects policies of general application that may affect service sector firms to review, with WTO tribunals empowered to determine if they are “reasonable”, whether they “could not reasonably have been expected” and whether licensing and qualification requirements and technical standards limit foreign firms’ access.

The WTO “Doha Round” Would Require Further Financial Deregulation

Even as Congress works to reregulate financial firms, U.S. trade negotiators are working to complete a WTO expansion called the “Doha Round.” The Bush administration led a push to

expand financial deregulation through this Round, which started in 2001. Unless the Obama administration takes speedy action to remove outrageous new deregulation measures from the negotiating table, this Bush trade-policy hangover will blight attempts to remedy the financial crisis. Among the Doha Round threats:

A new agreement setting additional constraints on domestic regulation. It seems unimaginable that, in the current context, WTO negotiations would be underway to establish an agreement imposing new, additional limits on regulation. But that is exactly what a “GATS Working Party on Domestic Regulations” is now completing for adoption through the Doha Round. It could empower WTO tribunals to second-guess governments on the subjective question of whether policies are really necessary, or if less trade restrictive means to meet policy goals could be employed.

A new agreement imposing limits on accountancy sector regulation. Already completed and slated for adoption as part of the Doha Round is an agreement establishing new “disciplines” to restrict non-discriminatory regulations in the accounting sector. Arthur Andersen, of Enron accounting scandal fame, helped formulate this text. These rules will put pressure on governments to deregulate the accountancy sector, rather than better regulate it, as was called for in the G-20 Communiqués.

WTO countries are under pressure to submit additional financial sectors to WTO and its expansive regulatory limits. The Bush administration signed onto a Doha Round “Financial Services Collective Request” making such demands. Instead of removing us from this more-of-the-same demand, Obama trade official Ron Kirk has said the U.S. insists on more such commitments.

How WTO Commitments Are “Scheduled”

During WTO negotiations, countries list the financial service sectors, if any, they agree to bind to various GATS rules, through a process called “scheduling.” Countries’ schedules are charts that list specific sectors –separated into two large categories called “Insurance” and “Banking and other financial services.” Securities and derivatives come under the second category. Countries’ schedules also list whether a specific sector or subsector will be bound to comply with the GATS Market Access rules and/or the National Treatment rules with respect to four WTO-designated modes of service delivery. The GATS rules cover every conceivable way in which a service may be delivered: Mode 1 is cross border trade in services, such as online banking by a consumer one country with a bank in another; Mode 2 is consumption abroad of a service, such as travel overseas to establish a bank account; Mode 3 is commercial presence - a foreign bank setting up operation in a new country (Mode 3 is why GATS has been called an investment agreement); Mode 4 is movement of natural persons across borders to deliver services, for instance an accounting firm in one country sending staff to work in another. Countries also list exceptions to commitments in these charts plus a special list of Most Favored Nation exceptions, and write headnotes to list additional commitments and exclusions.

The Solution: Shrink or Sink (and Ignore) the WTO!

Unfortunately, WTO rules *do* limit the policy space nations' need to address the financial crisis, and must be changed. However, in the interim we cannot allow the WTO to chill needed reform. Here's a blueprint for change.

First, do no further harm: no financial deregulation in the WTO Doha Round. Demands for nations to add financial sector commitments and new regulation-limiting agreements must be jettisoned.

Fix existing WTO rules to remove financial deregulation requirements and add safeguards for economic stability policies:

The changes needed are straightforward. The issue is whether the political will exists. The needed changes include removing automatic *deregulation* requirements from WTO service sector *liberalization* rules, and adding a meaningful safeguard to protect prudential policies.

It takes years for a WTO challenge to get an initial ruling, so act now: Unless policymakers understand how the WTO operates, important policy initiatives may be chilled. Even if a new financial service regulation or bailout proposal violates WTO

rules, a WTO country must formally challenge the policy for WTO action to be initiated. After a challenge is brought, it typically takes more than five years before issuance of a final WTO ruling, which could then result in trade sanctions. Thus, the "way to go" is to ignore the threats, enact legislation, and see if it draws an actual challenge.

WTO Rules Have Been Modified Before to Address a Global Crisis: In the past, when WTO rules conflicted with global policy priorities, nations negotiated changes. The 2001 "Doha Declaration on TRIPS and Public Health" countered WTO drug-patent rules' limits to a global response to the HIV/AIDS crisis. Like that pandemic, the financial crisis is a global emergency. Scores of WTO countries are seeking to implement the very financial stabilization policies that could be attacked as WTO violations. The WTO's already shaky legitimacy gives a clear indication that the necessary changes to the WTO's extreme deregulation requirements can be made. Moreover, because so many countries face the same WTO problems, such changes are both politically likely and foreseeable.

We Cannot Address the Financial Crisis without Addressing WTO-style Globalization: Please call Public Citizen's Global Trade Watch at 202-546-4996, or visit our website – www.TradeWatch.Org – for access to a database detailing U.S. GATS service-sector commitments, along with fact sheets and other informational material.