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Memorandum

From: Todd Tucker, Public Citizen¹

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Re: The WTO Conflict with Financial Transaction Taxes and Capital Management Techniques, and How to Fix It

The World Trade Organization's (WTO) General Agreement on Trade in Services (GATS) is the world's most significant multilateral agreement restricting countries' ability to use financial transaction taxes (FTT) and capital management techniques (CMT) to combat speculation and destabilizing capital floods and flights. Many debates around international financial regulation focus on the bodies that are comprised of *financial regulators*, many of which have codes or standards that discourage CMTs.² Yet these institutions and agreements have weak to nonexistent mechanisms for meaningful enforcement across their entire membership. In contrast, under the WTO, FTTs and CMTs can be challenged as GATS violations, and WTO panels can authorize the imposition of trade sanctions if these measures are deemed GATS-illegal. These sanctions can stay in place year-after-year until the policy is changed, and can even be directed at non-financial sectors of the economy (such as agriculture).

This memo provides a brief technical introduction to the GATS disciplines of relevance to FTTs and CMTs, and concludes with several suggested reforms of the GATS that can ensure that such policies are insulated from WTO challenge.

WHY USE FTTs OR CMTs?

An FTT is a small tax that is levied each time a financial transaction is made. In legislation before the U.S. Congress, the actual rate varies from 0.25 percent on the value of stock trades, to just 0.02 percent of the value of other transactions.³ The economic justifications for an FTT are that it: can raise a lot of revenue for other social goals, is relatively easy to administer, can improve the operation of financial markets, and can reduce "the potential rents from short-term trading that serve no productive purpose." As economist Dean Baker documents, FTTs have been used to positive effect in the past, and are widely supported within the economics profession. Many developed and developing nations have advocated for an FTT to be introduced.⁴

A CMT can take the form of a tax, or of some other restriction on capital flows. Nations typically impose CMTs for six reasons: fear of appreciation of the domestic currency, fear of economically distorting "hot money," fear of economically dislocating large inflows, fear of loss of monetary policy autonomy, fear of asset bubbles, and fear of capital flight. Countries that have used such policies have often fared better than those that have not, and removal of these policies

by developing countries has not been associated with economic growth. In the wake of the recent economic crisis, both developing and developed countries have considered or are imposing diverse types of CMTs. Even the IMF has begun to reverse its historic opposition to such measures.⁵

Generally speaking, such measures do not tax or regulate based on whether a service supplier is a national or foreigner, or whether the transaction is consummated by two humans in person or via media (telephone, Internet, etc.). The taxes or regulations are instead imposed based on whether domestic statute and regulation see the relevant activity as taking place under domestic jurisdiction.

GATS DISCIPLINES ON PAYMENTS AND TRANSFERS

Introduction to Key GATS Concepts and Disciplines

A brief introduction to the structure of GATS is necessary to appreciate the extent of the agreement's limitations on FTTs and CMTs.

The GATS creates disciplines on measures affecting trade in services in four distinct modes of delivery: Modes 1 (cross-border trade), 2 (consumption abroad), 3 (commercial presence) and 4 (movement of natural persons).⁶ WTO members each have a Schedule of Specific Commitments in services, which lists which service sectors – and in each service sector, which GATS disciplines (such as market access or national treatment) – each country committed to the GATS in the 1990s or at the time of their accession.⁷

Article XVI of the GATS deals with the substantive Market Access disciplines, and its Paragraph 2 prohibits countries from applying a set of six policies, which are mostly nondiscriminatory size limitations.⁸ Paragraph 1 of the article contains a footnote that references capital account liberalization:

“If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(a) of Article I [i.e. Mode 1] and if the cross-border movement of capital is an essential part of the service itself, *that Member is thereby committed to allow such movement of capital*. If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(c) of Article I [i.e. Mode 3], *it is thereby committed to allow related transfers of capital into its territory*.” [italics added]

Article XI refers to capital and current account restrictions:

“Article XI: Payments and Transfers

1. Except under the circumstances envisaged in Article XII, *a Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments*.

2. Nothing in this Agreement shall affect the rights and obligations of the members of the International Monetary Fund under the Articles of Agreement of the Fund, including the

use of exchange actions which are in conformity with the Articles of Agreement, provided that *a Member shall not impose restrictions on any capital transactions inconsistently with its specific commitments regarding such transactions*, except under Article XII or at the request of the Fund.” [italics added]

This language can be parsed in four ways: substantive obligations; faulty definitions; general architectural elements; and defense provisions.

Substantive Obligations: Thou Shalt Not Restrict Capital

The market access commitments envisioned in the footnote to Article XVI(1) set up a bifurcated obligation: if a country committed to market access in Mode 1 (i.e. cross-border trade), and the “cross-border movement of capital is an essential part of the service itself,” then the country must allow both capital *inflows and outflows* for that service. For countries that committed Mode 3 (i.e. commercial presence, often called foreign direct investment), the commitment is to allow capital *inflows* related to that investment. There are no explicit commitments in the Article XVI(1) footnote to allow capital inflows or outflows related to Mode 2 (consumption abroad) or Mode 4 (movement of natural persons).

It should be noted that “specific commitments” in this context – as explained below – refers to market access and national treatment commitments. As Article XI states, for current transactions, a WTO member shall not apply restrictions “relating to its specific commitments.” For capital transactions, a member “shall not impose restrictions inconsistently with its specific commitments.”

The GATS does not spell out how these substantive standards differ. The “relating to” standard in Article XI(1) may be interpreted more broadly than the “inconsistently” standard under Article XI(2). A “consistent imposition” of capital controls under Article XI(2) would likely be one that did not run afoul of countries’ commitments under Article XVI(1), which explicitly states rules only on Modes 1 and 3, but remains silent on Modes 2 and 4. It would appear that (outside of some narrow circumstances discussed below) countries could only maintain a current transaction restriction if they had no financial service commitments whatsoever: once even a single commitment in a subsector and mode were made, *any* restriction on current payments (even for Mode 2 and 4) may meet the “relating to” standard.⁹

For instance, say a Caribbean country committed financial advisory services to the GATS, but not the underlying trading services themselves. Would a tax on trades meet the “relating to its specific commitments” standard? It is difficult to know without further clarification.

We have not touched on how the GATS disciplines on current restrictions limit the policy options of countries *outside* of the financial services subsector. After all, a financial transactions tax could affect trade in retail and other services as well, and thus be put on the Article IX chopping block.

Faulty Definitions

What is a current restriction, and what is a capital restriction? An IMF Working Paper states that:

“Restrictions on payments and transfers for current international transactions can take various forms such as prohibitions on import payments and on the transfer of profits and dividends, advance import deposit requirements, absolute limits on the availability of foreign exchange for invisible [i.e. services] payments (such as for travel, study, and medical allowances) and rationing procedures for allocating foreign exchange to imports of goods and services.”¹⁰

Capital restrictions, by contrast, are typically associated with taxes, restrictions, or prohibitions on debt and investment flows less directly associated with the immediate payment for goods and services. Gallagher identifies the following instruments¹¹:

TABLE 1

Inflow Restrictions	Outflow Restrictions
<ul style="list-style-type: none"> • Restrictions on currency mismatches • End use limitations • Unremunerated reserve requirements • Taxes on inflows • Minimum stay requirements • Limits on domestic firms and residents from borrowing in foreign currencies • Mandatory approvals for capital transactions • Prohibitions on inflows 	<ul style="list-style-type: none"> • Limits on ability of foreigners to borrow domestically • Exchange controls • Taxes / restrictions on outflows • Mandatory approvals for capital transactions • Prohibitions on outflows

The IMF’s *Balance of Payments Manual* – used widely by economists – defines “current transactions” as “those involving the exchange of goods, the provision of services, and the receipt and payment of income and transfers.” “Capital transactions” refers to “changes in financial claims on, and liabilities to, the rest of the world.”¹² The IMF states that “A claim is a financial instrument that gives rise to an economic asset that has a counterpart liability,” while “Economic assets are resources over which ownership rights are enforced and from which future economic benefits may flow to the owner.”¹³

An example may illustrate how the definitions in the IMF *Manual* might apply to a financial service transaction. (We’ll operate from the perspective of the U.S. capital and current account.) Say a Floridian retiree logs on to their computer from home, and deposits \$100 in a new saving account in Panama in the year 2010. The Panamanian bank charges an upfront fee of \$5, but pays out five percent interest per year starting in 2011. In early 2012, the Floridian closes out the account and the Panamanian bank returns the deposit balance. From the 2010 balance of payments perspective, the \$5 fee is recorded as a U.S. financial service import in the current account, and the \$100 deposit is recorded as a U.S. financial asset in the capital account. In 2011, the five percent interest payment is recorded as a U.S. investment income receipt from abroad in the current account, and the \$100 deposit balance is (again) recorded as a U.S. financial asset in the capital account. Finally, in 2012, the U.S. capital account is debited \$100 in financial assets as the balance is repatriated.

These are examples rather than definitions, and in the legal context – particularly in the GATS setting but also among lawyers at the IMF – , there is substantial uncertainty about what many of the payments-related terms mean. One IMF economist argued that “the provision of all financial services included in GATS between residents and nonresidents should be included in the current account.” If this were the case, GATS Article XI(2) would seem to have little meaning in the financial services context, since all financial services restrictions would be considered current (rather than capital) measures.¹⁴

In a recent paper on financial services, the WTO Secretariat admits that,

“The GATS does not define terms such as ‘payments and transfers for current transactions,’ ‘current transactions,’ ‘capital transactions,’ ‘movement of capital,’ or indeed ‘restrictions.’ It is worth noting that some of these expressions have already been defined by the International Monetary Fund... The IMF Articles of Agreement define ‘payments for current transactions’ as ‘payments which are not for the purpose of transferring capital, and includes, without limitation: (1) all payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities; (2) payments due as interest on loans and as net income from other investments; (3) payments of moderate amount for amortization of loans or for depreciation of direct investments; and (4) moderate remittances for family living expenses.’ While these definitions are not legally part of the GATS, they are relevant for the present discussion...”

“Permissible measures depend on the definition to be given to the term ‘restriction’ contained in GATS Article XI, which, however, is not further specified in the Agreement. In that regard, it is worth noting that the IMF distinguishes between restrictions on payments and transfers – including exchange restrictions – from the underlying transaction on the basis of a technical criterion: ‘The guiding principle in ascertaining whether a measure is a restriction on payments and transfers for current transactions under Article VIII, Section 2 [of the Fund’s Articles of Agreement], is whether it involves a direct governmental limitation on the availability or use of exchange as such.’ According to Siegel (2002), the Fund therefore identifies these restrictions by this technical criterion, rather than by the purposes or economic effects of the restrictions, which would be the way to identify trade restrictions only. If no such technical criterion were used, it would be almost impossible to distinguish between trade and exchange restrictions, as both may be used to achieve the same purposes and have the same economic effect. For instance, an outright prohibition to provide a certain financial service would be a trade measure subject to scheduling under the GATS, but would not constitute a restriction on payments and transfers for that transaction.”¹⁵

Notably, the term “essential part of the service itself” is also not defined. Arguably, the only category of services trade where capital is an “essential part of the service itself” would be in financial services. An example can illustrate this point. If I contract with an Irish ship repair company to repair my ship in Ireland, the service involves no capital flow per se, but only product and cash flows: I send a payment to Ireland, and the company sends me back my

repaired ship. If I contract with an Irish bank to provide lending services, in contrast, the service they are providing *is capital management*, and the business arrangement will involve sending capital to and from Ireland. However, since “capital” is also not defined in the GATS, any definitive conclusion on when “capital” forms an “essential part of the service itself” is impossible to make.

The Planck Commentaries – a widely consulted source on WTO rules – also state that:

“the term ‘restriction’ should be construed broadly... as a basic rule, any measure that could impede international transfers and payments in connection with GATS services is prohibited. Restrictions can be direct or indirect. Direct restrictions affect the transactions themselves, for instance prohibiting certain transactions, setting quotas, providing for approval procedures, etc. Indirect restrictions, conversely, do not restrict international transfers and payments as such, but discourage them without directly limiting them by means of restrictive regulation, such as excessive taxation, measures requiring undue paperwork or those creating extensive delays, etc.”¹⁶

In general, IMF members often assume that the Articles of Agreement prohibit most current restrictions, and allow most capital restrictions. But Deborah Siegel, the IMF Attorney cited by the Secretariat above, states that:

“Under the Fund’s Articles, an exchange restriction would result from any governmental action that hampers the making of payments and transfers for current international transactions, including the acquisition of foreign exchange for such payments and transfers, regardless of the internal rules for payments among residents. The concept of restriction thus may be considered an ‘absolute’ standard. However, similarly to some trade rules, a determination of restrictiveness does not depend on the intent or purpose of the measure and need not derive from a total prohibition. For example, a measure would be restrictive if it increased the cost of transactions or introduced an unreasonable burden or undue delay... Whether any delay is ‘undue’ is assessed by the Fund on a case-by-case basis, taking into account the administrative capacity of the member.”¹⁷

In other words, a total prohibition on access to exchange for a current payment would likely be prohibited by the IMF Articles of Agreement, but borderline cases that increased the cost of or delayed transactions may be evaluated on a “on a case-by-case basis.” If such fundamental uncertainties persist even in the IMF context (with vast numbers of financial services specialists on staff), they are doubly as uncertain in the GATS context (where there are few such experts).

Reform of the GATS would be a compelling agenda if only for the benefit of having technical clarity on the meaning of “capital,” “current restrictions” and other key terms.

Architectural Elements: Certain Regulations Not Subject to Scheduling

The GATS differentiates between General Obligations (which apply to all WTO members) under Part II (comprising Articles II through XV) on the one hand, and Specific Commitments under

Part III (comprising Articles XVI through XVIII) on the other. Article XI falls under the former, but it is a bridge to the latter. As the WTO Secretariat notes in a recent paper,

“restrictions on transfers and payments for current transactions must not be maintained where a Member has made a commitment on financial services... Members undertake not to impose restrictions on any capital transactions inconsistently with its specific commitments regarding those transactions... Since these minimum obligations on capital movements for modes 1 and 3 are not individually negotiated as part of the schedules, it would appear that no reservations can be introduced with regard to these obligations under these two modes.”¹⁸

Put differently, countries cannot schedule exceptions to General Obligations (including the obligation not to restrict the payments noted in Article XI), but they can for Specific Commitments. If CMTs violate Article XI terms, they must simply be eliminated or brought into conformity with the GATS.

In this sense, the payments disciplines are even more severe than the general market access disciplines, since at least limitations to the latter commitments could have been scheduled by a country’s government in the 1990s. In contrast, the payments disciplines are binding on covered service sectors, irrespective of the scheduling prowess of past governments.

Article XI Defense Provisions: The Best Defense is Offensive

There are three “defenses” contemplated in the text of GATS Article XI that a country could invoke if a CMT were challenged: the Articles of Agreement cross-reference, the IMF request defense, or the GATS Article XII defense. (The first two would appear not to apply to an FTT.)

First, there is the general statement in Article XI(2) that “Nothing in this Agreement [i.e. GATS] shall affect the rights and obligations of the members of the International Monetary Fund under the Articles of Agreement of the Fund, including the use of exchange actions which are in conformity with the Articles of Agreement, provided that a Member shall not impose restrictions on any capital transactions inconsistently with its specific commitments regarding such transactions...” In other words, **this is not so much a “defense” as a “cross-reference.”** Even though the IMF Articles of Agreement generally allows capital restrictions, a WTO member using a CMT would not be able to avoid its GATS commitments by simple invocation of the Articles of Agreement, as noted by the phrase “provided that.”

Second, a country may impose capital restrictions “at the request of the Fund.” In other words, if a country’s CMT were challenged under the GATS, but the IMF had requested the CMT be imposed, then presumably the WTO tribunal would defer to the IMF’s judgment in its ruling. But, the IMF has rarely (until very recently) spoke encouragingly about capital controls, much less formally requested or required them as part of a country program.¹⁹ And, as Siegel notes, “the Fund has never invoked this provision” under the GATS.²⁰

The third and final limitation to the payments and transfers obligation imposes many new hurdles: it is the requirement that both current and capital restrictions (i.e. both FTTs and CMTs) meet the substantive and procedural conditions set in GATS Article XII.²¹

The first point to underscore here is that the IMF Articles of Agreement allow capital restrictions in or out of balance-of-payments crises, and typically prohibit current restrictions, but allow for some exceptions in balance-of-payments crises. The GATS, by contrast, disciplines capital restrictions in or out of such crises, and adds new disciplines on current restrictions. In fact, there are 10 limitations on countries' ability to respond to a balance of payments crisis, nine of which go beyond IMF requirements on capital restrictions or current restrictions or both.²²

1. "Balance of payments and external financial difficulties or threat thereof" must be "serious" before current or capital restrictions can be imposed. (It is troubling that a WTO tribunal would be empowered to determine whether a crisis or threat were sufficiently "serious" to met the terms for the Article XII exception: tribunals under the U.S.-Argentina Bilateral Investment Treaty, for instance, have determined that the country was not suffering enough to qualify for similar exceptions under that pact. More on this below.)
2. These restrictions "shall not exceed those necessary" to deal with such a crisis or threat.
3. They "shall avoid unnecessary damage to the commercial, economic and financial interests of any other Member." (The terms "necessary" and "unnecessary" on points 2 and 3 are especially troubling, since they are interpreted in a strict way in trade law contexts that put pressure on countries to deregulate as much as possible. Moreover, the damage threshold is exceedingly low: if the interests of even a single member (say an offshore financial center) were so impaired, a violation claim could be made.)
4. They "shall be temporary and phased out progressively" as the crisis or threat "improves." (This effectively restricts countries' ability to have forward looking, preventative measures in place. They instead must wait until a crisis hits to impose restrictions, and then must move to quickly phase them out.)
5. They "shall not be adopted... for the purpose of protecting a particular service sector."
6. They "shall not be ... maintained for the purpose of protecting a particular service sector." (These rules in points 5 and 6 are troubling, since it is conceivable that a capital transaction could be taken for both protecting the balance of payments and for protective purposes. If a WTO tribunal ruled that protection was among the motivations of a capital restriction, the applying country could be found in violation of its GATS commitments.)
7. They "shall not discriminate among Members."
8. They "shall be consistent" with the IMF Articles.
9. They "shall be promptly notified to the General Council."
10. Members "shall consult promptly with the Committee on Balance-of-Payments Restrictions" when they adopt such restrictions.

A member that violated any of these 10 conditions would be in violation of their WTO commitments, and could face WTO dispute settlement proceedings and trade sanctions.

Equally troubling are the special consultation provisions under the Committee on Balance-of-Payments. For non-Article XI-XII issues, no Secretariat or other WTO body would pronounce on a countries' potential GATS violation outside of the context of formal dispute settlement.

Countries weighing the initiation of formal dispute settlement will consider the diplomatic and economic costs and benefits of doing so, and may choose to hold their peace.

But in the Article XI-XII context, a pre-dispute settlement proceeding is automatically launched, with an opportunity for a Committee to pronounce on:

1. the nature and extent of the balance-of-payments and the external financial difficulties;
2. the external economic and trading environment of the consulting Member;
3. whether and which alternative corrective measures may be available;
4. whether the restrictions are being progressively phased out;
5. the compliance of the restrictions overall; and
6. other assessments the Committee wants to take up.

When combined with the measures outlined in the previous subsection, **this amounts to 15 substantive and procedural criteria and hurdles that payments restrictions are subjected to in the GATS to which they are not under the IMF.** Moreover, if the Committee were to find that a country had not met any of these 15 criteria, this would clearly weigh heavily in the deliberations of a WTO panel under any later dispute settlement. There have been no instances of the Committee conducting such an assessment, so there is a high degree of uncertainty as to how the proceeding would affect countries' policy space.

Also worth noting is the conclusion by economist Kevin Gallagher that balance-of-payments defense measures would likely apply only to measures governing outflows (i.e. reactive measures) rather than measures governing inflows (i.e. anticipatory measures).

OTHER WEAK GATS DEFENSE MEASURES

Prudential Measures Defense

We explore the problem with the GATS prudential measures language and other defenses in a related paper.²³ It is worth noting that the GATS Annex on Financial Services Article 2(a) provides no meaningful defense when a financial stability measure is challenged:

“2. Domestic Regulation: (a) Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member’s commitments or obligations under the Agreement” [emphasis added].

This suggests that prudential FTTs or CMTs could be challenged under the GATS as inconsistent with a “Member’s commitments or obligations” (this likely refers to Specific Commitments and General Obligations, although it is impossible to know this with certainty), if this defense measure were interpreted as applying to such situations.

Some have suggested that the prudential defense measure (weak as it is) would not even apply to instances of capital controls. This was the conclusion of two University of Zurich Law School scholars whose writings tend towards supportive of the current WTO regime. In a recent study of the provisions, Rolf Weber (a WTO panelist) and Christine Kaufmann wrote:

“The right of a member to issue or maintain such prudential regulation seems to find its limits in Article XI GATS. Indeed, paragraph 2 of the Annex on Financial Services underlines that the prudential carve-out should not be used to avoid commitments or obligations under the GATS Agreement. This sheds uncertainty on the relationship between the Annex on Financial Services and the GATS, in particular Article XI GATS. The issue is well illustrated by the current request from the EC to Chile to lift its requirement that a prior authorization by the Central Bank is necessary before profit repatriation to be allowed. Such restrictions are indeed considered by the EC to be in breach of Article XI... If this provision is interpreted as prevailing over the prudential carve-out, it seems to prevent countries from taking prudential measures with respect to payment in transfers, in fact measures, which could be ‘nevertheless very effective for dealing with financial stability.’”²⁴

The Planck Commentaries provide support for this conclusion, stating that members may not use prudential measures to “actually avoid any obligations under the GATS (including the obligation to liberalize international transfers and payments relating to services for which specific commitments have been made.”²⁵ Also, arbitrator Mark Kantor has a similar interpretation of the non-applicability to capital and current restrictions of a nearly identical prudential measures defense clause in bilateral U.S. trade and investment agreements.²⁶

Other Defenses

GATS Article XIV offers a series of additional defenses. It reads:

“Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:

- (a) necessary to protect public morals or to maintain public order; [Footnote: The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.]
- (b) necessary to protect human, animal or plant life or health;
- (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:
 - (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts;
 - (ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;

- (iii) safety;
- (d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members;
- (e) inconsistent with Article II, provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound.”

Working in reverse order, Articles XIV(d) and (e) are most closely related to payments and transfers, but only offer defenses from discriminatory tax-related deviations under Articles XVII (National Treatment) and II (Most Favored Nation Treatment), not non-discriminatory tax measures under Articles XI (Payments and Transfers) or XVI (Market Access). Thus, Article XIV(d-e) would not protect a FTT – a non-discriminatory measure applying to all financial services transactions in a nation’s territory – from GATS challenge under Article XI.²⁷

Article XIV(c) only offers a defense for the adoption or enforcement of measures “not inconsistent with the provisions of this Agreement” – in other words, not inconsistent with Article XI and XVI disciplines.

Articles XIV(a) or (b) are probably the most relevant, but they have not been tested relative to FTTs or CMTs. A defense under these articles would be difficult. First, a CMT would have to be shown to be “necessary to” protect lives, health, or public order. The latter term is defined as measures taken in order to avoid “a genuine and sufficiently serious threat ... posed to one of the fundamental interests of society.” As noted, the term “necessary” is a very restrictive term in trade law.

Once the necessity hurdle were overcome, there is the condition that the CMTs “are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services.” While an exhaustive exploration of this phrase is beyond the scope of this paper, it is worth briefly noting that a CMT is most definitely a “restriction on trade in services,” making it highly unlikely that it could meet the qualifications of the Article XIV chapeau. (Arguments could be made as to whether it is disguised or not.)

It is worth noting that the record of WTO exceptions in general is quite bad in terms of offering protection to members’ public interest measures, with these being ruled against nine out of ten times in WTO dispute settlement.²⁸ And Argentina’s invocations of similar exceptions of the U.S.-Argentina Bilateral Investment Treaty were ruled against partially or totally.²⁹

Central Bank Measures

Some have argued that the definition of “financial service supplier” under the GATS Annex on Financial Services excludes any actions taken by the Central Bank. This is clearly not true, as Bart de Meester, a WTO expert and legal fellow with Belgium’s Institute for International Law, concluded in a recent paper:

“The concept of ‘service’ in the GATS is a broad one and covers ‘any service in any sector except services supplied in the exercise of governmental authority.’ ‘Financial Service’ is defined in the Annex as ‘any service of a financial nature offered by a financial service supplier of a Member’ and a non-exhaustive list of financial services is provided. However, the Annex on Financial Services provides a more specific definition for the excluded services than the one in Article I GATS. The Annex excludes the following activities from the scope of the GATS: (i) activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies; (ii) activities forming part of a statutory system of social security or public retirement plan and (iii) other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government. Importantly, this does not mean that the measures taken by a central bank or monetary authority or other public entity are outside the scope of the GATS. Activities conducted by a central bank, monetary authority or any other public entity in pursuit of monetary or exchange rate policies are not considered ‘services’ within the scope of the GATS. Hence, if a government adopts a measure that affects such activities, this measure cannot be scrutinised under the GATS. However, *if a central bank or monetary authority elaborates an assistance programme, this does not mean that such assistance programme is outside the scope of the GATS (provided it affects trade in services).*”³⁰

In other words, the impact of “monetary or exchange rate policies” on trade in other financial services is challengeable under the GATS, but the “monetary or exchange rate policies” themselves are not considered activities that constitute services under the GATS.³¹ Indeed, many monetary, credit or exchange rate policy could violate GATS Article XVI market access or Article XVII national treatment terms, and thus affect “trade in services” and be potentially challengeable under the GATS. However, the government’s currency-printing monopoly per se (for instance) is what is likely addressed by GATS Article I(b)(i) language.³² This distinction makes intuitive sense, as Article I(b)(ii) and I(b)(iii) also refer to instances of effective public sector monopolies of an activity per se.

MODE 1 AND 2 AMBIGUITY

In its recent paper, the WTO Secretariat raises the issue of “whether a cross-border financial transaction should be classified as a mode 1 or a mode 2 transaction” and notes that – in an era of e-commerce – there is no straightforward definition of in what territory a financial service transaction is delivered, consumed or otherwise consummated. The Secretariat goes on to say, “It is clear that this question becomes particularly relevant when different levels of commitment have been undertaken for each of the two modes of supply, which is often the case, with more liberal commitments undertaken in general for mode 2.”

A recent paper by Federal Reserve economists is even more pointed, calling the classification system “particularly useless when addressing prudential concerns, fears of contagion and capital flows,” and that the Mode 1/2 distinction is especially “blurry, because it is not clear whether the consumer or the service crosses the border.”³³

As we note in the next section, many countries have fairly liberal Mode 2 financial services commitments, but fairly limited Mode 1 commitments. This grouping includes the United States, Argentina, Europe and most OECD countries. Such countries may undertake to restrict cross-border current or capital flows for financial services, thinking they are uncommitted under GATS. But the Secretariat here raises the possibility that what a country may consider a measure under Mode 1 could in fact be a Mode 2 measure, and vice versa. Moreover, if the “related to its specific commitments” standard in Article XI(1) were interpreted broadly, countries with significant commitments in Mode 2 but not Mode 1 wishing to apply an FTT to current transactions may be stymied.

As we state in the conclusion, a minimal fix to the GATS disciplines thus entails a clear separation between measures under these two modes.

COUNTRIES AFFECTED

There are over 60 countries whose current GATS commitments put them at risk of a WTO challenge of their CMTs, as shown in Table 2.

European Central Bank economist Nico Valckx has attempted to translate the heterogeneous GATS schedules into quantitative indices of 0.0 (low) to 1.0 (high) of financial service commitment depths by mode. A rank of over 0.4 in the Valckx index indicates that the country is committed to offer market access in that mode, but that it may have scheduled limitations on the exact number or type of operations.³⁴ This threshold should capture market access commitments that could be expected to require the lifting of payments and transfers restrictions. In practice, policy advisors will wish to consult the actual schedule texts for each country to confirm these tentative conclusions.

TABLE 2

RISK LEVEL 1 Countries with Mode 1, 2, 3 commitments	RISK LEVEL 2 Countries with Mode 2, 3 commitments, but not 1	RISK LEVEL 3 Countries with Mode 3 commitments, but not 1 or 2	RISK LEVEL 4 Countries with just Mode 2 commitments, but not 1 or 3 ³⁵
(13) Bahrain Ecuador Estonia* Kyrgyz Republic Malawi Mongolia Mozambique Nigeria ³⁶ Panama Qatar Romania* Sierra Leone Solomon Islands	(35) Argentina Australia Canada Cyprus^ Macau Hong Kong EU # Hungary* Iceland Indonesia Japan Latvia* Lithuania^ Malta^ New Zealand Norway Poland^ South Africa Switzerland Tunisia USA	(10) Bulgaria* Czech Republic* Dominican Rep. Ghana Israel Morocco Paraguay Peru Slovak Rep.* Slovenia*	(4) Kuwait Philippines Singapore Turkey

Source: Valckx 2002; author's analysis

* These countries have different but high levels of commitments now, and are slated to harmonize their schedules with the EU.

^ These countries have low to no commitments now, but are slated to harmonize their schedules with the EU.

Fifteen countries are included in the current EU schedule.

In addition to these countries, Aaditya Mattoo (of the World Bank and formerly of the WTO Secretariat) has found that Gambia, Guyana, Haiti, Kenya, and Papua New Guinea have extensive commitments that could put them in high commitment / risk categories.³⁷

NEGOTIATING HISTORY

If the GATS disciplines on payments and transfers seem extreme, this is because the drafters of these terms intended them to be. The negotiating history of the Uruguay Round showed that countries contemplated – and ultimately rejected – versions of the text that would have allowed countries to maintain capital controls. The chair of the Uruguay Round Working Group on Financial Services had outlined four negotiating options:

“The latter paper listed four options relating to payments and transfers matters, ranging from the obligation to freely permit all payments and transfers related to the provision of financial services which were liberalized under the agreement (option 1) to the "no obligation" option (option 4). An intermediate option (option 2) would permit restrictions on current payments that were in conformity with the regulations of the IMF, as well as restrictions on capital account transaction that were necessary because of severe balance-of-payments problems. Option 3 would combine a grandfathering of existing restrictions on payments and transfers with option 2, applicable to new restrictions.”³⁸

Option 3 or 4 would have provided more policy space than the resulting Option 2 of the final GATS text, and rules consistent with the IMF Articles. Yet the European Commission, for one, noted that it was precisely because the IMF Articles of Agreement contained “no direct obligations applied to restrictions on capital movements” that these new disciplines were needed. The EC worried that “Restrictions on payments and transfers could be imposed for reasons other than current account/balance of payments difficulties, such as monetary policy concerns, particularly in foreign exchange and/or capital markets, disturbances in the conduct of monetary and exchange rate policies, etc.” and wanted to ensure that any such restrictions should be “monitored against the backdrop of agreed disciplines” and “should be limited in nature and time.”³⁹

Ironically, now the European Commission (dominated by countries that have advocated an FTT) sees its policy options limited by the rules it for which it helped advocate. As the European Commission recently noted in a staff working paper on FTTs:

“the compatibility of such a levy with Article XI of the General Agreement on Trade in Services (GATS), which provides that WTO Members cannot apply any restrictions on international transfer and payments for current transactions relating to their specific commitments, would have to be further assessed. As the EU has taken specific commitments relating to financial transactions, including lending, deposits, securities and derivatives trading and these commitments relate to transactions with third countries, a currency transactions tax could constitute a breach of the EU's GATS obligations.”⁴⁰

CASE LAW WORRYING

The meaning of GATS Article XI was explored in the 2004 WTO panel report in *US – Measures Affecting the Cross-border Supply of Gambling & Betting Services* case (Antigua’s successful challenge of the U.S. ban on Internet gambling). In the case, Antigua alleged that:

“the United States maintains measures that restrict international money transfers and payments relating to the cross-border supply of gambling and betting services. In particular, Antigua points to the laws of the state of New York that render contracts that are based on wagers or bets void as well as an example of an ‘enforcement measure’ taken by the New York Attorney General against a financial intermediary that provides Internet payment services. In Antigua’s view, the purpose of these measures is to prevent foreign suppliers of gambling and betting services from offering their services on a cross-border basis. Antigua argues that, therefore, these measures violate Article XI:1 of the GATS.”

The WTO panel provided its view of the GATS Article XVI constraints on policies that limit capital flows:

“Article XI has not, as yet, been the subject of interpretation or application by either panels or the Appellate Body. In light of this and taking into account the limited facts and arguments submitted by the parties with respect to Antigua's claim under Article XI, we believe that there is not sufficient material on record to enable us to undertake a meaningful analysis of this provision and its specific application to the facts of this case ... However,

the Panel wants to emphasize that Article XI plays a crucial role in securing the value of specific commitments undertaken by Members under the GATS. Indeed, *the value of specific commitments on market access and national treatment would be seriously impaired if Members could restrict international transfers and payment for service transactions in scheduled sectors. In ensuring, inter alia, that services suppliers can receive payments due under services contracts covered by a Member's specific commitment, Article XI is an indispensable complement to GATS disciplines on market access and national treatment*" [italics added].⁴¹

In summary, even though the Panel determined it did not have enough information to determine whether a violation had occurred, its members nonetheless felt compelled to emphasize the key role that Article XI disciplines play in the GATS.

CONCLUSION AND POLICY RECOMMENDATIONS

In the wake of the economic crisis, countries are contemplating policies to reduce speculation and better manage their current (FTTs) and capital (CMTs) accounts. It is vital that trade and investment obligations not be invoked as a reason for inaction, and reform of the GATS and similar trade and investment treaties is vital for this end.

This conclusion has wide support. The Commission of Experts on Reforms of the International Monetary and Financial System was convened by the United Nations General Assembly president in the fall of 2008, in the early days of the financial crisis. It was chaired by Nobel Prize winner Joseph Stiglitz, with the participation of a host of distinguished academics from around the world. In September 2009, the Commission released a comprehensive report calling for changes to the global regulatory ceiling imposed by trade pacts like the World Trade Organization. Among the report's findings:

- “Many developing countries have entered into (North-South) free trade agreements (FTAs), bilateral investment treaties (BITs), and World Trade Organization (WTO) commitments that prevent them from regulating the operations of financial institutions and instruments or capital flows... they have also faced restrictions on their ability to manage their capital account and financial systems (e.g. as a result of financial and capital market liberalization policies). These policies are placing a heavy burden on many developing countries... Agreements that restrict a country's ability to revise its regulatory regime—including not only domestic prudential but, crucially, capital account regulations—obviously have to be altered, in light of what has been learned about deficiencies in this crisis. In particular, there is concern that existing agreements under the WTO's Financial Services Agreement might, were they enforced, impede countries from revising their regulatory structures in ways that would promote growth, equity, and stability...

“More broadly, all trade agreements need to be reviewed to ensure that they are consistent with the need for an inclusive and comprehensive international regulatory framework which is conducive to crisis prevention and management, counter-cyclical and prudential safeguards, development, and inclusive finance. Commitments and existing multilateral agreements (such as GATS) as well as regional trade agreements, which seek greater

liberalization of financial flows and services, need to be critically reviewed in terms of their balance of payments effects, their impacts on macroeconomic stability, and the scope they provide for financial regulation. Macroeconomic stability, an efficient regulatory framework, and functioning institutions are necessary preconditions for liberalization of financial services and the capital account, not vice versa. Strategies and concepts of opening up developing economies need to include appropriate reforms and sequencing. This is of particular importance for small and vulnerable economies with weak institutional capacities. But there has to be a fundamental change in the presumptions that have guided efforts at liberalization. As noted in previous chapters, one of the lessons of the current crisis is that there should be no presumption that eventually there should be full liberalization. Rather, even the most advanced industrial countries require strong financial market regulations.”⁴²

As well, the U.S. bipartisan Trade Reform Accountability Development and Employment (TRADE) Act states that investment provisions of future trade deals should “allow each country that is a party to the trade agreement to place prudential restrictions on speculative capital to reduce global financial instability and trade volatility.” This bill – cosponsored by a majority of House Democrats, committee chairs, and subcommittee chairs across a range of caucuses, and by nine Senators – provides a roadmap that has already achieved wide consensus in the U.S. Congress.

Several reforms can help insulate capital and current account management policies from GATS challenge. The first step would be to adopt an agreement, similar to the 2001 Doha Round Declaration on the TRIPS Agreement and Public Health⁴³ that clarifies that:

- Both GATS Article XIV and Annex on Financial Services Article 2(a) allow for countries to impose financial transaction taxes and capital management techniques (whether on a temporary or permanent basis).
- The definition of "restriction" under Articles XI and XII does not include taxation measures. This would help protect measures short of prohibition on access to the use of exchange that nonetheless help manage current and capital flows and reduce speculation, such as transactions taxes.
- GATS Article XII(3) is only meant to discipline restrictions which have a solely protectionist purpose.
- If a WTO member country has made commitments in a given sector for Mode 2 but not Mode 1, then that member is under no obligation to comply with the Market Access provisions of the footnote to GATS Article XVI(1). This would help protect the current and capital account regulations of the nearly 40 countries with ample Mode 2 but not Mode 1 commitments.⁴⁴

It is also important to delete the footnote from the GATS Market Access Article XVI(1). This would clearly separate the obligation to allow market access to foreign service-providers (i.e. true trade liberalization) from commitments to deregulate current and capital account regulations. (Article XI might have to be altered for consistency as well.)

Also, the prudential measures defense language should be strengthened to provide a more meaningful safeguard for current and capital account regulations. This could be done by making

it self-judging, as was successfully pushed for by House Ways & Means Democrats in the U.S.-Peru trade deals essential security defense mechanism.⁴⁵ Alternatively, the prudential measures defense language could be altered to shift the burden of proof, along the lines of the following language:

“2. Domestic Regulation: (a) Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from adopting or maintaining measures relating to financial services it employs for prudential reasons, including for the protection of consumers, investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or to ensure the integrity and stability of the financial system. For greater certainty, if a Party invokes this provision in the context of consultations or an arbitral proceeding initiated under the Dispute Settlement Understanding, the exception shall apply unless the Party initiating a dispute can demonstrate that the measure is not intended to protect consumers, investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or is not intended to ensure the integrity and stability of the financial system.”

It is also vital that no new domestic regulation disciplines be adopted in the Doha Round that could worsen the conflict between the GATS and capital and current account management.

To insulate capital and current account regulations from GATS challenge in the short term while these changes are being negotiated, WTO members should allow countries a grace period to withdraw or modify problematic financial services commitments made by previous governments, as WTO members already allowed for from 1994-1997.⁴⁶

Finally, similar alterations should be made to bilateral and regional U.S. trade and investment agreements.

ENDNOTES

¹ Todd Tucker is research director of Public Citizen’s Global Trade Watch division. He thanks Nathan Converse, Sarah Edelman, Kevin Gallagher, Jane Kelsey, and Lori Wallach for helpful comments.

² For developed nations, these consist primarily of the Bank of International Settlements (and associated bodies like the Financial Standards Board and Basel Committee on Banking Supervision), International Accounting Standards Board, International Association of Insurance Supervisors, and the International Organization of Securities Commissions. For developing nations, these consist also of the International Monetary Fund and the World Bank. The Organization of Economic Cooperation and Development and other voluntary groupings like the G-7 and G-24 also deal with these issues.

³ See Rep. Peter DeFazio (D-Ore.) Pres Release, http://www.defazio.house.gov/index.php?option=com_content&view=article&id=531:defazio-introduces-legislation-invoking-wall-street-transaction-tax&catid=60

⁴ Dean Baker, “The Benefits of Financial Transaction Taxes,” Center for Economic and Policy Research, Statement to the Bundestag, May 17, 2010, at 2-3. Available at: <http://www.cepr.net/documents/testimonies/baker-bundestag-2010-5-17.pdf>

⁵ Kevin Gallagher, “Policy Space to Prevent and Mitigate Financial Crises in Trade and Investment Agreements,” G-24 Discussion Paper Series, United Nations Conference on Trade and Development, at 3. Available at: <http://ase.tufts.edu/gdae/Pubs/rp/KGCapControlsG-24.pdf>

⁶ The first article of the GATS reads:

“Part I: Article I: Scope and Definition

1. This Agreement applies to measures by Members affecting trade in services.
2. For the purposes of this Agreement, trade in services is defined as the supply of a service:
 - (a) from the territory of one Member into the territory of any other Member;
 - (b) in the territory of one Member to the service consumer of any other Member;
 - (c) by a service supplier of one Member, through commercial presence in the territory of any other Member;
 - (d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.”

Subparagraphs (a), (b), (c), and (d) respectively refer to Modes 1 (cross-border trade), 2 (consumption abroad), 3 (commercial presence) and 4 (movement of natural persons).

⁷ The schedules typically observe the following norms:

- A list of one to 100-odd service sectors, ranging from “legal services” to “cargo-handling services.” Of these 100 sectors, 15 refer to financial services.⁷
- Each listed service sector has an adjacent 4 X 2 matrix, where countries indicate whether and to what extent they wish to be bound – in each of the four modes – to the disciplines under GATS Article XVI (Market Access) and Article XVII (National Treatment).
- In each matrix cell, countries can make the following inscriptions: “None” (meaning the sector is fully committed to the indicated GATS discipline); “Unbound” (meaning the sector is completely excluded from the indicated GATS discipline); or some qualified inscription (i.e. “None, except for” or “Unbound, except for,” etc.). Thus, the applicability of GATS Market Access obligations, say, to a specific country will depend on the extent to which their Schedule of Specific Commitments comes closest to a “None” entry for a given service sector and mode combination in the Market Access column.
- Finally, countries list headnotes and footnotes that further condition their commitments, along with a list of commitments to liberalize or deregulate other forms of domestic regulations under a column entitled “Additional Commitments.”

As can be seen, the GATS schedules are extremely complex. Even schedules that follow the above norms to the letter are difficult to compare, and many schedules do not follow them. Unless otherwise specified, this memorandum outlines disciplines that apply primarily to countries that have made substantial commitments in the 15 financial services sectors under Modes 1 through 3.

⁸ The full Article XVI text reads:

“Article XVI: Market Access

1. With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.[FIND FOOTNOTE TEXT IN BODY OF MEMO.]

2. In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:

- (a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
- (b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;

(c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;(9)

(d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;

(e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and

(f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.”

⁹ In other words, if a member made Mode 2 commitments in lending, it might have difficult imposing restrictions on current lending transactions under Mode 1 under the “relating to” standard.

¹⁰ Vicente Galbis, “Currency Convertibility and the Fund: Review and Prognosis,” IMF Working Paper, April 1996, at 4. Available at SSRN: <http://ssrn.com/abstract=882898>.

¹¹ Kevin Gallagher, “Policy Space to Prevent and Mitigate Financial Crises in Trade and Investment Agreements,” G-24 Discussion Paper Series, United Nations Conference on Trade and Development, at 3. Available at: <http://ase.tufts.edu/gdae/Pubs/rp/KGCapControlsG-24.pdf>

¹² IMF, “Balance of Payments and International Investment Position Manual,” December 2008, at 253. Available at: <http://www.imf.org/external/pubs/ft/bopman/bopman.pdf>. Accessed Feb. 26, 2010. Confusingly, the IMF now refers to what used to be called “capital transactions” as “financial transactions,” while what the IMF now calls “capital transactions” is a much more limited category.

¹³ *Ibid*, at 111 and 113.

¹⁴ See Alexei Kireyev, “Liberalization of Trade in Financial Services and Financial Sector Stability,” IMF Working Paper WP/02/138, August 2002, at 9. See bio at: <http://www.alexekireyev.com/fileadmin/templates/pdf/CV-Kireyev2007.pdf>

¹⁵ WTO, “Financial Services,” Background Note by the Secretariat, S/C/W/312 and S/FIN/W/73, Feb 3, 2010, at 4-5. Available at: <http://docsonline.wto.org/DDFDocuments/t/S/FIN/W73.doc>

¹⁶ “WTO - Trade in Services,” Edited by Rüdiger Wolfrum, Peter-Tobias Stoll and Clemens Feinäugle, Max Planck Commentaries on World Trade Law, Volume 6, (Koninklijke Brill N.V., Leiden, 2008), at 251-252.

¹⁷ Deborah Siegel, “Legal Aspects Of The IMF/WTO Relationship: The Fund’s Articles of Agreement and the WTO Agreements,” *American Journal of International Law*, July 2002, at 586-587.

¹⁸ WTO, “Financial Services,” Background Note by the Secretariat, S/C/W/312 and S/FIN/W/73, Feb 3, 2010, at 3-6.

¹⁹ In a comprehensive study of recent IMF programs, economists could only find one recent instance (Iceland) where the IMF had spoken encouragingly about capital controls to a borrower. It is not clear whether their imposition was strictly required by the IMF. See Mark Weisbrot, Rebecca Ray, Jake Johnston, Jose Antonio Cordero and Juan Antonio Montecino, “IMF-Supported Macroeconomic Policies and the World Recession: A Look at Forty-One Borrowing Countries,” Center for Economic and Policy Research, October 2009. Available at: <http://www.cepr.net/documents/publications/imf-2009-10.pdf>

²⁰ Deborah Siegel, “Legal Aspects Of The IMF/WTO Relationship: The Fund’s Articles of Agreement and the WTO Agreements,” *American Journal of International Law*, July 2002, at 598. A search of the WTO Documents website for “services,” “Fund,” and “request” yielded no further indication of an alleged Article XI violation, let alone a Fund request to allow such, since 2002 – when Siegel’s piece was published.

²¹ This article reads:

“Article XII: Restrictions to Safeguard the Balance of Payments

1. In the event of serious balance-of-payments and external financial difficulties or threat thereof, a Member may adopt or maintain restrictions on trade in services on which it has undertaken specific commitments, including on payments or transfers for transactions related to such commitments. It is recognized that particular pressures on the balance of payments of a Member in the process of economic development or economic transition may necessitate the use of restrictions to ensure, inter alia, the

maintenance of a level of financial reserves adequate for the implementation of its programme of economic development or economic transition.

2. The restrictions referred to in paragraph 1:

- (a) shall not discriminate among Members;
- (b) shall be consistent with the Articles of Agreement of the International Monetary Fund;
- (c) shall avoid unnecessary damage to the commercial, economic and financial interests of any other Member;
- (d) shall not exceed those necessary to deal with the circumstances described in paragraph 1;
- (e) shall be temporary and be phased out progressively as the situation specified in paragraph 1 improves.

3. In determining the incidence of such restrictions, Members may give priority to the supply of services which are more essential to their economic or development programmes. However, such restrictions shall not be adopted or maintained for the purpose of protecting a particular service sector.

4. Any restrictions adopted or maintained under paragraph 1, or any changes therein, shall be promptly notified to the General Council.

5. (a) Members applying the provisions of this Article shall consult promptly with the Committee on Balance-of-Payments Restrictions on restrictions adopted under this Article.

(b) The Ministerial Conference shall establish procedures⁽⁴⁾ for periodic consultations with the objective of enabling such recommendations to be made to the Member concerned as it may deem appropriate.

(c) Such consultations shall assess the balance-of-payment situation of the Member concerned and the restrictions adopted or maintained under this Article, taking into account, inter alia, such factors as:

- (i) the nature and extent of the balance-of-payments and the external financial difficulties;
- (ii) the external economic and trading environment of the consulting Member;
- (iii) alternative corrective measures which may be available.

(d) The consultations shall address the compliance of any restrictions with paragraph 2, in particular the progressive phaseout of restrictions in accordance with paragraph 2(e).

(e) In such consultations, all findings of statistical and other facts presented by the International Monetary Fund relating to foreign exchange, monetary reserves and balance of payments, shall be accepted and conclusions shall be based on the assessment by the Fund of the balance-of-payments and the external financial situation of the consulting Member.

6. If a Member which is not a member of the International Monetary Fund wishes to apply the provisions of this Article, the Ministerial Conference shall establish a review procedure and any other procedures necessary.”

²² The enumeration in this list is mine.

²³ Todd Tucker and Lori Wallach, “No Meaningful Safeguards for Prudential Measures in World Trade Organization’s Financial Service Deregulation Agreements,” Public Citizen Report, September 2009.

²⁴ Christine Kaufmann and Rolf Weber, “Reconciling Liberalized Trade in Financial Services and Domestic Regulation,” in Kern Alexander and Mads Andenas (eds.), *The World Trade Organization and Trade in Services*, (Amsterdam: Martinus Nijhoff Publishers, 2008), at 424. On Weber and Kaufmann’s background, see: <http://www.nccr-trade.org/people/kaufmann/> and <http://www.nccr-trade.org/people/weber/>

²⁵ “WTO - Trade in Services,” Edited by Rüdiger Wolfrum, Peter-Tobias Stoll and Clemens Feinäugle, Max Planck Commentaries on World Trade Law, Volume 6, (Koninklijke Brill N.V., Leiden, 2008), at 254.

²⁶ Mark Kantor, “International investment law protections for Chinese investment into the US,” in Karl Sauvant, ed., *Investing in the United States: Is the U.S. Ready for FDI from China?*, (Northampton, Mass.: Edward Elgar, 2010), at 161.

²⁷ In another paper, we examine how explicitly discriminatory tax measures may be desirable in dealing with tax-haven countries, but may also be limited by trade and investment agreements. See Todd Tucker and Lori Wallach,

“Panama FTA Would Undermine U.S. Efforts to Stop Offshore Tax-Haven Abuse and Regulate Risky Financial Conduct,” Public Citizen Report, April 2009.

²⁸ Article XX exceptions were invoked in EC-Asbestos, US-Shrimp, Argentina-Bovine Hides, Brazil-Tyres, EC-Tariff Preferences, US-Gasoline, Mexico-Soft Drink, DR-Cigarettes, EC-Trademarks, Canada-Wheat, and Korea-Meat. Only in the first two instances was the exception accepted.

²⁹ Article XI of the U.S.-Argentina BIT reads: “This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interests.” (Available at: http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_000897.asp) The investors that brought the cases were CMS, Continental, Enron, LG & E, and Sempra. On the rulings as to the non-self-judging nature of the BIT’s Article XI, see *Continental Casualty Company v. Argentina*, ICSID Case No. ARB/03/9 (US/Argentina BIT). Sept. 5, 2008, at 83. See also *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16 (US/Argentina BIT), at 114. (Available at: http://ita.law.uvic.ca/alphabetical_list_respondant.htm.)

In the CMS, Enron and Sempra cases, the tribunals rejected Argentina’s necessity plea for all of the challenged measures. In the Continental and LG & E cases, the tribunals rejected the necessity plea for some of the challenged measures. In all cases, the tribunal ordered the payment of compensation. See *Continental Casualty Company v. Argentina*, ICSID Case No. ARB/03/9 (US/Argentina BIT). Sept. 5, 2008, at 134; and *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16 (US/Argentina BIT), at 104-105.

A later trial annulled the charge against Argentina in the Sempra case. See *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Annulment Proceeding, Decision on the Argentine Republic’s Application for Annulment of the Award, June 29, 2010.

³⁰ Bart de Meester, “The Global Financial Crisis and Government Support for Banks: What Role for GATS?” Leuven Center for Global Governance Studies, Working Paper 32, December 2009, at 8.

³¹ This observation opens the obvious question: what constitutes a “monetary or exchange rate policy”? The Federal Reserve Board defines monetary policy as: “actions undertaken by a central bank, such as the Federal Reserve, to influence the availability and cost of money and credit as a means of helping to promote national economic goals.” It is much more common to see examples of monetary policies, rather than definitions (and neither is offered in the GATS text). The Board goes on to state: “The Federal Reserve implements monetary policy using three major tools: * Open market operations. The buying and selling of U.S. Treasury and federal agency securities in the open market; * Discount window lending. Lending to depository institutions directly from their Federal Reserve Bank’s lending facility (the discount window), at rates set by the Reserve Banks and approved by the Board of Governors; * Reserve requirements. Requirements regarding the amount of funds that depository institutions must hold in reserve against deposits made by their customers.”

“Exchange rate policy” is even less frequently defined. Alan Deardorff, a leading international economist, defines “exchange rate regime” as “The rules under which a country’s exchange rate is determined, especially the way the monetary or other government authorities do or do not intervene in the exchange market. Regimes include floating exchange rate, pegged exchange rate, managed float, crawling peg, currency board, and exchange controls.”

See : <http://www.federalreserve.gov/generalinfo/faq/faqmpo.htm> and see: <http://www-personal.umich.edu/~alandear/glossary/>.

³² The whole article reads:

“Annex on Financial Services

1. Scope and Definition

(a) This Annex applies to measures affecting the supply of financial services. Reference to the supply of a financial service in this Annex shall mean the supply of a service as defined in paragraph 2 of Article I of the Agreement.

(b) For the purposes of subparagraph 3(b) of Article I of the Agreement, “services supplied in the exercise of governmental authority” means the following:

(i) activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies;

(ii) activities forming part of a statutory system of social security or public retirement plans; and

(iii) other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government.

(c) For the purposes of subparagraph 3(b) of Article I of the Agreement, if a Member allows any of the activities referred to in subparagraphs (b)(ii) or (b)(iii) of this paragraph to be conducted by its financial service suppliers in competition with a public entity or a financial service supplier, “services” shall include such activities.

(d) Subparagraph 3(c) of Article I of the Agreement shall not apply to services covered by this Annex.”

³³ Francisco Parodi and Alejandra Pereira, “Financial Services Trade Liberalization in the Doha Round: Implications for Latin America,” *Integration and Trade*, January-June 2005, 9: 22. First part of quote from the draft version.

³⁴ Nico Valckx, “WTO Financial Services Commitments: Determinants and Impact on Financial Stability,” IMF Working Paper WP/02/214, December 2002; Nico Valckx, “WTO Financial Services Liberalization: Measurement, Choice and Impact on Financial Stability,” De Nederlandsche Bank Memorandum 705, October 2002. Includes supporting data provided by author.

³⁵ No country has just high Mode 1 commitments, with no Mode 2 or 3.

³⁶ Nigeria has high Mode 1 and 3 commitments, but little Mode 2 commitments.

³⁷ Aaditya Mattoo, “Financial Services and the World Trade Organization: Liberalization Commitments of the Developing and Transition Economies,” World Bank Policy Research Paper 2184, September 1999, at 47 and 50.

³⁸ Group of Negotiations on Services, “Note on the Meeting of 12-13 July 1990,” Working Group on Financial Services Including Insurance, GATT Document MTN.GNS/FIN/2, Aug. 10, 1990. Available at: <http://sul-derivatives.stanford.edu/derivative?CSNID=92110082&mediaType=application/pdf>. Accessed March 1, 2010.

³⁹ Ibid.

⁴⁰ European Commission staff working document, “Innovative financing at a global level,” SEC(2010) 409 final, April 1, 2010. Available at: http://ec.europa.eu/economy_finance/articles/international/2010-04-06-global_innovative_financing_en.htm

⁴¹ See WTO Panel, “United States – Measures Affecting The Cross-Border Supply of Gambling and Betting Services,” Report of the Panel, WTO Document WT/DS285/R, Nov. 10, 2004 at 232-233.

⁴² Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System, September 2009 Report, at 38-39, 104-105. Available at: http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf.

⁴³ See http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_trips_e.htm

⁴⁴ Other reforms are also worth debating, such as academic Regis Bismuth’s recent suggestion that:

“national measures based on IOSCO or IAIS standards should be irrebuttably presumed consistent with the GATS... there should be a rebuttable presumption that domestic regulations based on international norms devised in a plurilateral context involving the major economies and establishing the conditions of a level playing field in the banking sector are deemed adopted for prudential reasons and, consequently, consistent with the GATS.”

See Regis Bismuth, “Financial Sector Regulation and Financial Services Liberalization at the Crossroads: The Relevance of International Financial Standards in WTO Law,” *Journal of World Trade*, 44:2, March 2010, at 502.

⁴⁵ House Democratic leadership ensured that this provision...:

“Article 22.2: Essential Security: Nothing in this Agreement shall be construed: (a) to require a Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests; or (b) to preclude a Party from applying measures that it considers necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.”

... Included this footnote:

“For greater certainty, if a Party invokes Article 22.2 in an arbitral proceeding initiated under Chapter Ten (Investment) or Chapter Twenty-One (Dispute Settlement), the tribunal or panel hearing the matter shall find that the exception applies.”

See: http://www.ustr.gov/sites/default/files/uploads/agreements/fta/peru/asset_upload_file841_9542.pdf

⁴⁶ The GATS Second Annex on Financial Services that was agreed as part of the Uruguay Round in 1994 established that WTO members may “during a period of 60 days beginning four months after the date of entry into force of the WTO Agreement, improve, *modify or withdraw* all or part of the specific commitments on financial services inscribed in its Schedule” [italics added]. In 1995, as the post-Uruguay Round special additional negotiations on financial services began, WTO members decided to extend this modification period through 1997. See “Second Decision on Financial Services: Adopted by the Council for Trade in Services on 21 July 1995,” WTO Document S/L/9, July 24, 1995.