



Discussion Proposal at the WTO to Safeguard Financial Stability

In the wake of the global financial crisis, governments and international organizations such as the G-20 and Financial Stability Board now recognize the need for robust regulation of the financial services sector to ensure financial stability and to avoid future crises. At the same time, increasingly, government officials and trade and finance experts are questioning whether the World Trade Organization's General Agreement on Trade in Services (GATS) and related rules on financial services negotiated in the 1990s could pose obstacles to post-crisis efforts to enhance regulation underway both on the domestic and international levels.

In June 2012, World Trade Organization (WTO) member state Ecuador tabled a modest, but important proposal whose goal is to provide all governments with greater certainty that the WTO rules governing financial services provide sufficient policy space for needed financial reregulation and as well as to improve coherence between the WTO and other international bodies promoting financial reregulation. Ecuador specifically proposed that WTO members undertake a discussion at the WTO's Committee on Trade in Financial Services about current thinking at the international level on macro-prudential regulation and its relationship to the GATS rules. The proposal will be discussed at the next quarterly meeting of the Committee on Trade in Financial Services (CTFS) which will take place the first week of October 2012.

This commonsense proposal provides a concrete follow-up to a proposal made prior to the WTO's 8th Ministerial Conference in December 2011, when Ecuador proposed that Trade Ministers make a simple statement, acknowledging the need to review the WTO rules on financial services in light of the financial crisis and the efforts internationally and domestically to strengthen regulation. A majority of countries – including Brazil, India, China, South Africa, and Argentina - supported that initiative in the Committee in October 2011. But, unfortunately, the United States, European Union and Canada did not support the proposal to raise the issue at the Ministerial Conference. Members did agree that the Committee on Trade in Financial Services was an appropriate venue to continue consideration of a discussion, and the Chair of the Committee provided space on the agenda in 2012.

More than 100 countries, including dozens of developing countries, have GATS financial services commitments. Countries that did not schedule exceptions - and now post-crisis seek to re-regulate in committed sectors using mechanisms prohibited by GATS rules - could (1) face a WTO challenge, (2) choose not to institute a needed regulatory tool to avoid a threatened challenge, or (3) be required to negotiate compensation terms with affected member states to alter their commitments, which may be infeasible, especially for developing countries.

Financial consumer advocates believe it is very important for this discussion to take place at the WTO, as it is critical for all member states to have full confidence that the policy space exists in these agreements for financial regulation, so that countries are not chilled in their financial reform measures for fears that that ultimately a WTO Dispute Panel could decide what the rules mean in the context of a challenge to domestic laws.

We cannot afford to wait until the next financial crisis to ensure that countries' trade commitments do not interfere with financial regulation. Therefore, we urge all WTO member states to support Ecuador's modest proposal for discussion within the CTFS at the upcoming October 2012 meeting.

What are specific concerns that experts raise related to GATS and financial regulation?

1. Liberalization under WTO requires deregulation. The GATS "Market Access" rules (Article XVI(2)) under which countries made liberalization commitments prohibit maintenance or establishment of specific types of non-discriminatory regulation in committed sectors. The WTO Appellate Body ruling in Antigua's challenge of the U.S. Internet gambling ban established that a ban - for instance of a risky financial service or product - is an Article XVI(2)-forbidden "zero quota." This poses threats to countries' bans of risky financial practices or instruments in a committed sector. Provisions forbidding limits on size and legal entity are ambiguous, leading some countries to schedule limitations for the right to address firm-specific regulation or to firewall cross-sectoral risk. Many others, however, did not, and may face GATS constraints on their ability to address too-big-to-fail banks.

2. Limitations on capital management techniques. GATS rules forbidding limits on capital and current account flows could undermine developing countries' use of macroprudential measures, such as capital controls. A footnote to GATS Article XVI(2) requires that countries with Mode 1 commitments allow unrestricted capital flows in and out and with Mode 3 commitments, unrestricted capital flows in. GATS Article XI "Payments and Transfers" requires countries to allow capital flows in committed sectors. These rules apply to all GATS-committed sectors and no exceptions may be scheduled. They pose unique risks when applied to financial services, where capital flows are not merely incidental to provision of a service, but rather large, potentially destabilizing movements of capital are the service. GATS Article XII provides a limited exception for short term limits on flows with IMF approval in a balance of payments emergency. However, this exception does not provide for the use of standing restrictions on in-flows as a prophylaxis against crises.

3. Further limitations on domestic regulation. Article VI "Domestic Regulations" subjects non-discriminatory technical qualifications, licensing, permissions, and other commonly-used policies to review and challenge. In a post-crisis era, many observers question why the WTO's "Working Party on Domestic Regulation" would continue seeking to establish disciplines that further constrain domestic financial regulation.

4. Insufficient defense for prudential measures. The GATS Annex on Financial Services Article 2(a) supposedly can be used as a defense for regulatory measures taken for prudential reasons. However, while first sentence provides a defense for a range of prudential measures, the second sentence states that a country cannot use such measures to avoid their GATS commitments. Some argue this defense is self-cancelling, and everyone agrees that it is ambiguous. Numerous scholars, including WTO panelists, have discussed the need for clarification. This provision is not a carve-out that forbids challenges of countries' prudential financial policies. A review of GATS negotiating history shows that a bloc of Asian countries proposed a true prudential carve-out, but this was rejected. Five defense provisions were proposed, with the weakest version ultimately adopted.

Trade and finance experts have noted conflicts between WTO rules and financial regulation.

As the G20, most governments and even the IMF have recognized the need for financial re-regulation in the wake of the financial crisis, mainstream international trade and finance experts have raised concerns about the intersection between GATS rules and financial re-regulation efforts.

- **The 2008 Report of the UN's Commission of Experts on Reforms of the International Monetary and Financial System**, noted "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."
- **UNCTAD's 2011 Trade and Development Report** described in some detail concerns related to financial re-regulation and the GATS, including: "The General Agreement on Trade in Services (GATS) of the World Trade Organization (WTO), many bilateral trade agreements and bilateral investment treaties (BITs) include provisions relating to payments, transfers and financial services that may severely limit not only the application of capital controls, but also other measures aimed at re-regulating or restructuring financial systems."
- **A 2010 European Commission staff paper** noted a potential conflict between a Financial Transactions Tax (FTT) and the EU's commitments in the GATS: "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."