To Promote Economic Stability, Nations Must Free Themselves from WTO Financial Deregulation Dictates

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I. Executive Summary and Introduction

Growing unemployment and worldwide. Collapsing banks. A global contraction in economic activity. Bailouts. Nationalizations. More government involvement in numerous countries’ economies than seen in generations. While these headlines dominate the news, one of the root causes of the global economic crisis has largely been ignored: over the last several decades, U.S. and European governments and corporations have used “trade” agreements and international agencies like the World Trade Organization (WTO) to push countries to implement extreme financial deregulation and then lock in such policies. Too often, these deregulatory forces have found willing allies in corporate-friendly governments.

The economic crisis wracking the world today underlines both the failure of deregulation and the importance of preserving policy space, so that governments can deliver on the promise of democratic governance by implementing policies that serve their populations’ wellbeing. But in a perversion of democracy, new governments elected by populations demanding change can incur huge penalties for violating binding international commercial obligations – often agreed to by past governments – even if the new governments are acting to salvage their country from economic and social breakdown.

Yet, despite these harsh lessons, and even today in the context of a global crisis caused in part by radical financial deregulation, powerful multinational financial interests are pushing to lock countries into further financial deregulation using the Doha Round WTO negotiations. When the Doha Round was launched in 2001, the deregulation craze was in full swing. Yet, today the Doha Round agenda remains unchanged and includes, for instance, an agreement imposing new disciplines on countries’ regulation of all service sectors, a pact specifically limiting regulation of the accountancy sector, and numerous demands on specific countries to deregulate particular financial sectors.

The existing and proposed WTO rules are important because they are strongly enforced. WTO members are empowered to challenge each others’ financial sector polices in the WTO’s binding dispute settlement system. If WTO tribunals find that a domestic financial regulatory policy violates these constraints, the country is asked to conform its existing policy to the WTO rules. If a country fails to so within a set amount of time, the WTO can authorize trade sanctions, which can remain in place until the policy is changed. As part of such proceedings over financial regulatory policy, sanctions can be imposed against countries’ non-financial exports (such as manufactured goods or agricultural products) through what is called “cross retaliation.”

This report provides an in-depth introduction to the WTO financial services rules now in effect. It also examines proposals for further deregulation on the table in the Doha Round – and their general implications. The report concludes by offering policy recommendations that would fix the WTO and Doha Round’s conflict with financial reregulation.

To understand how the existing WTO rules affect each country requires review of what specific financial services – banks, insurance, securities, derivative, etc. – that a country agreed to submit to which specific WTO rules. Similarly, to understand what is at stake with respect to many – but not all – of the Doha Round deregulatory proposals requires reviewing what existing demands have been made of a country, and what offers countries have made to bind new sectors to the WTO deregulation obligations. Public Citizen has begun compiling such information on some countries, with country specific reports available at www.citizen.org/WTOFinancialDeregulation.
II. Existing WTO Rules Require Financial Deregulation

The World Trade Organization (WTO) oversees 17 commercial agreements, many of which have nothing to do with trade per se. Indeed, while many people still assume trade pacts are about traditional matters, such as tariff and quota levels, in fact, the WTO requires its members to conform their non-trade domestic policies to an expansive deregulatory agenda. The WTO’s General Agreement on Trade in Services (GATS) houses expansive financial services deregulation requirements, as do several related texts explored below. Over 100 countries have GATS commitments in the financial services area.

The WTO financial services provisions require simultaneous liberalization and deregulation of financial services that countries bind to WTO jurisdiction. In other words, under the WTO rules, if a country agrees to liberalize aspects of its financial sector by providing “Market Access”, it is simultaneously bound not to maintain or establish many common forms of regulation over those banking, insurance, securities or other service sectors. Once a country has submitted a service sector to WTO jurisdiction, it may only withdraw that sector (and thereby re-establish its regulatory space) after negotiating compensation deals with all other WTO members that claim that their commercial interests will be harmed by such a change.

The binding WTO pacts stand in sharp contrast to the various non-binding international accords between banking, securities and insurance supervisors, such as Basel II, which attempt (however imperfectly) to create a global regulatory floor. Rather, the WTO financial service rules constitute a global regulatory ceiling. These constraints on regulation are enforced through the WTO’s powerful binding dispute settlement system. Countries that fail to conform domestic laws to the WTO’s terms may be challenged by other countries (often at the request of business interests) before a WTO tribunal. These foreign tribunals are empowered to instruct nations to eliminate WTO-violating financial service regulations, with trade sanctions authorized for failure to comply. To date, WTO tribunals have ruled against the domestic policy in question in nearly 90 percent of cases brought before them. In virtually every case, both developed and developing countries have changed laws ruled WTO-illegal. Given this record, often the mere threat of a WTO challenge by a government – or an industry claim that a policy violates the WTO – results in countries modifying their laws or in a policy initiative being chilled. Not surprisingly, the WTO financial services terms – an unusually potent system of international rules – were pushed by the top financial institutions that stood to make short-term gains from deregulation, including AIG and Citigroup.

Despite the little-known negotiating history of the WTO financial service deregulation terms, some analysts and groups are starting to take note. This includes the United Nations Commission of Experts on Reforms of the International Monetary and Financial System, chaired by Nobel Prize winning economist Joseph Stiglitz which described the regulatory limits imposed by the WTO. The current dawning of public and policymaker awareness – about trade agreement constraints on reregulation generally and the WTO’s financial service deregulation terms specifically – has worried supporters of the WTO and its Doha Round, who grasp the political risk of broader public scrutiny. Indeed, few that call for further financial services “liberalization” at the WTO fail to announce that they are not calling for “deregulation” ... even as they demand that countries sign up to specific WTO rules that require deregulation and ban use of many basic regulatory tools.
Moreover, even post-crisis, various corporate interests have paid lip service to the need for stronger regulation, while simultaneously fighting efforts to improve regulation at home, and calling for conclusion of the Doha Round (with all its deregulatory requirements). And, the United States goes out of its way to say that liberalization requires a good regulatory framework, even as it pushes for countries to make additional commitments to comply with GATS Market Access rules (which forbid many of the very regulations the United States successfully employed prior to its 1990s deregulation).8

In response to growing inquires about the WTO’s financial service rules, the WTO’s supporters have launched two misleading arguments. First, they claim that the WTO rules only require non-discrimination, not deregulation. Second, they suggest that the GATS “carves out” financial service prudential regulations from WTO coverage.9 We address both claims below. (A final argument occasionally raised is that no WTO dispute settlement case has been brought against a financial services measure under the GATS. The most obvious explanation of this history is that, from establishment of these WTO rules until very recently, the trend in countries around the world has been towards the systematic deregulation of the financial sector. Rather than establishing new regulations that could run afoul of the WTO constraints, countries have been implementing extreme deregulation. The potential for cases is likely to grow as nations begin to reregulate, which is why an exploration of the actual GATS obligations is so crucial, and why the changes we recommend to the existing rules are critical. Moreover, the threats posed by these rules with respect to countries’ attempts to restore financial stability are not hypothetical. The ruling in cases that have been brought against financial policies under bilateral investment treaties, for instance against Argentina (which employed various reregulatory policies in response to its repeated financial crisis in the 1990s), show what is at stake.

WTO Rules Require Deregulation, Not Just Market Access and Non-Discriminatory Treatment

Contrary to WTO defenders’ claims, the WTO financial services provisions’ restrictions on countries’ non-discriminatory financial service sector regulations are expansive and onerous:

- **No limits on size**: The Market Access rules contained in GATS Article XVI(2) prohibit government policies that limit the size or total number of financial service suppliers in covered sectors.10 This ban applies absolutely. If a country has signed up its financial services to meet these rules, then it simply may not maintain or enact such size-limiting policies, even if they apply equally to domestic and

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

The United Nations Commission of Experts on Reforms of the International Monetary and Financial System, chaired by Nobel Prize winning economist Joseph Stiglitz, noted in its Report on Reforms of the International Monetary and Financial System: “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.”11 Americans for Financial Reform, an umbrella organization for consumer and labor groups advocating U.S. reregulation, called on President Obama to address this problem on the eve of the Pittsburgh G-20 summit. “Existing and prospective pacts that contain deregulatory obligations and constraints on oversight must be renegotiated so that policymakers can implement the consensus call to address the crisis in the manner they see fit without the threat of trade suits.”
foreign firms. These WTO rules also ban limits on the value of service transactions and number of service operations. (This GATS obligation could make it difficult to solve the “too big to fail” problem, whereby a single bank’s failure could endanger the entire financial system. Economists such as the former IMF chief economist Simon Johnson have called for size-limiting measures to resolve this “moral hazard” problem.)

- **No restrictions or requirements on specific types of legal entities**: The GATS Market Access rules also ban requirements that services be provided through specific types of legal entity, like a branch or non-profit agency, even if such policies are applied to domestic and foreign firms equally.

- **No limits on the types of financial service one entity may provide**: The GATS Market Access rules can also thwart governments’ attempts to limit the array of financial services any one firm is permitted to offer. This regulatory limit could conflict with attempts to “firewall” different financial services, which is a policy tool used to limit the spread of risk across sectors. Before it deregulated, the United States, for instance, used such policies to insulate consumer saving accounts by forbidding entities that operated such businesses from also providing risky securities or derivatives offerings.

- **No bans on risky activities**: Under the GATS Market Access rules, a country may not ban a highly risky financial service in a sector (i.e. banking, insurance, or other financial services) that it has committed to meet GATS rules. A WTO tribunal has already established the precedent that a regulatory ban of an activity violates GATS Market Access rules: The U.S. Internet gambling ban – which prohibited both U.S. and foreign gambling companies from offering online gambling to U.S. consumers – was found to be a “zero quota” and thus violate GATS market access requirements.

- **Standstill on new regulation**: The dictate to deregulate – and the limits on reregulation – are even more extreme for the 33 countries that agreed to additionally adopt the WTO Understanding on Commitments in Financial Services. In addition to the constraints noted above, the Understanding obligates its adopters to put a freeze on new regulations in covered financial service sectors. This so-called “standstill” provision is contained in the Understanding’s Article (A), and reads: “Any conditions, limitations and qualifications to the commitments noted below shall be limited to existing non-conforming measures.” The effect of this provision is to lock adopters into the level of deregulation they agreed to in the 1990s. Similarly, if
countries adopted the Understanding in 2009, they would be locked into today’s level of deregulation in committed sectors.

- **Foreign financial services firms must be allowed to establish a commercial presence:** The Understanding’s Articles B(5-6) also oblige its 33 adopters to allow foreign firms to establish or acquire operations within their territory. Unlike most GATS commitments, which are “bottom-up” (meaning only covering sectors specifically listed), this is a top-down commitment (meaning it covers all sectors unless a county lists a specific exclusion).16

- **No bans on new financial service products:** The Understanding’s Article B(7) also obliges its adopters to ensure that the commercial presence guaranteed under Article B(5-6) is accompanied by the right “to offer in [their] territory any new financial service.” In other words, while a country could ban its domestic firms from offering certain new risky financial service “products”, it could not equally prohibit foreign firms operating within the country from doing so.

- **Competitive deregulation of other non-discriminatory policies:** The Understanding also contains an obligation to “endeavour to remove or to limit any significant adverse effects on financial service suppliers of any other Member of: non-discriminatory measures that prevent financial service suppliers from offering in the Member’s territory, in the form determined by the Member, all the financial services permitted by the Member; non-discriminatory measures that limit the expansion of the activities of financial service suppliers into the entire territory of the Member; measures of a Member, when such a Member applies the same measures to the supply of both banking and securities services, and a financial service supplier of any other Member concentrates its activities in the provision of securities services; and other measures that, although respecting the provisions of the Agreement, affect adversely the ability of financial service suppliers of any other Member to operate, compete or enter the Member’s market…”17 While “shall endeavour” clauses are not enforceable in the same manner as the other provisions’ explicit constraints, this provision indicates the underlying extreme deregulatory philosophy of the Understanding and its proponents.18

- **Treating foreign and domestic firms alike is not sufficient:** In addition to the Market Access rules, GATS rules on non-discrimination extend beyond simply applying the same policies to domestic and foreign firms. The GATS National Treatment rules state: “Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.” In other words, even if a policy applies to domestic and foreign firms alike, it might inadvertently have a different effect on foreign firms. Even if this different effect is caused by the firm’s own business decisions, such a policy can violate the GATS constraints.

- **Other non-discriminatory domestic regulations are also subject to review:** GATS Article VI requires that, “In sectors where specific commitments are undertaken, each Member shall ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner.” This is an extremely broad provision, as it applies to regulations of general application that may affect service sector operations, not only those designed to regulate a specific service sector or the service sector generally. The provision also provides enormous discretion to a WTO tribunal to determine if the manner in which a country implements its policies are “reasonable, objective and impartial” – all highly subjective measures. Another clause of this GATS article additionally requires that with respect to sectors bound to GATS, a country “shall not apply licensing and qualification requirements and technical standards that nullify or impair such specific commitments in a manner which: (i) does not comply with” a specified set
of criteria and “could not reasonably have been expected of that Member at the time the specific commitments in those sectors were made.” The criteria include that such policies be “based on objective and transparent criteria, such as competence and the ability to supply the service; not more burdensome than necessary to ensure the quality of the service; and in the case of licensing procedures, not in themselves a restriction on the supply of the service.” What exactly is required by these provisions remains contested and is now the subject of negotiations in the Doha Round. However, it is clear that even non-discriminatory domestic policies that fall outside the Market Access-related policy limits and that cover the most fundamental ways in which services are regulated – licensing and qualification requirements and technical standards – are subject to additional constraints. And among the grounds for such attacks on non-discriminatory regulations are that other WTO countries could not have reasonably foreseen such policies being implemented in the future. In other words, a WTO member may challenge another’s service sector regulations as failing to meet these criteria. Then, a WTO tribunal would make the subjective decisions about the reasonableness, foreseeability and relevance of the challenged country’s laws.

Countries’ Prudential Measures Are Covered by the WTO Constraints

Another argument made to distract attention from WTO constraints on financial service regulation is the claim that there is a GATS provision that provides a safeguard for countries’ “prudential measures.” The WTO’s defenders sometimes inaccurately call this provision a “prudential carve-out.” Yet, a “carve out” is a specific mechanism that removes altogether a sector or domestic policy from coverage under an agreement. (If a sector or policy is “carved out”, then it is not subject to the agreement’s requirements or to an enforcement challenge.) The clause in question does not “carve out” prudential measures from the scope of the WTO’s constraints. Rather, the provision in question is only a defense that a country could raise after its prudential measure has been challenged.

Further, an examination of the actual language in the GATS Annex on Financial Services’ Article 2(a) shows that the provision in question 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].

A recent Public Citizen report analyses this provision in depth. In sum, as the second sentence makes clear, the provision may only be used to defend regulatory policies if such policies do not undermine the commitments and obligations established through the other WTO rules. This effectively eviscerates the use of the provision. Say country A had a prudential policy that country B didn’t like. B would only launch a WTO challenge if it thought A’s measure did not conform to the provisions of the agreement, i.e. undermining A’s obligations and commitments owed to B under the agreement. Yet, in that circumstance, which is what the second sentence of the provision describes, the seeming safeguard provided in the first sentence is negated. Moreover, research into the negotiation of this provision shows that other versions of text that could have actually provided a meaningful exception for such domestic policies. These earlier proposals did not provide tribunals with the discretion to substitute their judgment for those of government with respect to the legitimacy of prudential measures. But they were rejected in favor of the current clause, with its self-cancelling second sentence.19
III. Doha Round: Proposed WTO Rules Require Further Financial Deregulation

The Doha Round, if completed, could expand this deregulatory model. Among the proposals on the table:

- **A new agreement setting additional constraints on non-discriminatory domestic regulations.** It seems unimaginable that in the context of the current crisis and worldwide efforts to deregulate financial services, WTO negotiations would be underway to establish new, additional limits on domestic regulation. However, the GATS Article VI described above also included a mandate in subsection VI(4) for further negotiations to establish “any necessary disciplines” “with a view to ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers...” A “GATS Working Party on Domestic Regulations” is now devising the text of a new agreement that is slated to be adopted as part of the Doha Round that would translate the criteria noted above into more specific constraints. Some countries have pushed for extreme new limits on regulation, including the imposition of a so-called “necessity test.” This would empower WTO tribunals to second-guess domestic governments with respect to the subjective question of whether policies are really necessary, or if less trade restrictive means to meet these policy goals could be employed. Other countries have opposed the necessity test, and insisted that any new disciplines should only apply to committed sectors. The efforts of this latter bloc appeared to prevail for most of the last decade, resulting in draft disciplines on March 20, 2009 that did not include the necessity language. However, by April 1, Switzerland, Hong Kong, Taiwan, and Malaysia called for reinsertion of the deregulation-promoting necessity requirement – a proposal that seems even more ill-advised in the wake of the financial crisis.

It is worth noting that the new disciplines on domestic regulation of services that are now slated to be adopted in the Doha Round have implications far beyond the financial sector. These constraints would apply generally to all services bound to GATS, including energy, health and other sectors, depending on the country. If these disciplines go into effect, a new set of regulatory constraints would be added to existing GATS rules and the WTO’s tribunals would be empowered to determine compliance of countries’ policies in the event of a challenge.

- **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. According to the Accounting Disciplines text, they apply to any measure “affecting trade in accountancy services,” not only to accountancy regulations per se. Arthur Andersen, of Enron accounting scandal fame, helped formulate this text. This includes a requirement that accounting regulations be limited to what WTO tribunals judge to be “necessary.” 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 the GATS Market Access rules.** For instance, a Doha Round “Financial Services Collective Request” was signed by Australia, Canada, the European Communities, Ecuador, Hong Kong China, Japan, Korea, Norway, Taiwan, and the United States. It calls on countries to “remove limitations such as monopolies, numerical quotas or economic needs tests and mandatory cessions.” This request refers to deeper financial service sector commitments under GATS Article XVI(2) on Market Access, with all the attendant problems noted above.

• **“Increased use of the Understanding by Members as a minimum standard for liberalization.”** Leaked EU documents show such a demand has been made of developing nations in the current Doha Round negotiations. This would mean more countries would be subjected to the regulatory standstill, required to allow in all new risky financial products and services of foreign firms, and also to allow establishment of foreign firms operations within their countries on a top-down basis, along with all of the Understanding’s other deregulatory terms noted above.

• **“Standstill on certain non-discriminatory measures.”** Even for countries that do not adopt the Understanding, there is a stand-alone demand to lock in countries’ current levels of deregulation.

• **“Improved ability to sell products to locals or provide services from offshore [and] greater flexibility in the number and types of products which can be offered.”** This could undermine policies aimed at keeping toxic financial products offered elsewhere out of domestic markets. It could also undermine measures aimed at countering financial transfers with tax haven countries.
IV. Conclusion and Policy Recommendations

The mere existence of such an expansive, binding, radical WTO deregulation regime is exactly contrary to the intentions and needs of countries seeking to reregulate their financial sectors. It is unthinkable that Doha Round negotiators would not have altered their deregulatory proposals in the wake of a financial crisis brought on by deregulation. Yet, that is precisely the current state of affairs. Indeed, the top U.S. and other developed country trade officials announced in October 2009 that completing the Doha Round would require developing countries to make more ambitious commitments in the service sector. And, at the London and Pittsburgh G-20 summits, world leaders issued communiqués that simultaneously called for reregulation and for completion of the Doha Round, which would impose more deregulation.

To restore global financial stability, it is critical that the world’s governments be freed from existing WTO deregulation requirements, and that further Doha Round-driven deregulation be halted. The WTO’s 15-year record shows the harmful chilling effect that can occur when mere threats of WTO litigation are made. In the United States and many other countries, powerful financial firms and other corporate interests have been able to equate additional legislative checks on their behavior (which may run afoul of certain non-trade provisions of the WTO) with sparking a “trade war.” Newspaper editorial boards and right-wing think tanks eagerly echo this theme, as have some governments. These tirades have resulted in governments of even large, economically powerful nations backing down on proposals to counter the economic crisis in ways opposed by these interests. Clearly, the cause of restoring economic stability and prosperity would be better served by more adequately segregating trade and non-trade regulatory concerns, which corporate interests tend to conflate – both out of self-interest, and unfortunately also because our current global architecture gives them an intellectual foundation for doing so.

We suggest some specific changes needed to the WTO’s deregulation regime to restore the policy space for forward-looking financial reforms to take place. They are rather straightforward. The real issue is whether the political will exists to initiate the process to make such changes. The first and easy step is, first, to do no further harm. There should not be further financial service deregulation in any international agreement coming after the hard-learned lessons of the crisis.

First, Do No Further Harm: No Financial Deregulation in the WTO Doha Round

- No expansion of WTO financial service commitments through the Doha Round: Given that the current WTO Market Access rules conflate liberalization and deregulation, committing new financial service sectors to this regime inherently involves further deregulation – with countries newly banned from using some of the most basic policy tools needed to reestablish financial stability. Thus, until the WTO rules are changed, avoiding further deregulation means practically, this means that the demands and offers for binding new financial services to WTO constraints must be taken off the Doha Round negotiating table. A first step to initiating this process would be for a bloc of countries to withdraw their specific requests and offers related to financial services, and for the Financial Services Collective Request signed by 37 countries (explored on page 10) to be withdrawn. As parliamentarians become increasingly aware of the WTO activities related to financial service deregulation in which their trade and finance ministries are currently engaged, demands are likely to grow on more countries to ensure that WTO commitments are not being made that conflict with domestic reregulation processes. Further, given that the crisis has proven the perils of the extreme deregulation model, there should be
a moratorium on financial service commitments – and demands to make them – for countries now negotiating terms of accession to the WTO.

- **Shut down the Working Group on Domestic Regulations and jettison the draft disciplines on service sector domestic regulations now under negotiation in the Doha Round.** The current crisis has provided brutal lessons with respect to the perils of extreme financial service sector deregulation, just as the Enron scandal and Bolivia-Bechtel scandals provided with respect to energy and water service deregulation. There is simply no excuse for having a WTO negotiating group whose only remit is to limit domestic regulation in service sectors, at the very time WTO members are committed to reregulating. But that is exactly what the Working Group on Domestic Regulation represents. It should simply be shut down, and its draft agreement scrapped.

- **Scrap the Disciplines on Domestic Regulation in the Accountancy Sector.** If the Doha Round were concluded, new “disciplines” to restrict non-discriminatory regulations in the accounting sector are set to be automatically implemented. As noted, these Arthur Andersen-drafted disciplines will restrict accounting regulations to what WTO tribunals judge “necessary,” putting pressure on governments to deregulate as much as possible. This text should be scrapped.

**Fixing existing WTO rules to remove financial deregulation requirements**

Additionally, critical changes must be made to existing WTO financial service sector texts. These legal constraints on regulation are easy to remedy technically, if the political will exists. Most simply, these reforms are needed to separate out and remove the current WTO financial deregulation requirements that are entangled with WTO service sector liberalization measures:

- **Real safeguards for financial stability measures:** The current WTO provision that fails to safeguard prudential measures must be revised to ensure that these are truly safeguarded from WTO attack. Countries must be able to define for themselves which prudential regulations are required to ensure financial stability. Trade pacts should provide a default in favor of such measures’ sanctity, while also providing a means for countering attempts to abuse such a designation. Thus, the current Article 2(a) of the GATS Annex on Financial Services must be replaced with the following language to ensure that prudential measures are not susceptible to WTO challenge:

  “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.”

- **The GATS Market Access rules must be altered to remove automatic deregulatory constraints from applying to sectors that are liberalized:** GATS Article XVI(2) should be eliminated. This is the portion of the Market Access rules that forbid governments from employing nondiscriminatory limits (such as on the size of banking, securities and insurance firms, what services any one entity may
offer, and under what legal forms they may operate) when they agree to “liberalize” such sectors. This change would separate out commitments to liberalize from requirements to simultaneously deregulate offered sectors.

- **Terminate the Understanding on Commitments in Financial Services:** As we’ve described elsewhere, the Understanding is aimed specifically at forcing broad-scale deregulation of financial services – and ensuring that countries cannot reregulate, including through a specific standstill obligation. Various interests are pushing developing countries to sign on to this agreement during the Doha Round. Instead, this agreement, which embodies the exact policies and philosophy at the root of the current crisis, should be terminated.

Unless the changes noted above to the WTO financial service terms are implemented in the short term, WTO members should agree to a period during which their existing financial services commitments may be modified without having to negotiate compensation. In other words, countries should be allowed to list new limitations to their GATS Article XVI(2) commitments or withdraw sensitive sectors. They should also be allowed to list new headnotes to protect prudential measures, and to otherwise update their WTO financial service schedules to reflect the global trend towards reregulation and their countries needed policy space to implement such measures. While they do so, countries should not be required to pay off other WTO members, as is typically required. Simply put, either the deregulatory aspects of the WTO financial service terms must be promptly remedied through multilateral negotiations, or countries must be allowed to safeguard their domestic reregulation efforts by withdrawing from WTO commitments that undermine such efforts.
Each WTO member is required to “ensure the conformity of its laws, regulations and administrative procedures with its obligations.” WTO, Agreement Establishing the WTO, Art. XVI-4.

2 The WTO texts that cover financial services include the GATS and its Annexes on Financial Services, the Second and Fifth Protocols to the GATS, the Understanding on Commitments in Financial Services, and countries’ GATS schedules of commitments on financial services. Some commentators use the term WTO “Financial Services Agreement” (FSA) to describe the whole package, while others use this phrase only to describe the most recent batch of binding commitments countries agreed to in the 1997 Fifth Protocol – subsequent to the 1995 establishment of the WTO. We’ll just refer to these collectively as the WTO financial services terms. Texts of these instruments can be found at: http://www.wto.org/english/docs_e/legal_e/legal_e.htm.

GATS Article XXI (2)(a) “Modification of Schedules” “At the request of any Member the benefits of which under this Agreement may be affected (referred to in this Article as an “affected Member”) by a proposed modification or withdrawal notified under subparagraph 1(b), the modifying Member shall enter into negotiations with a view to reaching agreement on any necessary compensatory adjustment. In such negotiations and agreement, the Members concerned shall endeavour to maintain a general level of mutually advantageous commitments not less favourable to trade than that provided for in Schedules of specific commitments prior to such negotiations. (b) Compensatory adjustments shall be made on a most-favoured-nation basis. (3)(a) If agreement is not reached between the modifying Member and any affected Member before the end of the period provided for negotiations, such affected Member may refer the matter to arbitration. Any affected Member that wishes to enforce a right that it may have to compensation must participate in the arbitration. (b) If no affected Member has requested arbitration, the modifying Member shall be free to implement the proposed modification or withdrawal. 4(a) The modifying Member may not modify or withdraw its commitment until it has made compensatory adjustments in conformity with the findings of the arbitration. (b)If the modifying Member implements its proposed modification or withdrawal and does not comply with the findings of the arbitration, any affected Member that participated in the arbitration may modify or withdraw substantially equivalent benefits in conformity with those findings. Notwithstanding Article II, such a modification or withdrawal may be implemented solely with respect to the modifying Member.”


Pascal Lamy, Director General of the WTO, told a Washington audience in October 2009 that, “As you all know, in the world of the GATS, ‘liberalization’ is essentially about opening specified sectors to competition on a non-discriminatory basis. It does not mean deregulation. It has long been recognized that opening up certain services, such as financial and telecom services, may require a regulatory framework in order to protect consumer interests, and ensure competitive markets. At this point in the services negotiations, this is very important. Let me repeat it: opening markets is one thing, you can do it more or less. Regulation is another. You can open and regulate, open and not regulate, not open and regulate, or not open and not regulate. At this moment, it is important to understand this. If you open your market, you are saying you are regulating foreign and domestic in the same way. It is no coincidence that the GATS Annex on Financial Services preserves the right of Members to take measures for prudential reasons even if they do not conform to its obligations under the Agreement.” Later, he added: “I believe that it is worth throwing your weight behind a Doha services deal, a big part of which is already on the table.” Jeffrey Schott, a former trade negotiator who is now with the Peterson Institute for International Economics, said, “In terms of the Doha Round and the GATS, we should return to a point that Pascal Lamy made. It is about opening market access, they’re not not about deregulation.” Quotes taken from the Global Services Summit, October 2009.

For instance, in an October 2009 document, Goldman Sachs wrote: “Reforms to financial regulation are undoubtedly necessary, and we support them wholeheartedly.” But then they go on to say that they don’t approve of even mild deregulation proposals of the kind that have been floated by the administration: “as we seek to standardize more financial products, we must take care that we do not accidentally inhibit the ability of markets to create economic value. Markets should continue to offer a broad array of products that can be used by capital providers and capital consumers.” See “Effective Regulation, Part Four: Turning Good Ideas into Good Outcomes,” Goldman Sachs Global Markets Institute, October 2009. Available at: http://www2.goldmansachs.com/ideas/global-markets-institute/featured-research/effective-reg-part-4.pdf. Earlier in the year, however, Goldman Sachs International chairman Peter Sutherland criticized “the performance of the governments to reach an agreement on Doha.” See, “Ministers talk the talk, but the doubts remain over who will deliver on Doha,” The Times (UK), Feb. 2, 2009. Available at: http://business.timesonline.co.uk/tol/business/economics/article5635980.ece.

For instance, the United States submitted a proposal to the WTO that called for deeper GATS Market Access commitments, but also said, “Liberalization of trade in financial services, when undertaken in conjunction with transparent and strong regulatory regimes, benefits countries in many ways, some specific to the financial services sector and others related to the overall health of their economies.” See “Communication from the United States: Financial Services,” WTO Document S/CSS/W/27, Dec. 18, 2000.

For instance, in March 2009 testimony to the House Foreign Affairs Committee, Phil Levy of the American Enterprise Institute said: “If I may beg your indulgence for one point, and this is on the repeated attacks on the financial services agreement. Let me just note that the WTO financial services agreement has an unusually strong carve-out for prudential regulation. Now this can be done for all manner of excuses, including to ensure the integrity and stability of the financial system, regardless of any other provisions of the GATS, and that is the General Agreement on Trade and Services, and I am citing paragraph two there. And so I know that time is short, and I won’t beg further, but I wanted to put that on the record.” (http://www.internationalrelations.house.gov/111/48001.pdf)

GATS Article XVI(2) reads: “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; (e) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units or the requirement of an economic needs test; (f) 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; (g) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and (h) 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.”

11 Unless a specific exception were scheduled for the measure in the market access column, as noted in the above box.

Johnson says, “too big to fail is too big to exist.” See http://baselinescenario.com/2009/04/09/what-next-for-banks/

GATS Article XVI(2) reads: “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: … (e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and …”


Strictly speaking, countries become bound to the Understanding’s terms by inscribing some variation on the phrase “Commitments in this subsector are undertaken in accordance with the Understanding on Commitments in Financial Services” into a headnote in their schedule of GATS financial services specific commitments. Countries can adopt the Understanding for “insurance” or “banking and other financial services” or both. The 33 countries whose current schedules reference the Understanding include: Australia, Austria, Bulgaria, Canada, Czech Republic, Finland, Hungary, Iceland, Japan, Liechtenstein, New Zealand, Norway, Slovak Republic, Sweden, Switzerland, and the United States, as well as the European Communities members as of 1994 (Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain and the United Kingdom). The only developing nations that utilized the Understanding were Aruba, Netherlands Antilles, Nigeria, Sri Lanka (for banking not insurance), and Turkey. Additionally, eight countries - Cyprus, Estonia, Latvia, Lithuania, Malta, Poland, Romania, and Slovenia - are in the process of revising their commitments to match the EC schedule.

In bottom-up scheduling, a service sector is only included if it is listed. The Understanding text reads: “Commercial Presence: 5) Each Member shall grant financial service suppliers of any other Member the right to establish or expand within its territory, including through the acquisition of existing enterprises, a commercial presence. 6) A Member may impose terms, conditions and procedures for authorization of the establishment and expansion of a commercial presence in so far as they do not circumvent the Member's obligation under paragraph 5 and they are consistent with the other obligations of the Agreement.”

See text at http://www.wto.org/english/docs_e/legal_e/54-ufins_e.htm (This provision is written as an “endeavor to” clause, meaning the obligation is to try to achieve the goal. This stands in sharp contrast to the other obligatory provisions in the Understanding, in which a country is required to deregulate or to permit foreign forms to establish a presence. However, this clause is worth noting because it so perfectly embodies the philosophy underlying the WTO approach to financial services.)

Full quote: Former U.S. Trade Representative Mickey Kantor, who helped negotiate part of the WTO financial services provisions, made clear the views of their most militant proponents: countries “are going to have to make commitments in fact that are somewhat painful. Let me give you an example: if in fact you’re going to open your market to financial services in a way that we all would like, particularly in the banking and insurance sectors that make so much difference in an economy, the fact is here that you’re going to give up some of the restrictions that you have. …. Market access alone is not enough… When you negotiate market access, you also have to look at the internal regulations of the various economies to make sure they do not take away what you have just gave…. if we had been prescient enough, which I wasn’t, when we negotiated these agreements, we would looked have at that and made it even stronger in terms of the inability of countries to do that. So I guess my warning is this: the G-20 leaders are going to have to be prepared to say, when they open up and insist on others opening up, they get rid of those regulations which inhibit access, which restrict access, which in fact make access less than it would have been under other circumstances.” Public Citizen transcript of Oct. 13-14, 2009 Global Services Summit. On file with Public Citizen.


“The Working Party on Professional Services shall continue its work pursuant to the terms of reference contained in the Decision on Professional Services (S/L/3) taking account of any decisions which may be taken in the Council regarding work on Article VI-4. In doing so the Working Party shall aim to develop general disciplines for professional services, while retaining the possibility to develop or revise sectoral disciplines, including accountancy. No later than the conclusion of the forthcoming round of services negotiations, the disciplines developed by the WPPS are intended to be integrated into the General Agreement on Trade in Services (GATS).” See “Decision on Disciplines Relating to the Accountancy Sector, Adopted by the Council for Trade in Services on 14 December 1998,” WTO Document S/L/63, Dec. 15, 1998. See also, Ellen Gould and Bob Stumberg, “The Draft GATS Domestic Regulation Disciplines – Potential Conflicts with Developing Country Regulations,” South Center, SC/AN/TDP/SV/12, July 2009. Available at: http://www.uneca.org/arpc/egp0909/GATS.pdf.

Panagiotis Delmitasis, “Determining the Necessity of Domestic Regulations in Services: The Best is Yet to Come,” European Journal of International Law, 19:2, 2008. See comment by Switzerland in “Report on the Meeting Held on 1 April 2009: Note by the Secretariat,” WTO Document S/WDPR/M/40, May 12, 2009. Some have even suggested applying such new limits to all service sectors – even if
countries have not bound them under the GATS. This was raised in one WPDR meeting, and continues to be raised by certain academicians and commentators. “Some delegations said any horizontal disciplines should only be applicable to sectors where specific commitments have been made; other delegations felt this was also an issue for negotiation.” From “Report On the Meeting Held On 29 November 2000,” Working Party on Domestic Regulation, WTO Document S/WPDR/M/9, March 12, 2001. This possibility was also raised by U.S. negotiators in an interview with Patricia Arnold. See Patricia J. Arnold, “Disciplining domestic regulation: the World Trade Organization and the market for professional services,” Accounting, Organizations and Society, 30: 4, May 2005, at 306 and 316. (See also: Joel P. Trachtman, “Transatlantic regulatory cooperation from a trade perspective: a case study in accounting standards,” in Transatlantic Regulatory Cooperation: Legal Problems and Political Prospects, (London: Oxford University Press, 2000), at 232.


23 In the text of the draft disciplines published on March 20, 2009, the following provision was included under paragraph 10 on “General Provisions”: “These disciplines apply to measures by Members relating to licensing requirements and procedures, qualification requirements and procedures, and technical standards affecting trade in services where specific commitments are undertaken.” (Emphasis added). The necessity test was also excluded. See: “Disciplines on Domestic Regulation Pursuant to GATS Article VI-4, Second Revision, Informal Note by the Chairman,” WTO Document, March 20, 2009. Available at: http://www.wto.org/english/news_e/pres98_e/pr118_e.htm


25 The press release announcing the accountancy disciplines said: “Before the end of the forthcoming round of services negotiations, which commence in January 2000, all the disciplines developed by the WPPS are to be integrated into the GATS and will then become legally binding.” See: http://www.wto.org/english/news_e/pres98_e/pr118_e.htm

26 The Council on Trade in Services adopted a decision which said, “These disciplines are to be applicable to Members who have entered specific commitments on accountancy in their schedules.” Such a restriction is not included in the Accountancy Disciplines text itself. Thus, the exact interpretation of which countries and measures would be covered when the disciplines are implemented is thus somewhat indeterminate in the text. See: “Decision on Disciplines Relating to the Accountancy Sector, Adopted by the Council for Trade in Services on 14 December 1998,” WTO Document S/L/63, Dec. 15, 1998.


28 See e.g. Leaders Statement, The Pittsburgh Summit, Sept. 24, 2009 at, A Framework for Strong, Sustainable, and Balanced Growth para. 14: “We call on our international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June 2011…”

29 See “Financial Services Collective Request” at pg. 2.


34 See e.g. Leaders Statement, The Pittsburgh Summit, Sept. 24, 2009 at, A Framework for Strong, Sustainable, and Balanced Growth para. 14: “We call on our international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June 2011…”