



The treatment of financial services in trade agreements

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Financial development matters: impact on economic growth

The theory

Two specific channels

- Impact on capital accumulation
- Impact on the rate of technological progress

Functions giving rise to these effects

- Savings mobilisation
- Risk management
- Allocation of resources
- Monitoring managers
- Facilitating the exchange of goods & services

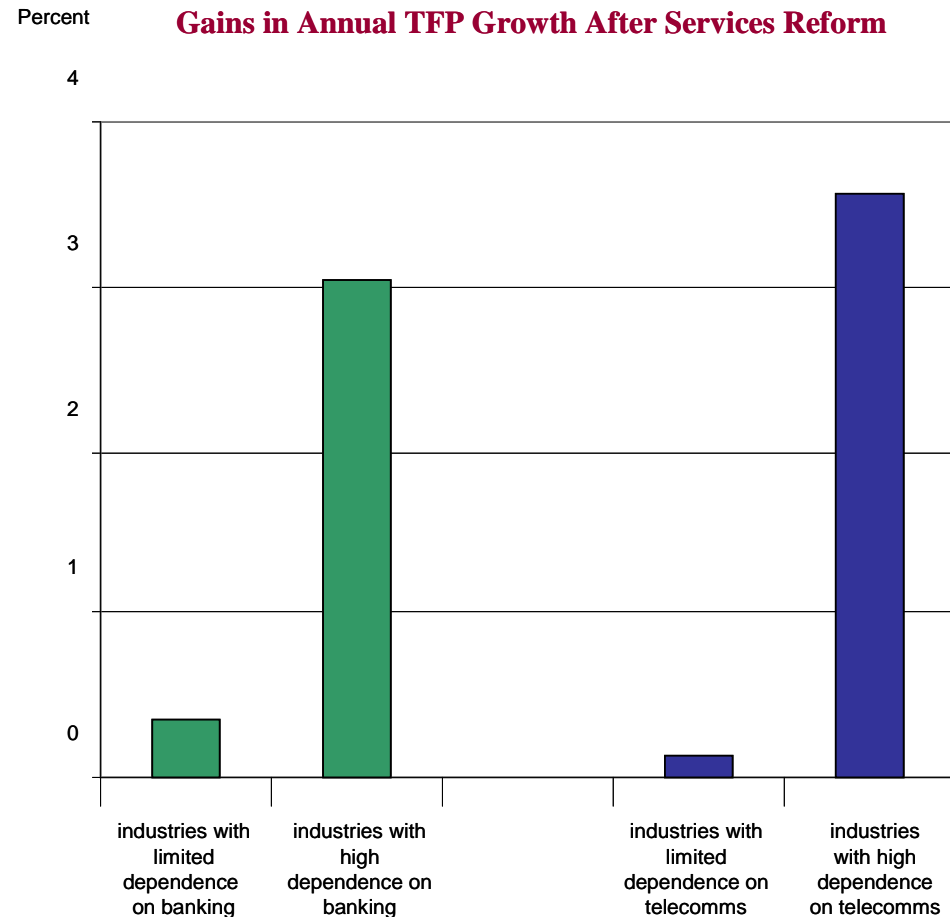
Financial development matters: impact on economic growth

The evidence

- A large body of evidence exists in support of strong linkages between financial sector development and levels of income and long-run growth performance
- Key policy challenges: not *whether* but *how*, *where* and *how fast* to promote prudentially sound competition in financial markets

The performance of downstream manufacturing industries benefits from service sector reforms

World Bank study based on panel data for 10,000 Indian firms for the 1990-2005 period finds that **banking**, **telecommunications** and **transport** reforms all have significant positive effects on the productivity of manufacturing firms



Source: Arnold, Javorcik, Lipscomb and Mattoo (2008)

Regulatory reform matters: Basic principles of financial regulation

- The specialness of finance...
 - Finance is ubiquitous – intermediation is pervasive
 - Asymmetric information is pervasive
- ...and its implications for regulation...
 - Protection of consumers (depositors, etc.)
 - Avoidance of systemic macro risks
- A typology of regulation in financial markets
 - Economic regulation (e.g. entry, competition)
 - Prudential regulation
 - Information regulation (first GATS complaint in FS; China-US-EU)

Liberalization Matters

What are the WTO discussions about?

The different dimensions of liberalization

- Capital account liberalization
- Domestic financial deregulation
- Internationalization of financial services

Regulatory reform matters: Learning from best practices

- Strengthen the legal, regulatory, accounting environments and the capacity to enforce regulation – sequencing matters
- Develop a diversified financial system
- Privatize state-owned institutions, but clean-up non-performing assets first
- Allow entry of foreign institutions
- Intensify competition (entry/market contestability matters more than the nationality of firms)
- Avoid excessive restrictions on activities and ownership opportunities
- Temper the temptation for haste: big bangs often generate big busts

The role of GATS negotiations

The value of commitments

- Main limitation to trade/financial reform in many developing countries is the lack of policy credibility
- GATS commitments may add credibility to plans for financial liberalization, now or in future - commitments have *signalling* properties
- GATS commitments can help to help lock-in an open trading and regulatory environment, and enhance the investment climate

The role of GATS negotiations

Appropriate design of commitments

- GATS and PTAs can help with the sequencing of reforms...
 - Establishment vs. cross-border trade
 - Trade vs. capital account liberalization
 - Upgrading of regulatory and supervisory frameworks
- ...but not all commitments promote good policy-making
 - Emphasis on entry and competition rather than on the nationality of financial firms
 - Avoidance of discriminatory treatment
 - Pre-committing to future liberalization can be helpful as a signalling device

The architecture of trade rules in financial services

Annex on Financial Services

- Content:
 - Definitions
 - Services supplied in the exercise of governmental authority
 - Prudential “carve-out”
 - Recognition of prudential measures
 - Dispute settlement provisions

Scope and Coverage of the GATS in financial services

- All financial services, except services supplied in the exercise of governmental authority
 - Monetary and exchange rate policies
 - Statutory systems of social security or public retirement plans
 - Activities conducted by a public entity for the account or with the guarantee or using the financial resources of the government (e.g. export credits)
- All measures, including by sub-central authorities (important in federal countries) and ROs operating under delegated authority

Key Definitions

“A financial service is any service of a financial nature offered by a financial service supplier of a Member”

- Includes all insurance and insurance related services, all banking and other financial services
- *“Financial service supplier”* means any natural or juridical person wishing to supply or supplying financial services but does not include a public entity

A broad set of listed activities

- Direct insurance (both life and non-life)
- Reinsurance and retrocession
- Insurance intermediation
- Auxiliary insurance services
- Acceptance of bank deposits
- Lending of all types
- Financial leasing
- Payment systems
- Guarantees and commitments
- Trading, either for one's account or for others
- Securities issues
- Money brokering
- Asset management
- Settlement and clearing services
- Provision and transfer of financial information or data

Prudential Measures

- The Annex on FS allows Members to take measures for prudential reasons, *including*:
 - for the protection of investors, depositors, policy holders; or
 - to ensure the integrity and stability of the financial system
- The measures shall not be used as a means of avoiding commitments or obligations under the GATS
 - Ø Prudential measures do not need to be scheduled, but ...
 - Ø ...they can be challenged under WTO dispute settlement procedures

Typical Prudential Measures

- Capital adequacy ratios and solvency margin requirements
- Liquidity ratios
- Requirements for preserving asset quality (provisioning or classification requirements)
- Fit and proper tests for members of the board of directors of financial institutions
- Disclosure and reporting requirements

Recognition of prudential measures

- Members may recognize the prudential measures of any other country
- Such recognition may be based on a bilateral agreement or may be accorded autonomously
- Adequate opportunity shall be afforded to other interested Members to join such agreements, as per GATS Article VII (Recognition)
- No need to notify to the WTO when entering into recognition talks

Dispute Settlement

- Panels for disputes on prudential issues and other financial matters shall have the necessary expertise relevant to the specific financial service under dispute
- Unique to financial services (bureaucratic “turf” at play)

The Understanding of Commitments in Financial Services

- Ø Alternative approach to scheduling specific commitments, without prejudice to the right to schedule according to GATS part III
- Ø Resulting specific commitments apply on an MFN basis
- Ø 31 WTO Members have made commitments according to it (mostly OECD countries and a few recent WTO Members)

The Understanding on commitments in FS

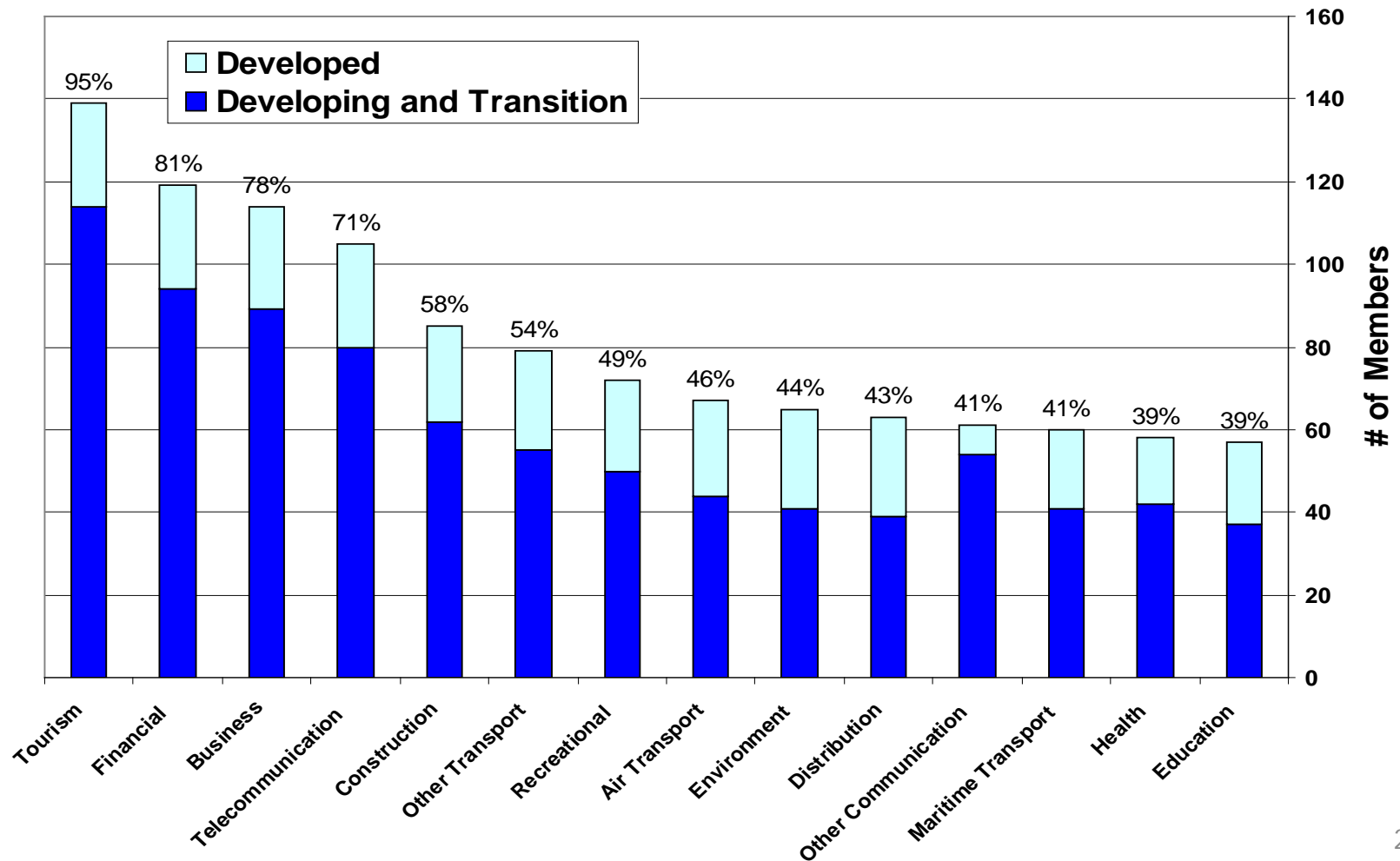
- Schedule monopoly rights and “best endeavours” commitment for their elimination
- MFN and N.T. in government procurement of financial services
- Cross-border supply of MAT insurance, reinsurance, retrocession, and services auxiliary to insurance
- Cross-border transfer of financial information and financial data processing, and other auxiliary FS, excluding intermediation
- Right to purchase abroad a wide range of financial services (modes 1 and 2)
- Right to establishment and expansion of a commercial presence (mode 3)
- Permission for the entry of certain personnel of established suppliers, including senior managers and certain specialists (mode 4)
- Permission for established suppliers to offer new financial services

**Patterns of commitments in
financial services trade:
GATS and PTAs**

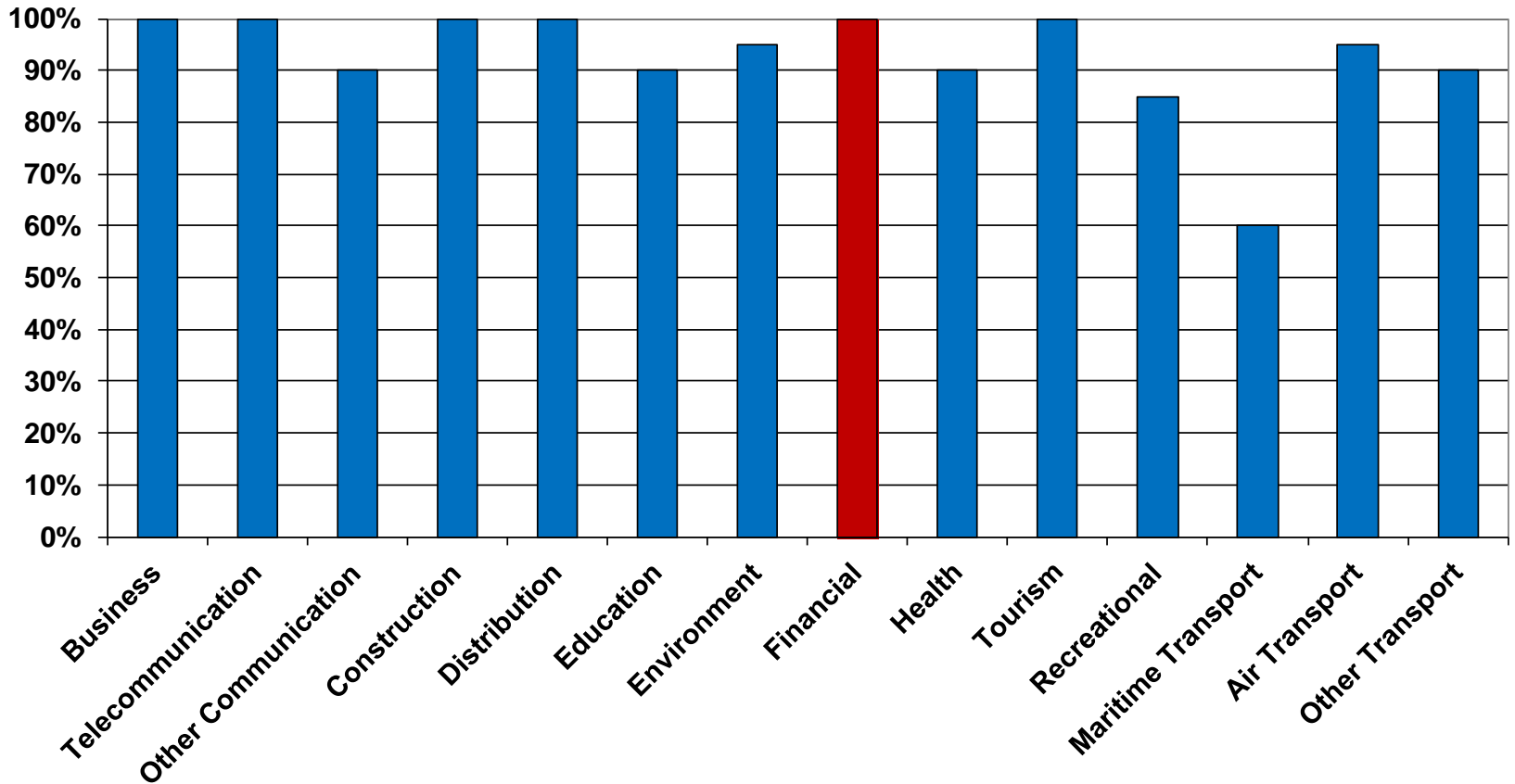
Factual observations

- Finance is the second most committed sector under the GATS (after tourism services)
- Relative to other key sectors, FS are generally not the most restricted
- PTA-induced margins of preference are among the smallest in the sector – because the Uruguay Round overtime negotiations yielded a relatively good harvest
- It is also an area where a significant number of DDA proposals have been made
- Initial DDA offers in financial services rarely involve new commitments, they mostly improve existing ones – negotiating leverage issues at play

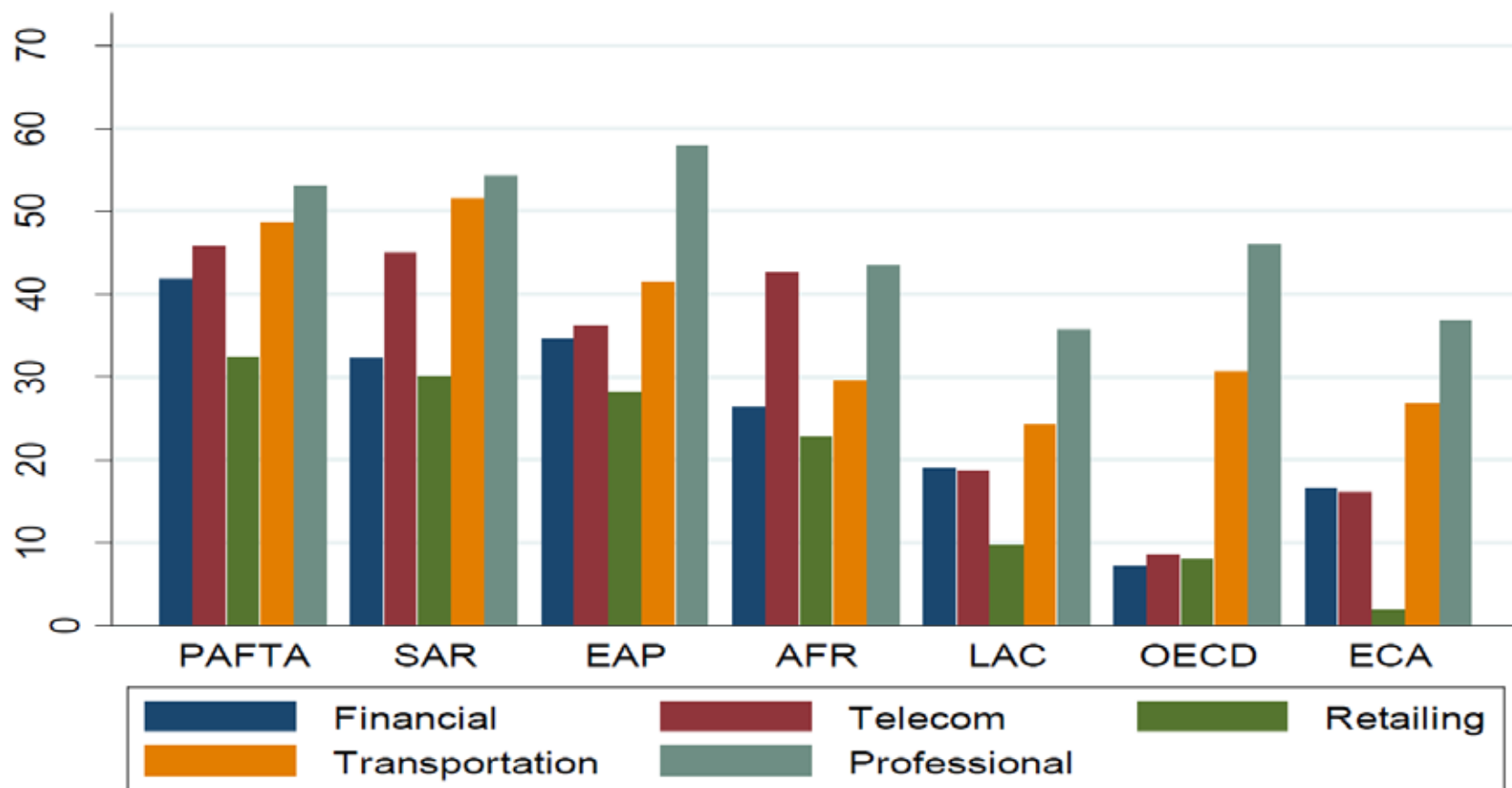
Sectoral distribution of current GATS commitments (current)



Proportion of Acceding Members with Commitments in Selected Service Sectors

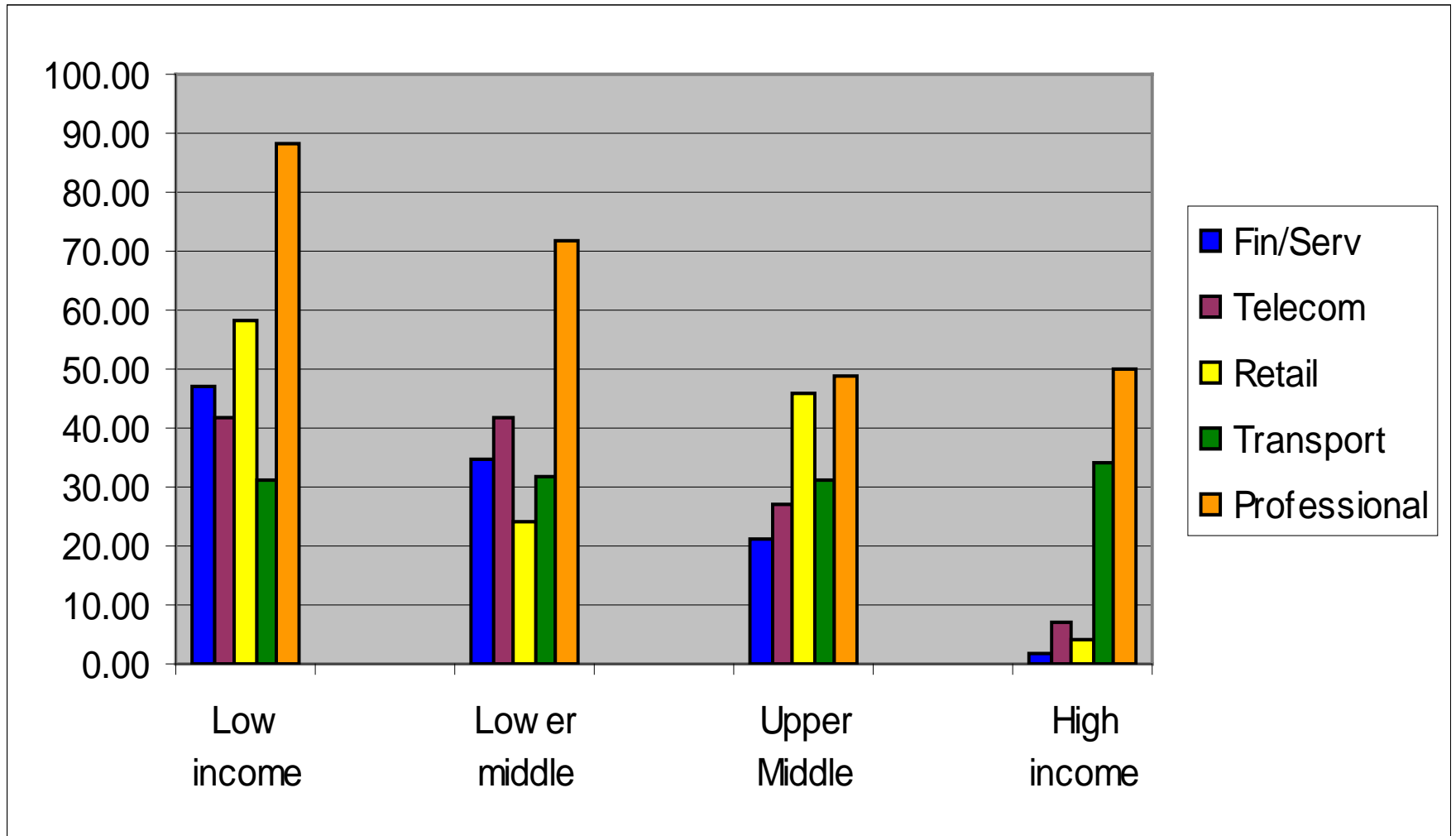


Services Trade Restrictiveness by Sector and Region

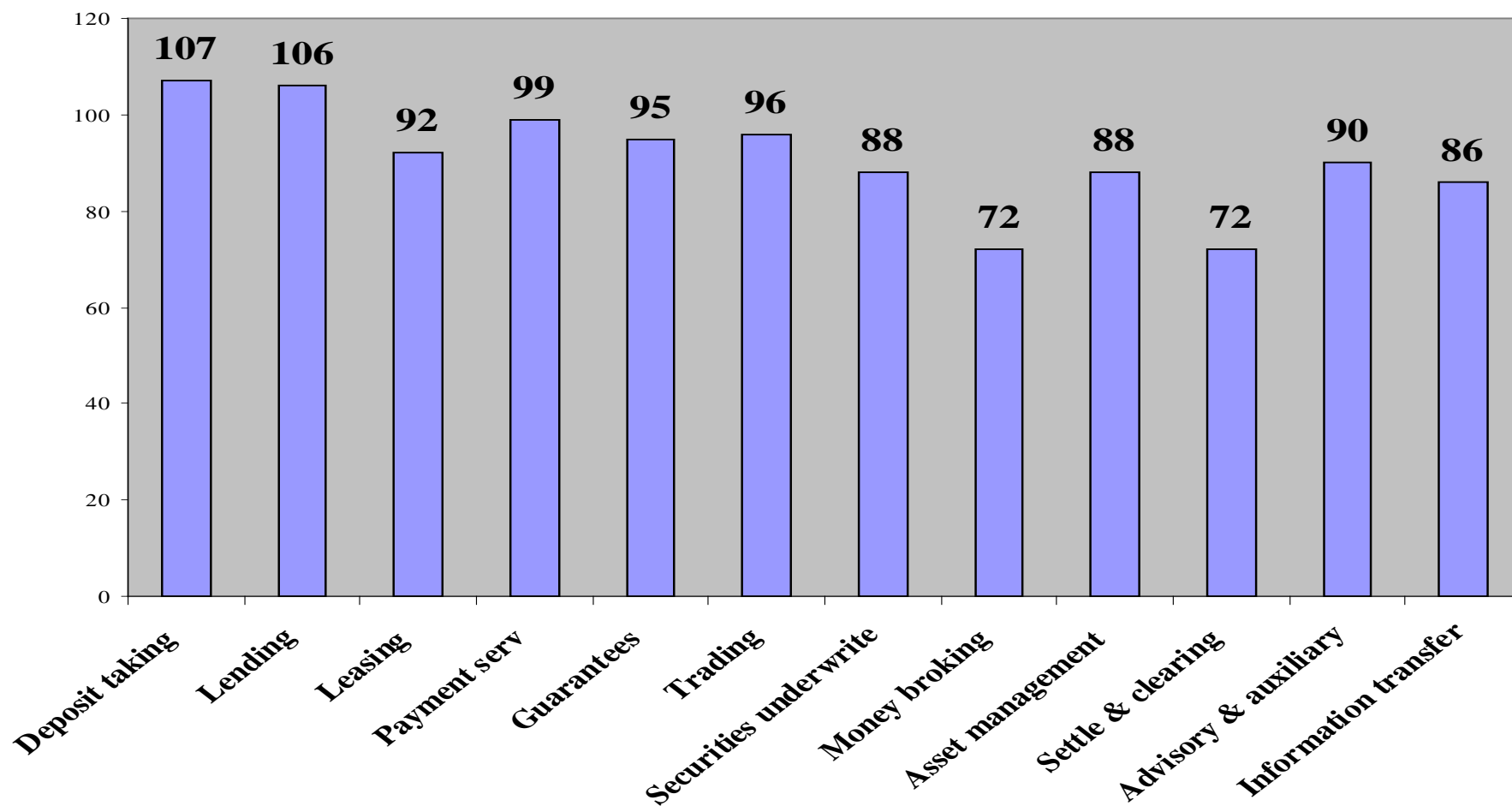


Note: Based on 100 countries (Algeria and Iran excluded);
Except for PAFTA, countries' regional affiliation follows WB classification.

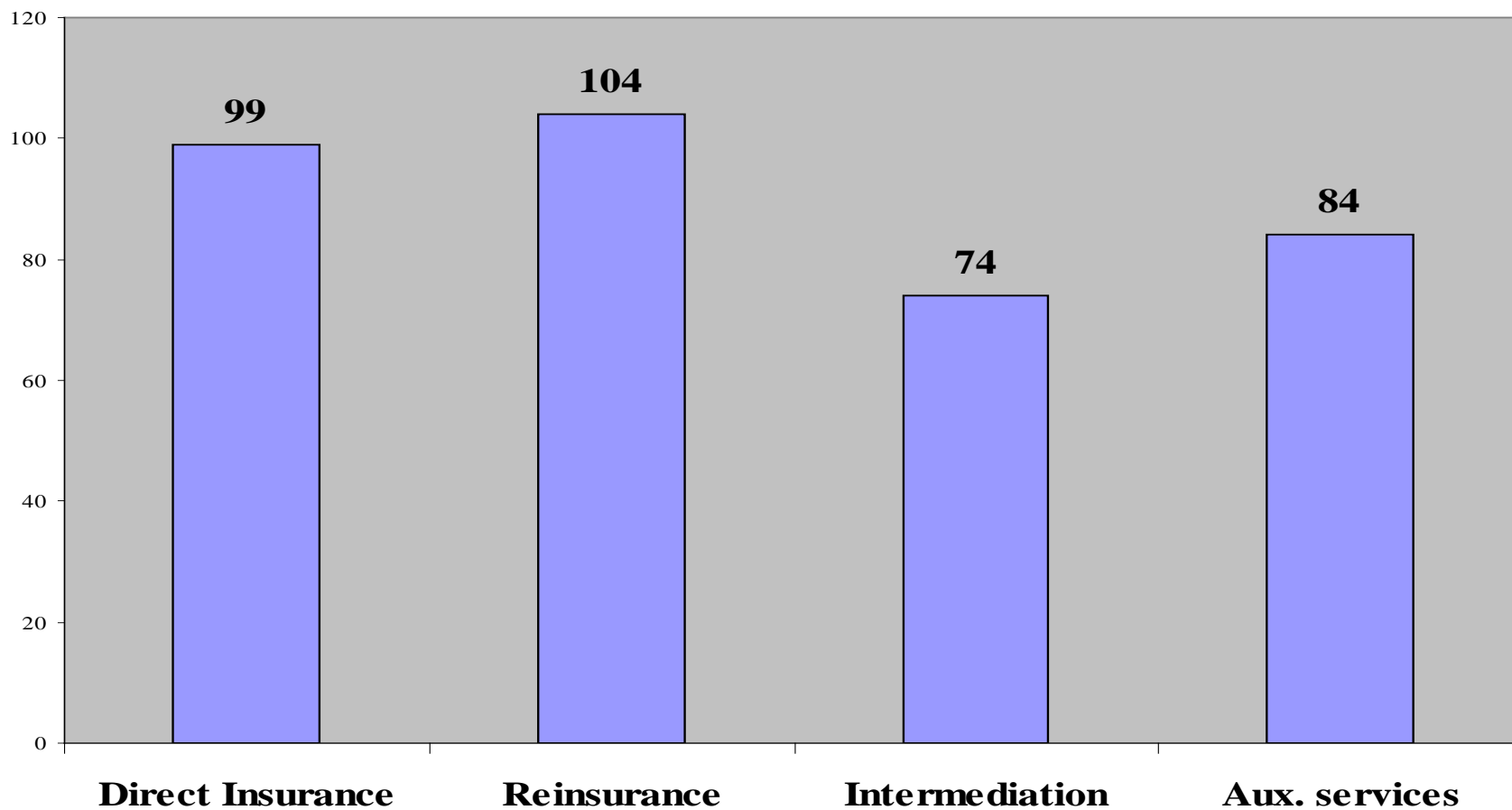
Restrictiveness by sector



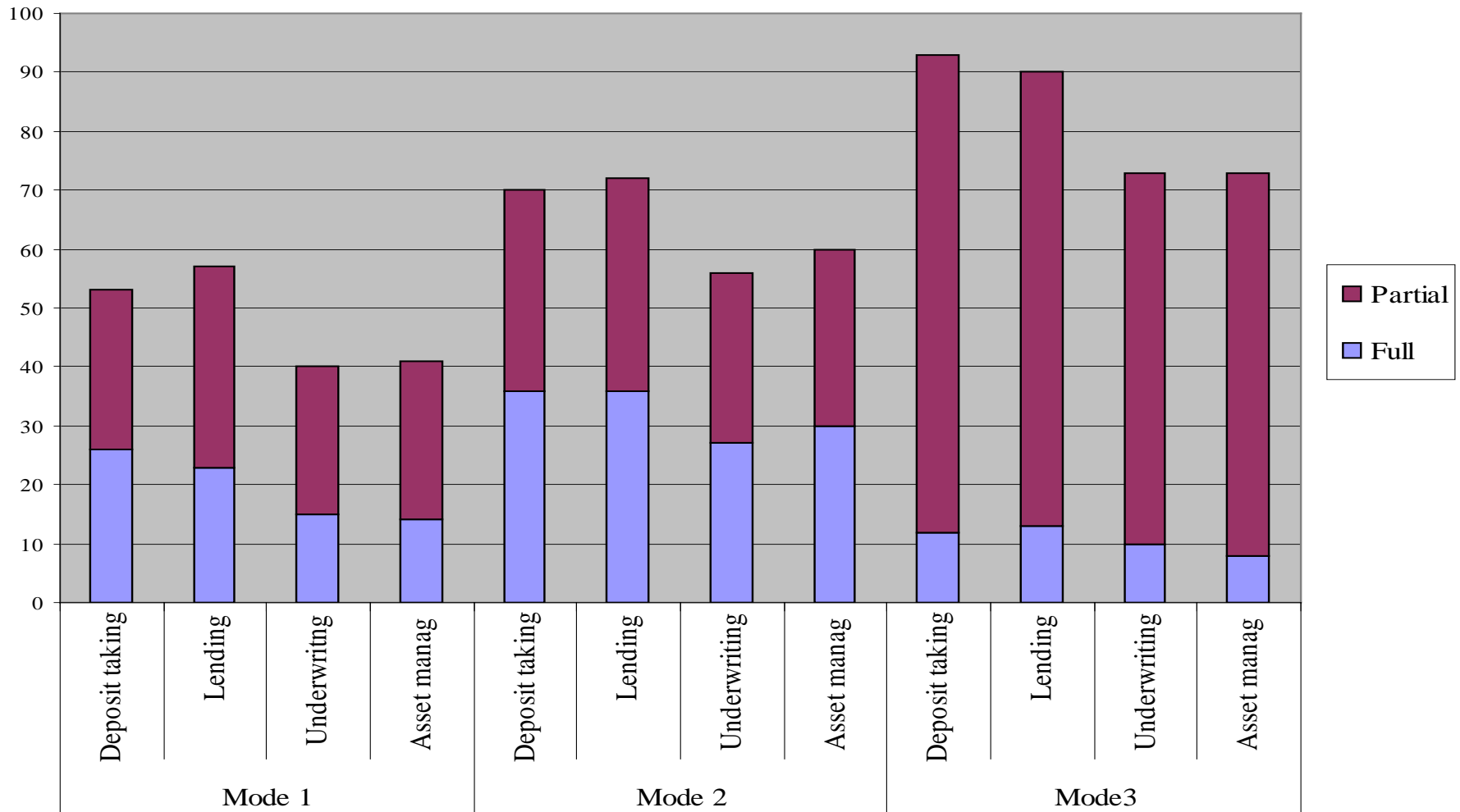
Specific Commitments on banking & other financial services (WTO Member countries, EC Member States counted individually)



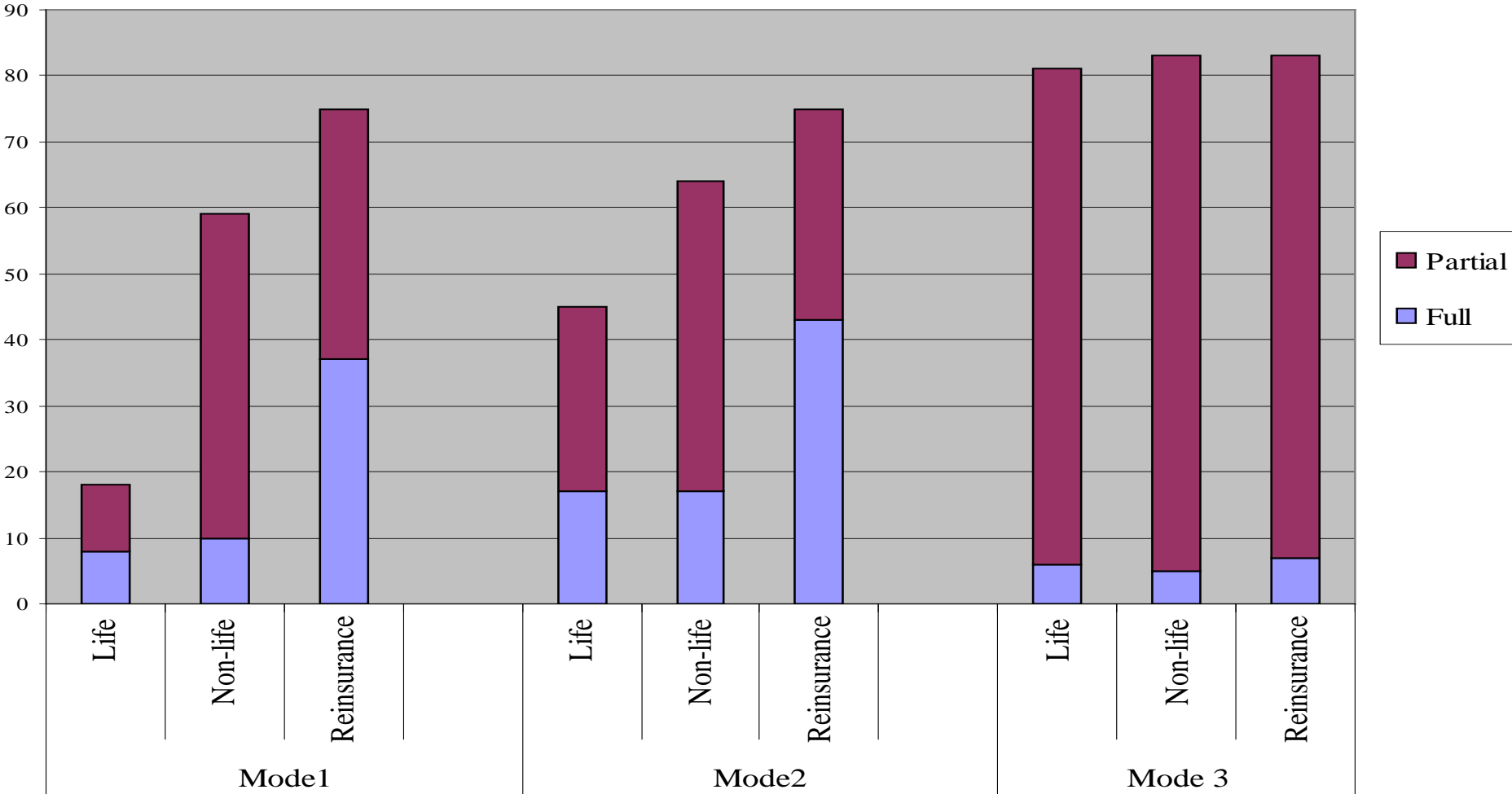
Specific Commitments
on insurance services
(WTO Member countries, EC Member states counted individually)



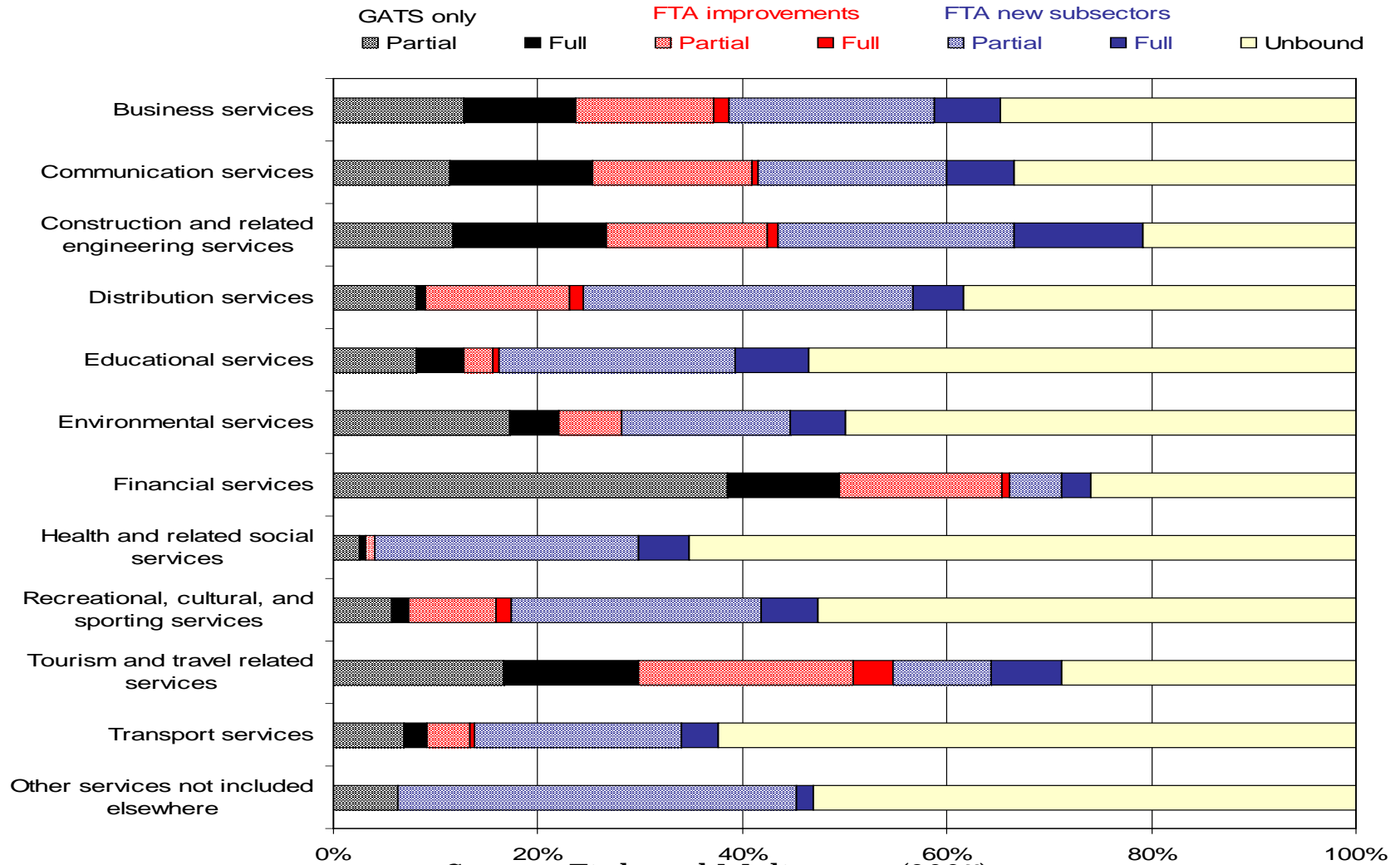
Modal pattern of commitments banking & other financial services



Modal pattern of commitments insurance services



GATS+ advances in Asian PTAs covering services: sectoral breakdown



Source: Fink and Molinuevo (2007)

Comparing the level of services trade and investment liberalization across sectors

Sector	GATS	DDA (0 to 100)	PTA	GATS/PTA %	DDA/PTA %	Pref. Margin %
Professional	30	39	67	44,8	58,2	41,8 – 55,2
Computer	55	74	93	59,1	79,6	20,4 – 40,9
Postal/Courier	14	20	53	26,4	37,7	62,3 – 73,6
Telecom	51	58	80	63,8	72,5	27,5 – 36,2
Audio-visual	17	20	50	34,0	40,0	60,0 – 66,0
Construction	40	46	75	53,3	61,3	38,7 – 46,7
Distribution	32	41	76	42,1	53,9	46,1 – 57,9
Education	18	25	57	31,6	43,9	56,1 – 68,4
Environmental	20	30	62	32,3	43,4	56,6 – 67,7
Financial	36	40	53	67,9	75,5	24,5 – 32,1
Health	8	11	34	23,5	32,4	67,6 – 76,5
Tourism	51	61	83	61,4	73,5	26,5 – 38,6
Maritime	12	23	57	21,1	40,4	59,6 – 78,9
Rail	14	20	52	26,9	38,5	61,5 – 73,1
Road	16	18	56	28,6	32,1	67,9 – 71,4
Auxiliary transport	21	24	58	36,2	41,4	58,6 – 63,8

Source: Author calculations based on Marchetti and Roy (2008)

**Financial Services and the Doha
Development Agenda:
what's (what was) at stake?**

Negotiating Context

- There is today much greater awareness of the infrastructural role of financial services
- There has been continued liberalization of financial markets, much of it unilateral, some induced by Bank-Fund lending (reluctance to bind the latter)
- There is a growing wedge between the *actual* degree of financial market openness and *bound* WTO commitments in FSA, though some of that wedge has been reduced in some cases under recent preferential trade agreements
- Uncertainties on how the recent financial crisis will affect the political market for *negotiated* FS liberalization

Current negotiations

- Proposals have been submitted by eleven Members: Australia, Canada, Colombia, Cuba, the European Communities, Japan, Kenya, Korea, Norway, Switzerland, and United States.
- A collective/plurilateral request has also been issued, targeted primarily towards emerging economies.
- Key negotiating objectives:
 - Advocate further expansion of MA, NT and additional commitments for all modes of supply
 - Reaffirm the right to regulate for prudential reasons, taking into account the special nature of the sector

DDA Negotiating Proposals

Issue	Aus	Can	EU	Jap	Kor	Nor	Swit	US	Cuba	Colo m bia	Ken va
Classificat.		4	4			4	4	4		4	
Barriers	4		4	4	4		4	4	4		
Modes 1&2 dist.			4				4			4	
Grand- fathering			4					4			
Regulatory issues		4	4	4	4		4	4			4
Mutual recognition	4									4	
Pace of liberalizat.					4				4	4	
Understan ding			4	4	4	4	4	4		4	
Developing countries		4					4		4	4	

Barriers identified in DDA proposals

- Restrictions on the form of commercial presence (preference for branching)
- Restrictions on foreign equity participation
- Discrimination between national and foreign providers
- Mandatory cession requirements
- Quantitative limitations on the number of suppliers
- Restrictions on geographical expansion
- Restrictions on movement of key personnel
- Greater use of the Understanding on an *à la carte* basis
- Restrictions on the supply of certain financial services on a cross-border basis
- Lifting of restrictions on MAT insurance, reinsurance and financial information services (limited requests for cross-border market opening)
- North-North vs. North-South negotiating issues: e-finance (N-N) vs. a traditional contestability agenda (N-S)
- Most recent push for enhanced access in securities

Towards greater transparency in financial services: US proposal

- Transparency in developing regulations
- Transparency in applying regulations
- Other principles (e.g. independence of regulator)
- Influenced by the Reference Paper in basic telecommunications

Towards greater regulatory transparency in financial services: US proposal

- Maintain independence of the regulator
- Public availability of regulations at reasonable cost
- Reasonable advance notice before requiring compliance with new regulations
- Establish in writing the activities for which a license to supply is required
- Establish the period of time normal to decide on an application
- Set fees for applications at reasonable levels
- Promptly acknowledge receipt of an application
- Take decision on a complete application within a reasonable period of time
- On request, explain the reasons for denial of an authorization or license
- For licensed suppliers, endeavour to avoid the application of prior product approval requirements for products supplied to consumers in the business community.
- Where prior product approval requirements exist, consider mechanisms to accelerate the introduction into the market and approval of insurance products.
- Allow authorizations or licenses to enter into force without undue delay
- Make publicly available information on types of conduct susceptible of disciplinary actions
- Establish procedures for disciplinary actions for violations
- Establish procedures for any review or appeal of administrative decisions

Liberalization challenges for developing-emerging countries

- Focus on the full range of FS commitments, to widen FS markets (banking, insurance, securities, asset management, pensions management, financial information services + underlying IT/telcoms infrastructure (goods and services))
- Focus on mode 3 commitments (commercial presence):
 - a traditional contestability agenda
 - repeal of barriers to entry/establishment
 - broaden range of permissible operations once established
- Making greater use of the Understanding on Commitments in FS in scheduling commitments (on a selective basis)
- Recourse to phased-in liberalization and pre-commitment to future liberalization via Art. XVIII
- Greater focus on competition/entry than on ownership
- Focus on the economy-wide gains from becoming a more efficient importer of FS
- Building coalitions supportive of market opening (via users)

Negotiating Challenges for Acceding Countries

- Not whether but how: commitments in financial services are a certainty given negotiating pressures from Member countries
- Predominant focus of requests and thus commitments likely to be on retail banking , non-life insurance and reinsurance
- Need to assess domestic financial sector competitiveness, identify bottlenecks (IMF/FASP; World Bank /ADB diagnostics may help)
- Perform a trade-related regulatory audit: identify, investigate and rank order trade and investment-restrictive measures and the policy/political economy rationales behind them
- Devise an adequate sequencing strategy: strengthening regulatory and prudential standards *prior to or in sync with* market opening
- Seek to embed aid for trade regulatory strengthening in sequencing strategy (Cambodia accession precedent)

Thank you!

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