

THE NEW TRADE ROUND: MUCH TO GAIN FOR FINANCIAL SERVICES

Summary: The financial services talks underway in Geneva are a major element in the World Trade Organization's "Doha Round" of multilateral trade negotiations. The aim of the talks is to extend the 1997 WTO Agreement on Financial Services, the first international agreement on trade in this key sector. The financial services industry has significant ambitions for the new round in terms of enhanced market access commitments and the strengthening of disciplines on the procedures by which financial services are regulated domestically. However, there are many inbuilt tensions in the round – political as well as commercial. This will complicate, and may frustrate, ambitions for a significant outcome in the financial services sector. While many countries understand the imperative of continued financial services reform, there are potential conflicts with other negotiating areas and in the approaches being pursued by different WTO members, especially developing countries.

The new round, involving more than 150 countries, was launched in November 2001 and is due to conclude in January 2005. It has a broad agenda, of which services are just one part. Nevertheless, financial services will be a key sector in the talks, with industry calling for greater market opening, securing of national treatment conditions to a greater extent than was achieved in 1997, and commitments aimed at improving regulatory environments around the world.

Where exactly do financial services fit in?

The Doha Round is the successor to the Uruguay Round, which was launched in 1986 and concluded in 1993. The Uruguay Round was a much larger undertaking since, in effect, it completely reconstructed the global trading system. One of its major achievements was to apply trade rules for the first time to the international services economy through an accord called the General Agreement on Trade in Services (GATS). When the WTO came into being in 1995, its members made commitments to open up or, at least, to bind (guarantee) a certain level of access and national treatment for all those services sectors they felt able to.

This was the beginning of a process called "progressive liberalisation", through which it was envisaged the services industries would be opened up, bit by bit, through successive rounds of negotiations. As in the case of industrial tariffs (in which average customs duties fell from around 40% after the 1939-45 War to around 5% now), the process was expected to take decades. At the end of the Uruguay Round, participants committed themselves to a new round of services (and agriculture) negotiations in 2000, regardless of whether a general trade round was underway by then.

The financial services component of GATS has always had a life of its own. For a variety of reasons, only limited national commitments were made in the sector in the Uruguay Round. It was only in 1997 that a stand-alone financial services negotiation was concluded with a healthy package of results.

The 1997 WTO Agreement on Financial Services

While countries generally did not commit to substantial liberalisation beyond existing law, the 1997 agreement did at least secure:

- creation of the first international rules for financial services firms;
- reduction and removal of many discriminatory restrictions;
- dispute settlement for agreement violations;
- specific liberalisation measures in emerging markets; and
- establishment of a “floor” from which to build future liberalisation.

The agreement, which came into force in 1999, is estimated to cover 95% of all international exchanges in financial services, including all financial service sectors, in both “banking” and insurance. Commitments in banking include investment banking, securities and asset management, as well as commercial banking (deposit taking, lending and payment systems), financial information and data processing.

The agreement covered all markets of any size which were WTO members at the time. Important WTO non-members such as China, Taiwan, Russia, Vietnam and Saudi Arabia were not covered, though, China and Taiwan have since joined the WTO and made a range of commitments on financial services in the process. The quality of commitments varies between countries. Developing countries (with a few exceptions) were more limited and selective in their commitments and still maintain substantial barriers.

Why are financial services now part of a general trade round?

The new GATS negotiations were launched on schedule two years ago. Considerable progress has been made in sketching out the objectives and negotiating methods. At the same time, services sectors and governments in the Quad countries (EU, U.S., Japan and Canada) and other, mainly industrialized, countries are developing detailed wish lists – including in financial services. Generally, the preparations are regarded as having gone well.

However, it became clear early on that the services negotiations could go only so far. Linkages were established, in particular with agriculture. In effect, the competitive farming nations – Australia, New Zealand, Brazil, Argentina, Malaysia, Canada, etc. – said that they would not allow the services negotiations to move more rapidly than those on farm trade (despite the fact that many such countries also have significant services interests). In response, the EU, Japan, Korea, Switzerland and others said that they could only move forward substantially on agriculture if it was in the context of much broader negotiations in which major trade-offs could be made.

That was the genesis of the failed effort to launch a broad new trade round in Seattle, in 1999, and the successful launch in Doha. However, the breadth of the Doha Round will create complications for achieving reasonably quick results in services. New issues have been pushed into the negotiating agenda and there are important challenges presented by the developing countries.

Among the new issues are proposals for multilateral agreements on investment (FDI) and competition policy. These are extremely controversial and there is little consensus on how to negotiate such agreements – or even whether to do so. Many trade experts believe that these two elements, if pursued, put at risk the conclusion date of 2005. Since the entire round is a “single undertaking” the services negotiations could also be delayed as a result.

A further complicating factor is the general reluctance of developing countries to take on more WTO commitments. The Doha round has also been dubbed the “development round”, which is often interpreted as meaning that it is for industrialised countries to make concessions and for poorer countries to be granted long implementation periods and, generally, softer terms. (Not all developing countries take that view, but many do.) This could create a tendency towards a “protectionist round” rather than a liberalising round. One possible way out will be a huge effort on technical assistance, capacity- and institution-building by the industrial countries. Many poorer nations want to achieve their integration into the global economy but lack the people, productive capacity and institutional solidity to do it.

What will be negotiated in financial services?

Financial services negotiations in the Doha round will fall into two main categories.

1) Market Access. In terms of specific commitments by individual WTO members, the round is an opportunity to press for enhanced market access and national treatment conditions. Financial services firms will be looking, for instance, for higher ceilings on equity participation and a loosening of numerical limitations on banking and insurance licenses.

The popular targets will be the advanced developing markets and China (despite the commitments made by Beijing to achieve WTO entry which, in any event, were so convoluted and imprecise that significant clarification will be unavoidable). However, there are of course the long-standing grudges among the big players – including access to Japan’s financial markets and U.S. state-level insurance restrictions.

2) Domestic regulation. Even where market access and national treatment is granted to financial services providers in foreign markets, the commitments can be negated if the domestic regulatory environment is opaque, corrupt, inefficient or all of the above.

This has become a very complex field of debate in the WTO. There are several strands, which can reasonably be divided between “sound” regulation and “fair” regulation, though they overlap significantly. There is no quarrel about the need for sound regulation: it is well accepted that financial services liberalisation will normally entail extensive re-regulation. Indeed, developing countries are likely to take the position that they cannot liberalise *until* they have adequate regulators and regulatory structures in place – and that will take time, and help.

The need for sound regulation was recognized in the Uruguay Round through the negotiation of a “prudential carve-out” for financial services. The carve-out gives almost absolute freedom to governments to decide on the necessary levels of prudential regulation. (NB. No definition of what constitutes a “prudential measure” is provided; no “necessity test” is envisaged, nor is there any basis for challenge by other WTO members.)

Securing *fair and transparent* regulation is another matter, and has become a priority objective for the financial services industry. Transparency is, in principle, fundamental to the GATS. However, the relevant article, Art III, is limited in scope. General measures must be published, but the duty to notify specific measures is limited to those affecting services activities on which actual GATS commitments have been made by the country concerned. Many financial services firms consider that transparency disciplines should apply to all sectors, regardless of whether commitments exist.

Next Steps?

A deadline of 30 June 2002 was set for WTO members to submit their country-by-country request lists to Geneva. Industry groups have been preparing their responses to requests from governments for input into their third-country lists. It is unclear when request-offer negotiations will begin in earnest, but this appears unlikely before 2003.

What is at stake?

The immediate payoff of the new financial services negotiations is likely to be modest. However, the long-term benefits of an expected new international agreement could be significant. The financial services industry's priorities for the new talks include:

- binding current access levels (since the 1997 agreement, some WTO members have unilaterally gone beyond their WTO commitments – until these are bound into a new agreement, they could be reversed by future governments);
- seeking enhanced commitments to permanent establishment, together with commitments on national treatment;
- improving transparency in law and regulation;
- enhancing cross-border access; and
- reducing and eliminating investment limitations (subject to appropriate transition periods)

Achievement of these goals could improve current and prospective business opportunities for financial services firms in major overseas markets, notably China, India, and Latin America.

Briefing notes are prepared by the Industry Advisory Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Advisory Committee.

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