

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

**THE WTO NEGOTIATIONS ON  
FINANCIAL SERVICES: CURRENT ISSUES  
AND FUTURE DIRECTIONS**

*Andrew Cornford*

No. 172  
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**DISCUSSION PAPERS**



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# THE WTO NEGOTIATIONS ON FINANCIAL SERVICES: CURRENT ISSUES AND FUTURE DIRECTIONS

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## **Abstract**

*Trade in financial services is a major item on the agenda of the Doha Round of multilateral trade negotiations stalled since the ministerial meeting in Cancun in September. This paper reviews trends in such trade and major issues which have been raised in these negotiations so far.*

*The WTO agreement on financial services reached in December 1997 is generally regarded as having contributed more to transparent policy regimes in the organization's member countries than to the opening of markets to foreign suppliers. The paper reviews statistical data bearing on trends in the market access of foreign banks since 1997, and finds no increase in the presence of banks from developing countries in the markets of developed countries but a large rise in the presence of banks from the latter in the markets of the former. However, the latter increase is likely to reflect less the impact of the 1997 agreement in the WTO than a more general movement in the direction of financial opening which was taking place anyway and helped to shape the agreement.*

*Watchwords in the submissions of major developed countries to the new round of negotiations include expanded market access and the removal from countries' commitments of limitations affecting several different financial activities (horizontal limitations). Moreover attention has been drawn to the need for greater regulatory transparency in the treatment of foreign banks. Similar objectives were also pursued on the developed-country side in the negotiations which ended in 1997.*

*In the WTO – as in many policy fora – developing countries continue to express their concerns about vulnerability to destabilizing capital movements. Although the rules of the GATS were designed to decouple liberalization of trade in financial services from that of capital-account transactions, they have not succeeded in alleviating several developing countries' misgivings. Other matters to which developing countries have drawn attention are the need for greater harmonization of different limitations in countries' commitments at the levels of national and local Government, and greater participation of developing countries in the setting of international standards with a bearing on market access and national treatment.*

*Some subjects have been raised by both developed and developing countries but from divergent points of view. Thus both developed and developing countries have raised the need for clarification of the distinctions between the modes of delivery of financial services specified in the GATS where these have been blurred by recent technological change, though concerns on the two sides are motivated by differences of perspective. Moreover both have also focused on the connections between work on financial services in the WTO and that on different aspects of the international financial system elsewhere. But whereas the thrust of developed countries' interventions here favours managing these connections in a mutually reinforcing way, developing countries are more circumspect owing to apprehensions as to the multiplication of factors incorporated in IMF surveillance and conditionality and of consequent constraints on national policy autonomy. Similarly the question of the scope of the prudential carve-out of the Annex on Financial Services developed countries appear to favour a tighter definition of its permissible scope, while many developing countries prefer to keep the carve-out broad and unconstraining. Both developed and developing countries have expressed support for more uniform classification of financial services in countries' commitments but there has been less consensus as to problems linked to statistics for different modes of delivery.*

## **A. THE POST-CANCUN CONTEXT**

As part of the Doha Round of multilateral trade negotiations stalled since the ministerial meeting in Cancun in September an agreement on trade in financial services is inevitably bound up with the fate of the Round as a whole. Trade in financial services was included in the WTO as part of the extension of the remit of its predecessor, GATT, during the Uruguay Round of multilateral trade negotiations (1986–1994), delayed agreement on the subject finally being reached at the end of 1997. The breakdown of negotiations at Cancun followed disagreements, mainly between industrialized and developing countries, over protectionism in agriculture and over the inclusion in the agenda of the Doha Round of the so-called Singapore issues, namely the relationship between trade and investment, the interaction between trade and investment, transparency in government procurement, and trade facilitation (customs procedures), and did not involve financial services as such. The difficulties at Cancun nonetheless reflect factors which help to explain the more general wariness of many developing countries towards several of the negotiating initiatives coming from the major developed countries as well as the increased frequency of flashpoints during ministerial negotiations. These factors include placing the major burden of structural adjustments required for liberalization on developing countries and exerting negotiating pressure on such countries regarding what for them are politically sensitive or controversial subjects, while keeping off the table subjects which could be a source of domestic political problems within developed countries. In the context of negotiations on financial services in the WTO these features of the negotiating stance of major developed countries are evident with respect to the issue of liberalization of capital-account transactions and certain other limitations on national policy autonomy towards the financial sector. Thus, greater unwillingness of developing countries to accept negotiating agendas over whose formulation they have little influence may also eventually involve financial services as well as the subjects which have proved most publicly contentious so far.

## **B. PREVIOUS AND CURRENT WTO NEGOTIATIONS ON FINANCIAL SERVICES**

The WTO agreement on financial services reached in December 1997 (as part of negotiations which were a continuation of the Uruguay Round agreed to avoid the widespread exemptions from MFN likely, had the negotiations been terminated earlier) is generally regarded as having contributed to more transparent policy regimes in the organization's member countries. But its contribution to the opening of markets to foreign suppliers varied greatly among the different parties to the agreement. Success under the first heading was virtually assured by the exhaustive examination of issues related to market access and national treatment in financial services during the negotiation of the framework agreement, the General Agreement on Trade in Services (GATS), and by the lengthy horse-trading over countries' commitments which followed. The heterogeneous quality of countries' commitments as to liberalization was likewise a predictable consequence of differences among countries in their interests at stake.

Particularly important here was an asymmetry in negotiating objectives between developed countries, on the one hand, and several developing countries, on the other.<sup>1</sup> Developed countries, especially those with large financial sectors, perceived their interests primarily as exporters of financial services and aggressively pursued the objective of market opening. In this pursuit they were backed by a powerful lobby of economists and other commentators working for official and private institutions who trumpeted the case for cross-border financial liberalization undertaken over a fairly short horizon

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<sup>1</sup> This point is emphasized in Dobson and Jacquet (1998:78).

subject to only limited safeguards. Developing countries, on the other hand, in many cases were more defensive. Few are exporters of financial services on a large scale. Moreover several have recently undergone the painful experience of bouts of financial instability where difficulties affecting domestic banking systems were typically accompanied by balance-of-payments crises requiring macroeconomic retrenchment and resulting in major setbacks to economic growth and living standards. This experience had a large role in determining their negotiating stance.

Progress in the new negotiations on financial services has been slow, reflecting that of the round as a whole. Submission of initial requests was originally scheduled for mid-2002, and that of formal offers as part of the negotiation of commitments by the end of March 2003. The response to these deadlines appears to have fallen short of expectations. However, the submissions and discussions so far during the negotiations indicate the principal concerns of many countries and features they would like to see in the final outcome.

Watchwords in the submissions of major developed countries include expanded market access and the removal from countries' commitments of limitations affecting several different financial activities (horizontal limitations). Moreover attention has been drawn to the need for greater regulatory transparency in the treatment of foreign banks. Similar objectives were also pursued on the developed-country side in the negotiations which ended in 1997. Newer concerns include clarification of the distinctions between the modes of delivery of financial services specified in the GATS where these have been blurred by recent technological change, in particular by the growth of e-banking. Another subject where there is pressure for clarification is the scope of the so-called "prudential carve-out" of the Annex on Financial Services of the GATS, which permits measures taken for prudential reasons or to ensure a financial system's integrity and stability notwithstanding other provisions of the agreement. Moreover under this and some other headings some developed countries have called for further scrutiny of the relation of the work in the WTO and that in other international bodies such as the IMF, the World Bank and standard-setting institutions which deal with different aspects of the functioning of the international system.

In the WTO – as in many policy fora – developing countries continue to express their concerns about vulnerability to destabilizing capital movements. As explained in section C, the rules of the GATS were designed to decouple liberalization of trade in financial services from that of capital-account transactions except to the extent that the latter was necessary for the fulfilment of a country's commitments under the GATS. However, this decoupling has not succeeded in alleviating several developing countries' misgivings. These misgivings reflect the pressures on them for substantial additional opening of their markets to foreign banks which may have substantial but not easily predictable consequences for capital inflows and outflows.

Some subjects have been raised by both developed and developing countries but from divergent points of view. Thus both developed and developing countries have focused on the connections between work on financial services in the WTO and that on different aspects of the international financial system elsewhere. But whereas the thrust of developed countries' interventions here favours managing these connections in a mutually reinforcing way, developing countries are more circumspect owing to apprehensions as to the multiplication of factors incorporated in IMF surveillance and conditionality and of consequent constraints on national policy autonomy. Similarly the question of the scope of the prudential carve-out of the Annex on Financial Services has also been raised by both developed and developing countries, but while the former appear to favour a tighter definition of its permissible

scope, several of the latter prefer to keep the carve-out broad and unconstraining. Other matters to which developing countries have drawn attention are the need for greater harmonization of different limitations in countries' commitments at the levels of national and local Government, greater participation of developing countries in the setting of international standards with a bearing on market opening and national treatment, and assistance to developing countries in their efforts to increase their exports of financial services.

Both developed and developing countries have expressed support for more uniform classification of financial services in countries' commitments but there has been less consensus as to problems linked to statistics for different modes of delivery – problems which are arguably most significant for delivery through commercial presence (Mode 3). Owing to their fundamental assumption that market opening and non-discrimination generally benefit both exporters and importers of financial services developed countries tend to play down the importance of lacunae in these statistics. Several developing countries, however, see themselves as parties granting rather than benefiting from concessions in negotiations of financial services, and as such would like to be able to value these concessions.

Subsequent sections of this paper treat in greater detail various subjects related to the current negotiations and their antecedents. Firstly (in section C) major features of the GATS are summarized with particular focus on those relevant to the current negotiations.<sup>2</sup> This section is followed by a brief review (in section D) of the outcome of the previous round of negotiations and of evaluation of the market opening which they achieved. Section E contains a survey of information on the commercial presence of banks from developing countries in developing ones, and of banks from developed countries in developing countries. This survey brings out the relatively small scale of the presence of developing countries' banks in developed ones and the limited changes in this scale in recent years. It also indicates that the period since 1996 has been characterized by a large increase in the internationalization of the banking sectors of several developing countries, though the influence of WTO negotiations is difficult to separate here from that of a broader trend towards opening up financial sectors. Section E then fleshes out the summary discussion in this section of selected issues and concerns raised so far in the negotiations.

### **C. OUTLINE OF THE GATS**

The GATS comes in two parts; firstly a framework of rules, principles and concepts which underlie obligations regarding measures affecting international trade in services; and, secondly, the specific negotiated commitments listed in countries' schedules for service sectors. The GATS covers four modes of supply: (1) cross-border supply; (2) supply through the movement of consumers to the location of the supplier; (3) supply through the establishment in a country of the commercial presence of legal entities from another country; and (4) the supply through natural persons of one country in the territory of another.

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<sup>2</sup> The discussion here is limited to banking and financial services excluding insurance, i.e. the following (which has been slightly abbreviated from the classification of the GATS Annex on Financial Services): acceptance of deposits and other repayable funds; lending of all types; financial leasing; payment and money transmission services; guarantees and commitments; trading in (a) money market instruments, (b) foreign exchange, (c) exchange-rate and interest-rate instruments and other derivative products, (d) transferable securities, and (e) other negotiable instruments and financial assets; participation in issuance of securities; money broking; asset management; settlement and clearing services for financial assets; provision and transfer of financial information and financial data processing; and advisory, intermediation and other auxiliary financial services related to activities already mentioned.

The key articles in the GATS regarding the scheduling of commitments are Article XVI (on market access) and Article XVII (on national treatment). Market access as such is not defined in the GATS. Rather the approach of the GATS is to list six categories of measure which are prohibited unless specified in a country's schedule (for each of the four modes delivery). The categories cover the following: (a) limitations on the number of service suppliers; (b) limitations on the value of service transactions or assets; (c) limitations on the number of service operations or on the quantity of service output; (d) limitations on the number of natural persons who may be employed; (e) limitations on the type legal entity through which a service is supplied; and (f) limitations on the permissible size of the participation of foreign capital either in terms of a maximum percentage limit on foreign shareholdings or in terms of the total value of an individual entity's or of aggregate foreign investment. National treatment is defined as treatment no less favourable than that accorded to like domestic services and service suppliers. Under Article XVII measures entailing deviations from national treatment are also to be included in a country's schedule.

Other Articles that bear on issues discussed below are Article III, which covers transparency regarding relevant policy measures; Article IV on the facilitation of increased participation of developing countries in services trade; Article X which permits emergency safeguard measures in certain circumstances and prescribes further multilateral negotiations on this subject in the future; Article XII which allows for the application of restrictions on trade in services and the associated payments and transfers in the event of serious balance-of-payments difficulties; and Articles XIV and XIV *bis* which provide for exceptions dictated by the requirements of public order, health, security, etc. Cross-border capital transactions are covered by Articles XI and XVI. Article XI.2 (on payments and transfers) states the "Nothing in this Agreement shall affect the rights and obligations of the members of the IMF under the Articles of Agreement of the Fund, including the use of exchange actions which are in conformity with the Articles of Agreement". This legitimates controls over capital transactions since the IMF Articles continue to permit policy autonomy regarding such controls. However this legitimation is subject to the proviso that "a Member shall not impose restrictions on any capital transactions inconsistently with its specific commitments regarding such transactions" (i.e., such as would frustrate its specific commitments under the GATS) – a proviso elaborated in footnote 8 to Article XVI which, for example, more specifically states that if a country undertakes a commitment regarding market access through Mode 3 (commercial presence), "it is thereby committed to allow related transfers of capital into its territory".

In addition to the Annex on Financial Services already mentioned, financial regulation is covered by Articles VI and VII. The first of these Articles treats domestic regulation generally. It is designed to ensure that regulatory measures affecting services trade are administered in a reasonable objective and impartial way, and that licensing procedures, qualification requirements and technical standards are transparent and objective and such as to ensure the service's quality rather to act as a restriction on its supply. Article VII sets out requirements to be met in cases where the granting of market access is contingent on the recognition of standards which result from harmonization under a multilateral agreement. In such cases member countries are to afford to other parties to the GATS adequate opportunities to negotiate accession either to these agreements or to others with comparable status in the context of eligibility for market access. The Article concludes with a reference to the desirability of basing recognition on multilaterally agreed criteria and of co-operation among parties to the GATS with a view to further development of such criteria.

Much of the Annex on Financial Services is concerned with definitions including the classification of different financial services already mentioned. A section of the Annex on recognition of prudential measures for financial services is similar to Article VII. The broadness of the scope for regulatory measures in the interest of financial stability afforded by the prudential carve-out described in section B is subject to the proviso that where such prudential 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”. And there is an explicit reference in the Annex to dispute settlement, which would presumably deal with cases brought under this heading, where the need is mentioned for panels to “have the necessary expertise relevant to the specific financial service under dispute”.

#### **D. THE 1997 AGREEMENT IN BRIEF**

As already mentioned, the 1997 agreement on financial services was probably notable more for its airing of issues and the consequent increased transparency concerning the sector than for its concrete achievements in terms of market opening. Many countries’ commitments simply specified rules already in place (“the status quo”), and in some cases less than this – the latter a procedure analogous to binding tariffs in GATT or WTO agreements at levels higher than those actually prevailing.

Among developed countries commitments typically bound the considerable amount of liberalization already undertaken during the previous two to three decades. Japan, the United States and the European Union made their commitments on the basis of the Understanding on Commitments on Financial Services, an initiative of like-minded countries in the negotiations to furnish a relatively uniform and liberal formula for undertaking commitments. While the Understanding provides for commitments as to unrestricted market opening under Mode 2 (the purchase by residents of one member country of financial services in the territory of any other), commitments specified under Mode 1 (cross-border supply) by countries taking this route are limited.<sup>3</sup> Some common features of countries’ regimes for financial services which were targeted by developed countries during the negotiations have largely disappeared from the limitations in their commitments regarding market access and national treatment. For example, there has been a reduction during recent years in the number of countries applying reciprocity tests to market access for foreign banks (that is to say rules enabling a country to withhold market access from banks of another country if their own banks do not enjoy similar conditions for market access in that country)<sup>4</sup> and the frequency of economic needs tests in bank licensing rules has also been reduced.<sup>5</sup> But there remain exceptions. For example, among the limitations on market access under Mode 3 specified by Portugal are that “the establishment has to

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<sup>3</sup> Other important features of the Understanding are a standstill on restrictions in areas specified, liberal rules regarding market access through Mode 3 (commercial presence), permission for suppliers of financial services to supply new financial services in the territory of any other member country (a particularly interesting provision for a sector which continues to be subject to rapid innovation), liberal rules concerning the granting of temporary entry of managerial and specialist personnel of foreign suppliers, and rules designed to ensure that non-discriminatory measures do not in practice adversely affect the ability of foreign suppliers to establish and expand their operations in a member country (a provision intended to promote “equality of competitive opportunity”, a concept often raised during negotiations on the GATS which may go beyond formal non-discriminatory treatment).

<sup>4</sup> Reciprocity was a feature of the offers of several developed countries during the early part of the negotiations, some countries specifying that its eventual removal would depend on the quality of other Members’ offers.

<sup>5</sup> Economic needs tests do not always go by this name but the rules for licensing foreign banks in the banking regimes of several countries have traditionally included features with the same effect such as “an economic interest test”, the ability of the applicant to demonstrate its potential to contribute to bank competition, satisfying the authorities that an additional corporation would be a source of public benefits or advantages, etc. For countries not setting such conditions a new bank’s profitability is implicitly assumed to indicate whether or not it meets an economic need.

increase the national banking system's efficiency", and "convenience and needs" are amongst the criteria considered in the licensing process in the United States, although this is not mentioned among the limitations in its schedule of commitments.<sup>6</sup> In the United States market access for banking entities licensed at state level is subject to reciprocity tests in several states. This is one of several limitations on both market access and national treatment in the United States schedule which apply at state level and reflect the diversity of the regimes for foreign banks associated with the country's multi-level licensing system.

One feature of Japan's schedule is of particular interest in view of the uncertainty as to the scope of actions permissible under the prudential carve-out of the Annex on Financial Services. Amongst its horizontal limitations is the statement that "For prudential reasons within the context of ... the Annex on Financial Services, Japan shall not be prevented from taking measures such as non-discriminatory limitations on juridical forms of a commercial presence ... and from applying non-discriminatory limitations concerning admission to the market of new financial services which shall be consistent with [a] regulatory framework aimed at achieving such prudential objectives". These limitations qualify commitments specified in the Understanding and point to Japan's intention to place off limits certain features of its prudential regime regardless of any more precise interpretation of the prudential carve-out which may be forthcoming in future.

Limitations on market access and national treatment in developing countries' schedules (like the associated legal regimes for the financial sector) were more heterogeneous than in those of developed countries. The absence of estimates of the effects of these restrictions or of alternative methods of evaluating commitments renders the task of ranking or otherwise evaluating developing countries' schedules by their degree of liberalization is difficult, though attempts have been made.<sup>7</sup> One survey of developing countries' schedules indicates that the most extensive commitments to liberalization were to be found among small economies in Africa, the Pacific, and Latin and Central America (Ghana, Kenya, Malawi, Mozambique, Sierra Leone, Papua New Guinea, Solomon Islands, Guyana, Haiti, and Panama).<sup>8</sup> Willingness to include commitments in a country's schedule was greater for Mode 3 (commercial presence) than for Mode 1 (cross-border supply). Indeed, for Mode 1 among countries of Latin and Central America only Ecuador, Guyana, Haiti and Panama included commitments in their schedules – in other words none of the region's countries usually classified as among the larger "emerging financial markets" – and among countries in Asia and the Pacific the situation was similar, only Indonesia and Malaysia of the larger "emerging financial markets" scheduling commitments. Another interesting feature of comparison of schedules by region is the much greater number of countries in Asia and the Pacific (India, Indonesia, the Republic of Korea, Kuwait, Malaysia, Pakistan, Philippines, Singapore, Sri Lanka and Thailand) than in Latin and Central America (Brazil and

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<sup>6</sup> Concerning the history of the "convenience and needs" test in legislation for United States banks since the second half of the nineteenth century see Jackson and Symons (1999:59 and 90).

<sup>7</sup> The Financial Leaders Group (FLG), set up by European and American financial service firms in 1996 to seek common ground in the negotiations on financial services and thus achieve more effective and balanced lobbying, conducted an evaluation of the commitments of 20 key emerging financial markets (Dobson and Jacquet, 1998:89). An attempt at ranking developing countries' commitments numerically is made in Mattoo (2000:380–385). This ranking uses weights for Modes 1, 2, and 3 for two distinguished activities of banks, deposit-taking and lending – weights heavily influenced by figures for United States, the only country for which suitable data are available on a regular basis. In the case of all three modes of delivery commitments specifying "unbound" were assigned a value of zero and those specifying "no limitations" were assigned a value of one. Cases where restrictions were specified were assigned a value 0.5 for Modes 1 and 2, and a value for Mode 3 between 0.1 and 0.75 corresponding to the measure specified in the schedule which was identified as having the most restrictive effects ("no new entry", for example, being assigned a value of 0.1 and "ceiling on foreign equity of more than 50 per cent" one of 0.75).

<sup>8</sup> Mattoo (2000:364–368).

Dominican Republic) scheduling limitations on both the number of foreign suppliers and on their equity participation.

As already mentioned, the commitments of some developing countries fell short of the degree of market opening already present in their policy regimes. Moreover commitments as to liberalization under other agreements were not always included in WTO schedules. For example, commitments undertaken by Indonesia, the Republic of Korea and Thailand as part of IMF programmes in response to the Asian financial crisis of 1997 were not included in their WTO schedules. In view of the widespread concern as to the exact scope for prudential measures provided by the carve-out of the Annex on Financial Services it is interesting that the Republic of Korea (like Japan) included an explicit and broad reference to its prudential regime among the horizontal limitations of its schedule (“As described in ... the Annex on Financial Services, Korea shall not be prevented from taking prudential measures including requirements related to parent companies, the minimum capital requirement, or minimum operating funds requirement”).

## E. RECENT TRENDS IN THE COMMERCIAL PRESENCE OF FOREIGN BANKS

As noted above, in the last round of negotiations countries tended to be more willing to schedule commitments to supply through commercial presence than to cross-border supply. The commitments were made during a period which has witnessed considerable changes in the commercial presence of foreign banks in different countries. Not all changes have been in the direction of increases. Indeed, there have been contractions in some major financial centres. In view of the generally long-term nature of decisions as to commercial presence the lack of indications that the WTO agreement of 1997 has already had a major impact is not surprising. More important influences have been retrenchment due to banking consolidation involving domestic and cross-border mergers and acquisitions, banking problems in parent countries (for example, in several developing countries due to recent banking-cum-external-payments crises and in Japan due to the proliferation non-performing loans), and even the disappearance of whole countries which once had a banking presence abroad.

**Table 1**  
**Number of banking entities<sup>a</sup> from developing countries in selected OECD financial centres/regions**

<i>Year</i>	<i>London</i>	<i>New York</i>	<i>Year</i>	<i>European<sup>b</sup> Union</i>
<i>1996</i>	153	118	<i>1996</i>	144
<i>2002</i>	122	90	<i>1999</i>	145

**Source:** *The Banker* (various issues).

**a** For the definition of banking entities see footnote 9.

**b** Other than the United Kingdom.

As shown in table 1, there have been substantial contractions in the presence of banking entities from developing countries in London and New York since 1996. These contractions are part of an overall change in the same direction in the foreign banking presence in these two financial centres.<sup>9</sup> In both cases the share of entities from developing countries has undergone only limited change, increasing from 37 to 39 per cent in London and from 38 to 40 per cent in New York. In London 19 developing economies (Brazil, Egypt, Hong Kong

<sup>9</sup> With the exception of the European Union the coverage of banking entities in tables 1 and 2 appears to be broad, including as it does branches (entities which are integral parts of the foreign parent bank and thus lack separate legal status), subsidiaries (legally independent entities wholly or majority-owned by a bank incorporated in another country), representative offices (entities prohibited from engaging in general banking business and serving as a liaison between financial institutions in their country of location and their foreign parent bank), and agencies (a United States office of a foreign bank at which credit balances incidental to or arising out of the exercise of banking powers may be maintained, cheques may be paid, and money be lent but at which deposits may not be accepted from United States citizens or residents). The European Union figures include only branches or subsidiaries.

(China), India, the Islamic Republic of Iran, the Republic of Korea, Kuwait, Malaysia, Mexico, Nigeria, Pakistan, Russia, Saudi Arabia, Singapore, Slovenia, South Africa, Taiwan Province of China, Thailand, and Turkey) recorded decreases in the number of their banking entities and 11 (Afghanistan, Argentina, Bulgaria, Croatia, Cuba, Czech Republic, Ecuador, The former Yugoslav Republic of Macedonia, Kenya, Poland, and Serbia) ceased to figure on the list of those with a presence, while 7 economies (Bahrain, Bangladesh, China, Cyprus, Lebanon, Philippines, and United Arab Emirates) recorded an increase. The corresponding figures for New York were as follows: 12 decreases (Bahrain, Argentina, Brazil, Chile, Indonesia, the Islamic Republic of Iran, Malaysia, Mexico, Poland, Singapore, South Africa, and Venezuela), 5 departures from the list (Croatia, El Salvador, Hong Kong (China), Peru, and Croatia), and 5 increases (China, India, the Republic of Korea, Taiwan Province of China, and Thailand). Information available for New York (but not at the time of writing for London) in *The Banker* concerning the date of establishment of foreign banking entities from developing countries in New York shows that 5 new entities were established since the end of 1997.

Available information also suggests that in recent years there has been a large increase in the presence of banks from developed countries in East Asia, Latin America, and Central and Eastern Europe. Despite significant omissions (of Japanese banks in the case of East Asian countries and of Mexico in the case of Latin America) and some differences in the completeness of the data for 1996 and 2000/2001 the figures in table 2 give an indication of this increase.<sup>10</sup> For the East Asian countries included the overall expansion exceeded 50 percent, larger proportional increases being recorded by China, Indonesia, and Viet Nam. For the Latin America and the Central European countries the expansion was much greater: in the first group Argentina, Brazil, Chile, Colombia, and Venezuela all recorded particularly large absolute increases, and in the second Hungary and Poland.

Also pointing to the large scale of the increase in the presence of foreign banks in developing countries in recent years are figures in the Consolidated Banking Statistics of the Bank for International Settlements (BIS) on such banks' local lending.<sup>11</sup> These figures show a much faster increase in the local claims in local currency in developing countries of the foreign offices of BIS-reporting banks than in their international claims, i.e. the sum of their cross-border claims in all currencies and of their local claims in foreign currencies only: for developing countries as a whole local claims were about 10 per cent of international claims in 1990 and 68 per cent in 2002, while the corresponding proportions for Asia and the Pacific were 20 per cent and 60 per cent, for Latin America and the Caribbean 8 per cent and 111 per cent, and for Europe 3 per cent and 57 per cent.

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<sup>10</sup>For data on the presence of foreign banks in developing counties available during the later stages of the Uruguay Round of negotiations on financial services whose completeness may vary significantly among regions see Cornford and Brandon (1999).

<sup>11</sup> The consolidated banking statistics of the BIS are available on a quarterly basis in press releases (together with commentary) and in *BIS Quarterly Review: International Banking and Financial Market Developments*.

**Table 2**  
**Number of banking entities<sup>a</sup> from selected developed countries in developing countries, 1996 and 2000/2001**

<i>East Asia<sup>b</sup></i>	<i>1996</i>	<i>2001</i>	<i>Eastern Europe</i>	<i>1996</i>	<i>2000</i>	<i>Latin America</i>	<i>1996</i>	<i>2000</i>
Brunei Darussalam	3	4	Albania	4	7	Argentina	14	74
Cambodia	..	2	Bulgaria	7	10	Bolivia	..	3
China	31	84	Croatia	11	14	Brazil	18	99
Hong Kong (China)	108	109	Czech Republic	43	52	Chile	12	44
Indonesia	7	36	Estonia	4	5	Colombia	4	35
Malaysia	9	33	Hungary	1	42	Ecuador	3	7
Philippines	9	24	Latvia	3	5	Guinea	..	1
Republic of Korea	41	42	Lithuania	..	4	Guyana	..	1
Singapore	87	118	Poland	16	45	Paraguay	..	7
Taiwan Province of China	31	40	Romania	14	16	Peru	9	25
Thailand	26	44	Slovakia	10	12	Suriname	..	1
Viet Nam	7	38	Slovenia	4	9	Uruguay	9	26
						Venezuela	9	54

**Source:** *The Banker* (various issues) and industry sources.

**a** For the definition of banking entities, see footnote 9.

**b** The banking entities are those from developed countries other than Japan.

.. Denotes not available or zero.

Regarding the effects of the WTO negotiations on market access these data are inconclusive. The figures for the contraction in the number of foreign banking entities in London and New York no doubt reflect the influence of other factors in two financial centres already operating liberal regimes of market access for foreign banks. A more conclusive evaluation of the effects of the WTO negotiations in developing countries would require studies of the way in which their commitments have been implemented at country level. However, in view of the rather limited amount of expanded market access in these commitments, the growth in the internationalization of the banking sectors of countries classified as emerging financial markets since the mid-1990s is likely to reflect less the impact of the 1997 agreement in the WTO than a more general movement in the direction of financial opening which served as the negotiations' backdrop and helped to shape the eventual agreement.

## **F. ISSUES IN THE NEW NEGOTIATIONS**

### **1. Market opening, financial stability, and international capital movements**

As will be evident from the introduction, two pervasive concerns have dominated discussions in the new negotiations so far. On the one hand, developed countries have been pressing the case for increased market opening and tighter rules for policy measures with restrictive effects on market access and national treatment and, on the other, developing countries wish to ensure the compatibility of further liberalization with financial stability. The latter concern has been reflected in interventions during the negotiations which raise the issue of connections between WTO commitments regarding financial services and the potentially destabilizing effects of international capital movements.

On the face of it this is a little surprising since, as explained in section C, Article XI of the GATS is intended to guarantee the primacy of IMF rules in this area.<sup>12</sup> Obligations as to the liberalization of cross-border transactions in the WTO are linked to the commitments to market access included in a country's schedule and are designed to prevent their frustration in practice through restrictions on the capital transactions necessary for their fulfilment. However, the decoupling in the GATS of market opening for financial services from liberalization of capital-account transactions generally leaves substantial scope for connections in practice. This is most easily seen for the hypothetical example of a country which enters into commitments to no limitations regarding Modes 1, 2 and 3 for all the activities mentioned in the Annex on Financial Services. To ensure effective implementation of such commitments the country would be obliged to undertake comprehensive liberalization of capital-account transactions. Moreover a country – not that in the hypothetical example just described – whose commitments were made through the Understanding (see footnote 4) would also be making an open-ended commitment to the liberalization of such transactions required by its obligation to “permit financial service suppliers of any other Member established in its territory to offer in its territory any new financial service”. Although commitments as to market opening for financial services often carry associated obligations as to the liberalization of capital transactions, the country making them will have to depend on guesswork for the estimation of the size of the capital movements which are likely

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<sup>12</sup> Article XI also prescribes restrictions on payments and transfers for current transactions related to commitments under the GATS (except as part of actions to safeguard the balance of payments as provided for in Article XII). As of the time of writing only 5 of the signatories of the GATS agreement (Albania, Angola, Colombia, Egypt, and Nigeria) have yet to accept the obligations of IMF Article VIII under which member countries do not restrict payments and transfers for current international transactions without the Fund's approval.

to ensue.<sup>13</sup> The difficulty of reaching estimates here is increased by the pace of change in the financial sector which, as described in section F.2, is adding to the range of transaction possible transactions under the different modes of delivery of the GATS.

That the discretion left to countries under the GATS regarding the liberalization of capital-account transactions has failed to alleviate many developing countries' concerns would appear to be linked to the pressures to undertake substantial further market opening during the new round of negotiations and to uncertainties as to what its effects would be. Whereas this discretion should give countries scope to avoid entering into commitments whose consequences they judge to be potentially risky or unfavourable, there may well be apprehension that such a negotiating stance will prove untenable as momentum builds for substantial concessions as to market access dictated by the interest of achieving a successful outcome of the negotiations.

## 2. E-banking

E-banking<sup>14</sup> is another subject on which both developed and developing countries have expressed concerns – but concerns often motivated by differences in perspective. The former have stressed the need for a new agreement on financial services to facilitate progress on this front. For some of the latter, on the other hand, the acknowledgement of the potential benefits of e-banking is accompanied by the view that it could prove another source of difficulties for financial regulation and of financial instability.

GATS commitments are undertaken with respect to specified activities and modes of delivery. According to one view, which commands wide support amongst developed countries, commitments are technologically neutral – i.e. not affected by the technologies associated with either the activities themselves or their modes of delivery. Thus so long as an e-banking service can be classified as an activity listed in the Annex on Financial Services and its mode of delivery can be identified, it would involve no new difficulty for the rules of the GATS. The unspoken assumption is that this classification is rarely problematic, and that attention can then focus on delivery.<sup>15</sup> Thus, for example, once classified under an activity listed in the Annex, an e-banking service supplied in a country by a foreign entity would belong under Mode 3 (commercial presence). The marketing and provision of e-banking deposits or certain other e-banking services by an entity in one country to customers in

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<sup>13</sup> On the basis of his personal assessment for the activities in the Annex on Financial Services, an IMF observer attributes major importance to “capital flows for virtually all financial services delivered through mode 3 (commercial presence), as such presence by its nature implies some form of cross-border investment. Indeed, the only activities under the heading of banking and financial services (excluding insurance) to which he does not attribute such importance are financial leasing, provision and transfer of financial information, and advisory, intermediation and other auxiliary services. See Kireyev (2002:10–14).

<sup>14</sup> E-banking (electronic banking) is currently developing at a pace which complicates the task of definition. Consumer e-banking includes such services as the provision of facilities (ATMs, stripe cards, etc.) now often of long standing for transactions through technology owned and controlled by banks, dial-up access for customers, access via open networks (primarily the Internet) and open software (Web browsers), facilities for opening accounts via the Internet, facilities for non-account-transfer payments through electronic cash, and selling other financial services via the Internet. See Reed (2000:143). The term also covers electronic services for corporations such as cash management systems and facilities for large-value electronic payments and the delivery of other wholesale banking products as well as for business-to-business market places and exchanges. See BIS (2001:5).

<sup>15</sup> In communications to the negotiations Hong Kong (China) and Switzerland both describe a traditional approach on their part to the regulation of foreign suppliers of e-banking services, under which those undertaking activities in the country are treated as having a commercial presence (Mode 3) and are licensed according to the same criteria as conventional banks, while the provision (and advertising) of financial services such as deposit-taking to residents from abroad is subject to a different regime not requiring such licensing.

another would be an instance of the cross-border supply of financial intermediation (an activity specified in the Annex), and would belong under Mode 1. And so on.

However, for some other countries, mainly developing ones, this view is unsatisfactory and does not give enough importance to problems of classification, in particular where innovation is involved. The definitions of some financial instruments and services are not in fact always clear-cut, and the meaning and coverage of terms can differ among countries' regulatory regimes. The difficulty can be illustrated with derivatives. Conventionally a derivative is defined as a financial arrangement whose value is derived from another financial instrument, index or measure of economic value. But as a recent treatise on the law of derivatives points out, this definition does not capture important properties of some new derivatives and is not always helpful for handling commercial, regulatory, and tax issues.<sup>16</sup> An alternative definition (preferred in this treatise), which focuses on the exchange of cash flows or actual deliveries between two parties, is that a derivative is "a financial arrangement involving mutuality and valued by reference to current market rates, prices or levels". The instruments covered by these two definitions in different regulatory regimes would not necessarily be identical. And it should perhaps not be surprising that "a notional contract with real world consequences" (as a derivative is described by the same author) should be so hard to pin down precisely.

But the important point for the negotiations of financial services is that such a lack of agreement on definitions, which is not limited to derivatives, has implications for the comparability among countries not only of definitions of existing activities but of laws and regulations applying to new ones, including those associated with new technology. There cannot always be assurance that a new instrument or service will be conveniently classified in the same way by different countries. For some countries features of a financial service resulting from new technology such as the internet may lead to distinct classification for regulatory purposes, whereas for others this may not be true.<sup>17</sup>

As noted in section B, some developed countries have requested a clarification of distinctions between different modes of delivery in the light of recent technological change. Particular attention here has been drawn to a blurring of the distinction between Modes 1 and 2, and to possible consequent legal uncertainty. This request at present lacks detail, but may be related to the problem of identifying the location of the supplier of certain services over the Internet (and perhaps also of agreeing on international rules for such identification). Their concern over the relation of technological change to the different modes also appears to reflect dissatisfaction with commitments under Mode 1 made during the last round of negotiations. Here a likely inference is that several developed countries view a continuation of such reticence regarding commitments under this Mode as a potential impediment to the development of cross-border e-banking.

An issue not so far raised in as many words at the negotiations but which are likely to underlie other concerns over e-banking is the character of regulatory regimes currently being introduced for it. Both new banking services made possible by electronic technology and certain features of more traditional banking services delivered electronically pose a new set of problems for regulation and supervision. These problems are related to such features of e-banking as the increased anonymity associated with

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<sup>16</sup> See Henderson (2003:3).

<sup>17</sup> Of considerable interest in this context is the European Parliament and Council Directive 2002/65/EC of 23 September 2002 concerning the distance marketing of financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC (Official Journal L271, 9.10.2002). The recitals of this directive point to many problems which are particularly relevant to the selling of financial services over the internet. However, its provisions refer to all distance marketing and explicit reference to the Internet and e-banking is avoided.

certain payments or transfers over the Internet and with electronic cash, the facilitation of the evasion of supervision by Internet technology – evasion which may be effectively countered in some cases only through strengthened cross-border cooperation among supervisors, the control of money laundering, and new banking risks.<sup>18</sup>

The consequences of such challenges to regulation and supervision have already included changes in national law and industry codes of good practice as well as international initiatives for the purpose of providing guidance as to the form which new rules should take.<sup>19</sup> As mentioned in section C, the GATS contains provisions designed to ensure the fair, non-discriminatory and transparent character of domestic regulation for foreign suppliers. It would thus be understandable if participants in the WTO negotiations should be concerned that the new rules and regulations to handle problems associated with e-banking which are not satisfactorily covered by existing banking regimes should meet the requirements of GATS Articles VI and VII. New regulatory and supervisory rules for e-banking should not be seen as an issue necessarily involving a divide between developed and developing countries since changes of potential interest in the context of the GATS are likely to be undertaken by both and in response to the same developments.<sup>20</sup>

On the developing-country side attention has been drawn to the possibility that e-banking will facilitate large, destabilizing international capital movements in the form of portfolio investment (viewed as susceptible to rapid reversals and thus as differing from foreign direct investment). Perhaps surprisingly, problems posed for the control of capital transactions by the lack of transparency of certain Internet facilities for payment and transfer have apparently not yet been raised under the heading of e-banking and international capital movements.<sup>21</sup>

E-banking also has systemic and macroeconomic implications likely to become increasingly important owing to its impact on mechanisms for payment, transfer and settlement and thus on both the financial system's "plumbing" and the conduct of monetary policy. The first is an issue relevant to the prudential carve-out of the Annex on Financial Services and may well be raised in future discussions under this heading (see section F.3). The implications of relations between electronic money and other traditional forms for monetary policy are unlikely to figure importantly in WTO negotiations as being beyond the usual remit of this forum (although it is easy to envisage that the subject will come to figure more importantly in future work on international financial reform elsewhere).

### **3. Prudential measures**

The financial crises of recent years have led to greatly increased attention to prudential regulation of the financial sector. Strengthening such regulation has been attributed a key role among initiatives for international financial reform. As noted in section C, the GATS recognizes Governments' need for considerable freedom of action for prudential measures to protect investors, depositors, policy holders and other persons covered by a financial-services supplier's fiduciary responsibilities, or to ensure the

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<sup>18</sup> See, for example, BIS (2000).

<sup>19</sup> Concerning regime changes in United Kingdom and the European Union see Reed (2000) and Edgar (2000). and for the outline of a supervisory framework addressing cross-border e-banking issues see BIS (2000:7–9).

<sup>20</sup> Indeed, the relation of electronic transactions to money laundering and fraud, targets of ongoing changes in legal regimes for e-banking, has been raised on the developing-country side.

<sup>21</sup> Problems of this kind have already been addressed on the ground. In Sri Lanka, for example, recourse is had to both legal limits and voluntary compliance for credit card transactions in this context. Credit card purchases from abroad are permitted but their United States dollar value is restricted by low Sri Lanka rupee limits on the cards. Moreover the central bank has instructed banks to remind customers that purchases of foreign financial instruments are illegal. See Mann et al. (2000:66).

financial system's integrity and stability. However, the scope and character of measures permitted under this heading are not specified. Indeed, the allowance of recourse to dispute settlement concerning a country's prudential measures is probably, *inter alia*, an indication of the difficulty which negotiators of the GATS faced when it came to spelling out the measures which are or are not permissible under the prudential carve-out of the Annex on Financial Services.

One set of questions under this heading is likely to be measures taken as part of the restructuring of banking sectors in the aftermath of financial crises such as that which broke out in Asia in 1997. Such restructurings can take place over extended periods of time, thus posing the question of whether all the actions involved can be classified as being covered by the reference to system integrity and stability. Moreover the restructurings may also be accompanied by substantial injections of government money in forms which some may consider as distorting competition and discriminating against foreign suppliers of financial services. To date there is no WTO case law to provide guidance here (though this may be about to change).<sup>22</sup> Thus it is unsurprising that a request for clarification as to the scope of the prudential carve-out has been made during the new negotiations.

Switzerland, for example, whilst acknowledging the need for ample room for manoeuvre with respect to prudential measures, has nonetheless drawn attention to the way in which in its view prudential regulation can be disproportionate to the problems at which it is directed and can involve limitations on the participation of foreign institutions in a country's financial sector. It recommends greater recourse to financial standards developed by organizations such as the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), the International Organization of Securities Commission (IOSCO), and the Joint Forum on Financial Conglomerates. These standards, Switzerland argues, could serve as the basis for a definition of the exceptional measures which may be taken for prudential reasons regardless of other provisions of the GATS.

It is unclear as yet what the practical implications of the Swiss recommendation might be. One possibility would be simply some kind of use of the work of the bodies mentioned in an exercise which attempted to define non-actionable prudential measures. Another possibility, which would probably have more far-reaching implications, might involve some kind of vetting of countries' regimes of prudential regulation and supervision as a precondition for according broad latitude with respect to prudential measures. Since the standard-setting bodies mentioned above are not responsible for vetting implementation, in this case the Swiss recommendation might point to the establishment of a link between such latitude and assessment of countries' prudential regimes as part of the Financial Sector Appraisal Programme (FSAP) carried out by the IMF and the World Bank. This programme is aimed at assessing vulnerabilities of a country's financial sector and identifying priorities for action, and is carried out partly on the basis of criteria for subjects such as financial regulation and

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<sup>22</sup> The Republic of Korea's restructuring of its financial sector in the aftermath of the 1997 Asian financial crisis – a restructuring which involved substantial injections of government money to deal with non-performing loans and to replenish banks' capital but which was also the subject of discussions between the country and the IMF in the context of the latter's programme of financial support – has recently been challenged in the WTO as involving actionable subsidies under the Agreement on Subsidies and Countervailing Measures (rather than under the dispute settlement procedure available for prudential measures under the Annex). In addition to its bearing on what are permissible prudential measures, this challenge raises questions concerning connections between work in the WTO and in the IMF, and concerning their mutual coherence.

supervision which are part of internationally agreed standards.<sup>23</sup> Financial sectors are now a subject of IMF Article IV surveillance, and FSAP can provide inputs to this process.

The implications of such a link for relations between work in the WTO and that on international initiatives concerning financial standards raise a number of questions. Many developing countries are likely to have reservations about an approach along these lines. Acceptance of the key financial standards is not universal. Objections focus not only on the contents of some of these standards but also on the resources and time required for their implementation. Moreover several have long-standing reservations as to constraints through the GATS on their autonomy regarding prudential measures standards.<sup>24</sup> One might also expect developing countries' still limited participation in standard-setting exercises to be raised here, and perhaps as a pertinent corollary the governance structure of the IMF and World Bank, where many developing countries feel their voice has too little weight in decision-making.<sup>25</sup>

Perhaps paradoxically linking the permissible scope of prudential measures under the GATS to standards-setting exercises elsewhere might serve as an argument for strengthening developing countries' case for improved representation in such exercises. The case would be based on the Annex on Financial Services itself and on Article VII of the GATS. The language here covers accession to standard-setting exercises and agreements per se, and not voting weights or the quality of participation.<sup>26</sup> Nevertheless, strengthening the links between work in the WTO and that in other international organizations on issues related to financial services (a proposal advanced by developed countries) may in the area of prudential measures actually furnish developing countries with an argument for shifts in imbalances in the existing structure of international financial governance.

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<sup>23</sup>The design and implementation of financial standards have been assigned a major role in ongoing efforts to strengthen the international financial system. The Financial Stability Forum, a body established by the finance ministers and central bank governors of the G-7 in February 1999 to promote international financial stability through improved exchange of information and cooperation with respect to financial supervision and surveillance, has identified 12 key financial standards which it considers particularly relevant for this purpose. Each of these standards concerns a particular subject area and has an issuing body (which is not necessarily that responsible for promoting and vetting its implementation). Taken together, the 12 key standards cover macroeconomic policy and data transparency, institutional and market infrastructure, financial regulation and supervision, corporate governance and accounting, and money laundering and terrorist financing. For descriptions of the origins and initial contents of these standards see Cornford (2002), and Walker (2001:307–311 and 316–338).

<sup>24</sup> During the Uruguay Round in 1990, for example, the SEACEN group of countries (Indonesia, Malaysia, Thailand, Nepal, Sri Lanka, the Republic of Korea, Philippines, Singapore and Myanmar – SEACEN being a group of their central banks or monetary authorities) made submissions expressing opposition to allowing prudential measures to be susceptible to dispute settlement under the GATS and, indeed, to subjecting any safeguard measure for the financial sector (whether temporary or of longer duration) to multilateral procedures or prior consultations.

<sup>25</sup>The representativeness of the bodies responsible for international standard setting varies, reflecting in many cases historical origins associated with organizations and initiatives involving the membership or participation of limited groups of countries. The BCBS, the body assigned the responsibility for standard setting in the area of banking supervision, has a long history of efforts at outreach consisting of contacts and increasingly collaboration and consultations with non-member regulatory bodies and other supervisory groups. However, these efforts have not succeeded in quelling criticism of its representativeness, and there are indications of increasing acceptance among developed-country supervisors that more needs to be done on this front, both in the BCBS and other bodies responsible for the setting of international standards. See, for example, Davies (2003).

<sup>26</sup> To quote 3(a) (on recognition) of the Annex on Financial Services: “A Member that is a party to ... an agreement or arrangement {related to the recognition through harmonization or otherwise of another country's prudential measures}, whether future or existing, shall afford adequate opportunity for other interested Members to negotiate their accession to such agreements or arrangements, or to negotiate comparable ones with it, under circumstances in which there would be equivalent regulation, oversight, implementation of such regulation, and, if appropriate, procedures concerning the sharing of information between the parties to the agreement or arrangement.”

#### 4. Classification and statistics

The classification of financial services in countries' commitments has been raised by a number of countries which have expressed a preference for uniform use of the classification in the Annex on Financial Services. In the previous round of negotiations three different classifications served as the basis for countries' commitments – that of the Annex, that of the United Nations Central Product Classification (CPC),<sup>27</sup> and countries' own.

The issue of statistical coverage since the initial introduction of services as a subject for negotiation in the GATT/WTO has commanded less consensus. As noted in section B, as part of a generally more defensive negotiating stance there has been greater concern over the value of services commitments on the developing-country side, financial services being a subject of special attention here owing to the scale of the business involved. In goods trade at least approximate estimates of the value of concessions can be made on the basis of data on imports and of econometric estimates of price elasticities for imports or other modelling exercises. But for services not only is there a lack of a widely accepted conceptual framework to serve as a basis for econometric estimates but statistical data for the different modes of delivery are inadequate or non-existent.

Delivery via Mode 1 (cross-border) is included in IMF statistics for the balance of payments on current account, the item financial services under this heading covering fees, commissions and other charges for financial intermediary and auxiliary services. However, a breakdown of the item by different financial service activities is not available, a circumstance which reduces the statistics' usefulness for services negotiations in the WTO. Figures for Mode 2 (consumption abroad) are not generally available. Earnings under Mode 4 (the presence of natural persons) are part of the item, compensation of employees (defined to include seasonal workers or others with a presence lasting less than a year), under income in the current account. But these figures are not broken down by major sectors, let alone by different activities within the financial sector.

As noted in section D, among developing countries willingness to undertake commitments in the last round of negotiations was greatest for Mode 3 (commercial presence). Currently data for valuing such commitments are lacking. A recently issued *Manual on Statistics of International Trade in Services* of the United Nations, the European Commission, IMF, OECD, United Nations, UNCTAD and the WTO is designed eventually to make a major contribution to filling this gap.<sup>28</sup> Its main tool for this purpose is to be statistics for Foreign Affiliates Trade in Services (FATS). These statistics will cover the operations of firms' foreign affiliates and will thus value activities associated with Mode 3. Categories of economic activity to which the Manual attributes priority under FATS are (1) sales, output, or both, (2) employment, (3) value added, (4) exports and imports, and (5) numbers of enterprises. Other variables pertinent to financial services negotiations which are mentioned in the Manual but accorded lower priority are net worth and net operating surplus.

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<sup>27</sup> The CPC for financial services (other than insurance) is as follows: financial intermediation (except investment banking); investment banking; mergers and acquisitions; corporate finance and venture capital; other services related to investment banking; securities brokerage; commodity brokerage; processing of securities transactions; portfolio management; trust services; custody; financial market operational services; financial market regulatory services; other financial market administration; financial consultancy; foreign exchange; processing and clearing of financial transactions; other services auxiliary to financial intermediation; and – somewhat surprisingly – packaging services. It is evident that this classification contains more overlapping than that of the Annex and lacks its coherence.

<sup>28</sup> UN/DESA (2002).

Data collected and published in response to the FATS proposal should eventually facilitate the assessment of the effects of foreign direct investment and market access via Mode 3. But except in at most a small minority they will not be available in time to be useful to participants in this round of WTO negotiations. Moreover it should be remembered that assessments of offers and commitments on the basis of statistics for foreign affiliates would require a significant presence of such entities in the sector or activity under consideration. For banking services the data in section E indicate that there has recently been a large expansion of the commercial presence of foreign firms in developing countries. However, not all countries and activities have been affected equally, and for those with a still small presence of foreign banks FATS may not provide an adequate basis for an assessment exercise. In view of the long lag before the availability of results under FATS and of the other difficulties just mentioned a rethinking of the way to value commitments seems called for. One approach might be recourse to data concerning the activities of domestic firms rather of foreign affiliates. The data would be those in firms' published accounts, though segmental reporting in these accounts – with segments at least approximating the classification of the Annex on Financial Services – would be required if the data were to be really useful to negotiators.<sup>29</sup>

## 5. Laws and regulation

As mentioned in section C, Articles III and VI of the GATS are intended to guarantee transparent, reasonable, objective and impartial regulations and laws for trade in services. The United States has submitted a set of more fully fleshed-out principles to which in its view countries should adhere under these Articles. The application of many of these principles would entail simply giving a more concrete form to the provisions of the Articles. However, under the heading of transparency in the development of regulations, the proposal includes the provision of procedures permitting and soliciting comments which would also include a reasonable amount of time for the process. The precise intention of this request is not clear but may be to facilitate intervention by foreign suppliers of financial services in the development of new regulations. In practice one would expect that at least informal channels would already be available in a country for major interested parties to communicate their views to the authorities on proposed legal or regulatory changes. However, formalizing such procedures might go beyond GATS Article VI. 2(b), which states that a member country should not be required to institute administrative procedures affecting trade in services which would be “inconsistent with its constitutional structure or the nature of its legal system”.

As illustrated in section D for the United States, regulations applied by Governments below the national level can restrict the scope of market access and national treatment for foreign suppliers of

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<sup>29</sup> When such data are available, an idea worth exploring would be to value offers or commitments on the basis of the formulae of real options theory. This theory draws on the concepts developed for valuing financial options, namely contracts conferring the right but not the obligation to buy or sell a financial asset such as a share at a preset price. The extension in real options theory is to the valuation of investment opportunities involving a contingent element as to whether to exploit the opportunity, and if so, as to the timing. Examples that have been discussed in the literature are mining concessions, patents, and more recently decisions regarding foreign direct investment. The valuation of firms whose main assets are contracts involving such opportunities has also been taken up under this heading. A commitment on services in the WTO considered from the point of view of the member countries other than the country making it is a concession with option-like features. If this point of view is accepted, then a commitment should be susceptible to valuation on the basis of real-options theory. For this purpose the key variables required would be the value of the asset to which the option applies, the variance of this value, the strike or exercise price, the time until the expiration of the option, and a riskless interest rate. One would thus need estimates of the profits of firms in the sector to value the asset, the historic variance of these estimates, an interest rate for government debt, the cost of entering or engaging in the activity in question (the strike price), and the time to expiration of the commitment. Perhaps the most difficult of these requirements would be segmental figures for profits and the time to expiration (since WTO commitments do not refer to a limited period of time).

financial services. Greater harmonization of national and local regulations has been raised at the negotiations but may raise legal or political problems for Members with federal structures, especially if significant power over international trade is devolved constitutionally to provinces or states.<sup>30</sup>

## **6. Special treatment for developing countries**

Article IV of the GATS is designed to facilitate increased participation by developing countries in world trade through negotiated commitments as to the strengthening of the capacity, efficiency and competitiveness of developing countries' services sectors through the provision of commercial access to technology, improved access to distribution channels and information networks, and liberalization of market access in sectors and modes of supply of export interest to such countries. Moreover developed-country members and others (to the extent possible) are to establish contact points to facilitate the developing countries' access to information about commercial and technical aspects of services supply, professional qualifications, and the availability of services technology.

Developing countries have frequently (and justifiably) drawn attention to the lack of concrete measures taken under this heading for either financial or other services. Among the specific demands put forward here are an assessment within the WTO of trade in services, developing countries' participation therein, and measures on the part of developed countries to achieve the goals of Article IV. More flexible negotiating procedures have also been proposed here with the aim of permitting limits on commitments as to liberalization, a latitude consonant with GATS Article XIX.2, which provides for "appropriate flexibility for individual developing country Members for opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access in line with their development situation and ... attaching to such access conditions aimed at achieving the objectives referred in Article IV".

## **7. Global policy coherence**

Traditionally the principal subject on which there has been GATT- or WTO-IMF coordination are exchange restrictions imposed by a member country for balance-of-payments reasons. Under Article XV of the GATT member countries accept the findings of the IMF as to whether the restrictions are in accordance with the latter's Articles of Agreement. An analogous role is attributed to the Fund under Article XII of the GATS. But the issues of international capital movements and prudential regulation (discussed in sections F.1 and F.3) are likely to lead to new overlaps between the work of the WTO and initiatives regarding the international financial system in other multilateral institutions. The need to review such overlaps has been raised during the new round of negotiations. Moreover these overlaps are arguably subsumed under the general issue of global policy coherence, a subject on which Governments adopted a declaration as part of the final outcome of the Uruguay Round.<sup>31</sup> This declaration noted that "the interlinkages between the different aspects of economic policy require that the international institutions with responsibilities in each of these areas follow consistent and mutually supportive policies". But this call was subject to provisos concerning the need to respect the mandates, confidentiality requirements and decision-making autonomy of each institution, and to avoid "the imposition on governments of cross-conditionality or additional conditions". The latter proviso could have implications for any initiative along lines described in section F.3 to link WTO members' latitude

<sup>30</sup> See, for example, Jackson (1997:88–89).

<sup>31</sup> Declaration on the Contribution of the World Trade Organization to Achieving Greater Coherence in Global Policy Making.

regarding prudential measures and assessments by the IMF and World Bank of countries' regulatory regimes.

Financial services are not the only topic with respect to which the agenda of the WTO poses questions as to global policy coherence. Nevertheless, the interaction of the so-called real economy and of money and finance has long been a fruitful source of issues under the heading of such services, and their importance lies in their links not only with production and trade but also with the functioning of the international financial system more generally. Perhaps the most explicit follow-up to the Declaration described above in the work programme of the ministerial declaration launching the new round of multilateral trade negotiations at Doha in November 2001 is the establishment of a working group to examine ways in which the multilateral trading system can contribute to a durable solution of developing countries' external indebtedness and to strengthening the coherence of international trade and financial policies with a view to safeguarding the system from the effects of monetary and financial instability. Past experience and realism about the willingness of the major actors to envisage changes in international economic governance argues against expecting too much from this working group. But the discussion of earlier sections does indicate that the more general issue of international financial stability, which is connected in several ways to subjects raised under global policy coherence, will nevertheless significantly influence actual sectoral negotiations in the current round such as those on financial services.

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