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**Financial Services in the WTO: Are Liberalisation and Regulation in Conflict?**

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## **FINANCIAL SERVICES IN THE WTO: ARE LIBERALISATION AND REGULATION IN CONFLICT?**

### **The issue**

1. Negotiations under way at the World Trade Organisation in Geneva will address, and perhaps to a significant extent reshape, the regulatory framework for financial and other services around the world. As they seek to reduce barriers to market access, those engaged in these talks are inevitably drawing lines between acceptable and unacceptable domestic regulation. Key constituencies are watching closely to see, and influence, where the lines will fall. Among the eager onlookers are private sector companies from, for instance, banking, insurance, securities and asset management, as well as national regulators and outside critics.

2. Much of the debate in the WTO turns on the issue of whether there are general principles of regulation to which all can sign up. Here there are differences between developed and developing countries, and, to a degree that is becoming increasingly obvious, between the European Union and the United States. It is highly desirable that private sector views should be made known to Governments and regulators. To this end, there have been useful discussions between private sector representatives on both sides of the Atlantic. This article offers some analysis of the different positions taken both in the public and private sectors, and puts forward some suggestions on how, in due course, differences could be bridged.

### **The background to the WTO negotiations**

3. For most of the past fifty years international trade negotiations focussed on trade in goods. However, the complex set of negotiations - the so-called Uruguay Round - which concluded in 1994 and created the World Trade Organisation also, and for the first time, covered trade in services. One of the agreements to emerge from the Uruguay Round, and to be administered by the WTO, is the General Agreement on Trade in Services, or GATS.

4. The GATS Agreement was basically a framework agreement establishing general principles for WTO negotiations on services, itself a useful achievement. On financial services, as on most other services, member Governments were in many cases willing to undertake not to add to the restrictions faced by foreign suppliers. They did not commit themselves to dismantle these restrictions to any significant degree. The aim of the new negotiations is achieve significant liberalisation. That is in the interests of the big financial service exporters like the EU and US, whose markets are already largely open and who would gain from improved overseas access. It is no less in the interests of countries around the world whose markets are more protected but whose economic future depends on access to high quality financial and other services.

### **The existing GATS provisions on domestic regulation**

5. Among the important principles enshrined in the GATS Agreement are those related to domestic regulation. Articles III and VI of GATS effectively provide a blueprint for reconciling liberalisation and regulation. Regulations affecting trade in services have to be published. They must be administered in a reasonable, objective and impartial manner. Applicants to provide services which Governments have agreed to liberalise must be given an answer within a reasonable period. Administrative decisions must be subject to review. These and other provisions are designed to ensure that liberalisation is not frustrated by regulatory failings.

6. At the same time the need for proper prudential regulation is specifically acknowledged in the GATS annex on financial services. This came to be known as the “prudential carve-out”, and was introduced to meet the concerns of regulators. So the existing GATS Agreement reflects a balance which many Governments can accept. On the one hand, there are good economic arguments for promoting quality and efficiency in financial services by opening up to foreign competition. On the other, market imperfections, and particularly the disparity between suppliers’ and customers’ knowledge of the financial soundness of suppliers, requires proper prudential regulation going beyond normal anti-trust restraints on market abuse.

### **The shape of the current debate**

7. Why then has the domestic regulation of services become an issue for debate, and sometimes controversial debate, at the WTO? This is because GATS Article VI.4 calls on the WTO Council for Trade in Services, “with a view to ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services”, to develop disciplines to ensure that such requirements are based on objective and transparent criteria, and are not more burdensome than necessary to ensure the quality of the service.

8. In terms of process, the task of debating and elaborating these disciplines falls to the WTO Working Party on Domestic Regulation, created in April 1999 for this purpose. It is due to complete its work by the conclusion of the present Round of WTO negotiations, which has been fixed for January 2005. So far the Working Party has made little progress. It has tried to work out how broadly similar disciplines could be applied to all services sectors. But the issues are not easy; and the Working Party can hardly be expected to move swiftly when significant differences persist among member Governments. It is therefore worth looking at the attitudes of the different key players in the debate on regulation which will be running over the coming months. This debate involves Governments in developed and developing countries, the private sector, regulators, and outside critics, notably in NGOs.

### **The private sector**

9. For some years now there have been regular contacts between the financial service industries in Europe, North America and East Asia over WTO services issues, with a view to establishing common ground and putting shared recommendations to Governments. A good current example of this work is the insurance model schedule, which insurance associations from the EU, the US, Canada and Japan have drawn up together and are jointly recommending to their Governments. The authors of this schedule see it as a framework of insurance regulation which will both promote competition in the market place and sound solvency-based regulation.

10. However, private sector views on regulatory issues are not always identical. Some sections of the US financial services community, perhaps influenced by the views of their own regulatory authorities, are

more cautious than their European counterparts in drawing up new disciplines under GATS Article VI.4. These differences are best seen in the debate which is emerging a Government level.

### **Views of EU and US Governments**

11. It is common ground across the North Atlantic that regulatory requirements applied to services should be objective and transparent. But hitherto the US have been reluctant to go beyond transparency into criteria based on necessity and proportionality, to reflect the Article VI.4 provision that requirements should be “no more burdensome than necessary to ensure the quality of the service”. The EU by contrast has argued that the criteria should relate to necessity and proportionality as well as transparency, although they have not yet elaborated these ideas in any great detail. A useful account of how such concepts might be translated into practice is contained in a paper sent to the Commission in May 2001 by the European Services Forum, a body which represents service industries across the European Union, and available on their website at [www.esf.be](http://www.esf.be).

### **Developing countries**

12. There are now more than 140 member countries of the WTO. In some of the smaller and poorer countries, regulatory systems, where they exist, are fairly basic. A number of Governments of developing countries have expressed resistance to new regulatory disciplines, mainly on the grounds that they do not have the skilled staff to administer them and that existing WTO commitments are more than they can readily cope with. There may also be an element of bargaining, since developing countries know that services are a high priority for the US and EU.

### **The Regulators**

13. It is difficult to attribute to regulators around the world a single view on what is or should be in the GATS agreement. The existing provisions, couched as they are in very broad terms, should cause them no great difficulty, although there are worries about how the powerful dispute settlement procedures of the WTO might be applied to breaches of WTO rules on domestic regulation. Understandably, perhaps, regulators have been mainly concerned with international agreements in their own fields (the Basel Accord, IOSCO, IAIS). Some of them may not yet have grappled with the fact that they are bound by the WTO agreements, particularly the GATS, and that their Governments are committed in the WTO to efforts to work out, and get agreed internationally, regulatory disciplines for service industries.

14. There are of course good reasons for such disciplines, and for preventing obscure or unnecessary regulation from impeding the growth of trade in services. But there is plenty of scope for misunderstanding or worse between trade negotiators and regulators, and the two need to stay close together as the work goes forward. Equally, there should be contact between the regulators and those in the financial services industry who take an interest in WTO matters. In the United Kingdom, for example, a senior representative of the Financial Services Authority sits on the private sector committee (the Liberalisation of Trade in Services, or LOTIS, committee) which pulls together views from the City of London and UK financial services.

### **The outside critics**

15. Several NGOs advocating third world development concerns have been critical of GATS, and not least of the provisions on regulation. They argue that GATS does, or may, deny developing countries the

ability to regulate in their own best interests, and to control foreign service suppliers and investors. These criticisms seem misconceived. Not only does GATS encourage prudential regulation, but it permits any member country to exclude foreign service suppliers or to admit them subject to conditions. It is difficult to argue that it is against the interests of developing countries that regulation should be transparent, or no more burdensome, or restrictive of trade, than necessary to secure its objectives. It is certainly not in the interests of foreign service suppliers to operate in a weak or badly-run regulatory environment. Conversely, the presence of foreign service suppliers familiar with an efficient regulatory environment should serve to strengthen the hand of local regulators who are still learning the ropes.

### **Elements of a solution**

16. The WTO debate on domestic regulation will not be concluded quickly. Any solution will need to respect the central concerns of the main players. The regulators will need to be convinced that international agreements reached in the WTO will not weaken their ability to put in place and implement necessary prudential regulation at home. The private sector will want to be sure that opportunities to export and invest abroad will not be frustrated by obscure or unnecessary regulation which is in fact protectionism in disguise. Developing countries will expect understanding of the need for sequencing, to cater for the practical limits on their ability to staff and finance new disciplines to be applied across all service sectors. The EU and the US, with the backing of their respective service industries, will need to find ways of reconciling their differences over the Article VI.4 mandate, possibly by a combination of regulatory principles which apply across all service sectors with other principles which will apply to certain sectors alone.

17. These are not impossible tasks, given the amount of common ground, both intellectual and practical, which already exists. But they have, understandably, been low on the agenda of Governments and financial regulators who have faced more immediate issues, political and economic, in the last couple of years. This is the moment for a fresh impetus, and for trade negotiators and regulators to work together on a coherent solution to be in place by mid-2004, ahead of the deadline for the conclusion of the GATS negotiations in early 2005.

### **Biographical note**

Christopher Roberts works for the London office of the international law firm, Covington and Burling, as their adviser on trade issues. He chairs the Liberalisation of Trade in Services (LOTIS) Committee which, under the umbrella of the trade association International Financial Services London, coordinates positions on service trade issues in the WTO in the interests of the City of London and UK financial services, and represents them to Governments. He is also chair of the policy committee of the European Services Forum, which performs a similar role on behalf of service industries generally across the European Union.

His earlier career was mainly spent in the British civil service. For ten years until the end of 1997 he was the UK Director-General of Trade Policy, and the senior British official responsible for WTO questions.