New efforts to move GATS negotiations: Ignore negative impacts on financial and food crises!

30 May 2008 - by Myriam Vander Stichele

On behalf of the Working Group on Services of Our World Is Not For Sale [OWINFS]

Summary

The new push to ensure that developing countries make more liberalisation commitments in services as part of a Doha deal is reflected in the **new draft text issued on 26 May 2008 by the chair of the services negotiations**, Ambassador de Mateo. This text is against developing countries' interest by keeping on the negotiation table demands to bind existing market openness and to make commitments with no priority exclusion of any service sector or mode of supply". The EU and the US will particularly be pressing for more commitments in the financial services sector.

However, this paper argues that:

- The necessary regulation, supervision and reforms proposed to deal with the current financial crisis are not in place to overcome the risks of financial instability which are still incorporated in the financial industry. No new commitments should therefore be taken.
- In this context, further liberalisation will lock-in international competition that promotes risky and crisis-ridden behaviour.
- New commitments in financial services will prevent governments from making interventions in the financial industry and on financial markets to curb speculative and destructive activities and financial products, including derivative trading in commodities and food in times of crises and rising prices.
- Developing countries have been requested to make commitments in risky and speculative financial services and to eliminate many measures that help to avoid financial crises.
- The draft negotiation text on domestic regulation might undermine prudential regulation needed to avoid financial instability and to protect domestic consumers.
- Some GATS rules undermine the right to prudential regulation and actions taken by Central Banks.
- Liberalisation of financial services is not likely to financially support the need for increased production of food but rather perpetuate the lack of financial resources to do so.

Introduction

A new draft text issued on 26 May 2008 by the chair of the services negotiations, Ambassador de Mateo, tries to include more liberalisation of services in the new efforts to conclude the Doha Round of trade negotiations. In addition, WTO Director General Lamy is pushing for a Signalling Conference where developing countries will be pressurised to present new services liberalisation. As has become clear over the past few months, the European Union (EU) and the United States (US) will insist on countries making further commitments to liberalize trade in services as part of whatever deal is finally reached .
During the GATS negotiations over past few years, the EU, the US, Canada and other developed countries have put specific emphasis on the liberalisation of **financial services**. Any Doha deal, therefore, is very likely to include a push for new commitments in financial services. However, as the world is recovering from severe shocks in the banking system and on international financial markets, and since proposals to reform regulation and supervision of the financial services industry are still being discussed, this paper explains why developing countries should bear in mind the dangers associated with further liberalisation of their financial sectors.

The financial services negotiations – as currently envisioned - will not stabilise financial markets or ensure that financial services are provided to those individuals and sectors which most need it. Their impact is being ignored by the many recommendations that have been made so far to deal with the financial crisis, including by the Basel Committee on Banking Supervision, the International Monetary Fund, the Financial Stability Forum and the financial industry itself.

1. Regulation not ready to allow financial services liberalisation

Governments, financial industry operators and experts agree that, in order to avoid negative impacts from trade liberalisation in the financial sector, adequate regulation needs to be in place before liberalisation. However, the 10 pages of recommendations[1] proposed by the Financial Stability Forum (FSF)[2], among others, demonstrate that many regulatory issues still need to be resolved.[3] The FSF recommendations[4] also indicate the current inadequacy of international cooperation among regulators and supervisors of internationally operating banks and other financial conglomerates.

The focus of GATS negotiations on financial services has been on increasing liberalisation, while ignoring the issue of right regulatory frameworks at the national level, and without providing support for adequate regulation in developing countries. The most glaring case is provided by the EU's request that some countries such as Brazil, Chile and India liberalise according to the far-reaching GATS' *Understanding on Commitments in Financial Services*[5] which requires that foreign financial service providers be given permission to introduce any new financial service.

A Doha deal might thus push developing countries to liberalise all kind of financial services without having the necessary regulations in place. For instance, the collective request on financial services made by a group of industrialized countries led by Canada required various developing countries to permanently open their markets for trade in "derivative products including, but not limited to, futures and options", as well as investment banking and (collective) asset management. However, these financial services products have shown during each financial crisis to be too little regulated, thereby contributing to financial instability.

2. The risks of liberalisation commitments

Once governments have made a GATS market access commitment on a particular service sector, the jurisprudence from the *US-Gambling* case makes it clear that they violate their obligations if they reverse liberalisation and ban the supply of any part of that service sector. In the financial services sector, this ruling means that GATS commitments prevent governments from prohibiting particular financial activities they consider having negative effects or being inadequately regulated. Government interventions in financial markets to curb speculative activities in times of high prices would be open to challenge if that government had committed financial sectors under the GATS.[6]

Within a context where financial regulation and supervision are clearly inadequate, the efforts by the chair of the GATS services negotiations to ensure more liberalisation commitments with "no a priori exclusion of any service sector or mode of supply"[7] is not appropriate. The continuing push from developed countries in the currents stage of the GATS negotiations requiring developing countries to bind existing commitments ---which is reflected in the brackets of paragraph 4 of the Annex in the new report by the chair of the services negotiations as well as efforts to hold a signalling "exercise"[8]--- completely ignores the risks of increased financial instability that would result from their proposals.

One should bear in mind that the EU and US negotiation requests are based on appeals from the financial industry lobby to create more permanent market access as well as introduce GATS rules that prevent governments from intervening in their profit making strategies. The financial industry has, for many years, developed an expansion strategy as the most important way to increase its profits. It is very influential in the financial services negotiations, among others, due to the lobby by those financial conglomerates whose malpractices resulted in large write-offs in 2007-2008.[9]
3. Prudential regulation under threat from GATS negotiations on financial services
Although the Annex on Financial services of the GATS agreement allows prudential regulation in the financial sector, e.g. to protect depositors, this cannot be done in a way that is considered to undermine liberalisation commitments. The vagueness of this prudential carve out has resulted in some developing countries facing GATS requests by the EU to eliminate many of the regulatory measures they had put in place after a financial crisis, for instance measures that oblige foreign banks to keep money reserves in the host country.[10] Such provisions are aimed at contributing to financial stability and avoiding liquidity problems in times of crisis. Indeed, many of the regulatory reform proposals made in 2008, for instance by the Financial Stability Forum, include requiring banks to increase their capital reserves. If the GATS negotiations had been concluded with developing countries agreeing to the EU requests, some countries might have been more vulnerable to the financial crisis as international banks would have used all their capital reserves coming from different countries around the world.

The current draft GATS text on disciplines in domestic regulation indicates that measures and standards in the financial sector could be challenged in the future on a variety of grounds, such as being not "objective", "relevant", or acting as a disguised restriction on trade. The new text by the chair of the services negotiations issued on 26 May 2008 calls for the completion of the domestic regulation text before the negotiations end. However, the negotiators have so far not been able to ensure that these domestic regulation disciplines are not applied to prudential regulation in financial services. Prudential measures could be severely restricted by the new disciplines, for example licensing procedures for banks would have to be made "as simple as possible".[11] Committing financial services before the new domestic regulation text is finalized may endanger domestic financial regulation. This would increase the uncertainty whether measures that are introduced to avoid a financial crisis and adapted to a country's circumstances, will not be considered (by the financial industry and WTO members) as restrictions to trade.

In addition, GATS rules can increase financial instability once commitments in financial services are made. For instance, GATS Art. XI.1.[12] does not allow countries to restrict international transfers and payments for current financial transactions that are related to services in sectors that were liberalised under the Agreement. GATS rules permitting restrictions on unstable capital flows are limited by many conditions in Art. XI.2, Art. XII and Art. XII.2. This undermines the room of manoeuvre of Central Banks such as Chile 's Central Bank which requires authorization before dividends can leave the country, which is forbidden under Art. XI (the EU has therefore requested Chile to eliminate this measure). The GATS market access rules that prohibit –except if a country has made exemptions- for instance limitations on the total value of service transactions or assets (Art. XVI.2.(b)) can also undermine measures to limit damage from the instability of speculative operations and products.

The problem is that negotiations on offers and requests are secret and subject to bargaining or arm twisting, while financial stability regulators might not be involved during such negotiations.

4. Financial services liberalisation might perpetuate the food crisis

Many studies (e.g. by the World Bank[13] and the IMF[14]) have shown that the opening of developing countries' markets to the establishment of foreign banks often leads to limited access to credit by small and medium sized industries, and by small and poor farmers. Such practice is in contradiction with a broad agreement in the international community, that increasing agricultural production in developing countries will be a key step towards addressing the root causes of the 2008 food crisis[15]. Improving farmers' access to credit plays an important role in making that possible. In times of crisis and risks (credit crunch), banks tend to lend less, especially to poor and "risky" farmers, thus further undermining food production and aggravating the food crisis.

The promotion by the financial industry of derivative trading in key agricultural commodities has been considered as contributing to the high food prices that makes food unaffordable to the poor. Over the past year, India has banned 'futures' trading in key agricultural commodities over concerns that speculation has caused sharp increases in the price of food staples like lentils, wheat, and rice. However, such interventions by India or other countries on financial markets to curb speculative activities on basic food staples could be challenged under the GATS dispute settlement once these countries have made commitments on these financial services.[16] It should be noted that quite a number of developing countries already received individual and collective GATS requests to make commitments in derivative services and some have offered to do so (e.g. South Africa). Developing countries would have to anticipate all areas where it might potentially want to restrict futures trading, (e.g. commodity futures), and include these as limitations on their commitment schedules. Otherwise, the ability to impose such restrictions would be lost.

Conclusion

The industrialised country arguments that the foreign financial industry will contribute to more efficiency and development in developing countries is to be challenged by many practices that lead to financial instability and misallocation of resources, including speculative products whose trade is remunerated with excessive bonuses while credit is lacking for domestic agricultural production.

As the world is still assessing the instability of the international financial markets, and has not introduced the necessary measures to mitigate the current financial crisis and avoid future crises, more commitments on the financial services would be a dangerous strategy to conclude the Doha negotiations. The texts of 26th May issued by the chair of the services negotiations to insist on further liberalisation commitments with "no a priori exclusion of any service sector or mode of supply" and finalising the domestic regulation disciplines is not in developing countries' interests. Drawing from the lessons of the recent financial crisis, it seems obvious that it would be unwise to commit to further liberalising financial services under GATS or free trade agreements. Such liberalisation should not be done through secretive bilateral GATS negotiations. At the same time, developing countries should become participants in all international standard setting bodies so that their needs can be incorporated in reforms of the financial industry.

For more information, Myriam Vander Stichele, Senior Researcher, Centre for Research on Multinationals (SOMO) can be contacted at: m.vander.stichele@somo.nl, +3120 6391291; or see www.somo.nl **and** www.ourworldisnotforsale.org/theme.asp?search=GATS

[1] Financial Stability Forum, *Enhancing market and institutional resilience*, April 2008, Annex A: available for downloading at: http://www.fsforum.org/publications/FSF_Report_to_G7_11_April.pdf

[2] The FSF was created in the aftermath of the 1998 Asian financial crisis and brings together on a regular basis national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

[3] Financial Stability Forum, *Enhancing market and institutional resilience*, April 2008, Annex A, recommendation II.11s: For instance, it recommends that "supervisors and central banks will examine the scope for addition steps to promote more robust and internationally consistent liquidity approach for cross-border banks"

[4] Ibidem, see recommendations V.5 to V.13: e.g. V.8 recommends that "supervisors and central banks should improve cooperation and the exchange of information including the assessment of financial stability risks"; recommendation V.5 " The use of international colleges of supervisors should be expanded so that, by end 2008, a college exists for each of the largest global financial institutions.

[5] http://www.wto.org/english/tratop_e/serv_e/21-fin_e.htm

[6] As Ellen Gould points out in a forthcoming analysis for the Canadian Centre for Policy Alternatives.

[7] WTO Council for Trade in Services, "Report by the Chairman – Elements required for the completion of the services negotiations: Annex", WTO New Items, 26 May 2008

[8] WTO Council for Trade in Services, "Report by the Chairman – Elements required for the completion of the services negotiations", WTO New Items, 26 May 2008.

[9] See among others: http://www.ratical.org/co-globalize/WTOhiddenA.html; http://www.ifsl.org.uk/output/TradePolicy-1.aspx in which Morgan Stanley and Citigroup are amongst others, involved.

[10] The EU wants to take away measures by which governments require money reserves to be located by foreign owned bank branches in the country itself. The EU has been requesting to replace existing measures as follows:
- Allow branches to use the parent banks' capital to meet prudential money reserve requirements, e.g. in India.
- Take into account the guarantee extended by the branch's head office or by another foreign bank for additional lending volume, e.g. in India.
- Allow borrower limits to take into account the foreign banks global capital, e.g. in India.
In other words, the EU made requests that money reserves do not need to sit in countries and that capital of a bank sitting abroad can be used for prudential reserves. However, as the experience of several financial crises in Argentina has shown, there is no guarantee that the parent company/bank will transfer the necessary financial reserves in times of a financial crisis in a country in which it did not hold reserves. The EU is requesting to eliminate these local capital requirements because the international banks, and other financial firms, want to use their capital around the world to make as much profit as possible or to use it in times of heavy profit falls in other countries. This is far from taking concerns of developing countries into account.

[11] As Ellen Gould points out in a forthcoming analysis for the Canadian Centre for Policy Alternatives.

[12] Art. XI.1.: " Except under the circumstances envisaged in Article XII, a Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments."

[13] World Bank, Finance for All? Policies and Pitfalls in Expanding Access, Washington, 2008: see pages 77-83 http://siteresources.worldbank.org/INTFINFORALL/Resources/4099583-1194373512632/FFA_book.pdf;

[14] E. Detragiache, T. Tressel, and P. Gupta, "Foreign Banks in Poor Countries: Theory and Evidence", IMF Working Paper WP/06/18, January 2006.

[15] See for example UN Secretary General Ban Ki Moon's speech at CSD on May 14, 2008: http://www.un.org/apps/news/story.asp?NewsID=26670&Cr=sustainable&Cr1=development

[16] As Ellen Gould points out in a forthcoming analysis for the Canadian Centre for Policy Alternatives: see footnote 6 and related text above.