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Memorandum

From: Lori Wallach and Todd Tucker, Public Citizen

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Re: Answering critical questions about conflicts between financial reregulation and WTO rules hitherto unaddressed by the WTO Secretariat and other official sources

In the wake of the worst financial and economic crisis since the Great Depression, diverse government officials, legislators and scholars have been raising questions about the potential for trade and investment agreements to conflict with needed financial services reregulation. Of particular concern are the provisions in the World Trade Organization's (WTO) General Agreement on Trade in Services (GATS), which set limits on the policies WTO signatories can maintain or establish with respect to financial service sectors they have committed to GATS.

This conflict was highlighted in the 2009 report of the UN Commission of Experts on Reforms of the International Monetary and Financial System. The commission was chaired by Nobel Prize winning economist Joseph Stiglitz, and included a host of distinguished academics, including former finance ministers and central bank heads from around the world:

“Agreements that restrict a country’s ability to revise its regulatory regime – including not only domestic prudential but, crucially, capital account regulations – obviously have to be altered, in light of what has been learned about deficiencies in this crisis. In particular, there is concern that existing agreements under the WTO’s Financial Services Agreement might, were they enforced, impede countries from revising their regulatory structures in ways that would promote growth, equity, and stability.” ...¹

Indeed, the GATS – and the financial service chapters of U.S. “free trade agreements” (FTAs) – conflate *liberalization* of financial services with *deregulation*. These pacts’ market access rules specifically forbid maintaining or establishing a list of non-discriminatory regulatory measures with respect to financial sectors countries have committed to liberalization. The pacts also contain provisions setting disciplines on other forms of domestic regulation, such as licensing and technical standards. The pacts impose constraints on the use of capital controls and also discipline facially neutral regulations of general application that might have a less favorable effect on foreign firms and services. (For more information on these rules, please see our report “To Promote Economic Stability, Nations Must Free Themselves from WTO Financial Deregulation Dictates,” available at: <http://www.citizen.org/documents/IntroductionToWTODeregulation.pdf>.)

Thus far, the official responses to the concerns raised about these conflicts have been disappointing. In this memo, we analyze two such inadequate “official responses.” The first is a response by the Obama administration’s Office of the U.S. Trade Representative (USTR) to a question posed by U.S. Senator Ron Wyden (D-Ore.) – a key U.S. legislator who chairs the U.S. Senate Finance

Committee's trade subcommittee. Wyden's questions are particularly notable, since the senator has regularly voted in favor of U.S. trade agreements, and voted for the WTO. In a response to written question posed by Senator Wyden, USTR summarily stated that WTO rules present no limits on financial regulation.

The second response we examine is a document issued by the WTO Secretariat on February 3, 2010 entitled "Financial Services: Background Note by the Secretariat." Many call this paper the "non-response" to over a year of growing questions from WTO member countries and others about the connection between the rules of the GATS on financial services and the global economic crisis.² Indeed, this was the Secretariat's first major study³ in nearly 12 years about the WTO's financial service rules.⁴ The new paper is a disappointment to anyone hoping for a convincing rebuttal to charges that the GATS promotes financial services deregulation. The 76-page document includes a lengthy discussion on the GATS treatment of corporate branches versus subsidiaries, and a very defensive discussion of the crisis' causes (bottom-line, in their estimation: WTO rules are in no way implicated). The paper avoids altogether the question of the WTO compatibility of the types of measures that countries have implemented in response to the crisis. This is despite a formal request in a paper tabled by WTO member countries on September 17, 2009 in the WTO's Committee on Trade in Financial Services,⁵ and via subsequent requests by additional WTO member countries at the General Council in December.⁶ Please see Public Citizen's detailed critique of the WTO Secretariat paper available at <http://www.citizen.org/documents/That%27sAllTheyGot.pdf>

With respect to the question of how GATS rules promoted past financial deregulation and could conflict with reregulation,⁷ several brief points in the Secretariat paper are especially worth highlighting here:

1. The WTO Secretariat did not rebut any of the main concerns about the GATS rules' deregulatory requirements that have been raised as the global financial crisis fostered broad reconsideration of past national and international regulatory approaches.
2. In fact, the WTO Secretariat confirmed many of these concerns.
3. When dealing with a controversial issue on which there is no record of official WTO interpretation with respect to provisions that are at best ambiguous, the Secretariat simply asserted that there is not a problem. They proceed to cite a subset of unofficial sources who offer "don't worry, be happy" arguments, rather than reviewing all of the international law review and other analyses, much less offering thorough legal analysis.

We also briefly examine the historical record – including information on the GATS' regulatory constraints, and a 1990 memo from now-Treasury Secretary Timothy Geithner (then a junior Treasury staffer in the first Bush administration) obtained through an ongoing Freedom of Information Act (FOIA) request by Public Citizen. These documents show that negotiators and legislators do not have to start from scratch when contemplating how the GATS rules conflict with financial regulatory policies, or how to fix this problem.

USTR'S UNFORTUNATE DISMISSAL OF SEN. WYDEN'S GOOD QUESTIONS

Senator Wyden submitted the following written questions after a March 3, 2010 hearing of the full U.S. Senate Finance Committee, at which USTR Ron Kirk testified:

“Some have suggested that the WTO General Agreement on Trade in Services contains rules that can limit the types of financial service regulations we can apply here in the United States. Furthermore, it has been argued that the current WTO rules prohibit regulatory bans and policies that restrict unfettered capital flow, which could make it more difficult to limit the size of financial firms and the types of services and products they provide. What is the USTR’s view about these arguments? Is the USTR considering proposing any changes to WTO rules to ensure that the U.S. is not limited in any way to impose reforms to manner in which financial services are regulated, including stricter prudential standards?”

USTR responded that [for convenience, we number their key points]:

“The WTO and all of our free trade agreements provide flexibility for governments to regulate and to develop new regulations. These agreements [1] also expressly allow the Parties to take prudential measures to ensure the stability of the financial system and to protect depositors; and [2] explicitly preserve the ability of a central bank or monetary authority to adopt measures pursuant to monetary and related credit policies or exchange rate policies. Because U.S. regulatory discretion is already protected by WTO rules, we do not see a need to propose any changes.”

WIDE AGREEMENT ON WEAKNESS OF GATS PRUDENTIAL LANGUAGE

USTR’s airy dismissal of Sen. Wyden’s inquiry relies heavily on a GATS prudential measures defense provision that countries can employ if a financial regulation were challenged as violating GATS policy constraints. This provision – codified in the GATS Annex on Financial Services Article 2(a) – has also been included with minor changes in various FTAs and U.S. bilateral investment treaties (BITs). This provision contains language that is at best extremely ambiguous, and according to some legal scholars, makes the measure almost impossible to use to defend prudential measures that might violate GATS terms. In a paper we produced for the Ford Foundation last year, we argue that several GATS rules related to financial services, including the prudential measures defense provision, urgently require reform. These GATS terms were agreed in the mid-1990s during the height of the deregulation craze. Now, post-crisis, they require alteration to provide policy space for reregulation.

To our knowledge, neither the USTR, Treasury Department, nor the WTO Secretariat have ever released a formal, comprehensive legal analysis of the GATS Annex 2(a) prudential measures defense language, which is systematically cited as the basis for dismissing concerns about the conflict between GATS and financial regulation. When these entities are confronted with questions about this conflict or the prudential provision’s scope, they “reassure” or “cite” unofficial sources as suggesting there is nothing to be worried about.⁸

Yet, the text of the clause, to which USTR’s point number 1 refers, highlights the problem at hand:

“Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. *Where such 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" [italics added].

As the second sentence makes clear, prudential measures *are only allowed* under GATS rules *if they don't violate any of the GATS rules*, which are very expansive, or operate to reduce a member country's commitments or obligations. Yet, a country would only need to employ this defense *if* its financial regulation were challenged before a WTO tribunal as violating GATS rules. Similar restrictions on prudential measures are in place in a dozen bilateral trade and investment agreements negotiated by the Bush administration.⁹

USTR states that U.S. trade agreements "also expressly allow the Parties to take prudential measures to ensure the stability of the financial system and to protect depositors." Yet, a comprehensive literature review spanning two decades of trade law publications conducted by Public Citizen found agreement that prudential financial measures are subject to dispute settlement, and could be ruled against. (To see our report detailing these findings, see <http://www.citizen.org/documents/PrudentialMeasuresReportFINAL.pdf>.)¹⁰ Indeed, while analysts disagree about how the GATS prudential measure defense clause would operate if triggered as a defense, they all agree that it does not prohibit challenges of prudential measures, that it is at best confusing, and that a WTO tribunal would have the final say.

In fact, a North American Free Trade Agreement (NAFTA) case brought against Mexico, which dealt with language similar to the GATS prudential measure defense clause, confirmed this point.¹¹ The target of the NAFTA challenge was a series of measures related to Mexico's bailout of its financial sector: Mexico deemed these "prudential" in nature, while a U.S. insurance firm, Fireman's Fund, claimed they constituted an indirect expropriation (among other violations) requiring compensation under NAFTA. Even though NAFTA does not have the self-cancelling language of the GATS provision, Mexico's prudential measure was still subject to challenge. The NAFTA case indicates that simply deleting the second sentence of the GATS prudential defense is not sufficient, and that a new second sentence that is either self-judging or shifts the burden of proof onto the complainant / claimant is needed to provide a real safeguard for prudential regulation.

As cited in the introduction, the U.N. Stiglitz Commission report called for changes to the global regulatory ceiling imposed by trade pacts like the WTO. Among the report's findings:

"The framework for financial market liberalization under the Financial Services Agreement of the General Agreement on Trade in Services (GATS) under the WTO and, even more, similar provisions in bilateral trade agreements may restrict the ability of governments to change the regulatory structure in ways which support financial stability, economic growth, and the welfare of vulnerable consumers and investors."¹²

"More broadly, all trade agreements need to be reviewed to ensure that they are consistent with the need for an inclusive and comprehensive international regulatory framework which is conducive to crisis prevention and management, counter-cyclical and prudential safeguards, development, and inclusive finance. Commitments and existing multilateral agreements (such as GATS) as well as regional trade agreements, which seek greater liberalization of financial flows and services, need to be critically reviewed in terms of their balance of payments effects, their impacts on macroeconomic stability, and the scope they provide for financial regulation. Macroeconomic stability, an efficient

regulatory framework, and functioning institutions are necessary preconditions for liberalization of financial services and the capital account, not vice versa. Strategies and concepts of opening up developing economies need to include appropriate reforms and sequencing. This is of particular importance for small and vulnerable economies with weak institutional capacities. But there has to be a fundamental change in the presumptions that have guided efforts at liberalization. As noted in previous chapters, one of the lessons of the current crisis is that there should be no presumption that eventually there should be full liberalization. Rather, even the most advanced industrial countries require strong financial market regulations.”¹³

Similar analytical conclusions – if contrary policy recommendations – came from the multinational corporation-dominated Emergency Committee for American Trade. In the group’s comments on the GATS-based prudential language in the U.S. Model Bilateral Investment Treaty, they state that stronger prudential measures language – to allow for capital controls, for instance – would undermine the very policy-restricting purpose of the provision.¹⁴

The WTO Secretariat’s February 2010 paper also makes a number of unwarranted assertions about the GATS Annex Article 2(a) prudential measures language:

- *That it is an “exception” or “carve-out.”* In fact, it is not termed such in the GATS, nor does it operate in such a manner. The provision, entitled “Domestic Regulation”, is a *defense* that may be raised after a country’s policy has been challenged. A “carve-out” is when a country excludes a specific policy or sector from coverage of the rules in its schedule of commitments. When a country has “carved out” a sector or policy, none of the WTO rules apply to it. Nor is the prudential defense an “exception” in the sense that the Secretariat insinuates, that is to say a provision of WTO text that simply defines certain government measures or activities as outside the scope of the relevant agreement. For instance, an actual GATS exception is the very narrow language in Article I(3)(b-c) that states that GATS rules do not apply to a service supplied in the exercise of governmental authority if that service is supplied neither on a commercial basis, nor in competition with one or more service suppliers.¹⁵
- That a measure falling within the provision “would be legally permitted.” Yet, in fact a WTO panel and the Appellate Body that would make such a determination on a case-by-case basis if the provision were raised as a defense in the event of a challenge.
- In trying to dismiss concerns about the second sentence of Article 2(a), the Secretariat paper states: “This provision is clearly intended to avoid abuse in the use of the exception.” The Secretariat is freelancing here: there is no textual basis for thinking that the second sentence of the prudential measures provision is intended only to “avoid abuse.” Indeed, reference to other WTO defense provisions proves the opposite. Textually, the provision states clearly that it is to discipline measures taken for allegedly prudential reasons that “do not conform to the provisions of the Agreement.” In contrast, the WTO has a boilerplate anti-abuse clause that is included in its various defense provisions. This turn of phrase is as old as the General Agreement on Tariffs and Trade (GATT) and appears in various WTO agreements. Its source is the *chapeau* of GATT Article XX: “**Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international**

trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures...” (emphasis added). This exact anti-abuse language appears in Article XIV provisions of GATS itself.¹⁶

- Later in the paper, the Secretariat states: “even if any specific measure could be considered as inconsistent with an obligation or commitment in the GATS, Members could still have recourse to the prudential carve-out, which, as explained in previous sections, recognizes the right of Members to take any measure for prudential reasons notwithstanding any other provisions of the Agreement.” For the reasons noted above, this is a specious claim.

NO AGREEMENT ON DEFINITION OF “PRUDENTIAL”

Many policies that countries apply for prudential reasons may not be considered prudential by other countries or by WTO panels. The types of financial service regulations that have been considered “prudential” range from minimum capital requirements for depository institutions, to leverage restrictions, to various consumer protection policies, and beyond. Many countries’ governments consider restrictions on capital inflows and outflows – both in crisis and non-crisis times – to be prudential in nature.¹⁷ In the GATT Uruguay Round debates, Mexico, India and many other developing countries’ representatives stated that infant industry protection applied to promote the development of domestic financial sectors should be considered prudential in nature.¹⁸ In the current re-regulation debate, there are far-ranging proposals for enhanced consumer protection measures, including the notion of adopting a precautionary principle approach for new financial instruments (i.e. the burden of proof is on the creator of a new financial product to show it is safe and useful to society and thus should be approved by government regulators).¹⁹ Indeed, economists across the political spectrum – from the Keynesian Hyman Minsky to the former Federal Reserve economist John Boyd, a self described “laissez faire” economist – have advocated a variety of regulatory interventions to keep banks small and oriented towards community lending.²⁰

How a WTO panel would rule on a challenge to such measures is unclear, but many governments and corporations have let it be known that they favor sharp limitations on which policies should be considered prudential.²¹ Indeed, some pro-GATS scholars suggest that WTO panels should limit the definition of prudential measures to only Basel II-type requirements.²² (Basel II refers to an agreement reached by central bankers from developed nations – under substantial industry influence – in 2004, which includes highly flawed notions of bank capital adequacy based on banks’ own “internal risk models.”²³) The opening for such a low-road approach provided by the mere presence of WTO-style “disciplines” on domestic regulation can encourage a race to the bottom and lowest common denominator regulation.

MONETARY POLICY NOT PROTECTED FROM CHALLENGE

USTR also stated in its response to Sen. Wyden that the WTO and U.S. trade agreements “explicitly preserve the ability of a central bank or monetary authority to adopt measures pursuant to monetary and related credit policies or exchange rate policies.” This too is an obfuscation of reality. As Bart de Meester, a WTO expert and legal fellow with Belgium’s Institute for International Law, concluded in a recent paper:

“The concept of ‘service’ in the GATS is a broad one and covers ‘any service in any sector except services supplied in the exercise of governmental authority.’ ‘Financial Service’ is defined in the Annex as ‘any service of a financial nature offered by a financial service supplier of a Member’ and a non-exhaustive list of financial services is provided. However, the Annex on Financial Services provides a more specific definition for the excluded services than the one in Article I GATS. The Annex excludes the following activities from the scope of the GATS: (i) activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies; (ii) activities forming part of a statutory system of social security or public retirement plan and (iii) other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government. *Importantly, this does not mean that the measures taken by a central bank or monetary authority or other public entity are outside the scope of the GATS. Activities conducted by a central bank, monetary authority or any other public entity in pursuit of monetary or exchange rate policies are not considered ‘services’ within the scope of the GATS. Hence, if a government adopts a measure that affects such activities, this measure cannot be scrutinised under the GATS. However, if a central bank or monetary authority elaborates an assistance programme, this does not mean that such assistance programme is outside the scope of the GATS (provided it affects trade in services)*” (emphasis added).”²⁴

Indeed, many monetary, credit or exchange rate policy could violate GATS Article XVI market access or Article XVII national treatment terms, and thus affect “trade in services.” This possibility was noted in a memo by current Treasury Secretary Geithner in his early career at Treasury (as we detail below). And other WTO members are already scrutinizing the dozens of U.S. bailout measures for their GATS consistency,²⁵ while a wide range of policy experts on all sides of the trade debate are calling for WTO cases against China’s exchange rate policy²⁶ – a key monetary measure by that country.

DEEP CONCERNS OVER SCOPE OF GATS CAPITAL CONTROL PROVISIONS

In the wake of the financial crisis, even the International Monetary Fund (IMF) is revising old opinions, and suggesting that capital controls could be beneficial for addressing destabilizing financial flows.²⁷

Yet, on pages 3-6 of its paper, the WTO Secretariat discusses capital controls, and notes:

“Although its main focus is on the *liberalization of trade in financial services*, the GATS could require individual Members to allow *capital movements* associated with a broad range of – primarily – financial services, depending on the level of specific commitments undertaken...

“Cross-border trade in some other services, for example, acceptance of deposits, lending, or trading in securities, is inseparable from capital movements. Hence, liberalizing such services transactions requires the liberalization of the related capital flows to make the transactions effective...

“restrictions on transfers and payments for current transactions must not be maintained where a Member has made a commitment on financial services...

“Members undertake not to impose restrictions on any capital transactions inconsistently with its specific commitments regarding those transactions.”

Here, the Secretariat confirms a very serious concern: that the GATS creates obligations to simply eliminate whole categories of non-discriminatory regulations. Stated differently, GATS commitments implicitly require capital account liberalization – which has been shown NOT to be associated with economic growth in developing countries, and leaves them prone to financial instability.²⁸

The problems do not end there. The Secretariat states that, “The GATS does not define terms such as ‘payments and transfers for current transactions,’ ‘current transactions,’ ‘capital transactions,’ ‘movement of capital,’ or indeed ‘restrictions.’” In contrast, definitions for such terms do exist through the IMF and other bodies. The lack of definition in the GATS text of the term “restriction” is especially troublesome, since it could encompass reregulatory measures that are being widely discussed at the moment, such as financial transaction taxes (FTT).²⁹ An FTT, by contrast, would explicitly not be considered a prohibited “restriction” under the IMF Articles of Agreement, since the IMF defines “restriction” as “a direct governmental limitation on the availability or use of exchange as such.”³⁰

The GATS disciplines on capital management techniques could impair countries’ ability to guarantee financial stability through transaction or speculation taxes, as the European Commission recently noted in a staff working paper on the topic:

“the compatibility of such a levy with Article XI of the General Agreement on Trade in Services (GATS), which provides that WTO Members cannot apply any restrictions on international transfer and payments for current transactions relating to their specific commitments, would have to be further assessed. As the EU has taken specific commitments relating to financial transactions, including lending, deposits, securities and derivatives trading and these commitments relate to transactions with third countries, a currency transactions tax could constitute a breach of the EU's GATS obligations.”³¹

The meaning of GATS Article XI was explored in the 2004 WTO panel report in *US – Measures Affecting the Cross-border Supply of Gambling & Betting Services* case (Antigua’s successful challenge of the U.S. ban on Internet gambling). In the case, Antigua alleged that:

“the United States maintains measures that restrict international money transfers and payments relating to the cross-border supply of gambling and betting services. In particular, Antigua points to the laws of the state of New York that render contracts that are based on wagers or bets void as well as an example of an ‘enforcement measure’ taken by the New York Attorney General against a financial intermediary that provides Internet payment services. In Antigua’s view, the purpose of these measures is to prevent foreign suppliers of gambling and betting services from offering their services on a cross-border basis. Antigua argues that, therefore, these measures violate Article XI:1 of the GATS.”

The WTO panel provided its view of the GATS Article XVI constraints on policies that limit capital flows:

“Article XI has not, as yet, been the subject of interpretation or application by either panels or the Appellate Body. In light of this and taking into account the limited facts and arguments submitted by the parties with respect to Antigua's claim under Article XI, we believe that there is not sufficient material on record to enable us to undertake a meaningful analysis of this provision and its specific application to the facts of this case ... However, the Panel wants to emphasize that Article XI plays a crucial role in securing the value of specific commitments undertaken by Members under the GATS. Indeed, *the value of specific commitments on market access and national treatment would be seriously impaired if Members could restrict international transfers and payment for service transactions in scheduled sectors. In ensuring, inter alia, that services suppliers can receive payments due under services contracts covered by a Member's specific commitment, Article XI is an indispensable complement to GATS disciplines on market access and national treatment*” [italics added].³²

There is significant concern that the GATS Annex 2(a) prudential defense language would not provide any safe harbor for capital management techniques. This was the conclusion of two University of Zurich Law School scholars whose writings tend towards supportive of the current WTO regime. In a recent study of the provisions, Rolf Weber (a WTO panelist) and Christine Kaufmann wrote:

“The right of a member to issue or maintain such prudential regulation seems to find its limits in Article XI GATS. Indeed, paragraph 2 of the Annex on Financial Services underlines that the prudential carve-out should not be used to avoid commitments or obligations under the GATS Agreement. This sheds uncertainty on the relationship between the Annex on Financial Services and the GATS, in particular Article XI GATS. The issue is well illustrated by the current request from the EC to Chile to lift its requirement that a prior authorization by the Central Bank is necessary before profit repatriation to be allowed. Such restrictions are indeed considered by the EC to be in breach of Article XI... If this provision is interpreted as prevailing over the prudential carve-out, it seems to prevent countries from taking prudential measures with respect to payment in transfers, in fact measures, which could be ‘nevertheless very effective for dealing with financial stability.’”³³

This GATS conflict with domestic capital management techniques was noted by the Stiglitz Commission and is detailed in another Public Citizen memo available at <http://www.citizen.org/CapitalControlsMemo>).

GATS RULES PROHIBIT REGULATORY BANS

The recent crisis has resurrected the notion that some types of financial services or products are so dangerous and so lacking in social utility that they should simply be banned. The U.S. Securities and Exchange Commission is proposing such measures in regards to naked short selling and flash trading.³⁴ Germany has implemented a ban on speculative short-selling. The European Centre for International Political Economy has said that Germany's ban could be a WTO violation not

defensible under the prudential measures defense provision, on the basis that (while non-discriminatory) it is more regulation than is being pursued by other countries.³⁵

One of the major concerns in regards to the GATS conflict with reregulation is the WTO Appellate Body ruling in Antigua's challenge of the U.S. ban on Internet gambling. The United States prohibited both U.S. *and* foreign gambling companies from offering online gambling to U.S. consumers. This non-discriminatory regulatory ban was ruled to constitute a "quota of zero" and thus to violate GATS market access requirements.³⁶ Unlike some areas of concern with the GATS, this one actually had jurisprudence associated with it³⁷ that confirms many concerns raised by GATS critics, and also by academics and practitioners such as Panagiotis Delimatsis (an academic who has argued in favor of stringent GATS domestic regulation disciplines), Joost Pauwelyn (a legal advisor to the WTO Secretariat from 1996-2002), and Federico Ortino (an expert in WTO and investment law).³⁸

Far from dispelling concerns that the GATS rules could be used to challenge a financial regulatory ban, the Secretariat in its February 2010 paper says: "an outright prohibition to provide a certain financial service would be a trade measure subject to scheduling under the GATS" (page 5). In other words, if a country's deregulation-prone government did not think to schedule a ban during the 1990s (as the U.S. did with respect to securities and derivatives, but *only* for onions futures), imposing a ban now in a committed sector would put the country in violation of its GATS commitments.

FIREWALLS AND TOO-BIG-TO-FAIL MEASURES

In the wake of the crisis, commentators from Paul Volcker to Simon Johnson to John McCain agree that banks got "too big to fail," and that firewalls and other size limitations need to be reinstated.

But the GATS Article XVI(2) Market Access rules could limit countries' ability to impose firewalls between distinct service sectors, such as between banking and securities, or between banking and insurance. Such firewalls could be seen as a prohibited limitation on the total value of service transactions or assets (covered by Article XVI(2)(b)), or on the total number of service operations or on the total quantity of service output (covered by Article XVI(2)(c)), or a prohibited measure which restricts or requires specific types of legal entity or joint venture through which a service supplier may supply a service (covered by Article XVI(2)(e)). Indeed, a WTO panel has never ruled to the contrary.

This and related points have been made by scholars such as Markus Krajewski and Petros Mavroidis (formerly a lawyer at the WTO Secretariat) who are notably not cited in the WTO Secretariat's paper, despite reference to numerous other opinions from outside the WTO jurisprudence, official documents and the Secretariat.³⁹ Moreover, there are provisions in the Understanding on Commitments in Financial Services (a document adopted by most OECD countries that entails additional market access and deregulation commitments) which could restrict firewalls. Indeed, the United States also explicitly committed to "reform" the Glass-Steagall Act in its GATS financial services schedule of commitments.

The February 2010 WTO Secretariat paper mentions these various provisions in passing, but does not explore their GATS compatibility. In fact, the Secretariat appears to suggest that new firewalls could indeed violate GATS commitments: after discussing the possible interest by member

countries in such policy tools, the Secretariat worryingly notes that “even if any specific measure could be considered as inconsistent with an obligation or commitment in the GATS,” a country facing a WTO challenge could invoke in its defense before a WTO tribunal what the Secretariat called an “exception” related to prudential measures.⁴⁰ (Per above, this clause is a defense, not an exception, and its text is highly ambiguous at best.)

Moreover, the Secretariat also appears to dismiss firewalls as a useful regulatory device. The Secretariat oddly excludes the removal of New Deal-era firewalls as a contributing root cause to the crisis, but then adds patronizingly that such “regulatory initiatives seem genuinely motivated by the need to avoid systemic risk.”⁴¹

CERTAIN FORMS OF DOMESTIC REGULATIONS NOT SUBJECT TO SCHEDULING

At several points, the Secretariat in its paper notes that many kinds of domestic financial service regulation (specifically mentioning capital controls) cannot be scheduled as limitations on GATS obligations.⁴² Indeed, according to the GATS Scheduling Guidelines, any non-Market Access or non-National Treatment measure falls under GATS Article VI, which covers “Domestic Regulation.” The constraints on domestic regulation set forth in Article VI automatically apply to any service sector that has been committed under the GATS Market Access or National Treatment provisions. The Secretariat’s point is that certain forms of domestic regulation cannot be listed as exceptions in countries’ schedules. In other words, if capital control, interest rate, minimum capital or any other financial rules violate GATS terms, they must simply be eliminated or brought into conformity with the GATS. This is another way that the GATS promotes deregulation.

DIPLOMATIC RESTRAINT AS A SAFEGUARD AGAINST CHALLENGES OF FINANCIAL PRUDENTIAL MEASURES IS OVERSTATED

Another of the arguments embedded in claims that the WTO financial service provisions do not eliminate countries’ prudential policy space is that, as a former U.S. regulator noted, only governments can bring WTO cases.⁴³ That is to say, governments would operate under some sort of diplomatic screening process that would result in certain fights not being picked because a government would take into consideration that an attack on another country’s prudential regulation could later boomerang into an attack on that country’s own policies.

This is a highly debatable notion. Both the U.S. Congressional Oversight Panel on the Troubled Asset Relief Program⁴⁴ and G-20⁴⁵ have suggested that legislation that tackles tax and regulatory havens is related to financial services reregulation. But Panama made a recent announcement that a major plank in its effort to be removed from tax haven watch lists is to launch WTO cases against countries that put them on such lists.⁴⁶ (Panama has previously commented in WTO sessions that countries that place limits on the financial service transactions of countries deemed tax havens are violating WTO rules.)⁴⁷ Some countries’ whose economies are highly dependent on tax havens (such as Aruba, Liechtenstein, the Netherland Antilles and Switzerland) have taken deep commitments under the GATS Understanding on Commitments in Financial Services.

In sum, countries whose economies revolve around offshore activities may conclude that the *real economic* costs of stoically suffering anti-tax haven measures outweigh the *theoretical diplomatic* benefits of keeping quiet at the WTO. Indeed, this is proven by the case of Antigua, which decided

to prioritize its economic interests in offshore gambling revenue over predictable U.S. fury when it challenged U.S. Internet gambling measures at the WTO.

WTO FINANCIAL SERVICES PROVISIONS LOCK IN DEREGULATION

Former U.S. Treasury official Barry Newman, who went on to work at Bear Stearns, was unusually candid in his assessment of the benefits of NAFTA-style trade pacts. He told a 1993 congressional hearing on NAFTA financial services provisions that:

“future Mexican governments may change, and they may not have the same attitudes of the current government. The benefit of NAFTA is that it will lock into an internationally legally binding and enforceable agreement the kinds of changes that the present government is seeking and that we are strongly encouraging so that it will be very much more difficult for future governments to pull back from what is now being developed in the context of the NAFTA.”⁴⁸

It would be difficult to find a clearer exposition of the real dangers associated with including legally binding limits on domestic financial service regulation in trade pacts. When the WTO financial services provisions were negotiated and implemented, there was a prevailing consensus that the shift to deregulation would be permanent. This consensus has been all but swept away after the 2007-09 financial meltdown, but the binding trade obligations remain.

WIDE CONSENSUS FOR CLARIFICATION OF GATS OBLIGATIONS

As some of the quotations above indicate, even WTO defenders argue that renegotiation of the GATS rules on domestic prudential regulation of financial services would be useful. They acknowledge that leaving the definition of acceptable prudential measures up to a WTO panel risks the legitimacy of the entire system. As leading GATS proponents Pierre Sauvé and James Gillespie have written, there should be some “clarification of the boundaries of the ‘prudential carve-out,’” and note that “it would be far better (in terms of regulatory legitimacy) for such a clarification to arise from a negotiated understanding among regulators than from a panel ruling (regardless of the degree of financial expertise panelists might have).”⁴⁹

And the IMF, which is generally in favor of increased trade in financial services, appears to agree. As Deborah Siegel, senior IMF counsel, has written, the GATS lacks clear definitions of what types of capital controls the agreement restricts, and could result in a situation where IMF-approved or IMF-allowed policies could be GATS violations. She states: “Leaving issues of the Fund / WTO relationship to the WTO’s dispute settlement panels effectively amounts to allocating the conduct of international relations to judges; experience shows that the judicial process alone cannot properly ensure coordination between international organizations.”⁵⁰

Thus, both WTO critics and defenders share an interest in renegotiating the space for prudential policies in the GATS.

ALTERNATIVE GATS FRAMEWORKS FOR PRUDENTIAL MEASURES WAS CONSIDERED

When thinking of how to reformulate a balanced prudential carve-out that truly protects reregulation, legislators need not delve into any radical tomes.

In the Uruguay Round negotiations, there were several alternative proposals for a WTO financial services prudential *exception* that would have more fully protected financial stability policies, but these were rejected in favor of the current GATS language.

In June 1990, Felipe Jaramillo, the Colombian diplomat in charge of the Uruguay Round services negotiations, proposed five options for a carve-out provision that could protect countries' financial stability measures. Each of these options would have entailed more policy space than what the United States and other developed country governments desired and eventually obtained in the WTO text. According to the negotiators' meeting minutes (the only record we have of this debate), the options...

“ranged from narrow to broad in scope. The first option provided for a prudential carve-out limited to a qualified national treatment provision. The second option was broader, permitting all ‘reasonable’ prudential and fiduciary measures. Option three was a variation of option two, enumerating examples of permissible measures. Option four provided for an unqualified right to take such measures. Option five aimed at defining as precisely as possible the prudential actions that would be permitted, so as to reduce legal uncertainties.”⁵¹

Similarly, the negotiating history of the Uruguay Round showed that countries contemplated – and ultimately rejected – versions of the text that would have allowed countries to maintain capital controls. The chair of the Uruguay Round Working Group on Financial Services had outlined four negotiating options:

“The latter paper listed four options relating to payments and transfers matters, ranging from the obligation to freely permit all payments and transfers related to the provision of financial services which were liberalized under the agreement (option 1) to the ‘no obligation’ option (option 4). An intermediate option (option 2) would permit restrictions on current payments that were in conformity with the regulations of the IMF, as well as restrictions on capital account transaction that were necessary because of severe balance-of-payments problems. Option 3 would combine a grandfathering of existing restrictions on payments and transfers with option 2, applicable to new restrictions.”⁵²

Option 3 or 4 would have provided more policy space than the resulting Option 2 of the final GATS text, and yielded rules consistent with the IMF Articles. Yet the European Commission, for one, noted that it was precisely *because* the IMF Articles of Agreement contained “no direct obligations applied to restrictions on capital movements” that these new disciplines were needed. The EC worried that “Restrictions on payments and transfers could be imposed for reasons other than current account/balance of payments difficulties, such as monetary policy concerns, particularly in foreign exchange and/or capital markets, disturbances in the conduct of monetary and exchange rate policies, etc.” and wanted to ensure that any such restrictions should be “monitored against the backdrop of agreed disciplines” and “should be limited in nature and time.”⁵³

In September 1990, the Malaysian delegation circulated a proposal for a GATS structure that was also endorsed by Indonesia, Thailand, Nepal, Sri Lanka, Korea, the Philippines, and Singapore to the members of the GATT “Working Group on Financial Services including Insurance.” The maintenance of prudential measures was a theme throughout,⁵⁴ and the proposed text read:

“(v) Domestic regulation (prudential regulation)

Compliance of the MFTS and sectoral annotations on financial services should not impinge on a supervisory authority’s right to:

- (a) Exercise adequate and proper supervision over the foreign financial institutions operating in its country;
- (b) Implement rules and regulations to ensure that foreign financial institutions maintain sound and prudent practices and policies;
- (c) Take necessary action for the protection of depositors and investors; and
- (d) Allow flexibility to governments to impose measures for maintenance of stability in the financial system.

Measures taken for prudential reasons should not be subject to any dispute settlement procedure.”⁵⁵

FOIA DOCUMENTS SHOW EVEN GEITHNER THOUGHT MORE POLICY SPACE WAS NEEDED

Even the U.S. government had advanced GATS proposals more protective of policy space. As documents released to Public Citizen under FOIA indicate, as early as April 1990, an under-30 year old Treasury Department official named Timothy Geithner raised the possibility that Glass-Steagall firewalls, state level regulations, and other prudential measures could be challenged under the new global rules... if the rules were insufficiently deferential to national regulators.⁵⁶ The GATS draft that the first Bush administration had tabled by that time was less expansive than the final product: it defined market access and national treatment narrowly to target only overtly discriminatory conduct.⁵⁷

What a difference a few years can make. By December 1991, the WTO financial services terms would be completed, and would include, for covered sectors: a ban on regulatory bans, even non-discriminatory ones (i.e. simply forbidding a hazardous activity in a covered sector); a ban on size limits on banks or other financial service providers; a ban on measures to stem capital floods and flights; and a ban on non-discriminatory measures that inadvertently “modify the conditions of competition in favor of services or service suppliers” in the domestic market. (The first three examples refer to the GATS Market Access Article XVI obligations; the last example refers to the National Treatment Article XVII obligations.)

The Bush and Clinton administrations agreed to conform a vast array of U.S. financial services to these rules, and would further commit to the Understanding on Commitments in Financial Services and its extreme deregulatory provisions. The Understanding includes a “standstill” provision which binds its adopters from creating new regulations (or reversing past deregulation) in a variety of ways. They would also commit to allow in “new financial services” – no matter their risk level. Geithner, who had originally worried about the compatibility of GATS with non-discriminatory regulations, was dispatched to sell the more intrusive version of the GATS. A November 24, 1997 document obtained through FOIA show that Geithner was urging his then-boss, Deputy Treasury

Secretary Larry Summers, to call Goldman Sachs and other corporations to gauge support for the GATS talks.⁵⁸

CONCLUSION: LOOKING FORWARD

The WTO threat to financial services reregulation is far from a hypothetical concern, as the European Commission report citing the conflict between GATS and a financial transaction tax noted above shows. Threats about WTO compatibility problems have been raised with respect to other countries post-crisis financial service policies, including, among others, Ecuador's anti-tax haven measures, Germany's ban on speculative short selling, and various U.S. bank bailout policies. And, as the final WTO Appellate Body ruling reaffirmed in Antigua's successful challenge of the U.S. ban on Internet gambling, regulatory bans are prohibited by the GATS; the panel in the same case noted that cross-border financial flow restrictions are subject to GATS disciplines. The existing conflicts must be identified and resolved in favor of WTO member countries having the policy space they need to restore financial stability via reregulation. And, no additional GATS rules limiting financial regulation nor commitments of financial sectors under the existing rules must be included in the Doha Round.

Yet, first, the existing GATS restrictions on financial services regulation could become even more intrusive on domestic policy space if the current WTO Doha Round agenda is completed. The pre-crisis demands by the Bush administration for further financial service commitments under the current deregulatory rules remain on the table as the U.S. position 18 months into the Obama administration. Indeed, even as the Obama administration prioritizes financial reregulation at home in the wake of the financial crisis proving the deregulation model misguided, USTR has actively pressed other countries to make deeper deregulatory commitments in financial services... The United States remains a signatory to a Doha Round plurilateral request on financial services offered in 2005 that includes a demand for all WTO countries to submit additional financial sectors to the GATS regulatory constraints. Geneva-based WTO negotiators from several other countries have reported to us that more financial service sector commitments, including those that extend beyond the plurilateral request, are among the top demands made to them by USTR officials in 2009 and 2010 during discussions of U.S. expectations for concluding the Doha Round. As *Inside U.S. Trade* reported in October 2009,

“The U.S. has made clear that, under this new approach [on sectoral service offers], existing plurilateral requests would still remain on the table, sources said... In an Oct. 12 speech at a services business conference in Washington, USTR Ron Kirk highlighted that the U.S. needs further concessions on services from key trading partners. ‘But we believe that the biggest gains for the global economy are likely to derive from the multilateral services liberalization, and the offers on the table, frankly, in the services sector just aren’t there,’ he said.”⁵⁹

And in the March “2010 Trade Policy Agenda,” USTR wrote that “improved packages in services (providing new market access in key infrastructure services sectors such as financial services ...)” is key to moving Doha forward.⁶⁰

Second, a GATS “Working Party on Domestic Regulation” continues to work out text in Geneva that would impose additional disciplines on permissible domestic regulations. In these talks, some countries are pushing hard to force a “necessity test” for *all types* of domestic regulation, not only

the types of policies covered by the market access, national treatment and Understanding provisions noted above.

Third, awaiting adoption as part of the Doha Round is also new WTO “*Disciplines on Domestic Regulation in the Accountancy Sector*,” which include the necessity test. The fallen Arthur Andersen firm (of Enron accounting scandal fame) helpfully revealed to the *New York Times* their role in devising these rules, which could undermine legitimate domestic regulations in that key sector.⁶¹ All sorts of conflict-of-interest and other accounting rules that have significant impact on multinational corporations could be deemed to fail the necessary test.

An agenda for reform looking forward would begin with the principle of “first, do no harm.” These three initiatives must be shelved, along with other requests to commit to deeper GATS disciplines on non-discriminatory regulations.

This will help avert the most immediate damage. But more is needed. The concerns expressed by the European Commission, the UN Stiglitz Commission and others show that a reworking of the prudential measures language is necessary. The negotiating history points to several alternative GATS provisions that would be more protective of policy space. As well, the U.S. bipartisan Trade Reform Accountability Development and Employment (TRADE) Act states that investment provisions of future trade deals should “allow each country that is a party to the trade agreement to place prudential restrictions on speculative capital to reduce global financial instability and trade volatility.” This bill – cosponsored by a majority of House Democrats, committee chairs, and subcommittee chairs across a range of caucuses, and by nine Senators – provides a roadmap that has already achieved wide consensus in the U.S. Congress. And, as Public Citizen has studied the question of the GATS prudential measures defense provision and reviewed the alternatives under past discussion, we developed a proposed alternative provision that could provide more meaningful safeguards, while also hedging against abuse:

“2. Domestic Regulation: (a) Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from adopting or maintaining measures relating to financial services it employs for prudential reasons, including for the protection of consumers, investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or to ensure the integrity and stability of the financial system. For greater certainty, if a Party invokes this provision in the context of consultations or an arbitral proceeding initiated under the Dispute Settlement Understanding, the exception shall apply unless the Party initiating a dispute can demonstrate that the measure is not intended to protect consumers, investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or is not intended to ensure the integrity and stability of the financial system.”

Finally, as detailed more exhaustively in another Public Citizen report (available at: <http://www.citizen.org/documents/IntroductionToWTODeregulation.pdf>), the GATS Market Access rules require modification so as to separate out the deregulatory requirements from the market access commitment terms. In other words, those rules must be altered so that countries that choose to liberalize retain their ability to utilize the policy tools (limits on size, firewalls, legal form requirements) now forbidden even if applied on a non-discriminatory basis with respect to any sector committed to liberalization in GATS Article XVI. Finally, as we describe in the paper noted

above, the extreme deregulatory terms of the Understanding on Commitments in Financial Services are simply inappropriate given the unfortunate lessons the global financial crisis has delivered about this deregulation model. The Understanding should be scrapped.

ANNEX: WTO SECRETARIAT PAPER DOES NOT REBUT MAIN CONCERNS ABOUT GATS

As noted above, the WTO's February 2010 paper failed to address many of the concerns of GATS critics. Those who defend the WTO but are also sensitive (either for political or substantive reasons) to charges that the agreement promotes financial deregulation might have wished that the Secretariat had made several points to shut down specific concerns that have been raised.

Here's a Top 13 list of claims the WTO's defenders would have liked the Secretariat to make, but which it did not, because it cannot:

1. That GATS rules only require that foreign firms be treated like domestic firms, and that a WTO panel would never rule against a non-discriminatory domestic regulation.
2. That WTO panels have already established that countries are free to adopt non-discriminatory financial services regulations without risking GATS challenges.
3. That any policy that is permitted by the so-called "international financial regulatory bodies" (like the Basel Committee for Banking Supervision, IMF, etc.) is automatically allowable under the GATS, and that the WTO just imports the definitions and disciplines of these more knowledgeable bodies.
4. That countries can ban financial services they fear are toxic, even if past governments signed up these sectors (perhaps inadvertently) to the GATS.
5. That GATS contains no disciplines for capital controls that many developing countries are now seeking to use, and that countries now desiring to restrict capital flows (through financial transaction taxes or other means) can simply add these as limitations to their schedule in the Doha Round negotiations.
6. That the Doha Round does not entail deeper financial services commitments.
7. That the bank bailouts of the last two years present no GATS conflicts.
8. That the Standstill provision in the Understanding on Commitments on Financial Services does not amount to a lock in of the regulatory status quo in place in the 1990s.
9. That monetary policies, such as those of the U.S. Treasury Department or Federal Reserve, are not subject to GATS disciplines.
10. That countries that fear that past governments overcommitted domestic financial service sectors to GATS rules at the height of the deregulation craze can withdraw those sectors without having to pay compensation to other WTO members.
11. That anytime a country adopts a financial services policy for prudential reasons, then there is no way that this policy can be challenged at / ruled against by a WTO panel.
12. That the GATS has been determined by a WTO panel to not restrict countries from adopting firewalls between commercial and investment banks (as the United States did under the Glass-Steagall Act and later amendments).
13. That the GATS has been determined by a WTO panel to not apply to policies limiting the size of individual firms.

Indeed, the Secretariat would not have been able to support the above points, even had it wished to, which is why changes to the GATS are urgently needed.

ENDNOTES

¹ Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System, September 2009 Report, at 38-39. Available at: http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf, at 104-105.

² See, for instance, “Discussion Document by Argentina, India and South Africa on the Financial Crisis and Related Matters,” WTO Document, Sept. 17, 2009; and Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System, September 2009 Report, at 38-39. Available at: http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf. See also: Americans for Financial Reform, “Global Issues Paper, June 2009. Available at: <http://ourfinancialsecurity.org/issues/working-in-the-international-system/>

³ WTO, “Financial Services,” Background Note by the Secretariat, S/C/W/312 and S/FIN/W/73, Feb 3, 2010. The paper is available at: <http://docsonline.wto.org/DDFDocuments/t/S/FIN/W73C.doc>

⁴ Previous major studies included a 1989 Note by the GATT Secretariat entitled “Trade in Financial Services” (GATT Document MTN.GNS/W/68, dated Sept. 4, 1989), and a 1998 Background Note by the WTO Secretariat entitled “Financial Services” (WTO Document S/C/W/72, dated Dec. 2, 1998). Smaller studies include a 1996 Note by the WTO Secretariat entitled “Technical Issues Concerning Financial Services Schedules” (WTO Document S/FIN/W/9, July 29, 1996) and an Informal Note by the Secretariat attached to the 2001 GATS Scheduling Guidelines (WTO Document S/L/92, March 28, 2001).

⁵ WTO, “Discussion Document by Argentina, India and South Africa on the Financial Crisis and Related Matters,” WTO Document, Sept. 17, 2009.

⁶ WTO, “General Council - 17 - 18 December 2009 - The Financial and Economic Crisis and the Role of the WTO - Communication from Argentina, Ecuador and India,” WTO Document WT/GC/W/617/Add.1, Dec. 15, 2009.

⁷ For simplicity, references in the paper to the GATS conflict with regulations refer to conflicts with respect to covered sectors.

⁸ See WTO, “Financial Services,” Background Note by the Secretariat, S/C/W/312 and S/FIN/W/73, Feb 3, 2010 for a clear example. For an analysis, see Todd Tucker, “That’s All They’ve Got?”: What Latest WTO Secretariat Paper on Financial Crisis Does and Does Not Say About GATS Disciplines on Financial Regulation,” Public Citizen Memorandum, March 15, 2010, Available at: <http://www.citizen.org/documents/That%27sAllTheyGot.pdf>. On the response from Treasury, see discussion in comments section of Sarah Anderson, “Memo to U.S.: Only Fools Rush In,” *Guardian.Co.Uk*, March 21, 2010, Available at: <http://www.guardian.co.uk/commentisfree/cifamerica/2010/mar/18/china-usforeignpolicy>

⁹ The GATS’ Annex on Financial Services provision on domestic regulation provided the basis for the 2004 Model U.S. Bilateral Investment Treaty’s (BIT) provision on prudential regulation, which was contained in BITs with Rwanda and Uruguay. Similar language was also contained in U.S. “Free Trade Agreements” (FTAs) with Australia, Bahrain, Central America, Chile, Morocco, Oman, Singapore, and agreements signed by President George W. Bush but not approved by Congress with Colombia, Korea, and Panama. Many of these deals allow not only governments, but also private investors, to bring cases against prudential measures. Under these FTA “investor-state” enforcement provisions, foreign investors can directly demand cash compensation from governments in foreign tribunals – in addition to the pacts being enforceable by government-to-government dispute settlement tribunals.

¹⁰ Todd Tucker and Lori Wallach, “No Meaningful Safeguards for Prudential Measures in World Trade Organization’s Financial Service Deregulation Agreements,” Public Citizen Report, September 2009. Available at: <http://www.citizen.org/documents/PrudentialMeasuresReportFINAL.pdf>.

¹¹ See International Centre for Settlement of Investment Disputes, Additional Facility, Fireman’s Fund Insurance Company (Claimant) and The United Mexican States (Respondent), Award Before the Arbitral Tribunal constituted under Chapter Eleven of the North American Free Trade Agreement (NAFTA), ICSID Case No. ARB(AF)/02/01, July 17, 2006, at 59, 73-77, 95, and 103. Available at: http://www.naftaclaims.com/Disputes/Mexico/Fireman/FiremansFund-Mexico-Final_Award.pdf

¹² Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System, September 2009 Report at 82. Available at: http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf

¹³ Ibid at 104-105.

¹⁴ As ECAT’s submission during the State Department’s 2009 Model BIT review said, “In addition, Article 20.1 provides governments the ability to take measures that would otherwise be contrary to the BIT for ‘prudential reasons or to ensure the integrity and stability of the financial system.’ Additional flexibility is simply not needed and would have highly negative effects on U.S. investors and their U.S.-based operations. Indeed, to adopt the proposals made would be to deny investors the very protection that they need at the time that they most need it. Including such provisions would increase substantially the risk for foreign investors, chilling, rather than promoting, the very investment that many

developing countries are seeking. Incorporating provisions to permit capital controls would also have a severely negative effect on U.S. investors compared to many of their counterparts from Europe and beyond, that benefit from strong free transfer provisions, without capital control or balance of payment exceptions, in their countries' BITs. Creating a greater exception in the U.S. Model BIT would mean U.S. investors can be discriminated against compared to their foreign competitors." See Written Statement of the Emergency Committee For American Trade Concerning The Administration's Review Of The Model Bilateral Investment Treaty (BIT), July 31, 2009, at 19. Available at: <http://www.regulations.gov/search/Regs/home.html#documentDetail?R=0900006480a0247a>

¹⁵ We note that that GATS Article XIV is titled "General Exceptions," but it too would be more accurately deemed a "defense measure."

¹⁶ GATS Article XIV (*General Exceptions*) "Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures..."

¹⁷ "Communication from Colombia," GATT Document MTN.TNC/W/67, Feb. 11, 1991, and "Communication from Colombia," GATT Document MTN.TNC/W/68, Feb. 20, 1991.

¹⁸ "Communication from Mexico: Test of the Applicability Of Concepts, Principles And Rules To The Financial Services Sector," GATT Document MTN.GNS/W/71, Sept. 15, 1989; "Communication from Cameroon, China, Egypt, India, Kenya, Nigeria and Tanzania," GATT Document MTN.GNS/W/101, May 4, 1990.

¹⁹ The UK's top financial regulator advocated a variation on this theme, for instance. George Packer, "Call to curb London from UK watchdog," *Financial Times*, Aug. 27, 2009.

²⁰ For Minsky's recommendations, see Hyman P. Minsky, *Stabilizing an Unstable Economy*, (New York: McGraw Hill, 2008), at 355 and 367-368. For Boyd's remarks, see video of a forum at the Economic Policy Institute from Sept. 9, 2009. Available at: <http://www.epi.org/publications/entry/event20090909/>.

²¹ Aaditya Mattoo, "Financial Services and the World Trade Organization," World Bank Research Working Paper 2184, September 1999. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=629174

²² Christine Kaufmann and Rolf Weber, "Reconciling Liberalized Trade in Financial Services and Domestic Regulation," in Kern Alexander and Mads Andenas (eds.), *The World Trade Organization and Trade in Services*, (Amsterdam: Martinus Nijhoff Publishers, 2008). See also Bart de Meester, "Testing the European Prudential Conditions for Banking Mergers in the Light of Most Favored Nation in the GATS," Leuven Centre for Global Governance Studies, Working Paper 10, January 2008; Mamiko Yokoi-Arai, "GATS' Prudential Carve Out in Financial Services and its Relation with Prudential Regulation," *International and Comparative Law Quarterly*, 2009.

²³ Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation*, (Washington, D.C.: Peterson Institute for International Economics, 2008).

²⁴ Bart de Meester, "The Global Financial Crisis and Government Support for Banks: What Role for GATS?" Leuven Center for Global Governance Studies, Working Paper 32, December 2009, at 8.

²⁵ This work is ongoing in the WTO General Council and Committee on Trade in Financial Services. See WTO, "Discussion Document by Argentina, India and South Africa on the Financial Crisis and Related Matters," WTO Document, Sept. 17, 2009.

²⁶ See March 12 interventions by Nobel Prize Winner Paul Krugman, pro-"free trade" analyst Fred Bergsten, and labor-affiliated economist Rob Scott. Available at : http://www.epi.org/resources/event_20100312/

²⁷ Jonathan D. Ostry, et. al., "Capital Inflows: The Role of Controls," IMF Staff Position Note SPN/10/04, Feb. 19, 2010. Available at: <http://www.imf.org/external/pubs/ft/spn/2010/spn1004.pdf> . Accessed Feb. 26, 2010.

²⁸ Kevin Gallagher, "Losing Control: Policy Space for Preventing and Mitigating Financial Crises in Global Trade and Investment Agreements," UNCTAD, 2010, forthcoming. See also: M. Ayhan Kose, Eswar S. Prasad, Ashley D. Taylor, "Thresholds in the Process of International Financial Integration," NBER Working Paper No. 14916, April 2009.

²⁹ See comments by Gordon Brown, Nancy Pelosi, and others: <http://www.cepr.net/documents/ftt-support.pdf>

³⁰ Deborah Siegel, "Legal Aspects Of The IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements," *American Journal of International Law*, July 2002, at 566.

³¹ European Commission staff working document, "Innovative financing at a global level," SEC(2010) 409 final, April 1, 2010. Available at: http://ec.europa.eu/economy_finance/articles/international/2010-04-06-global_innovative_financing_en.htm

³² See WTO, "United States – Measures Affecting The Cross-Border Supply of Gambling and Betting Services," Report of the Panel, WTO Document WT/DS285/R, Nov. 10, 2004 at 232-233.

³³ Christine Kaufmann and Rolf Weber, "Reconciling Liberalized Trade in Financial Services and Domestic Regulation," in Kern Alexander and Mads Andenas (eds.), *The World Trade Organization and Trade in Services*,

(Amsterdam: Martinus Nijhoff Publishers, 2008), at 424. On Weber and Kaufmann's background, see: <http://www.nccr-trade.org/people/kaufmann/> and <http://www.nccr-trade.org/people/weber/>

³⁴ "SEC's 'Naked' Short-Selling Rule Permanent," *Associated Press*, July 27, 2009; Jacob Bunge, "Direct Edge Wins Exchange Status From SEC," *Dow Jones Newswires*, March 12, 2010. The SEC will have a final vote on the ban on flash trading in the near future; it is expected to pass.

³⁵ See commentary at: <http://www.ecipe.org/blog/naked-misbegotten-germany/?searchterm=prudential>

³⁶ See WTO Appellate Body, "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services - AB-2005-1 - Report of the Appellate Body," WTO Document WT/DS285/AB/R, July 4, 2005, at 88.

³⁷ WTO, "United States - Measures Affecting The Cross-Border Supply of Gambling and Betting Services," Report of the Panel, WTO Document WT/DS285/R, Nov. 10, 2004 at 232-233.

³⁸ Joost Pauwelyn, "Rien ne Va Plus? Distinguishing Domestic Regulation from Market Access in GATT and GATS," *World Trade Review*, 4, (2005), at 131-170. See also: Federico Ortino, "Treaty Interpretation and the WTO Appellate Body Report in US-Gambling: A Critique," *Journal of International Economic Law*, January 2006; Panagiotis Delimatsis, "Don't gamble with GATS - The interaction between Articles VI, XVI, XVII, and XVIII GATS in the light of the US - 'Gambling' case," *Journal of World Trade Law*, December 2006. For their biographies, see <http://hei.unige.ch/sections/dr/faculty/pauwelyn.php>; http://phase1.nccr-trade.org/images/stories/projects/ip8/CV_Delimatsis%200609.pdf; and

<http://www.kcl.ac.uk/schools/law/about/people/academic/ortino>

³⁹ For instance, legal scholars have argued that the GATS Articles XVI(2)(b-c) could be seen as applying to individual firm limits. See Markus Krajewski, *National Regulation and Trade Liberalization in Services*, (The Hague: Kluwer Law International, 2003), at 91. See also Petros Mavroidis, "Highway XVI re-visited: the road from non-discrimination to market access in GATS," *World Trade Review*, 6:1, 2007, at 17-18.

⁴⁰ Secretariat paper at 37.

⁴¹ *Id.* At 37.

⁴² *Id.* At paragraphs 17 and 20.

⁴³ "Disagreement over whether a particular measure falls within the prudential carve-out is subject to WTO dispute settlement procedures and thus potentially to determination by a dispute settlement panel. Most regulators, however, do not appear to be particularly concerned about this possibility. For one thing, prudential issues are dealt with intensively in other fora, as discussed in the following section, so there is some basis for assuming that certain types of rules will always be considered prudential. Moreover, if a country was concerned that a particular measure might not be generally accepted as prudential in the future, it listed that measure as an exception in its schedule of commitments. Another very important reason for the apparent lack of concern is that only governments--not private parties--may bring claims to dispute settlement in the WTO; and, in the absence of a truly egregious action, governments may prefer to respect each other's ability to determine which rules may be prudential." See Sydney J. Key, "Trade Liberalization and Prudential Regulation: The International Framework for Financial Services," *International Affairs*, 75: 1, January 1999, at 67-68.

⁴⁴ See <http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf>

⁴⁵ <http://www.pittsburghsummit.gov/mediacenter/129639.htm>

⁴⁶ "Panamá protegerá sus servicios internacionales y financieros," *Xinhua Spanish*, Aug. 6, 2009. Available at: <http://spanish.peopledaily.com.cn/31617/6720014.html>; "Panama to accuse Ecuador of discriminatory trade practices before WTO," *BBC*, Sept. 18, 2009.

⁴⁷ Council for Trade in Services, "Report of the Meeting Held on 9 July 2001," WTO S/C/M/54, Released Aug. 27, 2001. In this meeting, the Panamanian delegation's intervention focused on how GATS exceptions would not apply to OECD measures on harmful tax havens, because Panama does not have any double taxation treaties (which is one of the GATS exceptions). In regards to the other exception, on the "the imposition or collection of direct taxes in respect to services or service supplier of other members," the Panamanian delegation said: "It was difficult to imagine how the Panamanian tax regime could have an impact on the ability of other jurisdictions to impose and collect taxes on Panamanian services or suppliers that required the application of discriminatory measures, measures distinct to those used in the cases of other suppliers other than nationality." Panama is not alone in advocating this line of argument. Bruce Zagaris, a leading international tax attorney that has represented tax-haven governments, has stated that anti-tax haven measures "are likely to trigger... litigation in the WTO against the United States for discriminating against trade in financial services in violation of the General Agreement on Trade in Services." See Bruce Zagaris, "Use a Multilateral Approach in International Tax Enforcement," *Tax Analysts*, 2009. See bio at: http://www.bcr.us/2006/en/bruce_zagaris.shtml

⁴⁸ Comments of Barry Newman, Hearing before the House Committee on Banking, Finance and Urban Affairs, "Financial Services Chapter of NAFTA," Serial Number 103-71, Sept. 28, 1993, at 45. See also: http://mitsloan.mit.edu/alumni/clubs/newyork/files/news_apr04.pdf

⁴⁹ See Pierre Sauvé and James Gillespie, "Financial Services and the GATS 2000 Round," *Brookings-Wharton Papers on Financial Services*, 2000.

⁵⁰ Deborah Siegel, "Legal Aspects Of The IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements," *American Journal of International Law*, July 2002.

⁵¹ "Working Group on Financial Services Including Insurance, "Note on the Meeting of 11-13 June 1990," GATT Document MTN.GNS/FIN/1, July 5, 1990, at 23.

⁵² Group of Negotiations on Services, "Note on the Meeting of 12-13 July 1990," Working Group on Financial Services Including Insurance, GATT Document MTN.GNS/FIN/2, Aug. 10, 1990. Available at: <http://sul-derivatives.stanford.edu/derivative?CSNID=92110082&mediaType=application/pdf>. Accessed March 1, 2010.

⁵³ *Ibid.*

⁵⁴ Among the key provisions related to prudential measures:

"(i) Scope and definition

(a) Financial services shall cover transactions as contained in Article I of MFTS. However, countries should have the right to prohibit the provision of a financial service on prudential grounds.

(b) Countries may choose to limit coverage of financial services which, on the effective date of the MFTS, are governed by a legal framework involving governmental regulation...

"(iii) Most Favoured Nation Treatment

As defined in Article III of the MFTS, but subject to:

(a) Prudential need to limit concentration of foreign service providers from any one country; and

(b) The MFTS and sectoral annotations on financial services should not prohibit the establishment of regional cooperation agreements to promote additional liberalisation among countries which share similar cultural and economic systems, such as the SEACEN countries...

"(iv) Transparency

(a) The need for transparency is recognised but this should be limited only to the publication of laws and regulations relevant to financial services sector. Countries should not be required to publish administrative guidelines and other decisions taken as this is an onerous requirement. In some cases, such decisions are conveyed orally to the financial institutions and the publication of such decisions would, therefore, be cumbersome and impractical.

(b) Measures taken for prudential reasons or to effect monetary policies should be made available at the discretion of the supervisory authorities and only after the threat to stability has been overcome or the objective of the policies achieved.

(c) The need to achieve transparency in the financial services sector should not compromise a supervisory authority's right to reject individual applicants without disclosing the reasons for the rejection...

"(vii) Market access

Application of Article XVI of the MFTS for financial services should be qualified as follows:

(a) Countries should be free to choose one or all of the modes of delivery to effect liberalisation of financial services, based on prudential, monetary policy or balance of payments considerations.

(b) Commercial presence

Granting market access through commercial presence should be subject to several criteria in order to meet the needs of developing economies. These include: Right to establish "presence" cannot be automatic; In admitting foreign institutions, supervisory authorities should be allowed to adopt selective admission criteria based on prudential considerations; The right of supervisory authorities to determine the mode of entry i.e. via the

setting up of new financial institutions or the acquisition of domestic institutions should be respected; The judgement of supervisory authorities on the number of financial institutions that an economy can effectively support should be respected; and Rejection of applications to establish a commercial presence by a supervisory authority on prudential grounds should not be subject to review.

(c) Cross-border

Market access through cross-border trade may be subject to payment restrictions as may be allowed by the International Monetary Fund; and Countries should be allowed to limit the degree of liberalisation of cross-border financial services (e.g. retail banking), taking into account prudential, monetary policy or balance of payments considerations.”

Under the National Treatment article, a provision reads: “National treatment should not preempt a country's right to impose conditions on the operations of foreign institutions to take into account: The unique circumstances of individual countries, e.g. countries which have a high foreign content in their domestic banking industry; The level of development and competitiveness of the domestic institutions vis-a-vis foreign institutions. In this regard, the need for a core of strong indigenous financial institutions which pursue policies consistent with the national objectives should be recognized.”

⁵⁵ “Communication from the Delegation of Malaysia,” GATT Document MTN.GNS/FIN/W/3, Sept. 12, 1990.

⁵⁶ Timothy Geithner, “Uruguay Round / Financial Services: U.S. Measures in the Banking and Securities Sectors,” Treasury Department Memo, April 20, 1990. On file with Public Citizen.

⁵⁷ See United States, “Agreement on Trade in Services,” GATT Document MTN.GNS/W/75, Oct. 17, 1989. Available at: <http://sul-derivatives.stanford.edu/derivative?CSNID=92080100&mediaType=application/pdf>

⁵⁸ Memorandum from Assistant Treasury Secretary Timothy Geithner to Deputy Treasury Secretary Larry Summers on the GATS, Nov. 24, 1997. On file with Public Citizen.

⁵⁹ Jamie Strawbridge, “U.S. Floats New Approach For Services Liberalization In Doha Round,” *Inside U.S. Trade*, Oct. 16, 2009.

⁶⁰ USTR, “The President’s 2010 Trade Policy Agenda,” at 4.

⁶¹ On the involvement of Arthur Andersen, see Patricia J. Arnold, “Disciplining domestic regulation: the World Trade Organization and the market for professional services,” *Accounting, Organizations and Society*, 30: 4, May 2005; and Anthony DePalma, “WTO Pact Would Set Global Accounting Rules,” *The New York Times*, March 1, 2002.