International Trade in Banking Services and the Role of the WTO: Discussing the Legal Framework and Policy Objectives of the General Agreement on Trade in Services and the Current State of Play in the Doha Round of Trade Negotiations

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I. Introduction

This article reviews the progress achieved in the liberalization of international trade in banking services as part of the General Agreement on Trade in Services (GATS). In particular, it examines the existing legally binding commitments and discusses the progress in the negotiations at the Doha Round.[1]

The liberalization of trade in financial services is one aspect of the trend toward international economic and financial integration. The driving forces of global, regional, or bilateral economic integration are two: first, economic and technological developments that

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1. The November 2001 Declaration of the Fourth Ministerial Conference in Doha, Qatar, provided the mandate for trade negotiations on a range of subjects and other work, including issues concerning the implementation of the existing trade agreements. This round of trade negotiations is expected to conclude in the Sixth Session of the Ministerial Conference that will be held in Hong Kong in December 2005. Regarding trade in financial services, pursuant to the Doha mandate, participants in the services negotiations have been negotiating since June 30, 2002. *See generally* World Trade Organization, Services: The New Negotiations, http://www.wto.org/english/tratop_e/serv_e/s_negs_e.htm(last visited Oct. 13, 2005).

facilitate the flow of goods, services, capital, and persons; second, the operation of political forces that eliminate the remaining legal and institutional impediments to cross-border transactions through either unilateral domestic reform or international legal agreements. The concept of financial integration denotes the economic integration of financial markets and activities: first, the elimination of legal obstacles obstructing cross-border flows of capital, financial services, and financial institutions and, second, the economic and technological forces that facilitate cross-border financial activities, so that with respect to finance, there are no foreigners within the integrated area.[2] The institutional component of this process (i.e., the elimination of artificial legal barriers obstructing financial flows, services, and institutions) is an essential but not sufficient condition of international financial integration. The original rival of international economic integration was geography, not legal and political institutions. The historical causes of fragmentation of national markets were distance, expensive, and inefficient means of transportation and poor communications. Legal and institutional obstacles became apparent only after rapid advances in information technology, telecommunications, and transportation rendered the prospect of transnational economic relations realistic.

There are four main tracks of institutional reform, not mutually exclusive, available to those countries that elected to open their financial systems to international competition: (1) the unilateral track, in which the abolition of legal barriers is the outcome of unilateral domestic reform; (2) the bilateral track, in the case of a reciprocal agreement between two countries to eliminate barriers with regard to bilateral trade; (3) the multilateral regional track, in which a number of countries in the same region form a free trade area, abolishing internal frontiers that obstruct the circulation of specified classes of goods, services, persons, and capital transactions; and (4) the multilateral non-regional track of reform, in which the free trade area aims to achieve a truly global coverage.[3] In this respect, the World Trade Organization (WTO) is the only global institution dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments.

The paper is structured as follows. In section two, the question of tradability of banking services is discussed and the four different modes of supplying banking services across national borders are presented. The different types of barriers and obstacles to trade in banking services are discussed in section three, and the various strategies to deal with them are outlined in section four. In section five, a brief history of financial services negotiations in the WTO is presented and the most important provisions of the GATS are discussed, as well as their importance for trade in banking services. In section six, there is an overview of the current state of play with regard to the liberalization commitments undertaken under the GATS by the 148 WTO members. An assessment of the state of play is presented in

2. *See* Hal Scott, International Finance, Transactions, Policy and Regulation, 1-2 (Foundation Press, 11th ed. 2004); Ali M. El-Agraa, *General Introduction*, *in* Economic Integration Worldwide 1 (Ali M. El-Agraa ed. 1997); Fritz Machlup, *Economic Integration* in International Economic Integration, Critical Perspectives on the World Economy 119-20 (Miroslav N. Jovanovic ed. 1998).

3. *See* generally Sydney J. Key, Financial services in the Uruguay Round and the WTO (1997) [hereinafter Key, Financial Services]; Sydney J. Key & Hal S. Scott, International Trade in Banking Services: A Conceptual Framework (1991); Sydney J. Key, The Doha Round and Financial Services Negotiations (AEI Press 2003); GATS 2000: New Directions in Services Trade Liberalization (Pierre Sauvé & Robert M. Stern eds., Brookings Institution Press 2000) [hereinafter GATS 2000]; Pierre Sauvé, Trade Rules Behind Borders : Essays on Services, Investment and the New Trade Agenda (Cameron May 2003).

section seven. In section eight, the key issues and the progress achieved so far in the current Doha Round are discussed.

II. The Tradability of Banking Services

For financial institutions and the national economies in which they are headquartered, financial activities with nonresidents are valuable sources of revenue and represent a dynamic and growing aspect of international trade in services. The notion of financial services essentially refers to the full array of functions performed by financial institutions, including, but not limited to, the acceptance of deposits, lending, payment services, securities trading, asset management, financial advice, settlement, and clearing services.[4] In conducting these activities with nonresidents, financial institutions engage in international trade in financial services.[5]

Financial activities were not always regarded as tradable activities. With regard to insurance, for example, the existing regulatory structure in the United States—where insurance activities are largely subject to exclusive state regulation with very little oversight at the federal level—is to a great extent attributable to the Supreme Court's opinion in *Paul v. Virginia* that interstate insurance transactions are not transactions of commerce and trade and, thus, not subject to the constitutional powers of Congress to regulate interstate commerce by means of federal legislation. In the language of the Supreme Court in 1868, contracts of insurance

> are not articles of commerce in any proper meaning of the word. They are not subjects of trade and barter offered in the market as something having an existence and value independently of the parties to them. They are not commodities to be shipped or forwarded from one State to another, and then put up for sale. They are like other personal contracts between parties which are completed by their signature and the transfer of the consideration.[6]

More recently, the winds of change in international economic relations have affirmed the significance of financial services for international trade and the balance of national payments. As of the end of 2003, the value of international trade in financial services—either by provision of services at a distance, by movement of the client, or by way of local establishment in the host country—amounted to nearly 4.5 percent of the total value of global trade in commercial services ($1.7 trillion), or $80-85 billion.[7] Furthermore, foreign direct investment in banking in the form of branches, agencies, and subsidiaries, or by means of cross-border mergers and acquisitions, increased dramatically between the early 1980s and

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4. *See* General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex on Financial Services, 33 I.L.M. 1125 (1994) [hereinafter GATS].

5. *See* United Nations, Manual on Statistics of International Trade in Services 8-12 (2002); GATS, *supra* note 4, at art. I; Consolidated Version of the Treaty Establishing the European Community and Certain Related Acts, arts. 49-51, Dec. 12, 2002, 2002 O.J. (C 325) 54, *available at* http://europa.eu.int/eur-lex/lex/en/treaties/dat/12002E/pdf/ 12002E_EN.pdf [hereinafter EC Treaty].

6. *Paul v. Virginia*, 75 U.S. 168, 183 (1868).

7. *See generally Cross-Border Trade in Financial Services*, *Economics and Regulation*, 75 Fin. Markets Trends 23 (Mar. 2000); World Trade Organization, Economic Research and Statistics Division, *Measuring Trade in Services* (Nov. 2003), *available at* http://www.wto.org/english/res_e/statis_e/services_training_module_e.pdf;World Trade Organization, World Trade Report 2004: Exploring the linkage between the domestic policy environment and international trade (2004), *available at* http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report04_e.pdf.

the late 1990s.[8] Indicatively, the foreign share of local bank assets in low-income countries increased from 19 percent in 1995 to 42 percent in 2000.[9] In some countries of Central and Eastern Europe and Latin America, financial assets under foreign control had reached over 50 percent of total bank assets by 2000.[10] On average, the share of assets controlled by foreign-owned banks in thirteen major emerging markets rose by some 23 percentage points between 1994 and 1999.[11] The trend of foreign entry is primarily led by large financial groups in the G-7 countries. U.S. banks, for example, now earn an estimated 15 percent of their income in cross-border activities, and this figure rises to 45 percent for the five largest and internationally active banks.[12]

Notwithstanding the upward trend, in absolute terms, foreign banks still find it difficult to enter local financial markets, and when they do, they tend to concentrate on certain key countries. In rich industrial countries, on average, the foreign share of local bank assets remains at or below 10 percent,[13] and mergers and acquisitions of banks across borders are still rather uncommon.[14] In emerging markets, a small group of rapidly growing countries in Latin America, Central and Eastern Europe, and East Asia account for almost the totality of foreign bank entry,[15] while a substantial number of low income countries host no foreign banks.[16] In most cases, these low income countries are the very countries that most desperately need the financial resources that foreign financial institutions can contribute to local financial systems. By World Bank estimates, the banking systems of sixty poor countries, with a total population of 200 million people, are so tiny that the total banking assets in each jurisdiction fall short of $1 billion[17]—which is less than the total assets of Cambridge Savings Bank, a small community bank in Cambridge, Massachusetts.

From a conceptual point of view, the *2002 Manual on Statistics on International Trade in Services*—a joint project of the United Nations, the European Commission, the Interna-

8. *See generally* Committee on the Global Financial System, Bank for Int'l Settlements, Foreign Direct Investment in the Financial Sector of Emerging Market Economies 4 (Mar. 2004); Fariborz Moshirian, *International Investment in Financial Services*, 25 J. Banking & Fin. 317 (2001); Stijn Claessens et al., *How Does Foreign Entry Affect the Domestic Banking Market?* 25 J. Banking & Fin. 896 (2001); Allen N. Berger et al., *Globalization of Financial Institutions: Evidence from Cross-Border Banking Performance* 23 (Brookings-Wharton Papers on Financial Services, Working Papers Series Research Dep't 99-25, 2000), *available at* http://www.federalreserve.gov/pubs/feds/2000/200004/200004pap.pdf; Claudia Buch & Gayle Delong, *Cross-Border Bank Mergers: What Lures the Rare Animal?* (Kiel Institute for World Economics, Working Paper No. 1070, 2001), *available at* http://www.uni-kiel.de/ifw/pub/kap/2001/kap1070.pdf.

9. *See* Nihal Bayraktar & Yan Wang, *Foreign Bank Entry, Performance of Domestic Banks and the Sequence of Financial Liberalization* 2 (World Bank Policy Research Discussion Paper 2004), *available at* http://www.cl.psu.edu/sba/workingpapers/.

10. *See* Open Doors: Foreign Participation in Financial Systems in Developing Countries 19-27 (Robert E. Litan et al. eds., Brookings Inst. Press 2001) [hereinafter Open Doors].

11. *Id.* at 114.

12. *See* Charles W. Calomiris & Robert E. Litan, *Financial Regulation in a Global Marketplace*, *in* Brookings-Wharton Papers in Financial Services 2000 283, 285 (Robert Litan & Antohny Santomero eds., 2001).

13. *See* Claessens et al., *supra* note 8; Claudia M. Buch, Globalization of Financial Markets: Causes of Incomplete Integration and Consequences of Economic Policy 46 (2003).

14. *See* Allen N. Berger & David C. Smith, *Global Integration in the Banking Industry*, Fed. Res. Bull., Nov. 2003, at 451.

15. Committee on the Global Financial System, *supra* note 8, at 4-5.

16. *See* Stijn Claessens & Jong-Kun Lee, *Foreign Banks in Low-Income Countires: Recent Developments and Impacts*, *in* Globalization and National Financial Systems 109 (James Hanson et al. eds., 2003).

17. *See* Gerard Caprio, Finance for Growth-Policy Choices in a Volatile World 158 (2001).

tional Monetary Fund (IMF), the Organisation for Economic Cooperation and Development (OECD), the WTO, and the United Nations Conference on Trade and Development, which sets out an internationally agreed upon framework for the compilation and reporting of statistics on trade in services—has extended the definition of international trade in services to include both services supplied between residents and non-residents as well as services provided through foreign affiliates established abroad.[18]

For purposes of services trade negotiations and depending on the location of the supplier and the recipient of services, one may therefore identify four modes of international trade in banking services: (1) in providing the service, the financial institution remains outside the territory of the consumer, and the consumer remains inside his territory of residence (cross-border services); (2) in providing the service, the financial institution remains outside the territory of the consumer, and the consumer moves outside the territory of his residence (consumption abroad); (3) in providing the service, the financial institution establishes a commercial presence in the territory of the consumer, and the consumer remains inside his territory of residence (commercial presence); (4) the service is provided by natural persons established in the territory of the consumer (presence of natural persons).[19] The most important modes of trade in banking and other financial services are, by far, modes (1) and (3) that, respectively, cover the cross-border provision of services and the establishment of branches and other forms of commercial presence overseas.

III. Examining the Barriers to International Trade in Banking Services

Although physical barriers at the border and tariffs do not obstruct the flow of financial capital across borders, a large number of national laws and regulations preclude or disturb international financial integration. Legal impediments to international capital flows and trade in financial services are classified as direct or indirect, depending on whether the adverse effects of the pertinent rules on cross-border transactions are express and intentional or indirect and inadvertent.[20]

A. Direct Barriers

Direct (or discriminatory) measures draw an explicit distinction between resident and nonresident financial institutions, investors or borrowers to the disadvantage of nonresidents (overt discrimination), or result in disadvantageous treatment of nonresidents without stating so explicitly (covert discrimination). In light of the three most common modes of delivery of banking services across borders, institutional barriers may obstruct, discourage, or prevent financial institutions from operating in another country, consumers from accessing financial services abroad, or services from being delivered at a distance without the parties being simultaneously present. With regard to the specific aspect of the service to which the discriminatory rule relates, discriminatory barriers may relate to the firm providing the service (e.g., a prohibition of entry in the local market), the customer receiving the service (e.g., a requirement that local depositors may not deposit funds with foreign

18. *See* Manual on Statistics on International Trade in Services, *supra* note 5.
19. *See* Key & Scott, *supra* note 3.
20. *See generally id.*; Key, Financial Services, *supra* note 3.; Sauvé, *supra* note 3.

institutions or adverse tax rules which might have the same effect), or the cross-border flow of capital upon which the service relies.

Historically, the most commonly used measures have been rules that obstruct or prohibit the entry and operations of banks and other financial institutions in foreign markets by way of local branches, agencies, and subsidiaries.[21] Foreign entry in local markets can be restricted by a rich assortment of administrative measures that aim to reduce or preclude the number of foreign firms entering the national market or the ability of local customers to access foreign financial institutions. At one extreme, direct barriers can take the form of complete prohibition of cross-border financial linkages, flows of capital, or entry of foreign financial institutions in the domestic market. In practice, less draconian forms of limitations and operating restrictions on capital flows, market entry, and permissible activities of foreign financial institutions are more common. A small sample would include prior official authorizations for performing international capital transactions, limitations on the presence of foreign financial institutions to a single city or region, and restrictions on the asset growth or market share of foreign firms in domestic markets.[22]

It is also common to make foreign entry conditional on various limitations, for example, on the permissible legal form of the local entity or its legal powers to engage in financial activities. Restrictions on the total number of foreign firms that are permitted to operate in the country as well as occasional and temporary moratoria or freezes on the issuance of new regulatory licenses or charters are also common. When foreign entry takes the form of equity investment in an existing local firm, local rules have often specified the maximum percentage of equity that could be taken up by foreign investors. An equally effective means of discrimination is introduced by national measures that restrict the ability of local residents to receive services from foreign banks and other financial institutions.

In addition to direct restrictions on foreign entry, the hostility of local authorities toward foreign financial institutions may take the form of various operating restrictions that disturb the operations of foreign institutions after initial entry to the market has been secured. These measures have the effect of limiting the size of the domestic market available to foreign firms either directly or indirectly, for example, by increasing the cost of their operations, limiting the number of branches that a foreign bank may establish, discouraging local customers from doing business with them, or affording discriminatory benefits to domestic competitors.[23] Common practices include rules that directly limit the size of the market available to foreign firms;[24] rules that set maximum limits on the potential growth of foreign

21. *See generally* Ingo Walter, Barriers to Trade in Banking and Financial Services (Thames Essay No. 41, 1985); Ingo Walter & H. Peter Gray, *Protectionism and International Banking: Sectorial Efficiency, Competitive Structure and National Policy*, 7 J. Banking & Fin. 597 (1983); Sydney Key, *Trade Liberalization and Prudential Regulation: The International Framework for Financial Services*, 75 Int'l Affairs 61, 65-66 (1999); Meir Heth, *Towards International Free Trade in Banking Services*, *in* Rules for Free International Trade in Services 177-206 (Daniel Friedman & Ernst-Joachim Mestmäcker eds., 1990).

22. Heth, *supra* note 21; Walter, *supra* note 21; Walter & Gray, *supra* note 21.

23. *See* Walter, *supra* note 21, at 49-81.

24. These rules identify classes of clients who may or may not be served or define how the clients are to be served, including: rules that limit the presence of the foreign bank to a certain number of branches or within a single location; rules that mandate the submission of loans above certain limits to the scrutiny of the central bank; rules that reserve particularly profitable activities for local or state-owned banks; and rules that preclude foreign firms from doing business with retail customers, local authorities, or public enterprises.

firms, either in absolute terms or by defining the maximum permissible market share;[25] rules that increase the cost of funding of foreign firms by prohibiting the acceptance of local deposits (prohibiting certain types of deposits or deposits from certain types of customers); rules limiting the geographic range of foreign banks' local operations; nuisance measures that are designed to increase the cost of doing business locally or compromise the quality of financial services (e.g., limitations on acquiring real estate, limitations on staff and management recruitment, exclusion from essential clearing and settlement networks, and other forms of discriminatory treatment with regard to taxes, benefits, and subsidies that augment the competitive advantage of domestic financial institutions).

B. Indirect Barriers: Diversity of Regulatory Treatment and the Cost of Doing Business Internationally

The removal of all discriminatory regulatory barriers and the establishment of a level playing field between domestic and foreign financial institutions do not necessarily lead to full contestability and integration of international banking markets. With the substantial decline of direct legal barriers during the 1980s and 1990s, a subtler and more elusive source of legal restrictions has come to the forefront: the coexistence and conflict of diverse national laws and regulatory standards. In particular, it is argued that the diversity of national regulatory structures and rules imposes substantial regulatory costs on international financial operations, thus obstructing the process of international financial integration.[26] The concept of regulatory diversity refers to the coexistence of many national jurisdictions with legal and regulatory systems that develop different laws, regulations, and practices to suit diverse national and local preferences, objectives, and resources. Whatever its effects on international economic relations, regulatory diversity is the inevitable outcome of the right of sovereign jurisdictions to self-government and rulemaking autonomy.

Diversity is a universal and inherent quality in our lives. Given that different individuals and groups have different preferences, experiences, and objectives, legal diversity across different nations is inevitable and desirable. Legal rules constitute essential instruments of political and economic organization. They ought to adapt and cater to local preferences, needs, resources, and objectives. Different nations seldom hold identical views concerning the content of their laws. In his celebrated political treatise *The Spirit of Laws*, the French philosopher Charles de Montesquieu identified the inevitable diversity of national laws that "should be adapted in such a manner to the people for whom they are framed that it should be a great chance if those of one nation suit another."[27] Another Frenchman, Voltaire, did not quite agree. He lamented the fragmentation of the international legal order portraying the evils of legal diversity (and implicitly the virtues of legal harmonization) in the following terms: "Is it not an absurd and terrible thing that what is true in one village is false in

25. For example, special gearing ratios, reserve requirements, and capitalization limits may be set at different levels for foreign banks in order to constrain their market share.

26. *See*, e.g., Scott Bradford & Robert Z. Lawrence, Has Globalization Gone Far Enough? The Costs of Fragmented Markets (2004); Miles Kahler, *Trade and Domestic Differences*, *in* National Diversity and Global Capitalism 298, 299 (Suzanne Berger & Ronald Dore eds., Cornell Univ. Press 1996); Alan Sykes, *The (Limited) Role of Regulatory Harmonization in International Goods and Services Markets*, 2 J. Int'l Econ. L. 49 (1999) [hereinafter Sykes, *The (Limited) Role*]; Albert Breton & Pierre Salmon, *External Effects of Domestic Regulations: Comparing Internal and International Barriers to Trade*, 21 Int'l Rev. L. & Econ. 135 (2001).

27. Charles de Montesquieu, The Spirit of Laws, Book 1, Chapter 3, 30 (Prometheus Books 2002).

another? What kind of barbarism is it that citizens must live under different laws? When you travel in this kingdom you change legal systems as often as you change horses."[28]

The classic argument that regulatory diversity obstructs international economic integration is rather simple: regulatory differences across countries can increase the cost of transactions consummated and firms operating across national boundaries.[29] More specifically, the legal and regulatory framework can potentially increase the costs for nonresident firms engaging in cross-border economic activities more than it increases costs for resident firms inside the regulating jurisdiction, thus conferring a competitive advantage on domestic firms against their foreign competitors or merely rendering international activities costly and unappealing.[30] The collateral effects of legal and regulatory diversity and heterogeneity are diffused and indirect because the cause of incomplete integration is not the discriminatory treatment of non-resident financial institutions, but the very coexistence of heterogeneous domestic legal and regulatory institutions across national boundaries.

The structure and diversity of the international legal and regulatory system raises the economic cost of virtually all types of international economic transactions but remains particularly relevant for international banking and finance: financial activities are subject to extensive, complex, and often cumulative regulatory structures relating to systemic safety and soundness, consumer and investor protection, privacy, market integrity, and corporate governance, to name just a few. Since the sheer scope of the spectrum of regulations affecting financial institutions and markets increases the odds of regulatory diversity across nations, international financial activities appear to be particularly vulnerable to this particular type of transaction cost.

Obviously this is neither new nor extraordinary. Internationally, active financial institutions, investors, and borrowers have always been subject to foreign laws and regulatory procedures. What makes the current experience remarkable is not so much regulatory diversity per se, but the acute tension between, on the one hand, the unprecedented opportunities afforded by the technological and commercial forces of economic globalization and, on the other hand, the less accommodating reality of an international legal order that still comprises hundreds of sovereign sources of law. It is the economic and technological capacity to fully integrate national markets perhaps for the first time in history that places the remaining asymmetries or imperfections into a whole new perspective.[31]

A fair summary of the economic burden posed by legal and regulatory diversity in a world of international transactions and conflicting domestic regulations would include information costs, uncertainty, duplication, and lost economies of scale. First, internationally active

28. Voltaire, Oeuvres de Voltaire VIII, at Dialogues (1838). Credit for unearthing this quotation belongs to Professor Philip R. Wood. *See* Philip R. Wood, Maps of World Financial Law 4 (2005).

29. *See* Sykes, *The (Limited) Role*, *supra* note 26; Paul Brenton, *What Are the Limits to Economic Integration?* 5-6 (Center for European Policy Studies, Working Document No. 177, 2001).

30. *See* Alan Sykes, *Regulatory Protectionism and the Law of International Trade*, 66 U. Chi. L. Rev. 1, 3 (1999) [hereinafter Sykes, *Regulatory*]; Alan Sykes, *Exploring the Need for International Harmonization: Domestic Regulation, Sovereignty and Scientific Evidence Requirements: A Pessimistic View*, 3 Chi. J. Int'l L. 353, 354 (2002) [hereinafter Sykes, *Exploring the Need*].

31. *See* Maarten Smeets, *Globalisation and the Trade Policy Response*, 24 J. World Trade 56, 64-68 (1990); Hanah Buxbaum, *Conflict of Economic Laws: From Sovereignty to Substance*, 42 Va. J. Int'l. L. 931, 931-77 (2002); Sol Picciotto, *The Regulatory Crsis-Cross: Interaction between Jurisdictions and the Construction of Global Regulatory Networks*, *in* International Regulatory Competition and Coordination (Bratton et al. eds., 1996); Horatia Muir Watt, *Experiences from Europe: Legal Diversity and the Internal Market*, 39 Tex. Int'l L. J. 429 (2004).

banks incur significant expenses and loss of time in their attempt to gather and evaluate information about foreign laws and practices. Furthermore, they often incur so-called surprise costs when new rules are adopted in foreign markets, over which local firms have been consulted and therefore gained competitive advantage.[32] Even more worrisome, domestic legal reform may result in seemingly non-discriminatory rules that are nevertheless fully adapted to the structure and traditional operations of local firms but pose significant compliance challenges for incoming foreign institutions.[33]

Second, the co-existence of many national sources of law and regulation may cause uncertainty as to the circumstances that trigger the application of foreign laws and the involvement of national supervisory authorities, law enforcement agencies, and courts.[34] The provision of financial services across borders, increasingly via electronic networks, often stretch the traditional link between the reach of prescriptive and enforcement jurisdiction and the boundaries of territorial sovereignty.[35] Because of the intangible nature of banking services and advances in financial technology, banks providing services to international clients are not required to be in physical proximity to the territory of their clients. In the absence of strong territorial nexus, the application and enforcement of domestic regulatory standards by the authorities of the host country are likely to depend on unilateral policy considerations that tend to vary among nations.[36] In the domain of economic regulation, different countries may hold different views on what the subject-matter of regulation and how long the arm of domestic regulation and supervision should be. Hence, it is often difficult to tell if an international operation will trigger the application of foreign laws. There is now empirical evidence suggesting that uncertainty as to the circumstances that trigger the application of foreign rules and regulatory standards increases transaction costs and may potentially discourage international financial operations.[37]

Another significant barrier raised by regulatory diversity in a fragmented international legal order is the cumulative application of multiple, inconsistent, or plainly different national rules and regulatory procedures. The most characteristic obstacles in that group are domestic rules in the form of licensing procedures that regulate the entry of foreign insti-

32. *See* Sykes, *The (Limited) Role*, *supra* note 26.

33. *See* Sykes, *Regulatory*, *supra* note 30; Sykes, *Exploring the Need*, *supra* note 30.

34. *See*, e.g., Jurgen Basedow, *Conflicts of Economic Regulation*, 42 Am. J. Comp. L. 423 (1994); John C. Coffee, Jr., *Competition Versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation*, 50 Bus. Law. 447, 482 (1995); International Chamber of Commerce, Report on Jurisdiction and Applicable Law in Electronic Commerce (June 6, 2001), *available at* http://www.iccwbo.org/home/statements_rules/statements/2001/jurisdiction_and_applicable_law.asp (last visited Oct. 13, 2005); Stephen Choi, *Assessing Regulatory Responses to Securities Market Globalization*, 2 Theoretical Inquiries in L. 613, 641-43 (2001).

35. *See, e.g.*, Buxbaum, *supra* note 31; Picciotto, *supra* note 31.

36. *See* Andreas Lowenfeld, *Public Law in the International Arena: Conflict of Laws, International Law, and Some Suggestions for their Interaction*, *in* Recueil Des Cours: Collected Courses of the Hague Academy of International Law 321 (1980); Jurgen Basedow, *Wirtschaftskollisionsrecht, Theoretischer Versuch über die Odnungspolitischen Normen des Forumstaates*, 52 RabelsZ 8 (1988).

37. *See* Incomplete European Market for Financial Services (Paolo Cecchini et al. eds., 2003); Economic & Financial Committee, Report on EU Financial Integration 16-22 (2002); Martin Schüler and Friedrich Heinemann, *How Integrated Are the European Retail Financial Markets? A Cointegration Analysis* 5 (Center for European Research, Discussion Paper No. 02-22, 2003), *available at* ftp://ftp.zew.de/pub/zew-docs/dp/dp0222.pdf (last visited Oct. 14, 2005); Ahi Mitrani, *Regulating E-Commerce, E-Contracts and the Controversy of Multiple Jurisdiction*, 7(2) Int'l Trade L. & Reg. 50, 50-51 (2001); International Chamber of Commerce, Survey on Jurisdictional Certainty for International Contracts (2001).

tutions in the local market. While the right of domestic firms to engage in financial activities is subject to obtaining prior regulatory authorization once, their overseas competitors must overcome the competitive disadvantage of securing compliance with two licensing procedures, one in the home and one in the host country, prior to acquiring the right to serve local clients. Furthermore, having complied with multiple sets of regulatory standards, internationally active financial institutions are subject to the distinct, but equally disturbing process, of proving so to each one of the seized authorities through duplicate reports, audits, and similar mechanisms.

An even more disturbing situation arises where, as a result of the operation of conflict of laws or extra-territorial jurisdiction, two sets of incompatible national rules are applied to a single set of facts, for example, the regulation of the bank's structure of corporate governance simultaneously by the home country and the country where cross-border activities are taking place. In this case, in the event of incompatibility of two sets of applicable standards, compliance with one set of rules is necessarily a violation of the other, rendering the pertinent activities impossible. In most cases, the overseas operations of financial institutions are subject to a single system of law in the country where the operations are conducted. For example, the branch of a U.S. bank in Athens offering banking services to local residents operates almost exclusively under Greek law. In this case, the bank is subject to a single set of rules that apply equally to domestic financial institutions. The problem here is the need to adapt the services, corporate literature, market conduct, trading practices, or advertising information to the requirements of each national market that the bank intends to enter. This requirement destroys the economies of scale that an integrated financial market promises to deliver.[38] The disturbance is particularly annoying if the underlying legal differences are not so much caused by subjective differences in political objectives and regulatory interests as by pure chance or lack of information about better alternatives, particularly in the small print of the legal framework.

IV. How to Facilitate International Trade in Banking Services: The Political Economy of International Financial Integration

All available models of financial integration entail some degree of coordination and cooperation among participating countries, but, otherwise, there are many types of structural reforms towards financial integration: international agreements that prohibit discriminatory national measures; supranational institutions that produce total, partial, or minimum harmonization of national rules and centralization of supervisory and enforcement functions; mutual recognition of national standards and practices and home country regulatory control; in contractual matters, harmonization of conflict of laws and freedom of choice of applicable law; and an infinite number of hybrid solutions, including the current imperfect model of mutual recognition with residual host country powers.

A. The Negative Form of Economic Integration

In the negative form of economic integration, participating countries undertake legal obligations to eliminate direct legal barriers and measures that discriminate against non-

38. *See* The Committee of the Wise Men (Lamfalussy Committee), Final Report on the Regulation of European Securities Markets 10 (2001).

resident financial institutions, issuers, and investors. To achieve this purpose, international legal commitments of economic integration routinely refer to restrictive measures that participating countries shall abolish or shall not adopt.[39] Legal instruments addressing these explicit barriers constitute forms of negative economic integration because they do not set de novo rules and standards regulating the activities in question, but rather limit themselves to prohibiting national rules that restrict international financial activities.[40] The liberalizing force of negative integration relies on the enforceability of the legal commitments undertaken by participating countries. When sovereign jurisdictions commit themselves to abolishing restrictions on market access as well as regulations discriminating against foreign financial institutions, the credibility of the liberalization exercise relies on the ability of affected market actors or other sovereign states to enforce these legal commitments through a judicial process based on the rule of law.

Legal commitments to eliminate direct barriers to international financial transactions may ensure the parity of overseas financial institutions vis-à-vis domestic competitors through a wide concept of non-discrimination. But even if non-discriminatory national measures are eliminated, there is a certain point beyond which the normative effects of negative legal covenants cannot reach. Negative integration is a de-regulatory mechanism. Once the most troubling law-based restrictions have been dismantled, it becomes increasingly problematic to fit the remainder of obstacles within the scope of negative commitments of non-discrimination and market access. The less visible obstacles posed by regulatory diversity and other structural barriers relate to the existence and application of more than one set of rules as a problem in itself rather than the placement of undue burdens on the incoming bank as compared to domestic competitors. This uncertainty marks the boundaries of legal commitments prohibiting discriminatory treatment as methods of financial liberalization. A different approach is needed beyond this point.

B. The Positive Form of Economic Integration

The negative form of economic integration is often unsuitable to remedy the twin effects of regulatory diversity, namely high regulatory costs and competitive inequality. By definition, only the coordination, harmonization, or convergence of national regulatory policies and standards would constitute an effective remedial response. The process of international legal convergence and harmonization invariably requires voluntary constraints on national

39. "No Party may adopt any measure restricting any type of cross-border trade in financial services by cross-border financial service providers of another Party . . . ." North American Free Trade Agreement, art. 1404(1), Dec. 17. 1992, 32 I.L.M. 289 [hereinafter NAFTA]. "[R]estrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited." EC Treaty, *supra* note 5, at art. 43. "[A]ll restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited." EC Treaty, *supra* note 5, at art. 56. On the concept of negative integration *see* J. Pelkmans, *The Institutional Economics of European Integration*, *in* Integration Through Law: Europe and the American Federal Experience 318, 318-21 (Cappelletti et al, eds., 1986).

40. The term negative refers solely to the legal effects of the integration commitment. It is conceivable that instruments of negative integration are set out in positive language, mandating rather than prohibiting certain measures. "Each Party *shall accord to investors* of another Party *treatment no less favorable* than that it accords to its own investors . . . ." NAFTA, *supra* note 39, at art. 1405 (emphasis added). This does not change the effect of the rule as prohibiting discriminatory national measures rather than setting substantive regulatory requirements.

regulatory autonomy and a certain transfer of lawmaking power from the national arena to a supranational body, organization, or even more complex lawmaking institutions. It is, in other words, a process of positive integration in that that the coordination of domestic regulatory institutions at the international level aims to replace different national standards with common international rules or allocate regulatory responsibility among interested countries in some other way in view of reducing the regulatory burden of doing business internationally.

1. *Legal Harmonization as an Instrument of Economic Integration*

The pursuit of international legal and regulatory harmonization by international institutions, sovereign states, or networks of cooperating national authorities constitutes a significant policy instrument towards the elimination of indirect legal barriers that disturb regional or global economic and financial integration.[41] The notion of international legal and regulatory convergence or harmonization refers to the process by which national laws and regulatory standards become increasingly similar, comparable, or at least equivalent.[42]

Conceptually, the strong form of regulatory harmonization results in complete and absolute uniformity of national standards. At a lower level of uniformity, regulatory harmonization may conceivably generate a broad array of outcomes ranging from the basic approximation of national legal systems (which may share similar general principles and objectives but differ in detail) to the substantial convergence of national rules, regulatory practices, and standards relating to them.[43]

2. *Mutual Recognition as an Instrument of Economic Integration*

Another policy towards international economic integration is mutual recognition. Mutual recognition refers to the agreement between sovereign states whereby they agree to the transfer of regulatory authority from the host country where a transaction takes place to the home country from which a product, person, service, or firm originate.[44] It reflects the general principle that if a service can be provided lawfully in one jurisdiction, it can circulate in any other participating country without having to comply with the laws of these other jurisdictions.

The term mutual denotes the parity and reciprocity of the undertaken obligations. The recognition is of the equivalence, similarity, compatibility, or, at least, acceptability of another state's regulatory framework and represents the scope, *rationae materiae*, and scale of the reciprocal obligations. The equivalence of national norms is conceptually static because it reflects a fact and a situation that exists, whereas the recognition is conceptually normative

41. *See* Pier Jan Slot, *Harmonisation*, 21 E.L.R. 378, 378-381 (1996); Daniel Vignes, *The Harmonization of National Legislation and the EEC*, 15 E.L. Rev. 358, 358-61 (1990); Sykes, *The (Limited) Role*, *supra* note 26, at 50.

42. *See* Marc Angel, *From the Unification of Law to its Harmonization*, 51 Tul. L. Rev. 108 (1976-1977); Jaroslav G. Polach, *Harmonization of Laws in Western Europe*, 8 Am. J. Comp. L. 148 (1959); Rene David, *The Methods of Unification*, 16 Am. J. Comp. L. 13 (1968-1969).

43. *See* Martin Boodman, *The Myth of Harmonization of Laws*, 39 Am. J. Comp. L. 699 (1991); Sandeep Gopalan, *New Trends in the Making of International Commercial Law* 23 J.L. & Com. 117 (2004); David Leebron, *Claims for Harmonization: A Theoretical Framework*, 27 Can. Bus. L.J. 63, 66 (1996).

44. *See* Kalypso Nicolaidis, *Mutual Recognition of Regulatory Regimes: Some Lessons and Prospects*, *in* Regulatory Reform and International Market Openness, 171 (Organization for Economic Cooperation and Development ed., 1996).

and dynamic because it mandates a certain action and leads to a new arrangement between participating Member States. Member States take stock of the equivalence and convergence of national regulatory frameworks, evaluate and accept the remaining differences, and undertake reciprocal obligations to open up national borders to banks and services originating in the mutual recognition area.

Mutual recognition is a hybrid of negative and positive integration. It goes beyond the mere elimination of barriers in that it pursues liberalization through the equivalence of national regulatory perspectives and the measured and safe allocation of regulatory responsibility. In parallel, it is not a typical model of positive integration in that the replacement of national rules by common standards is not strictly required. It is an instrument of regulation because the division of responsibility among participating jurisdictions has a clear normative element; it is also a means of deregulation because a disturbing layer of national control is abolished. Ideally, services lawfully provided in one jurisdiction may freely circulate across national borders. Hence, mutual recognition secures market openness and promotes the values of trade liberalization by reducing structural barriers while simultaneously avoiding the excessive policy and transaction costs of full harmonization and uniformity. It thereby preserves local regulatory choices and preferences and stimulates potentially healthy regulatory competition.

The model of mutual recognition presupposes that participating countries are satisfied that the legal and institutional framework of their fellow participants is equivalent to their own standards of regulation and supervision. The principle of equivalence of national standards as a necessary precondition of mutual recognition reflects the inextricable connection and reciprocity between the liberalization and the regulatory perspectives of international finance. Uncoordinated and unconditional mutual recognition puts into question the very rationale of national regulatory policy and produces high policy costs in the form of deep compromise of national regulatory perspectives. Hence, it must be resisted and dismissed out of hand as a perilous concession of market access and an implausible waiver of local control and sovereignty vis-à-vis firms and services, towards which the essential trust and confidence are lacking.

Given the diverse national views on what constitutes a market failure and how this should be corrected, the model of uncoordinated mutual recognition leads to the situation in which services lawfully provided in the country of origin may upset public policy objectives in the country of destination and produce effects that are unacceptable for the host jurisdiction. In the absence of equivalence, sovereign states are likely to regard the respective regulatory framework of fellow states as being of poor quality and low economic efficiency, too liberal and insufficient to meet their own standards of social protection, fairness, and financial stability, or both. And there is of course the traditional argument of the "race to the bottom" that renders the political acceptance of uncoordinated mutual recognition extremely unpromising regardless of whether the risk of regulatory laxity is fanciful or real. As long as the risk is perceived to be real, it suffices to destroy political consensus regardless of whether it actually is a real risk.

Thus, to create the necessary equivalence in the substantive rules of different legal systems as a basis of mutual recognition, a coordinated process of legal harmonization is normally required. Harmonization purports to bring about consonance or accord in the legal institutions of participating countries, in other words, to reduce the disturbances caused by legal plurality and diversity. Legal harmonization is a dynamic process in that it changes the status quo and induces a new legal environment into being. Equivalence is a descriptive concept and denotes an existing state of affairs whereby legal institutions are corresponding or virtually identical in value, effect, or function. In any case, the correlation between mutual recognition and the establishment of common rules is strong and the policy of minimum harmonization (as opposed to total uniformity) as basis for mutual recognition sound.

V. Trade in Banking Services and Multilateral Negotiations in the WTO

The GATS—the most significant product of the Uruguay Round of trade negotiations—is, in terms of coverage, the most far-reaching among the international legal instruments that regulate the terms of trade in services among nations. The 1997 Financial Services Agreement and the specific national commitments on financial services operate against the legal and institutional framework established by the GATS. The agreement on trade in services reached in the Uruguay Round is perhaps the most important single development in the multilateral trading system since the General Agreement on Tariffs and Trade itself came into effect in 1948.

The GATS itself, in the preamble to the official text, makes reference to the three underlying ideas that shaped the negotiation and formulation of the final text: first, the establishment of a multilateral framework of principles and rules, in the form of the GATS, aimed at progressively opening up trade in services, contributing to economic development worldwide; second, WTO members, particularly developing countries, would still have to regulate the supply of services to meet national policy objectives; and third, it should be a key objective of the international trade regime to help developing countries take a fuller part in world trade in services, particularly through strengthening the capacity, efficiency and competitiveness of their own domestic services.[45]

A. The History of the Financial Services Agreement

At the end of the Uruguay Round negotiations in 1993, negotiations on financial services remained largely unfinished.[46] Some specific commitments to provide market access and national treatment were made in the sector, but most developed countries with an interest in open financial markets did not consider them sufficient to conclude the negotiations. As most countries did not make adequate commitments, the risk was that they would nevertheless benefit from other nations' liberalization commitments under the normative impact of the most-favored-nation principle. Hence, the Second Annex on Financial Services to the GATS and the Decision on Financial Services adopted at the end of the Round provided for the continuation of extended negotiations in this sector.[47] The negotiations on financial services were expected to continue for a six-month period following the entry into force of the remaining texts comprising the GATS (i.e., until the end of June 1995).[48] It was envisaged that, upon conclusion of these negotiations, participating countries could improve, modify, or even withdraw all or part of their commitments.[49]

45. *See* GATS, *supra* note 4, pmbl.

46. World Trade Organization, Financial Services: The results of the financial services negotiations under the General Agreement on Trade in Services (GATS), http://www.wto.org/english/tratop_e/serv_e/finance_e/finance_fiback_e.htm (last visited Oct. 13, 2005) [hereinafter Financial Services].

47. *Id.*

48. *Id.*

49. *Id.*

The 1995 negotiations were actually concluded on July 28, 1995, instead of June 30, as initially planned.[50] The agreement is known as the interim agreement, since negotiators again decided that the results of the negotiations were not satisfactory and envisaged further negotiations for a period of two years. As a result of the 1995 negotiations, twenty-nine WTO Members (counting the European Union (EU) as one) improved their schedules of specific liberalization commitments.[51] "Those improved commitments were annexed to the Second Protocol to the GATS."[52] Three other countries—Colombia, Mauritius, and the United States—decided not to improve their commitments and took broad exemptions from the most favored nation clause based on reciprocity. "As a result of those extended negotiations, and with new accessions to the WTO, [ninety-seven] Members of the WTO (counting the EU) individually) had commitments in financial services by mid-1997 in the area of financial services, compared to some [seventy-six] countries at the end of the Round."[53] The Second Protocol and the commitments annexed to it entered into force on September 1, 1996.[54]

The new round of financial services negotiations was launched in April 1997. "Members again had an opportunity to improve, modify or withdraw their commitments in financial services and to take MFN exemptions"[55] from the MFN principle (MFN exemptions) in the sector from November 1 until December 12, 1997. As a result, a new and improved set of commitments in financial services under the GATS was agreed to on December 12, 1997. "A total of [fifty-six] schedules of commitments representing [seventy] WTO Member governments and [sixteen] lists of MFN exemptions . . . were annexed to the Fifth Protocol to the GATS, which was open for ratification and acceptance by Members until [January 29, 1999]."[56] Fifty-two Member governments accepted the Protocol by the due date, and those Members decided to put the Protocol into force on March 1, 1999.[57]

"With five countries making commitments in financial services for the first time, the total number of WTO Members with commitments in financial services increased to 104 upon the entry into force of the Fifth Protocol."[58] As a result of the negotiations, the United States, India, and Thailand decided to withdraw their broad MFN exemptions based on reciprocity. The new commitments contained, inter alia, "significant improvements allowing commercial presence of foreign financial service suppliers by eliminating or relaxing limitations on foreign ownership of local financial institutions, limitations on the juridical form of commercial presence (branches, subsidiaries, agencies, representative offices, etc.), and limitations on the expansion of existing operations."[59]

B. Banking Services in the GATS

With regard to international trade in banking services, the institutional framework and national commitments established under the GATS, in general, and the 1997 Financial

50. *Id.*; *see* Second Protocol to the General Agreement on Trade in Services, June 24, 1995, 33 I.L.M. 99 (1996).

51. Financial Services, *supra* note 46.

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

Services Agreement, in particular, largely define the current state of play. To understand the methodology and normative impact of this framework, there are no less than seven legal instruments to consider: (1) the GATS, which is a general framework agreement governing the liberalization of the entire services economy, including banking and financial services; (2) the GATS Annex on Article II Exemptions that determines the circumstances under which nations may depart from the overarching MFN principle; (3) the GATS Annex on Financial Services that contains important provisions regarding trade in financial services and often exempts financial services from the general provisions of the GATS; (4) the Understanding on Commitments in Financial Services entered into by financially developed countries to undertake liberalization commitments that in many important respects exceed the degree of liberalization achieved under the general 1997 Financial Services Agreement; (5) the Schedules of Specific Commitments and Lists of Article II Exemptions that contain the specific commitments undertaken by individual countries in different sectors, modes of supply, and specific types of service; (6) the Second Protocol to the General Agreement on Trade in Services, also known as the Interim Agreement; and (7) the Fifth Protocol to the GATS, the so-called Financial Services Agreement that incorporates the commitments currently in force in the field of banking and financial services.

C. Introducing the General Structure of the GATS

Generally, the 1997 Financial Services Agreement and the specific national commitments on trade in banking services operate against the legal and institutional framework established by the GATS.

This framework consists of a central set of rules, the core text of the General Agreement on Trade in Services, a number of ancillary legal texts, which are either annexed to the Agreement or informally agreed upon by the national representatives such as the so-called Understanding on Commitments in Financial Services. It shall not be presumed that the texts annexed to the main Agreement are of lesser importance. In fact, the substantive normative impact of the GATS and its effectiveness as an instrument of trade liberalization relies on the breadth and depth of the liberalization commitments tabled by national representatives, which are take the form of Schedules of National Commitments annexed to the body of the Agreement.

Generally, the GATS covers all measures taken by Members affecting trade in services and all service sectors. The Agreement is unusual in taking a wide view of what constitutes trade, and defines trade in services as the supply of a service through any of four modes.

Certain GATS obligations are of general application in all sectors of the services economy, while others depend on the sector-specific commitments assumed by individual Members. The first overarching obligation relevant for all types of services is the principle of transparency that requires that each Member publish promptly "all relevant measures of general application"[60] affecting trade in services. The second overarching legal commitment is the MFN principle that prevents Members from discriminating among their trading partners. The Agreement, however, permits Members to list temporary exemptions to MFN.

The liberalizing effects of the GATS depend on the extent and nature of sector-specific commitments assumed by individual Members. A member's obligations—even in such fun-

60. GATS, *supra* note 4, at art. III.

damental respects as treating a foreign supplier of services on the same basis as a national supplier—depend largely on the specific commitments it has undertaken in its national schedule. The core provisions of the GATS in this context relate to market access (article XVI) and national treatment (article XVII). These provisions apply only to sectors explicitly included by a Member in its schedule of commitments and are subject to the limitations that a Member has scheduled. This was a crucial choice of institutional design that reveals one of the major structural weaknesses of the GATS regime for financial services.

Rather than agreeing to a general commitment of market access and national treatment unless an exception is specifically stated in the national Schedule, it was decided that Member States must specifically list the sector and type of service that they want to commit, the nature of the commitment, and any applicable exemptions. The problem with this approach is that it is impossible to tell the scope and scale of financial services liberalization in a given country by reading the GATS and the relevant national schedule. For example, the Schedules reveal the commitments that a country has decided to make in banking services but do not reveal the applicable restrictions if a country has decided to remain unbound with regard to a given service or sector. The Schedules disclose the sectors and modes of supply that a nation has decided to open to international competition but reveal nothing about the regulatory restrictions awaiting foreign firms in sectors and modes of supply that no commitment has been undertaken.

In addition to tolerating legal uncertainty as to the applicable regulatory framework, this positive list approach posed significant challenges for national delegations negotiating the commitments. While it is relatively easy to make a blanket commitment of full liberalization and then carve out specific regulatory limitations in certain areas of overarching national concern, it has proven to be particularly challenging to scan through the entire body of national law for economic sectors and regulatory domains where no particular objection to liberalization exists. As Kenneth W. Dam, a prominent negotiator and insider, put it: "[a]lthough one can argue conceptually that in a perfect world there would be not difference in substance between the negative and positive list approaches, adoption of the positive list approach in fact doomed the negotiations to a trivial result."[61]

D. The Scope of Coverage

The GATS framework applies to financial services. A financial service is any service of a financial nature offered by a financial service supplier of a Member.[62] Financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance). A financial service supplier means any natural or juridical person of a Member wishing to supply or supplying financial services.[63] The notion of banking services includes the following activities: acceptance of deposits and other repayable funds from the public; lending of all types; financial leasing; all payment and money transmission services, including credit, charge, and debit cards, travelers checks, and bankers drafts; guarantees and commitments; provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services; ad-

61. *See* Kenneth W. Dam, The Rules of the Global Game: a New Look at U.S. International Economic Policymaking 123 (The University of Chicago Press 2001).

62. GATS, *supra* note 4, Annex on Financial Services.

63. *Id.*

visory, intermediation, and other auxiliary financial services on all the activities listed in this list, including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.[64] Whether the GATS applies therefore depends on the nature of the service, not the type of financial intermediary involved. All types of financial intermediaries enjoy identical rights under the GATS, provided that they engage in the same types of activities.

E. The Four Modes of International Trade in Banking Services

The GATS framework applies to four modes of delivery of banking services in accordance with the structure illustrated in Chart one. First, cross-border services (mode one)—the bank is not present in the territory of the importing state and the service is delivered within the territory of the importing state.[65] Note that the criterion for trade in mode one is the location of the bank outside the territory of the importing state and the delivery of the service within that territory. Hence, defining the place where the service is delivered is a crucial criterion for the distinction between mode one and mode two. Given that the location where the service is provided is not clear in many cases of cross-border banking services, for example in the case of electronic finance, the distinction between modes one and two is particularly problematic and constitutes one of the open technical questions of the current financial services negotiations in Doha.

The second mode of supply under the GATS is consumption abroad (mode two)—the bank is not present within the territory of the importing state and the service is delivered to the consumer outside the territory of the consumer's residence.[66] The definition of mode two is consistent with the definition of mode one, whereby the location of the delivery of the service and not the physical movement of the customer is the crucial criterion. Although it is often believed that mode two refers to services provided to consumers traveling abroad, in fact the relevant criterion is not the movement of the consumer but the place of the delivery of the service.

The third mode of supply is commercial presence (mode three)—the bank is commercially present within the territory of the importing state, and the service is delivered therein.[67] The notion of commercial presence covers a variety of investment vehicles, representative offices (legal entities of the home country), branches (legal entities of the home country), subsidiaries (legal entities of the host country over which the bank has direct or indirect control), associates (legal entities of the host country over which the bank holds a minority interest), and correspondents. Foreign bank entry can take one of two forms: entry via a branch or subsidiary and entry via the purchase of an existing franchise. Banks such as Citibank, JP Morgan Chase, and Deutsche Bank usually follow the first strategy, while ABN AMRO, Commerzbank, ant HSBC tend to purchase existing franchises.[68] Finally, the fourth mode of supply is temporary movement of persons (mode four)—the bank is commercially present within the territory of importing state and the service is delivered within

64. *Id.*
65. GATS, *supra* note 4, at art. I(2)(d).
66. GATS, *supra* note 4, at art. I(2)(b).
67. GATS, *supra* note 4, at art. I(2)(c).
68. *See generally* Michael Pomerleano & George J.Vojta, *Foreign Banks in Emerging Markets: An Institutional Study*, in Open Doors, *supra* note 10.

Chart 1: Modes of Trade in Banking Services under the GATS Framework

EXPORTING STATE → IMPORTING STATE

Mode 1 (cross-border services)	**Mode 2 (consumption abroad)**	**Mode 3 (commercial presence)**	**Mode 4 (temporary movement of persons)**
Supplier not present *within* the territory of importing state	Supplier not present *within* the territory of importing state	Supplier commercially present *within* the territory of importing state	Supplier commercially present *within* the territory of importing state
Service delivered *within* the territory of importing state	Service delivered *outside* the territory of importing state	Service delivered *within* the territory of importing state	Service delivered *within* the territory of importing state *through* nationals of the exporting state
The distinction between modes 1 and 2 is problematic because it presupposes that the location where the service is provided is evident. The distinction has a "trade perspective" (scope and scale of GATS commitments relate to mode of supply) and a "regulatory perspective" (the territory in which a service is delivered is relevant for the exercise of regulatory jurisdiction)		E.g., *representative offices*, *branches*, *subsidiaries* or *minority interests in local associates*	Intra-corporate transfers of high-level executives, managerial personnel and skilled specialists.
Movement of capital depends on type of services (e.g., lending, acceptance of deposits (no movement of capital in advisory services))	Movement of capital is conceivable in certain occasions (e.g., deposit of funds abroad; lending in a third country)	Movement of capital is involved in initial establishment (FDI); then it depends on how local activities are funded	

the territory of importing state through nationals of the exporting state.[69] Mode four today accounts for less than 2 percent of the total value of services trade.[70] Present commitments refer almost exclusively to high-level personnel. More than 40 percent of mode four commitments are for intra-corporate transferees whose mobility is intimately related to foreign direct investment; another 50 percent of commitments cover executives, managers and specialists, and business visitors.[71]

69. GATS, *supra* note 4, at art. I(2)(d).

70. See *World Trade Developments in 2004 and Prospects for 2005*, *in* International Trade Statistics 2005 1, 8 (World Trade Organization 2005), *available at* http://www.wto.org/english/res_e/statis_e/its2005_e/its05_general_overview_e.pdf.

71. *Id.*

F. Trade in Banking Services and International Capital Flows

International trade in financial services and international financial flows are related but distinct concepts. Some activities involve both trade in financial services and cross-border financial flows simultaneously. For example, a bank lending money to nonresidents engages in international trade in financial services and performs an international transfer of capital. This is not always the case, as the following table illustrates.

Table 1: Trade in Banking Services and International Capital Flows

	Loan by domestic supplier	**Loan by foreign supplier on a cross-border basis**	**Loan by foreign supplier established in the country**
Loan Involves Domestic Capital Only	1. *Neither financial services trade nor international capital flow* (e.g., a resident bank lends to a resident using local capital)	3. *Financial services trade only* (e.g., a nonresident bank lends to a resident who travels abroad. The funds stay in the country of the bank)	5. *Financial services trade* plus forward direct investment (e.g., a nonresident bank establishes a branch locally and lends money by using funds borrowed locally)
Loan Involves Foreign Capital Only	2. *International capital flow only* (e.g. a resident bank lends to a resident using funds that the bank borrowed abroad)	4. *Financial services trade and international capital flow* (e.g. a nonresident bank lends to a resident by transferring the funds locally)	6. *Financial services trade* plus inward direct investment and international capital flow related to the supply of the loan

If a resident bank provides a loan to a resident using domestic capital (cell 1), this creates neither international trade in financial services nor an international capital transaction. If a resident bank borrows from abroad and provides a loan to a resident (cell 2), this creates an international flow of capital but there is still no international trade as between the bank and the client. Conversely, when a resident travels abroad and borrows from a nonresident bank in foreign currency and the funds stay in the country where the bank is located (cell 3), the transaction creates trade in financial services (consumption abroad) but does not entail an international capital transaction. This will only happen in situations that fall within the scope of cells four and six.[72] Moreover, the physical entry of financial institutions in foreign markets constitutes a significant form of international trade in financial services but does not necessarily involve cross-border flows of capital other than the original investment in setting up the branch or subsidiary (cell 5).

72. *See* Masamichi Kono & Ludger Schukhnecht, *Financial Services Trade, Capital Flows, and Financial Stability* (World Trade Orgganization Working Paper ERAD-98-12, 1998), *available at* http://www.wto.org/english/res_e/reser_e/pera9812.doc; Natalia T. Tamirisa, *Trade in Financial Services and Capital Movements*, 24 J. Fin. Servs. Res. 47 (2003); Masamichi Kono & Ludger Schuknecht, *How Does Financial Services Trade Affect Capital Flows and Financial Stability?*, *in* The Internationalization Of Financial Services: Issues And Lessons For Developing Countries, 139-175 (Stijn Claessens & Marion Jansen eds., 2000) [hereinafter Internationalization].

It therefore turns out that full capital mobility and trade in financial services constitute closely associated but conceptually separate perspectives of international financial integration. For policy purposes, the distinction implies that the elimination of barriers to international trade in financial services, either on a cross-border basis or through the entry of foreign institutions in local markets, does not strictly require the liberalization of financial flows between residents and nonresidents and vice versa. In substance, however, trade in financial services in an international order of tight capital controls is too costly and unappealing. A meaningful process of international financial integration should no doubt attack on both fronts—although the political reality may dictate otherwise.

Article XI of the GATS takes into account the relevance of capital flows for the provision of some services and seeks to ensure that capital restrictions are not used to reverse liberalization commitments in cases where the flow of capital is necessary for trading in services. Article XI of the GATS affirms that the GATS does not affect the rights and obligations of the members of the IMF under the Articles of Agreement of the Fund, including the use of exchange actions that are in conformity with the Articles of Agreement. Nevertheless, Members shall not impose restrictions "on any capital transactions inconsistently with their specific services commitments regarding such transactions."[73]

G. The Subject-Matter of Liberalization Commitments: Measures Affecting the Supply of Financial Services

An important question relates to the subject-matter of the GATS financial services framework. Put simply, what sort of laws, rules and regulations are subject to liberalization commitments on market access, non-discrimination, regulatory transparency and so forth?

According to article I of the GATS, the agreement applies to "measures by Members affecting trade in services."[74] Measures by Members means measures taken by central, regional, or local governments and authorities, as well as those taken by non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities. The WTO Panel on *EC-Bananas III* defined the scope of application of the GATS in the following terms: "The scope of the GATS encompasses any measure of a Member to the extent it affects the supply of a service regardless of whether such measure directly governs the supply of a service or whether it regulates other matters but nevertheless affects trade in services."[75]

The Appellate Body upheld this finding and held that "[t]he use of the term 'affecting' reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word 'affecting' implies a measure that has 'an effect on', which indicates a broad scope of application."[76] In accordance with the foregoing definition, the liberalization commitments undertaken in the WTO cover all measures taken by governments or regulatory authorities provided that, first, there is trade in banking services and, second, the measures affect such trade.

73. *See* GATS, *supra* note 4, at art. XI.

74. *Id.* at art. I.

75. Panel Report, *European Communities—Regime for the Importation, Sale and Distribution of Bananas III*, ¶ 7.285, WT/DS27/R/USA (May 22, 1997).

76. Appellate Body Report, *European Communities—Regime for the Importation, Sale, and Distribution of Bananas III*, ¶ 20, WT/DS27/AB/R (Sept. 9, 1997).

H. Discussing the Normative Impact of the GATS: The Principles of Most-Favored Nation, National Treatment, and Market Access

The purpose of the GATS is the removal of barriers to trade in services through a process of negative integration. The framework specifies measures that nations must eliminate or refrain from taking. The process is de-regulatory in that it involves the elimination or reduction of trade barriers. There is no process of positive integration that would result in the transfer of law-making and standard-setting powers from nation states to the WTO level. The second underlying idea, which is a stark reminder of the limitations of the GATS as a mechanism of negative integration, is the express carve-out of prudential matters from the normative effect of the financial services commitments. Whatever the implications of national regulation on international trade, there is no provision in the GATS preventing national authorities from taking measures to ensure the integrity and stability of the financial system or for prudential reasons, including the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial service supplier.

1. *The Principle of Most-Favored Nation*

One of the most significant principles of the GATS is the MFN rule. According to article II of the GATS, in adopting measures affecting trade in banking services each country "shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable that that it accords to like services and service suppliers of any other country."[77]

The motto of the GATS is "favor one, favor all." Members cannot afford privileges to services or firms originating in other countries without affording the same treatment to all other members. MFN means treating one's trading partners equally on the principle of non-discrimination. Under GATS, if a country allows foreign competition in a sector, equal opportunities in that sector should be given to service providers from all other WTO members.

The legal commitment of MFN raises a number of interpretative difficulties. The first difficulty is whether the concept of like services and services suppliers is given a narrow or wide scope. Suppose that Country X has no objections to foreign banks establishing branches within its domestic territory, provided that the country of origin of the foreign bank never applied to the IMF for financial assistance in the past. The rule discriminates between banks from different countries on the basis of their nationality. But is a bank from Group A (countries which never applied for IMF assistance) like a bank from group B (countries which applied for IMF assistance)? One view is that a bank is like any other bank, and, therefore, the measure breaches the MFN clause. But a narrower view of the MFN provision would be that banks from countries with weak financial systems are not like banks from countries with strong financial systems—assuming programs of financial adjustment administered by the IMF are indications of a country's financial weakness. Hence, the measure falls outside the scope of article II. The wider the definition of like services, the more measures will fall within the scope of the MFN clause, with potential benefits for international trade.

The issue has now been resolved. A bank from Group A is like a bank from Group B regardless of the quality of the financial systems in the two groups. Under WTO law, the

77. *See* GATS, *supra* note 4, at art. II.

notion of like services is a wide one—to the extent that the service suppliers concerned supply the same services, they should be considered like for the purposes of article II.[78]

A second difficulty relates to the definition of the notion of "treatment no less favorable." Is it limited to de jure discrimination, or is it extended to de facto discrimination as well? The answer is that article II prohibits both de jure and de facto discrimination against services and firms originating in different WTO Members.[79]

Regarding the permissible exemptions from the obligations under article II of the GATS, the Annex on article II exemptions is clear. First, WTO Members may negotiate and schedule exemptions from MFN to the benefit of specific WTO Members. Second, the principle of MFN does not apply to regional agreements of trade integration. Provided that the conditions of article V are met, WTO Members may enter into bilateral or multilateral trade agreements that would otherwise breach the MFN principle.

The principle of MFN is an interesting rule of trade liberalization. On certain conditions its impact could be substantial but in itself it is hardly a method of trade liberalization. A WTO Member is perfectly capable of respecting the MFN rule even in the absence of liberalization commitments, provided that it treated all foreign firms similarly. Indeed, a country may be completely isolated from international markets and still comply with the MFN rule provided that no foreign country received trading privileges. The principle of MFN has liberalizing effects only when it is complemented by affirmative commitments of trade liberalization, primarily commitments of market access and equal national treatment.

2. *The Principle of Market Access*

Market access is one of the fundamental concepts of the GATS framework and signifies the commitments of WTO Members to open up their borders to trade in services, including banking services. The Agreement does not define the concept of market access, but there is little doubt that the concept refers to the ability of exporting firms to provide services in one of the four modes of trade in services. In contrast with the MFN principle, the GATS does not contain an overarching rule prohibiting restrictions on market access. Instead, it was a major choice of institutional design that WTO Members must expressly list the types of services and the modes of supply that are subject to a market access commitment, as well as any restrictions to market access that apply in the relevant types of services and modes of supply.

Provided that a market access commitment is in place with regard to a given type of service (e.g., acceptance of deposits) and a mode of supply (e.g., modes 1, 2, and 3), article XVI of the GATS contains an exhaustive list of measures that a member shall not maintain or adopt: (1) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers, or the requirements of an economic needs test; (2) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test; (3) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test; (4) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for,

78. Panel Report, *Canada—Certain Measures Affecting the Automotive Industry*, ¶ 10.248, WT/DS142/12 (Oct. 4, 2000).

79. Appellate Body Report, *supra* note 76, ¶ 231-23.

and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test; (5) measures that restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and (6) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.[80]

The list of market access restrictions that a WTO Member cannot maintain or adopt has no effect unless the WTO Member schedules a specific market access commitment with regard to a given type of service and mode of supply. When the commitment is in place, the measures enumerated in the list cannot be maintained or adopted unless the member schedules a specific limitation. Specific commitments on market access effectively preclude or eliminate discriminatory barriers. The common denominator of the limitations enumerated in the list of article XVI is that they preclude, restrict, or otherwise impede access to the market of the WTO Member employing the limitation.

Under the scheme established by the GATS, a WTO Member grants full market access in a given sector and mode of supply when it does not maintain in that sector and mode any of the types of measures listed in article XVI. The measures listed comprise four types of quantitative restrictions (items (1)-(4)), as well as limitations on forms of legal entity (item (5)) and on foreign equity participation (item (6)). The list is exhaustive.

3. *The Principle of National Treatment*

The close-ended list of market access limitations does not exhaust the pool of potential discriminatory measures against foreign financial institutions. There is a potentially open-ended list of measures that are designed for, or simply result in, less favorable treatment of foreign banks vis-à-vis their domestic competitors. The national treatment rules of the GATS framework are designed to eliminate or reduce this long list of discriminatory provisions. Again, the prohibition of discriminatory treatment does not apply automatically. WTO Members must schedule specific types of services and modes of supply that will be subject to the national treatment requirement. For these types of services and modes of supply, in which specific commitments have been scheduled, article XVII of the Agreement requires each WTO Member to accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment "no less favorable" than that it accords to its own like services and service suppliers.[81]

A WTO Member grants full national treatment in a given sector and mode of supply when it accords in that sector and mode conditions of competition no less favorable to services or service suppliers of other Members than those accorded to its own like services and service suppliers. The national treatment standard does not require formally identical treatment of domestic and foreign suppliers: formally different measures can result in effective equality of treatment; just as formally identical measures can in some cases result in less favorable treatment of foreign suppliers (de facto discrimination). Thus, it should be borne in mind that limitations on national treatment cover cases of both de facto and de jure discrimination. Of course, the institutional design of the Schedules of specific commitments permits WTO Members to retain the right to discriminate between identical

80. *See* GATS, *supra* note 4, at art. XVI.
81. *See* GATS, *supra* note 4, at art. XVII.

services supplied through different modes by not guaranteeing national treatment with respect to each mode.

The policy of national treatment may raise difficulties and destroy reciprocity to the extent that rules and regulatory practices are different in different jurisdictions. Reciprocal national treatment obligations necessarily result in some sort of advantage for financial institutions originating in countries with complex and more restrictive regulatory structures when they operate in markets with less strict regulatory regimes. This is a structural problem of competitive equality that is caused by differences in national rules rather than the principle of national treatment. Eliminating structural barriers will always involve some sort of regulatory coordination or even the harmonization of laws and covenants of mutual recognition of regulatory standards and supervisory practices.

I. The Understanding on Commitments in Financial Services

Against the background and general framework of financial services commitments undertaken under the 1997 Financial Services Agreement, a smaller group of WTO Members (predominantly developed OECD countries) reached a consensus to go beyond the provisions of the 1997 Agreement and the minimum rules established by GATS pursuant to a more liberal approach under the so-called Understanding on Commitments in Financial Services.[82]

The countries participating in the Understanding agreed (1) that their residents can go abroad and purchase all types of banking and financial services; (2) to extend national treatment and MFN status to non-resident financial institutions as regards the purchase of financial services by public entities in their jurisdictions; (3) to extend national treatment to non-resident financial institutions with regard to provision and transfer of financial information and financial data processing and advisory and other auxiliary services, excluding intermediation, relating to banking and other financial services; (4) to extend full market access to an enterprise with commercial presence in their territories that would automatically cover new financial services that may be developed in the future; (5) to extend national treatment with regard to access to payment and clearing systems, participation in, or access to, any self-regulatory body, securities or futures exchange or market, clearing agency, or any other organization or association; (6) to extend entry rights to skilled workers, senior managers, and other professionals working for commercial present foreign financial institutions; and (7) to endeavor to remove or limit the effects of non-discriminatory measures that prevent incoming firms from offering permitted services, measures that impose geographic restrictions, measures that impose on incoming securities firms the full banking regulatory framework, and other measures that affect adversely the ability of incoming firms to operate, compete, or enter the WTO Member's domestic market.[83] This is an interesting provision aimed at solving the crucial issue of prudential regulatory measures that, despite their non-discriminatory character, raised regulatory hurdles for incoming foreign firms. The use of the term "endeavor" must no doubt mean that the enforceability of this commitment is rather limited, if at all existent.

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82. WTO, *Understanding on Committee of Financial Services*, http://www.wto.org/english/tratop_e/serv_e/21-fin_e.htm (last visited Oct. 13, 2005).

83. *Id.*

J. Domestic Regulation in the GATS

The institutional prominence of regulatory harmonization as an instrument of international financial integration diminishes dramatically outside single European market. In the framework of the WTO, the GATS does very little to address the trade effects of non-discriminatory domestic regulations in general. With regard to financial services in particular, it explicitly exempts non-discriminatory measures pertaining to financial stability, monetary policy, and investor protection from its main disciplines, which in any case fall short from demanding common national regulations. Other regional economic areas with significant financial market components, such as the North American Free Trade Agreement, the Association of South-East Asian Nations, and the Southern Common Market, are equally reluctant to address the integration costs of regulatory diversity by way of formal harmonization instruments.[84]

With particular regard to financial services, the insulation of domestic regulatory autonomy from the formal disciplines of the international trade regime is almost complete. Article 2 of the GATS Annex on Financial Services contains a crucial provision for the institutional reconciliation of the rival values of regulation and financial services liberalization. In dealing with the political dynamics of the negotiation process, GATS negotiators had to address the reluctance of national financial supervisory authorities to implicate domestic institutions of prudential supervision in the legal process of WTO-sponsored liberalization. They felt that there were probably enough multilateral international institutions and standard-setting bodies with a mandate to discuss the international financial regulatory and supervisory framework. On the other hand, the subject-matter of the GATS commitments was sufficiently broad to turn any domestic rule into potential GATS material. To the extent that a large number of more or less well-intentioned and non-discriminatory regulatory provisions are capable of having collateral trade effects, financial services commitments could conceivably have important ramifications for the exercise of regulatory and supervisory oversight by national authorities. For that reason, the national delegations were not prepared to mess with the complex and delicate issue of institutional and organizational structure of their regulatory and supervisory systems. As a result, in the GATS framework, the rivalry between regulation and liberalization was settled in favor of the regulatory status quo. Under article 2 of the GATS Annex on Financial Services 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.[85] Provided that the regulatory measures apply similarly to domestic and overseas financial institutions, they are immune to the disciplines imposed by the GATS. As soon as this prudential carve-out was agreed, the financial regulators who were present in the negotiations and were previously

84. *See* NAFTA, *supra* note 39, at art. 1410; Association of Southeast Asian Nations, ASEAN Framework Agreement on Services, *available at* http://www.aseansec.org/6628.htm; Thomas C. Fischer, *A Commentary on Regional Institutions in the Pacific Rim: Do APEC and ASEAN Still Matter?*, 13 Duke J. Comp. & Int'l L. 337 (2003); Ramkishen S. Rajan & Rahul Sen, *Liberalisation of Financial Services in Southeast Asia under the ASEAN Framework Agreement on Services*, 18 J. Int'l Banking L. & Reg. 132 (2003); Gabriel Gari, *Free Circulation of Services in Mercosur: A Pending Task*, 10 L. & Bus. Rev. Am. 545 (2004); Eva Holz, *MERCOSUR: Lessons from the Recent Past-The Case of the Financial Services*, 10 L. & Bus. Rev. Am. 299 (2004).

85. *See* GATS, *supra* note 4, at art. II.

agonizing over the implications of the new framework on their regulatory discretion packed their stuff and went home.

The prudential carve-out permits a WTO Member to take measures to ensure the integrity and stability of the financial system or for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial service supplier, regardless of other provisions of the Agreement. But these powers cannot be used as a means of avoiding the Member's commitments or obligations under the Agreement where domestic measures do not accord with the fundamental principles of MFN, national treatment, and market access. Schematically, if a measure is taken for genuine prudential reasons, the measure is not caught by the GATS commitments unless the measure breaches one of the fundamental GATS disciplines. For example, if it treats foreign banks less favorably than domestic ones. If that were the case, the prudential carve-out would not suffice to rescue the national measure in question. In these cases, the appropriate course of action for interested national authorities is to negotiate an express limitation in the national list of national treatment and market access commitments.

In short, the effects of financial liberalization in the WTO are much softer than the European approach towards regulatory diversity and the structural trade barriers generated by prudential regulatory standards. Nevertheless, a certain level of discipline on the direction, content, and procedure of non-discriminatory national regulations is not altogether absent from the GATS. First, there is the requirement of transparency. Each Member shall publish promptly and, except in emergency situations, at the latest by the time of their entry into force, all relevant measures of general application that pertain to or affect the operation of this Agreement, including international agreements pertaining to or affecting trade in services.[86] Further, in sectors where specific commitments are undertaken, each Member shall ensure that all measures of general application affecting trade in services are administered in a reasonable, objective, and impartial manner.[87] Moreover, the Working Party on Domestic Regulations was established to draft disciplines relating to technical standards, licensing, and qualification requirements for all services sectors. So far it has produced no meaningful results with regard to financial services. Finally, it will be recalled that the WTO Members that scheduled their commitments according to the Understanding on Commitments in Financial Services committed themselves to endeavor to remove or limit the effects of non-discriminatory measures which prevent incoming firms from offering permitted services, imposing geographic restrictions, imposing on incoming securities firms the full banking regulatory framework, and generally affecting adversely the ability of incoming firms to operate, compete, or enter the host jurisdiction.

In principle, the removal of structural barriers to trade—which are caused by differences in national rules and the overlapping or consecutive application of many layers of regulation and supervision, consumer protection rules, accounting standards, and so forth in different WTO Members—requires coherent strategies of positive integration. Other policies that could adjust domestic regulations to the needs of international trade include requirements of necessity and proportionality in regulating commercial activities (enforced in the EU but not in the GATS); requirements of due process in the administration of laws and regulations, such as prior consultation with domestic and foreign firms before the enactment of regu-

86. *See id.* at art. III.
87. *Id.* at art. VI.

latory reforms; predictability in standard-setting and enforcement; objective criteria in the exercise of supervisory control; transparency of regulatory objectives; and other principles of good regulatory practice.[88]

VI. The Current State of Play: A Study of Remaining Barriers and National Commitments

The current state of play is the outcome of the 1997 Financial Services Agreement as supplemented by subsequent commitments scheduled by countries that joined the WTO since December 1997. It should be noted at the outset that there are currently 148 WTO Members but forty countries have declined to make commitments in relation to banking services.[89] This does not necessarily mean that trade in banking services with residents of these jurisdictions is impossible. National Schedules of Specific Commitments contain positive commitments of market access and national treatment. In the absence of positive commitments, the actual practices of the jurisdiction in question may or may not preclude international trade in services. In practice, by not scheduling liberalization commitments, WTO Members remain unbound and retain their sovereign powers and discretion as to how to treat foreign financial institutions.

A. MFN Commitments

MFN commitments are by far the most far-reaching with regard to trade in banking services. Since the principle of MFN is automatically applicable unless a specific exemption has been scheduled (in contrast with the positive list approach of market access and national treatment), it is perhaps unsurprising that all but eight WTO Members have accepted the principle of MFN with regard to financial services.

B. Market Access and National Treatment

There are many types of commitments of market access and national treatment in the national schedules of WTO Members. Different countries have scheduled different commitments and limitations depending on the mode of supply, type of banking service, and nature of liberalization commitment. It is impossible to discuss individual nations' commitments one by one, but a few general observations are in order.

Including the twenty-five EU Member States, thirty-seven countries have scheduled financial services commitments in accordance with the provisions of the Understanding on

88. *See generally* Geza Feketekuty, *Regulatory Reform and Trade Liberalization in Services*, *in* GATS 2000, *supra* note 3.

89. Antigua and Barbuda, Saint Christopher and Nevis, Fiji, Bangladesh, Rwanda, FYR Macedonia, Barbados, Niger, Grenada, Belize, Myanmar, Guatemala, Botswana, Guinea, Guinea Bissau, Brunei, Darussalam, Moldova, Madagascar, Burkina Faso, Mauritania, Togo, Burundi, Mali, Tanzania, Cameroon, Maldives, Cambodia, St Lucia, Central African Republic, St. Vincent and the Grenadines, Chad, Suriname, Congo, Swaziland, DR of Congo, Trinidad and Tobago, Djibouti, Uganda, Dominica, and Zambia. The best compilation of the thousands of pages of national legal commitments is David Hartridge et al., Handbook of GATS Commitments: Trade in Services under the WTO (2003). The Schedules and the remainder of official texts comprising the GATS can also be found electronically at http://docsonline.wto.org/gen_home.asp?language=1&_=1.

Commitments in Financial Services.[90] These are primarily (but not exclusively) OECD countries with the most advanced and competitive financial systems. Furthermore, it should be noted that on average high and medium income countries scheduled the most advanced commitments, and most other income groups scheduled commitments commensurate with the level of their financial sector development.[91]

With a few exceptions (e.g., Malaysia and Mexico), the scheduled commitments of important emerging market economies offered little new market access to foreign financial institutions. In fact, most countries either scheduled already existing practices (Argentina, Brazil, Chile, India, Indonesia, Japan, South Korea, and Thailand) or, even worse, scheduled less than what they were already practicing. The Philippines, for example, committed to permit foreign equity participation in domestic banks up to a limit of 51 percent when the actual domestic rule is more generous, allowing foreign equity participation up to a limit of 60 percent.[92] The same can be said of OECD countries that had already opened their markets to a substantial degree and thus opted for using the GATS framework to bind the existing status quo.

Some WTO Members (e.g., Malaysia, Brazil, Hong Kong, China, Indonesia, Pakistan, Philippines, and Thailand) were reluctant to schedule liberalization commitments that went as far as the regulatory status quo because they wanted to retain the discretion to adjust the regulatory environment in the future. On the other hand, they wanted to assure the foreign firms already operating in the market that any future changes would not affect their operations. Hence, when scheduled commitments are tighter than the applicable rules, they are often supplemented by footnotes or references that clarify the scope of application of the commitments with regard to existing financial institutions.

Besides the thirty-seven financially developed nations that adopted the Understanding on Commitments in Financial Services, the most extensive commitments to liberalization were made by small economies in Africa, the Pacific, and Latin and Central America (Ghana, Kenya, Malawi, Mozambique, Sierra Leone, Papua New Guinea, Solomon Islands, Guyana, Haiti, and Panama). Furthermore, commitments to liberalize the commercial presence of foreign financial institutions by way of branches or subsidiaries (mode three) were far deeper and more extensive than commitments to liberalize cross-border banking at a distance (mode one). In fact, extending the scale and scope of banking services commitments for mode one is one of the priorities of the current round of negotiations. For example, with regard to cross-border services (mode one) and among countries in Latin and Central America, only Ecuador, Guyana, Haiti, and Panama included commitments in their schedules. In other words, none of the region's large emerging markets tabled commitments. Among countries in Asia and the Pacific the situation was similar, with only Indonesia and Malaysia of the larger emerging financial markets tabling mode one commitments. With regard to mode three commitments, countries in Asia and the Pacific (e.g. India, Indonesia, Korea, Kuwait, Malaysia, Pakistan, Philippines, Singapore, Sri Lanka, and Thailand) are more likely to schedule limitations on the commercial presence or equity participation of

90. Australia, Norway, Canada, Sri Lanka, EU Members, Switzerland, Iceland, Turkey, Japan, United States, Liechtenstein, New Zealand, and Nigeria. *See id.*

91. *See generally* Ying Qian, *Financial Services Liberalization and GATS–Analysis of the Commitments under the General Agreement on Trade in Services (GATS) at the World Trade Organization (WTO)*, *in* INTERNATIONALIZATION, *supra* note 72.

92. *Id.*

foreign financial institutions than countries in Latin and Central America, where only Brazil and the Dominican Republic were largely reluctant to afford unlimited market access to foreign financial institutions.

There is some consensus among academic and political observers that the financial services agreement was useful in binding existing regulatory and trade practices but achieved little actual liberalization beyond that point.[93] The modesty of the success is often attributed to the sectoral nature of the negotiations that limited the opportunities for inter-sectoral concessions. Put simply, the negotiations were carried on by finance ministries rather than trade officials, which hindered the scope for bargaining trade commitments across different sectors. Developing countries were less than enthusiastic about services negotiations because they reasonably suspected that their own services firms would gain very little from international market liberalization. To the extent that they were prepared to negotiate, the only meaningful way would have been through hard bargaining across different sectors in the hope that their agreement on financial services liberalization would be matched by other countries' reciprocal agreements in other services sectors and crucially in the goods and commodities markets where developing countries enjoyed a comparative advantage. By insulating financial services negotiations from the remainder of trade negotiations, the structure of the GATS framework generated a strong defensive attitude among developing countries that was eventually reflected in the modest results of the national schedules of commitments.

C. Remaining Limitations on Market Access and National Treatment

The positive list approach of the national schedules of commitments makes it impossible to assess the actual degree of liberalization of individual countries. A substantial number of countries have scheduled fewer and less extensive liberalization commitments than the competitive opportunities that they actually afford to foreign financial institutions. The absence of commitments in the multilateral GATS framework does not necessarily imply the existence of extensive barriers in the domestic legal environment. One of the structural differences of the positive list approach is that policy makers, financial institutions, and academics must still examine the domestic regulatory standards of each jurisdiction to determine potential barriers to trade. The GATS national schedules of commitments do not tell the whole story.

For the following information on remaining discriminatory barriers to trade in banking services several sources were relied on, including the 2004 National Trade Estimate Report on Foreign Trade Barriers of the Office of the U.S. Trade Representative,[94] the 1998 National Treatment Study of the U.S. Department of Treasury,[95] the Trade Policy Reviews of individual WTO members (conducted by WTO specialists),[96] the Market Access Database

93. *See* Dam, *supra* note 61, at 127; Wendy Dobson & Pierre Jacquet, Financial Services Liberalization in the WTO 90 (Institute for International Economics 1998).

94. Office of the U.S. Trade Representative, 2004 National Trade Estimate Report on Foreign Trade Barriers, *available at* http://www.ustr.gov/Document_Library /Reports_Publications/2004/2004_National_Trade_Estimate/2004_NTE_Report/Section_Index.html.

95. U.S. Department of Treasury, National Treatment Study 1998, http://www.treas.gov/offices/international-affairs/nts/ (last visited Oct. 13, 2005).

96. World Trade Organization, Trade Policy Reviews, http://www.wto.org/english/tratop_e/tpr_e/tpr_e.htm (last visited Oct. 13, 2005).

(operated by the External Trade Directorate of the European Commission),[97] and relevant academic commentaries.[98]

Table 2: Remaining Barriers in Key WTO Members

Remaining Barriers	**WTO Members**
Market Access	
Chartering on the basis of discretionary 'economic needs' or 'needs and convenience' or 'efficiency' test	United States, Portugal, Egypt, Malaysia, Singapore, Sri Lanka, Chile, India
Moratorium on new charters	Brazil, Malaysia
Limitations on foreign ownership of domestic financial institutions	Ghana, India, Kazakhstan, Korea, Malaysia, Norway (subject to special authorization), Philippines, Singapore
Limitations on the number of branches	Costa Rica, Guatemala, India, Korea, Philippines, Singapore, Thailand, Pakistan
National Treatment	
Limitations on the number of ATMs	Singapore
Portfolio restrictions based on branch-based regulatory capital as opposed to consolidated position	Argentina, China, Korea and Turkey (list these measures as limitations on schedules), Guatemala, India, Chile (do not list the measures in the belief that they are within the scope of the prudential carve-out)
Limitations on permissible activities of foreign banks	Vietnam (no deposits and credit cards), China (no participation in local currency operations)
Discriminatory Tax Treatment	Canada
Poor Regulatory Transparency in the Financial Sector	Angola, Republic of Korea, Ukraine

A brief note on the position in the United States is also in order. Clearly the United States has long provided market access opportunities to foreign financial institutions on the basis of national treatment. However, the dual regulatory nature of the banking system in the United States continues to generate obstacles for international firms operating in the country. For example, branching of state-chartered foreign banks is still subject to limitations in California, Hawaii, Massachusetts, Oregon, Pennsylvania, Utah, and Washington. The initial entry or expansion by a foreign person through acquisition or establishment of a state-chartered commercial bank subsidiary is prohibited or limited in twenty-eight States.[99] Furthermore,

97. Market Access Database, http://mkaccdb.eu.int/ (last visited Oct. 16, 2005).

98. *See* Pierre Sauvé & Karsten Steinfatt, *Financial Services and the WTO: What Next?*, *in* Open Doors, *supra* note 10.

99. Alabama, Arizona, Arkansas, Colorado, Delaware, Indiana, Kansas, Louisiana, Maryland, Michigan, Minnesota, Mississippi, Montana, Nebraska, Nevada, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. World Trade Organization, *Trade Policy Review United States*, WT/TPR/S/126 (Dec 13, 2003).

branch licenses for foreign banks are not available in six states,[100] and representative offices of foreign banks are not allowed in eighteen states.[101]

VII. Assessing the Progress in Banking Services Liberalization and Issues for the Doha Round of Negotiations

The progress achieved so far may tell two entirely different stories depending on the premise from which one starts. If the starting premise is a world of disrupted trade in banking services, blatant protectionism, tight controls on international capital flows, and few opportunities for cross-border trade, the 1997 Financial Services Agreement and subsequent developments clearly marked a change for the better: the establishment of an ongoing process of multilateral negotiations resulting in legally binding commitments, subject to quasi-judicial review; the elimination of discriminatory barriers to market access in a large number of developed countries; the reduction of barriers in many developing and emerging market economies; the achievement of a more or less integrated market for wholesale services to non-consumer parties; and a broad participation of sovereign jurisdictions which keeps expanding.

Looked at from a different perspective, the progress thus far is at best modest. In the era of financial globalization, where cross-border trade in banking services may benefit from the extraordinary advances in information, telecommunications, and network technology, the GATS framework has done little to advance international trade in banking services despite the broad participation and resources available to it. A large number of countries, inside and outside the WTO, remain entirely uncommitted. Supplying services across borders remains largely unaffected by existing commitments whereas trade in services through locally established entities is subject to persistent discriminatory barriers. The scope for further improvement of legal commitments regarding types of services and modes of supply is vast. Last, but not least, under the existing institutional design of the GATS framework, the large pool of structural non-discriminatory barriers will never be addressed.

As always, the truth is in the middle. Inasmuch as it is obvious that the GATS process has thus far contributed to banking services liberalization, there is huge scope for improvement and a number of thorny issues to be resolved in subsequent rounds. Depending on the WTO Member, more services and modes of supply can still be included or financial services commitments be scheduled for the first time. Also, existing exemptions and limitations can be eliminated leading to the gradual elimination of applicable barriers to trade. In particular, market access and national treatment commitments can be broader and stronger. The few exemptions from MFN can be eliminated. The clarification of the definition of mode one (cross-border services) and mode two (consumption abroad) in light of electronic banking and finance is a pressing need. With regard to substantive commitments, the scope and scale of mode one commitments is nowhere near the level of liberalization for commercial presence. In the era of electronic banking and finance, the gap has to be bridged. The same applies for the divide between developed and developing countries, which, however, is linked to the fate of reciprocity in the central issues of the current round, namely agriculture and intellectual property.

100. The States are Delaware, Georgia, Louisiana, Mississippi, Missouri, and Oklahoma. *Id.*
101. *Id.*

Second, the institutional framework could do with some simplification and user-friendliness. There are seven GATS-related legal instruments and dozens of national schedules that constitute the legal framework for trade in banking services. Some of them are ambiguous (intentionally or unintentionally) and poorly drafted. A fundamental structural weakness is the positive list approach. Simply put, we cannot make sense of the applicable barriers to international trade unless we take the pains to examine individual legal systems. A negative list approach whereby WTO Members undertake full commitments of market access and national treatment and list specific exemptions and limitations makes much more sense and improves dramatically the final product. It is also easier to negotiate and agree from a technical point of view.

The remaining gaps between liberalization commitments and liberalization practices could be eliminated. Arguably the function and technical definition of the prudential carve-out must be discussed. Negotiating parties must clarify the scope of the domestic regulatory deference. What is prudential? Is there still a requirement of transparency? Is the deference absolute or limited by requirements of proportionality, necessity, and suitability?

Furthermore, there is currently no standstill provision, which means that current commitments may theoretically be revoked. Since the 1997 Agreement, further market opening for financial services has taken place in a number of emerging market economies, either through unilateral action or as part of the conditionality in IMF financial assistance programs. Despite the changes, there has been no concomitant alteration in the relevant national schedules of commitments, which creates further gaps between reality and liberalization commitments. The new round should address this question.

With regard to the crucial relationship between financial sector stability and financial services liberalization, recent developments have revealed a difference in perspectives between financially developed and developing economies.[102] For developed countries, there is work to be done in many interesting areas, such as establishing meaningful regulatory dialogue and cooperation between financial services negotiators and financial regulators within the WTO context; strengthening the existing links between international standard-setting bodies such as the Basel Committee, the International Organization of Securities Commissions (IOSCO), and the WTO to ensure consistency, mutual understanding, and non-duplication of efforts; actively promoting a financial liberalization ethos in the domestic regulatory agenda (e.g. enhancing regulatory transparency, participation of foreign financial firms, selection of the least restrictive among suitable measures of regulation, supervision, consumer protection, etc.); and, finally, in the long term, identifying areas of substantial regulatory convergence with a view of initiating mutual recognition discussion at a broad international level. For developing economies and financial systems, the current round of financial services negotiations raises a slightly different set of regulatory priorities, such as continuing to work towards the strengthening of domestic financial systems and legal institutions of regulatory and supervisory control in tandem with the reduction of regulatory barriers.

The foregoing agenda reveals an extraordinary mix of issues and policies that could or should have been included in the current Doha round of financial services negotiations.

102. *See, e.g.*, Stijn Claessens & Marion Jansen, *Overview—The Internationalization of Financial Services: Issues and Lessons for Developing Countries*, *in* INTERNATIONALIZATION, *supra* note 72; *see generally* Sauvé & Steinfatt, *supra* note 98; WENDY DOBSON & PIERRE JACQUET, FINANCIAL SERVICES LIBERALIZATION IN THE WTO (1998).

Some of the items are already within the current agenda (e.g., quantitative and qualitative improvements of national commitments). Others require a more profound revision or improvement of the whole process. Taken together, they set the optimal objective against which the progress of the current Doha round could be measured.

VIII. The Doha Round and Development in Financial Services Negotiations

One of the main strengths of the GATS is the ongoing obligation of WTO Members to enter into successive rounds of negotiations to progressively liberalize trade in services. In other words, the formal adoption and implementation of the GATS schedules of commitments is not the end of the story. It was recognized that liberalization of trade in services would be a long process with several rounds of negotiations.

A. The Doha Round

With regard to financial services, the post-Uruguay Round ended in December 1997 with the Financial Services Agreement. The ink in that agreement was hardly dry when a new round of services negotiations had to begin according to the provisions of the GATS. Indeed, the services negotiations started officially in early 2000, under the auspices of the WTO Council for Trade in Services. Financial services were a key component of this process from the start. In March 2001, the Services Council established the negotiating guidelines and procedures. The work towards further progress in the institutional conditions of international trade was further stimulated in November 2001 by the Declaration of the Fourth Ministerial Conference in Doha, Qatar that provided the political mandate for trade negotiations on a range of subjects, including financial services. The Doha Declaration endorsed the work already done with regard to services, reaffirmed the negotiating guidelines and procedures, and established some key elements of the timetable, including the key deadline (January 1, 2005) for the conclusion of the negotiations as part of a single undertaking.

According to the Doha Declaration, the "negotiations on trade in services shall be conducted with a view to promoting the economic growth of all trading partners and the development of developing and least-developed countries."[103] It was envisaged by the Doha services timetable that participants should submit initial requires for specific commitments by June 30, 2002 and initial offers byMarch 31, 2003. The actual progress turned out to fall short of these expectations.

Following the September 2003 Cancún Ministerial Conference, the deadlock in highly contestable political issues relating to agricultural subsidies had a knock-on effect on services negotiations. To heal the wounds, WTO Members in Geneva began efforts to put the negotiations and the rest of the work program back on track. Work intensified in the first half of 2004, with the new target date of reaching agreement on a package of framework agreements by the end of July, in effect Friday, July 30. The first draft of the July package was circulated on July 16, and members started negotiating intensively in various formats

103. World Trade Organization., Ministerial Declaration of 14 November 2001, WT/MIN(01)/DEC/1, 41 I.L.M. 746 (2002).

in the fortnight beginning July 19. Final political agreement on a revised set of political guidelines for negotiators was reached by the (then) 147 WTO members shortly after midnight on August 1, 2004. These political commitments, also known as the July package, were relevant for the political climate and mandate for banking services negotiations in the following respects:

- WTO members reaffirmed the Ministerial Declarations and Decisions adopted at Doha and their full commitments to give effect to them.
- In the light of the poor results achieved since the beginning of the services negotiations in January 2000, WTO members endorsed the recommendations of the WTO Council for Trade in Services that basically urged negotiators to increase their efforts towards greater services liberalization.
- More importantly, the delays and failures of the past few years were recognized and a new deadline was set in the hope to induce a new wave of liberalization requests, offers, and commitments. Under the new deadline, which is currently in force, revised offers for liberalization commitments must be tabled by May 2005. The negotiations will conclude with the ministerial sessions to be held in Hong Kong in December 2005, one year later than envisaged in the 2001 Doha Declaration.

B. The Key Issues

With regard to banking services, the main objectives of the current Doha agenda draw heavily on the limitations and shortcomings of the 1997 Agreement. First, more developing countries are expected to broaden their commitments and reach the scope and scale of commitments made by financially developed WTO Members. Second, commitments in mode one (cross-border services) are expected to match the level of commitments in mode three (commercial presence). It is also expected that the scope of the prudential carve-out will be defined although there is currently disagreement among developed countries (that like it narrow) and developing countries (that wish it was broader). The Doha round is also hoped to strengthen the disciplines relating to regulatory transparency and administrative due process as a means of removing some of the structural barriers that impede international financial activities. Finally, it is expected that WTO Members will clarify the relations between the work in the WTO and the work in other international organizations and standard-setting bodies involved in the international financial system, such as the Basel Committee. In that respect, developed countries believe that the processes of financial liberalization and soft international regulatory convergence are mutually reinforcing, but ought to remain separate and independent, while developing countries have repeatedly expressed their discomfort at being recipients of standards set by others and for that reason want to link WTO commitments with greater input in the process of international standard-setting.

C. The Progress Achieved so Far

The financial services component of the Doha round has missed several deadlines and milestones and probably fallen short of expectations. Perhaps the most obvious conclusion is that developed countries are encouraging more market access and national treatment commitments, while developing countries are still refusing to open their cards before other more pressing trade disputes were settled. The data are revealing. Despite the deadline for the final submission of offers by May 2005, no more than eleven WTO Members (the EU considered as a single WTO Member) have tabled initial offers or revised offers for financial services commitments. These are Turkey, Chile, EC, Liechtenstein, United States, Japan, Norway, Canada, Australia, New Zealand and Iceland. The following table summarizes the extent to which the initial offer or revised offer improves on the WTO Member's commitments under the 1997 Agreement. It is apparent that the most jurisdictions in this table are close to exhausting the room for further improvements in GATS-related national treatment and market access.

Table 3: Initial or Revised Offers in Financial Services as of March 2005

WTO Member and Date of Offer	**Summary of Offer**
Turkey (September 2003)	Existing limitations on market access remain
Chile (July 2003)	No commitments in modes 1 and 2; limitations on market access remain
EU (June 2003)	Removal of remaining restrictions in specialist sectors such as investment management companies
Liechtenstein (April 2003)	Existing limitations on market access and national treatment remain
USA (April 2003)	Some limitations on market access are removed; further commitments in mode 1 (e.g. U.S. mutual funds receiving investment advice across borders) subject to reciprocity
Japan (April 2003)	Most existing limitations remain
Norway (April 2003)	Most existing limitations are removed
Canada (April 2003)	Limitations on national treatment and market access are removed
Iceland (April 2003)	Limitations are removed
Australia (April 2003)	No further commitments in mode 1; limitations of mode 3 are removed
New Zealand (March 2003)	No further commitments

IX. Conclusions

The 1997 Financial Services Agreement was a key moment in the history of international financial integration. Within the context of a legally binding international agreement, a substantial number of WTO Members committed themselves to eliminate or reduce discriminatory barriers to trade in banking and financial services. It was an important step towards international financial integration despite the remaining weaknesses and gaps. A new round of financial services negotiations was launched in January 2000 and was later incorporated in the 2001 Doha Development Agenda. During the last few years, the progress made by financial services negotiators has been modest at best with few developed countries being able to go much further in their liberalization commitments. From their part, developing jurisdictions are unlikely to rush in further financial services commitments before their remaining trade differences with developed countries, particularly in the area of agricultural products and commodities, are settled.

With particular regard to remaining weaknesses, it has become evident that a large number of developing and emerging market countries made no or few commitments to trade liberalization. It also became clear that regulatory diversity in domestic prudential, monetary, and investor protection standards has remained largely outside the scope of the normative effects of the GATS commitments despite its collateral economic effects on international banking operations. The specific obligations of market access and national treatment undertaken by WTO members under the GATS do not address the indirect effects of regulatory diversity. Provided that there is no direct discrimination against foreign financial institutions, the general provisions of the GATS—as reinforced by the explicit exemption afforded to national prudential and investor protection measures by the Annex on Financial Services—impose no disciplines and constraints on the exercise of regulatory rulemaking and enforcement powers by national authorities.

On close inspection, the complete insulation of national regulatory choices from the constraints and disciplines generated by international trade commitments reflect a rather outdated and plainly unfounded concept of national regulatory autonomy: first, that the elimination of direct barriers to international trade in financial services suffices to ensure free international trade; and, second, that national regulatory autonomy in the financial sector is so precious and inalienable that it cannot be constrained by international covenants.

It is obvious that neither perception of national regulatory choices accurately reflects the current state of the world. Non-discriminatory regulations and practices are capable of disturbing international financial integration. And national regulatory choices in the financial sector are influenced and shaped by all sorts of international forces, including the process of soft regulatory convergence on the basis of international standards and codes. It is therefore plausible to suggest that trade negotiators depart from the present position and exploit the convergence that has been achieved by the soft harmonization activities of several standard-setting organizations and bodies.

How would the work of international standard-setting bodies such as the Basel Committee, the IOSCO, or the International Association of Insurance Supervisors (IAIS) be associated with international trade negotiations? Arguably it is premature to suggest a strong form of mutual interaction and influence that would emulate the model of financial integration in Europe. There, regulatory harmonization operates as a basis of mutual recognition of national regulatory systems that underpins the single passport in intra-community trade in financial services. Furthermore, the European Court of Justice takes into account the level of harmonization of the national laws in evaluating the proportionality and necessity of regulatory action against nonresident financial institutions. For various reasons, it is very problematic to use the process of international regulatory convergence as an instrument of trade liberalization in the WTO in a similar way (i.e., as a basis for mutual recognition of national regimes and litigation proceedings before the Dispute Settlement Body of the WTO).

It makes good sense, however, to establish a soft form of mutual understanding and interaction between the WTO and national trade negotiators on the one hand and standard-setting bodies and regulators on the other. This soft relationship could take the form of reciprocal consultation and cooperation between officials of the two groups and regular feedback on the possible implications of liberalization activities to regulatory activities and vice-versa. This will perhaps enable trade negotiators, whose training and expertise do not extend to issues of financial regulatory policy, to appreciate that national legal and regulatory institutions are not as divergent as they originally thought—with obvious positive implications for their perceptions of the benefits of open financial markets. It will also enable the standard-setting bodies to understand the implications of common international standards on international market openness and plan their regulatory activities according to the expected outcome of negotiations concerning further liberalization of financial services trade. In that respect, the joint meeting of representatives from the Basel Committee, the IOSCO, and the IAIS, with the WTO Committee on Trade in Financial Services in October 2001, where the direction of the future work of the two groups of experts was jointly discussed, sets an encouraging precedent.[104] In conclusion, the policies towards the settlement of the antagonistic relationship between international financial openness and national regulatory policies must reach beyond the minimum disciplines of national treatment and market access, thereby taking advantage of the extraordinary progress achieved in the structure and governance of the international financial system.

104. *See* Committee on Trade in Financial Services, *Report of the Meeting Held on October 11, 2001*, S/FIN/M/32 (Nov. 9, 2001).