

Trade Agreements Limits on Financial Regulation

Foreclosed homes. Lost jobs. Collapsing banks. The greatest government involvement in the economy in generations. While these headlines dominated the news of 2008-2009, a root cause of the global financial crisis was largely ignored: during the decades leading to the crisis, the U.S. government and corporations had pushed extreme financial deregulation worldwide using “trade” agreements.

Starting in the late 1980s, the U.S. government and corporations pushed to redefine “finance” from a service that supports the real economy to a tradable commodity whose flow across borders should be uninhibited. They successfully pushed for financial services to be included in “trade” negotiations, including those establishing the World Trade Organization (WTO). “The sector was truly unique in that respect, and there is little doubt within the trade policy community that financial sector support in the European Union and the United States was a determining force in concluding the FSA [WTO Financial Services Agreement],” notes a study posted on the WTO’s own website.

The WTO’s General Agreement on Trade in Services (GATS) and the financial service chapters of U.S. “Free Trade” Agreements (FTAs) limit the regulation of financial service sectors subject to these agreements. The United States bound most service sectors relating to banking and securities to comply with these rules and made sizeable commitments in the insurance sector. The “trade” pact rules simply ban many common forms of financial regulation, even if such policies apply to domestic and foreign firms equally. U.S. government and corporate efforts in trade negotiations complemented domestic lobbying to weaken and eventually repeal the New Deal’s system of banking regulation. For instance, the Glass-Steagall Act created a firewall between commercial and investment banks to prevent the former from speculating with consumers’ savings. But the 1997 U.S. WTO commitments noted an intent to change Glass-Steagall to conform with WTO rules. The Gramm-Leach-Bliley Act, which did so, passed in 1999 – the year the WTO’s Financial Services Agreement (FSA) took effect.

Some people still assume “trade” pacts are about traditional matters, such as tariff cuts. In fact, the WTO, North American Free Trade Agreement (NAFTA) and other U.S. FTAs require signatories – including the United States – to conform domestic policies to a broad *non-trade* deregulatory agenda. Few in Congress read the legislation implementing the WTO in 1994 or NAFTA in 1993, much less the pacts’ actual 900-page texts. Congress didn’t even get a vote on the expanded U.S. financial service deregulation commitments contained in the subsequent WTO Financial Services Agreement. But if any country’s laws fail to comply with WTO, NAFTA or FTA rules, the laws can be challenged before foreign tribunals, and the country can be subjected to indefinite trade sanctions until its laws meet “trade” pact dictates. The FTAs even allow individual financial services firms to sue governments in extrajudicial tribunals to obtain unlimited taxpayer compensation for violations of their new “trade” pact rights.

Stiglitz-led United Nations Commission Calls for Reform of WTO’s Regulatory Ceiling

The UN Commission of Experts, chaired by Nobel Prize-winning economist Joseph Stiglitz, noted that: “The framework for financial market liberalization under the Financial Services Agreement of the General Agreement on Trade in Services (GATS) under the WTO and, even more, similar provisions in bilateral trade agreements may restrict the ability of governments to change the regulatory structure in ways which support financial stability, economic growth, and the welfare of vulnerable consumers and investors.”

The Problem: Overreaching “Trade” Agreement Rules

So-called “trade” agreements – both existing and proposed – limit the domestic-policy options lawmakers can pursue in areas that are not trade-related. The WTO enforces 17 different agreements, only a handful of which relate to tariffs and quotas – the traditional terrain of “trade” policy. Others limit subsidies governments can provide to green industries, forbid domestic economic stimulus funds from being directed to domestic workers and firms, set parameters for how our health-care system is managed, and even constrain how our federal and state governments can expend our tax dollars in government procurement. NAFTA and similar FTAs contain analogous provisions, and also empower foreign investors to directly challenge governments for alleged violations.

One of the most controversial WTO agreements is the GATS, which sets out rules for how countries can regulate their economies’ “service sectors.” What’s a service? Basically anything you can’t drop on your foot, from banking to energy, education to healthcare. The WTO Secretariat was unusually direct in describing the GATS’ implications: *“Governments are free in principle to pursue any national policy objectives **provided the relevant measures are compatible with the GATS.**”*

One of the most controversial service sectors covered by the GATS is finance. When many countries initially rejected the extreme banking, securities and insurance deregulation pushed by U.S. and European governments and corporations, additional negotiations were launched after the WTO was established to push for deeper commitments. In all, over 100 countries have WTO financial services commitments.

The United States and some other countries also committed to even greater deregulation by adopting an additional WTO agreement, called the “Understanding on Commitments in Financial Services.” When all was said and done, the United States was bound to extremely broad WTO obligations to stay out of regulation of “banking,” “other financial services” and “insurance.” Consider just one sector that has gained notoriety for contributing to the financial meltdown: derivatives. In the expansive WTO category called “Trading of Securities and Derivative Products and Services Related Thereto,” the only policy space that the United States preserved for regulating derivatives was for onion futures. Really.

Taken as a whole, the WTO’s limits on financial service sector regulation are expansive. These rules not only guarantee foreign financial firms and their products access to U.S. markets, but also include numerous additional rules that limit how our domestic governments may regulate foreign firms operating here:

No new regulation: The United States agreed to a “standstill” provision which requires that we not create new regulations (or reverse liberalization) for the list of financial services bound to comply with WTO rules. This means that the United States has bound itself not to do what Congress and regulators have tried to do in the crisis’s wake – to create new financial service regulations. Indeed, when regulators began to issue new rules after the Dodd-Frank financial reregulation bill was passed, European and other financial firms claimed some of the strongest proposals violated WTO rules.

Certain forms of regulation banned outright: The United States agreed that it would not set limits on the size of financial firms, the types of financial services one entity may provide or the types of legal entities through which a financial service may be provided in the broad array of financial services signed up to the WTO. These WTO rules conflict with countries’ efforts to put size limitations on banks (so that they do not become “too big to fail”) and to “firewall” different financial services (a policy tool used to limit the spread of risk across sectors, as Glass-Steagall did between commercial and investment banking).

No bans on risky financial service “products” in committed sectors: A WTO tribunal has already ruled that a ban, even if it applies to domestic and foreign firms, constitutes a forbidden “zero quota” that violates service sector market access obligations. This restriction conflicts with proposals to limit various risky investment instruments, such as certain derivatives.

Treating foreign and domestic firms alike is not sufficient: The GATS market access limits on U.S. domestic regulation apply in absolute terms. In other words, even if a policy applies to domestic and foreign firms alike, if it goes beyond what WTO rules permit, it is forbidden. And, forms of regulation not outright banned by these rules must not inadvertently “modify the conditions of competition in favor of services or service suppliers” of the United States, even if they apply identically to foreign and domestic firms. Might aspects of the Wall Street bailout have “changed the conditions of competition” in favor of U.S. firms? Other WTO members have begun reviewing just this question.

Other non-discriminatory domestic regulations also subject to review: GATS subjects policies of general application that may affect service sector firms to review, with WTO tribunals empowered to determine if they are “reasonable,” whether they “could not reasonably have been expected” and whether licensing and qualification requirements and technical standards limit foreign firms’ access.

The only exception to these rules is viewed by many to be useless: WTO, NAFTA and other U.S. FTAs contain a “prudential exception” that can be invoked as a defense if a financial policy is challenged. However, the provision contains a clause that many deem “self-cancelling.” That is to say, the effectiveness of the provision is at best contested in that its acceptable use is explicitly limited to circumstances where invoking the exception does not contradict a country’s “trade” pact commitments. But a country would not use the exception unless it felt that a financial policy did just that.

The Proposed Trade in Services Agreement (TISA) Would Require More Financial Deregulation

Even as regulators worked to reregulate financial firms after the 2008-2009 crisis, U.S. trade negotiators were trying to revive a beleaguered WTO expansion called the “Doha Round.” The Bush administration led a push to *expand* financial deregulation through this Round, which started in 2001. The Obama administration continued with the Bush agenda. The Doha Round became deadlocked and then was altogether derailed by disagreements between countries. However, the United States joined a small bloc of WTO countries in trying to revive the financial deregulation agenda from the Doha Round by pushing for new “Trade in Services Agreement” (TISA) negotiations. Congress was notified of these negotiations in January 2013. While the TISA negotiations have been undertaken in complete secrecy, from leaks of the TISA financial services annex, we know that, instead of learning from the financial crisis, the TISA doubles down on the deregulatory WTO rules, includes leftover Doha initiatives, and pushes even more financial deregulatory rules, including:

Setting additional constraints on domestic regulation. It seems unimaginable that, after the lessons of the global financial crisis, any agreement would impose new, additional limits on financial regulation. But from TISA leaks, we know that parties have pushed to revive proposals from the “GATS Working Party on Domestic Regulations” that would do just that. The rules could empower trade tribunals to second-guess governments on the subjective questions of whether policies are really necessary and whether less trade-restrictive means to meet policy goals could be employed.

Allowing consumers' sensitive financial data to be offshored. Despite concerns about privacy and exposure to unwanted surveillance, TISA rules could require that financial firms be permitted to transfer consumers' personal financial data overseas.

Requiring acceptance of financial products not yet invented. TISA would require governments to allow any new financial products and services – including ones not yet invented – to be sold within their territories.

In praising the launch of the TISA, the U.S. Chamber of Commerce noted that banks and other firms “have seen trade and regulatory barriers multiply in ways that could not be foreseen two decades ago when the General Agreement on Trade in Services was negotiated.” The Chamber welcomed the TISA as a “chance to tackle emerging trade barriers” – a euphemism for post-crisis efforts to reregulate finance.

The Solution: Shrink or Sink (and Ignore) “Trade” Pact Limits on Financial Regulation

Unfortunately, some existing “trade” pact rules *do* limit the policy space nations need to prevent financial crises. Other rules are at best unclear and can chill needed reforms. These rules must be changed. However, in the interim we cannot allow “trade” agreement rules to inhibit needed reform. Here’s a blueprint for change:

First, do no further harm: no additional financial deregulation via the TISA or bilateral agreements. Demands for nations to add financial sector commitments must be jettisoned along with new regulation-limiting agreements.

Fix existing WTO, NAFTA and FTA rules to remove financial deregulation requirements and add safeguards for economic stability policies: The changes needed are straightforward. The issue is whether the political will exists. The needed changes include removing automatic *deregulation* requirements from “trade” pact service sector *liberalization* rules, and adding a meaningful safeguard to protect prudential policies.

It takes years for a trade agreement challenge to get an initial ruling, so policymakers should not allow threats of challenges to be used as a tool to scale back reregulation: Industry groups like the U.S. Chamber of Commerce are already using the deregulatory WTO rules to threaten new financial regulations by trying to raise the specter that their implementation could spark trade disputes.

But even if a new financial regulation would conflict with “trade” pact rules, a country must formally challenge the policy for dispute resolution action to be initiated. After a challenge is brought, it typically takes more than five years before issuance of a final WTO ruling that could result in trade sanctions. Thus, the “way to go” is to ignore the threats, implement robust financial regulations, and see if it draws an actual challenge.

WTO Rules Have Been Modified Before to Address a Global Crisis

In the past, when WTO rules conflicted with global policy priorities, nations negotiated changes. The 2001 “Doha Declaration on TRIPS and Public Health” countered WTO drug-patent rules’ limits to a global response to the HIV/AIDS crisis. Like that pandemic, dealing with the financial crisis and avoiding future such crises is a global emergency. Scores of WTO countries are seeking to implement the very financial stabilization policies that could be attacked as WTO violations. With so many countries facing the same WTO problems, changes could find wide support.

For access to a database detailing U.S. GATS service-sector commitments, along with fact sheets and other informational material about “trade” pact rules affecting financial regulation, please contact Public Citizen’s Global Trade Watch at 202-546-4996, or visit our website: www.TradeWatch.org