International Chamber of Commerce
The world business organization

ICC Policy Statement

A Business view on the benefits of opening trade in financial services

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Introduction and background: financial services liberalization after Cancùn

The failure of the Cancùn Ministerial may delay the GATS negotiations in the WTO, although services liberalization was not among the more contentious WTO issues debated at Cancùn. However, in terms of economic importance, services in general and financial services in particular are definitely key sectors for growth and employment in both industrial and developing countries. Further liberalization of trade in financial services (i.e., banking, insurance, securities and related services) could, therefore, significantly promote economic development worldwide.

From a global business perspective, which the ICC is committed to maintaining, the best framework for this would be the multilateral GATS negotiations in the WTO. This is so because the WTO includes most countries of the world among its members, its dispute settlement mechanism is an effective tool for granting legal certainty for trade and investment in services under international law and its agreements have superior allocation effects because of the principles of most-favored-nation treatment and (in the long run) national treatment. As a second-best solution, bilateral Free Trade Agreements could also be regarded as a helpful means of financial services liberalization, especially if the Doha Development Round did not regain momentum in the near future. Of course, every country is welcomed to take unilateral liberalization steps even before conclusion of multilateral or bilateral liberalization agreements. Such agreements should then include a binding commitment to these unilateral measures.

The ICC Policy Statement on Liberalization of Trade in Financial Services of December 2000 and the ICC Policy Statement on Liberalization of Trade in Insurance Services of May 2000 acknowledged the merits of the first WTO financial services agreement of 1997, but identified a need to further reduce the significant number of remaining barriers to trade in financial services through the GATS negotiations that were starting at that time, also calling for the active participation of developing countries in these negotiations.

Today, four years into the GATS negotiations, the financial services liberalization offers tabled so far by WTO members do not appear to comply with the requests made in the ICC's 2000 policy statements. Many WTO members have not tabled a GATS offer yet, and among those who have, many seem reluctant to include significant financial services liberalization measures.

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While the requests for liberalization and fair and transparent regulation of financial services specified in the ICC's 2000 policy statements remain valid, this ICC policy statement focuses on the import benefits of a further opening-up of banking, insurance and s ecurities markets for businesses, consumers and governments. These benefits are often neglected in trade policy negotiations, where suppliers of goods and services, with their exporting interest, often are a more vocal influence than the many enterprises, consumers and governments on the demand side. By directing attention to the import benefits of financial services liberalization, the ICC also wants to encourage those WTO members that are net importers of financial services to table substantial offers in the ongoing GATS negotiations instead of giving too much weight in their overall WTO position to those non-services issues on which the Cancùn Ministerial got bogged down.

Local presence of foreign financial institutions: still huge benefit potential ahead for developing countries

From a general economic standpoint, opening up a country's financial sector to competition from abroad tends to improve the quality and diversity of the financial products offered, while at the same time putting pressure on their prices. Local offices of foreign financial institutions invest long-term capital in the domestic financial sector, make available valuable know-how and create jobs. Generally speaking, opening up a country's financial sector must be seen as highly conducive to growth and development.

In past WTO negotiations, this huge import benefit potential has often been overlooked. Accordingly, the performance of many national economies, especially in developing countries, is often severely hampered by an inefficient and intransparent financial sector, as their level of financial sector liberalization often falls short of that of most industrial countries. While industrial countries like the EU member states and the US have already largely liberalized establishment and operating conditions for a commercial presence (GATS mode 3), gave a binding commitment to such liberalization in the first WTO Financial Services Agreement of 1997, and have already offered to abandon some remaining obstacles in the current Doha Development Round, many developing countries in 1997 committed themselves to a much lower degree of market access for foreign financial institutions, retained many restrictions on them, and have offered little or nothing so far in the current WTO/GATS negotiations.

Temporary movement of highly-skilled personnel: another source of benefits and a prerequisite for market access of foreign financial firms

As regards GATS mode 4, temporary movement of personnel, industrial countries such as the EU member states and the US committed themselves to much less in the 1997 agreement than under mode 3. Here, developing as well as industrial countries still can deliver something in the Doha Development Round. Their financial sectors could certainly profit from improved temporary access for highly-skilled personnel, such as managers and experts, from other WTO member states. The net effect on domestic employment would probably be positive rather than negative. In addition, mode 4 liberalization is, to a large extent, a prerequisite for mode 3 liberalization, e.g. sending managers and experts to establish a commercial presence.

Thus, to fully realize the import benefits of opening up financial sectors for foreign firms, a sufficient degree of openness for temporary movement of personnel is required, too.

Cross-border financial services: how to reap benefits and avoid risks

Cross-border financial services, though harboring some potential for problems, can also improve choices and access to capital for domestic businesses, governments and customers. Few industrial or developing countries have committed themselves extensively under GATS mode 1, cross-border financial services, so far. While th is mode of trade in services also could improve choice, quality and prices of financial services for businesses and consumers both in developing and industrial countries, supervisory concerns appear to be an obstacle to significant liberalization under this GATS mode in the current WTO round. Developing countries operating capital-account restrictions would have a further reservation about mode 1 liberalization of financial services.

Nevertheless, there are cross-border financial services to which these concerns do not apply (e.g. trade-related financial services, financial information flows, advisory and auxiliary services) or would be more than compensated by import benefits. While recognizing the special need to protect the interests of consumers with regard to retail financial services, for cross-border financial business with professional clients, investor protection concerns at supervisory level would hardly apply. Technological developments like e-commerce have created new potential for import benefits from cross-border financial services. They only can be reaped through sufficient mode 1 liberalization.

Such liberalization should be considered in the WTO as well as outside (e.g., for transactions involving supervisory concerns that would require a recognition of the quality of home-country supervision).

Developing countries: How to safeguard benefits and avoid risks from financial sector liberalization

As shown in the preceding sections, import benefits of financial sector liberalization apply also to developing countries. This goes for foreign financial firms' local presence, transfer of highly-skilled personnel and even cross-border financial services. There are, however, some risks involved which have to be taken care of. Nevertheless, most of these can be avoided by a suitable combination and timing of financial sector reform (where necessary), liberalization of market access for foreign financial institutions, and capital-account liberalization.

First, establishing modern regulatory and supervisory systems (institutions and legal framework) is required in many developing countries in addition to financial sector liberalization. Advanced countries and international development banks should include modernization of other WTO members' financial sector framework in their official assistance programs. Foreign financial institutions' know-how and the competitive pressure they put on domestic financial institutions can drive developments also in this field. Financial sector reform and opening reinforce each other. Reasonable periods of time for implementation of liberalization commitments may be advisable to improve both competition among financial institutions and the quality of regulation and supervision.

Second, during the 1990s, some developing countries shielded inefficient financial sectors while fully opening up their capital account to large-volume but volatile cross-border financial flows. Subsequent financial crises in such countries have shown in the meantime that, to strengthen soundness and stability of local financial and economic sectors, significant liberalization of market access for international financial firms' local presence (including temporary transfer of highly-skilled personnel) should, ideally, precede capital-account liberalization. The development and performance of such countries' financial and economic sectors could definitely profit from further significant liberalization steps in the field of market access. In addition, developing countries should include a commitment to capital-account liberalization in their economic policy strategy, providing for a sufficient transitional period to increase soundness and stability in their financial sector by more basic reform and liberalization steps first.

Third, concerns expressed by domestic financial firms in developing countries about being subjected too fast to overwhelming competition from more advanced foreign financial institutions can, again, be accommodated by providing for reasonable transition periods in their commitment to making significant liberalization steps. This would allow emerging markets to learn from internationally experienced financial firms. As experience shows, a policy of nurturing infant industry can only help to make domestic sectors competitive if there are clear and binding deadlines for a gradual removal of existing restrictions on foreign competition. Without any increase in outside competitive pressure over the course of time, small markets in particular have no incentives to develop. It has also to be kept in mind that domestic financial institutions even in less advanced countries always have the competitive advantage of superior knowledge of the local markets and that foreign firms often focus on market niches that may not be covered by domestic firms.

Many developing countries appear to be reluctant to make a binding commitment in the GATS framework of the WTO to liberalization steps that they would be willing to offer unilaterally. But such a strategy may have several disadvantages. First, without a binding commitment under international law, the market access rights conceded to foreign firms are less secure. Accordingly, their incentive to access developing countries' financial markets is smaller, so that essential import benefits may not materialize with unilateral liberalization only. Second, the GATS allows each WTO member state to negotiate an individual liberalization strategy, including degree, sequence and promptness of the liberalization steps. It should also be noted that in the field of financial services the so-called "prudential carve-out" under section 2 (a) of the GATS Annex on Financial Services allows measures to preserve the stability of financial systems that may violate liberalization commitments. In addition, Article XII of the GATS permits countries suffering from or threatened by a balance-of-payments crisis temporary exemptions from their liberalization commitments if such exemptions are necessary and applied in accordance with the most-favored-nation principle and the rules of the International Monetary Fund.

As the risks seem manageable, import benefits are strong case for developing countries' liberalization of market access for financial services along the lines requested in the ICC policy statements of 2000.

Industrial countries: some potential still for further benefits from financial services liberalization

While industrial countries have opened up their financial sectors for a commercial presence of international financial firms to a large extent already, both unilaterally and in the WTO, cross-border services and temporary movement of highly-skilled personnel still offer some potential for additional liberalization-related import benefits. While concerns from a financial supervision or labor market and immigration policy standpoint undoubtedly have to be taken into account here, intelligent public policy management should allow these countries to reap more and more of these potential import benefits of liberalization.

The current WTO negotiations definitely could achieve some progress here, although more extensive liberalization of cross-border financial services may require recognition of the quality of home-country supervision.

Conclusion

Import benefits are a strong case for liberalization of financial services. This applies to developing countries, where there often is a huge potential for liberalization of foreign financial firms' commercial presence. It also applies to industrial countries regarding their remaining restrictions in GATS mode 3 and larger liberalization potential in GATS modes 1 and 4. As has been shown in this paper, the specific risks of such liberalization measures for deve loping and industrial countries can be managed.

The governments of the world should consider opening up their financial sectors further also in view of the import benefits for their businesses and consumers and even the governments themselves. This can be done not only by conducting multilateral and bilateral liberalization negotiations, but also by adopting unilateral measures, which should, however, be incorporated on a binding basis into any multilateral and bilateral agreement concluded.

The national committees of the ICC are requested to promote the awareness of these import benefits of further financial services liberalization in their countries.

About ICC

ICC is the world business organization, the only representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world. ICC promotes an open international trade and investment system and the market economy. Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment policy as well as on vital technical and sectoral subjects. ICC was founded in 1919 and today it groups thousands of member companies and associations from over 140 countries.

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