The Emergence of “Fractured” Regional Markets

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Introduction

This paper looks at the liberalization attempts of the financial service sector within the General Agreement on Trade in Services (GATS) of the World Trade Organisation (WTO) and investigates the inherent risks of progressive liberalization as a potential "public bad" for countries and regions in many of the developing world. Charles Wyplosz (1999) suggests that financial instability is a challenge to the international financial system and identifies this instability as a "public bad", although not a "classical one". The author goes on to explain that financial instability is a public bad through its potential of producing negative externalities that spread across countries producing budgetary costs and severe redistributive effects, forcing countries into a spiral of fiscal constraints with potentially adverse political backlash (Wyposz 1999: 156).

One difficulty in studying the liberalization of financial services and its role in producing a "public bad" is its rather recent inclusion in trade agreements. Leroux (2002) cites that GATS is only the third trade agreement to address trade in financial services. In actuality there are four trade agreements to address trade in financial services if we include the EU. The European Council meeting in Lisbon set the year 2005 for the establishment of an integrated European financial service market (EC 2001).

The first agreement focusing on financial services was the Free Trade Agreement between Canada and the United States of America (FTA), entering into force on January 1, 1989. The FTA on trade in financial services was rather limited focusing on an exchange of specific market access concessions between Canada and the United States. The Agreement was suspended with the entry of the second agreement of the North American Free Trade Agreement between the Government of Canada, the Government of the United Mexican States and the Government of the United States (NAFTA), which entered into force on January 1994.

Unlike the narrow scope of financial liberalisation services within the FTA, NAFTA spelled out a comprehensive and immediate liberalization package in financial

services between the three North American countries, including for the first time a binding dispute settlement mechanism which the FTA did not have. NAFTA can thus be considered a model for the integration of financial services within the WTO Agreement. It included the principles of "national treatment"[1] and "most-favoured-nation treatment"[2] that became core principles for the WTO (Leroux 2002).

The strongest pressure for global financial liberalization stems from the Single European Act that went into effect on July 1, 1987. The Single European Act opened the market for the free movement of goods; the creation of a free market in the financial services and transport sectors; the granting of full freedom to professionals to practice throughout the Community, and the liberalization of capital markets. These actions were guided by three basic principles: the equivalence of each member state's legislative objectives; the institution of minimum standards when harmonization was required; and a reliance on the concept of mutual recognition to avoid, whenever possible, the complications involved in formulating and harmonizing Community-wide standards (Cameron 1992: 35).

The EU-Commission's Action Plan on the "Implementation of the Financial Market Agreements" and the General Agreement on Trade in Services can be understood as complimentary neoliberal mechanisms to push for progressive liberalization within the financial sector. Any conflict that cannot be resolved at the EU level can during the present negotiation phase be moved to the WTO level by entering into suitable commitments under the GATS agreement that are then binding on the EU.

One of the questions raised in this paper is whether the world-wide liberalization of the financial sector negotiated within the multilateral trading agreements of the WTO has the potential for creating financial globalization? Many authors refer to the present post-Bretton Wood system as a "market-led global financial system" referring to a process in which financial markets of various countries of the globe are integrated into a global financial world, where the traditional limits of time and space have largely been eradicated. Giovanoli (2000) describes the market-determined

[1] "National Treatment" within the WTO rules (Article XVII) means that GATS members must grant foreign services and service suppliers treatment no less favourable than domestic services and suppliers.
[2] "Most Favoured Nation (Article II) means that formal agreement between any two member countries has to apply to all members. In effect, all trading partners within the WTO must be treated equally.

fluctuating exchange rate system of the post-Bretton Wood era as one driven by the volume of financial assets, the sophistication of international financial transaction, the speed of international funds transfers and the advances in telecommunications technology “which make it possible for any market participant to shift instantaneously even the largest investment from one side of the globe to the other and carry out transactions in the most sophisticated financial instruments, including derivatives” (Giovanoli 2000: 6).

Internal and external liberalization of the financial sector (floating currency, removal of capital controls, deregulated takeover and merger activities, unregulated foreign direct investment, interest rate liberalization) was seen as a condition for achieving financial globalization. At the same time, there are centrifugal pressures of deglobalization[3] in the financial sector. While in some cases large sections of regional and national financial markets are integrated into the international financial markets, in other cases only a small fraction is able to do so. Many developing countries with low export potential and a rather small local financial market are not even considered for membership in the international club of finance. The global “fracturing” of the financial system is readily visible if we analyse the initial GATS liberalization “requests”[4] which are aimed at individual, specified countries to seek liberalization commitments from WTO member states. In the first round of liberalization requests submitted as part of the 5th Protocol in 1999, the United States and the EU expressed little interest in gaining access to financial markets in the small economies of the Least Developed Countries (NICs). Instead, they targeted largely protected national financial markets of NICs ranging from East Asia, Latin America to the Middle East, in which international investments banks and insurance companies (specializing in organizing security markets as brokers, dealers and underwriters of securities and insurances) anticipate high capital gains irrespective of some of the financial meltdowns of the 1990s (Young 2003). This has changed in the most recent rounds of liberalization requests in 2002. On average the EU has made fewer

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[3] The term “deglobalization” was made popular by Walden Bello, Focus on the Global South. According to Bello, deglobalization does not mean withdrawing from the international economy. “We are speaking about reorienting our economies from the emphasis on production for export to production for the local market” (Bello 2001: 39).

[4] The WTO Ministerial Round in Doha in 2001 set a timetable for further GATS negotiations. In June 2002, WTO members began to submit so-called “requests”. These requests are aimed at individual, specified countries and seek liberalization commitments in targeted service sectors. The EU tabled its country-specific proposals on July 4, 2004, requesting from 109 countries binding liberalization in targeted service sectors. The EU included 94 countries for liberalization requests of finance services (out of a total of 109 countries).

requests to the Least Development and low-income countries than industrialised countries, nevertheless, it has targeted 21 Least Developed Countries and 30 low income country WTO Members for financial liberalisation (World Development Movement 2003).

Rather than presuming, as is done in much of the existing literature, that financial liberalization is moving to financial globalization, it may be more appropriate to envision the future international financial market as a **"fractured"** market (Harris 1998), producing integrated regional financial markets, enclaves of integrated financial markets within regions, and regions that are non-integrated.

The article will first provide an overview of the structure and main disciplines of the General Agreement on Trade in Services in financial services, as well as the concurrent liberalization measures in the financial service sector within the EU. Second, the so-called "liberalization requests" and "initial draft" offers will be analyzed. The requests are aimed at individual, specified countries seeking liberalization commitments in targeted service sectors. In response, member states had to submit their "initial offers" in which countries state their willingness to open particular sectors for liberalization by April 29, 2003.[5] Finally, the likely risks and "public bads" of financial instability for many of the developing countries and regions from the financial liberalization commitments within the GATS and the EU will be at the centre of the final section.

How GATS works?

The GATS is the first legally enforceable trade agreement that covers trade and investment in services. The Agreement covers 12 service sectors[6], subdivided into 160 services, and extends to virtually all services, including transport, investment, education, communications, financial services, energy and water services, and movement of persons (UNDP 2003: 25). Trade in services has been a very dynamic

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[5] Since only 38 offers have been made by the time of the 5. Ministerial Meeting in Cancun, Mexico, September 10-14, 2003, the EU Trade Commissioner, Pascal Lamy, announced that the deadline for the offers will be extended until March 2004. (Press conference in Cancun on the 14th September 2004 at the Conference Center).

[6] These sectors are: 1) Business and Professional services; 2) Communication Services 3) Building- and Installation 'Services, 4) Distribution Services 5) Education 6) Environmental Services 7) Financial Services 8) Medical and Social services 9) Tourism and Travel Services 10) Recreational, Culture and Sport 11) Transportation, 13) Other not listed Services.

growth sector of the world economy. Between the early years of the 1970s and the 1990s, trade in international services increased by 1.200 percent. Exports of services earned in 2001 world-wide nearly 1,5 billion (trillion?) US-Dollars. The share of the service sector in world trade has reached around 30 percent (Lipke/Vander Stichele 2003), but there is a wide disparity between the supply capacities of the North and the South. The EU and the USA are by far the largest service exporters (about two thirds of world trade), a development which has so far entailed few reciprocal benefits for the South (German Parliament 2003).

The GATS negotiators opted for two strategies: "top-down" rules which apply for the entire 160 services listed in the agreement, and "bottom-up" rules which allow governments to choose the services for which these rules apply. The "bottom-up" rules are unusual in WTO agreements in that specific commitments apply only for those services that a government has chosen to include for liberalization. The ***National Treatment*** (Article XVII) and ***Market Access*** (Article XVI) are the key "bottom-up" rules which apply only if a government has specifically committed the service. The principle of ***National Treatment*** means that GATS members must "grant foreign services and service suppliers treatment no less favourable" than domestic services and suppliers. This measure essentially prohibits any regulation which would give preference or a competitive advantage to a domestic service industry and means that certain foreign suppliers would also be entitled to the same subsidies that are given to a competing domestic supplier (WTO Article XVII). ***Market Access*** covers government attempts to place quantitative limits on the number of service suppliers or outlets, regardless of whether they are domestic or foreign (World Development Movement 2003).

The "top-down rules" apply to all service sectors with the ***Most Favoured Nation*** (Article II)[7] being the one basic obligation in GATS which applies to all services of a WTO member. What this means, in effect, is that all trading partners must be treated equally. Countries are allowed to list exemptions to the application of this rule, but these may apply for ten years only. Article III of the GATS also contains the obligation of **Transparency** that applies to all services. It demands that Members have to

[7] The GATS does contain an exception to the most-favoured national principle for regional integration treaties (Article V). This means that the trade advantages within the EU common market do not have to be automatically granted to "third-party countries" outside the EU.

publish, at least annually, the relevant laws, regulations and other general measures which affect trade in services. GATS thus creates pressures to enter into negotiations with Members starting even at the planning stage of enacting domestic regulations and laws (Fritz and Scherrer 2002).

Services that are “supplied in the exercise of governmental authority” are excluded from the scope of application of the GATS agreements. Except for areas such as government, parliament, courts, the military, and internal security, there is considerable disagreement over what the term “in the exercise of government authority in fact means. There seems to be some agreement, that sectors that are partially privatized, that are growing towards privatization or in which quasi-State or private suppliers are administering public tasks potentially fall outside the protection of the sovereignty clause (Scherrer and Yalçin 2002: 6). In terms of the financial services, “services supplied in the exercise of governmental authority” refer to the activities of the central bank or monetary authorities, activities forming part of a statutory system of social security or public retirement plans; and other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the government (Annex para. 1(b) cited in Leroux 2002: 429).

Furthermore, Article I (2) of GATS, lists four different modes of how services are supplied. Examples are cited from the different modes of service supply within the financial services:

- Mode 1 *Cross-Border Supply*. A service that originates in one Member’s territory and is provided in the territory of another Member (i.e., a business enterprise headquartered in Germany borrows money from a bank registered in London).
- Mode 2 *Consumption Abroad.* A service that is provided in the territory of one Member for a consumer of services from another Member (i.e., A British family on vacation in Italy utilizes the Italian bank services).
- Mode 3 *Commercial Presence.* A service that is provided by a service provider of one Member via a business or professional establishment in the territory of another member (i.e., banks, insurance and security firms offer from their foreign branches or subsidiaries services to private and business clients).

- Mode 4 *Presence of Natural Persons.* A service that is provided by a service provider of one Member through the presence of a natural person of a Member in the territory of another Member (i.e., A Hungarian insurance company sends managers to work in its foreign branch in Germany) (GATS Annex para 1(a); Werner 1999: 36).

This classification scheme permits a highly differentiated liberalization of services. A country can limit its liberalization commitments to specific modes and/or demand additional exceptions for itself. In principle, these "bottom-up rules" allow countries to open the market only in those areas they see fit. Once countries have signed a commitment they are permanently bound by it, unless they provide compensation in the form of monetary payment or liberalizations in different sectors to Members who will incur losses as part of the reversal (Article XXI).

In the *Understanding on Rules and Procedures Governing the* ***Settlement of Disputes (***Article XXIII GATS)***,*** the WTO has created recourse to disputes if a member breaches the obligations under the GATS agreements. The Dispute Settlement Procedures establish a unified system for all parts of the WTO system. Different from the previous dispute settlement within the General Agreement of Trade and Tariffs, the WTO dispute settlement has provided a new appellate procedure. The presumption under previous procedures is reversed, with the ultimate result that the appellate report will come into effect as a matter of international law in virtually every case. Failure to comply can give rise to the negotiations of compensation or the suspension of concessions (Leroux 2002; Jackson 1994).

Financial Services and GATS

The General Agreement on Trade in Services (GATS) entered into force on January 1, 1995. It was only in 1999 that the 5th Protocol to the General Agreement on Trade in Services came into effect, with 102 WTO members states signalling their readiness to negotiate financial services within the WTO. The negotiations on services started in 2000. The fact that only a short-term Interim Agreement on the liberalization of financial services was reached in 1995 without the participation of the United States reflected the very different positions held by developing and developed countries on

opening the door to financial liberalization. Indeed, many developing countries refused to agree to any binding liberalization measures. In contrast, the OECD countries pushed for liberalization, since member financial sectors were already largely liberalized. In particular, the United States played a very aggressive negotiating position. Its strong comparative advantage in the service sector was to compensate for its large trade deficits in the goods market (Werner 1999).

The recent dominance of financial services is connected to the rapid development of mutual funds and pension funds as "institutional investors" in the United States financial markets, in fact exceeding the banking system in size.[8] As securities became to replace the loan system as the principal form of credit, the institutional structures of the financial systems started to specialize in organizing securities markets and investment banks became brokers, dealers, and underwriters of securities. The securitization of credit created the environment for financial services mediated via non-bank institutions to supply the liquidity necessary in the securities markets (Guttmann 2001). Financial innovations (derivatives, hedgefonds, stock-index futures, options) have made it possible to invest large sums of capital quickly in all the world's markets to secure trade and credit transactions often with a highly speculative character. Of the roughly 1.2 billion US dollars traded each day in currency markets, at best only five percent is for financing trade and direct investment, the rest is accounted for by brokered and speculative transactions between internationally operating financial institutions that are only very indirectly involved with the actual processes of production (German Parliament 2002). In this global race for high capital gains, financial services in the form of insurance services, banking services, and investment and asset management operate almost entirely without supervision in a virtually intransparent arena.

Despite the interest in financial service liberalization, the US declared a temporary exception to the "Most Favoured Nation" obligation in 1995, since it feared that developing countries would "free-ride" and take advantage of the "National

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[8] Mutual funds had US$6755 billion in total assets and pension funds exceeded US$7 trillion, compared to US$5770 billion in 2001 (Guttmann 2001)

Treatment", in this way gaining access to the American market while protecting their own domestic financial sectors (Leroux 2002). The US signed only on to the 5th Protocol in December 1997, once it was satisfied that the Agreement reflected its interests. In fact, the Coalition of Services Industries (CIS) lobbied very hard to have the American Congress approve the 5th Protocol: "We believe that the offers on the table provide significant commercial opportunities for the US financial services industry…" (Werner 1999: 19).

A chronological overview of the history of negotiations for financial services shows the very uneven progress that has been made in terms of financial service liberalization:

History of Negotiations and Time Schedule For Financial Services within WTO

- **1993** No agreement reached at the end of the Uruguay Round to include an agreement on financial services. Consultations for a Basic Agreement were postponed three times.
- **1995** The EU presented an Interim Agreement without the participation of the US
- **1997** Signing of the 5th Protocol of the GATS. 56 WTO-Member States submitted their commitments to liberalization.
- **1999** 5th Protocol to GATS went into effect. 102 WTO member states committed themselves to liberalization.
- **1999** Expiration of the dead line of national ratification and implementation of the Agreement.
- **1999** Breakdown of the 3. WTO-Ministerial Conference in Seattle.
- **2000** Start of the contractual negotiations for liberalization of the GATS Agreement. Negotiations are based on the list of commitments of the 5th Protocol.
- **2001** 4. WTO-Ministerial Conference in Doha, Quatar (November 9-13). „Doha Development Round". Schedule for future GATS-negotiations presented:
- **June 2002** Exchange of reciprocal liberalization „requests" of WTO member states. The EU has sent very specific liberalization requests for all services to 109 countries. Of these 109 country specific liberalization requests, 94 are addressed to countries requesting liberalization in the area of financial services. The EU received in turn requests for all services from 35 WTO member states, of which 27 are from Developing Countries.
- **March 2003** Submission of the" initial draft offers" from WTO member states to the WTO in Geneva.
- **2003** Break-down of the 5. WTO-Ministerial Conference in Cancún, Mexico (September 10-14). Due to the break-down of the Conference GATS was not negotiated.
- **March 2004** Since only 38 "initial draft offers" were submitted to the WTO by the time of the 5th Ministerial Conference in Cançun, Pascal Lamy, the EU Trade Commissioner, announced in Cançun that the deadline for submission of draft offers will be extended until March 2004.
- **January 2005** Official Ending of WTO-Negotiations. Due to the breakdown of negotiations in Cançun, this deadline can in all likelihood not be met, according to Pascal Lamy.

Scherrer, Fritz, Mosebach 2003: 32; Bundesverband deutscher Banken 2001: 15; Bundesministerium für Wirtschaft und Arbeit 2003; Werner 1999; http://europa.eu.int/comm/trade/services/pr290403_en.htm (14/05/2003); Young, Brigitte present at the Ministerial Meeting in Cançun.

Financial services are rather broadly and non-exhaustively defined within GATS. In general, they are defined as a service of a financial nature offered by a financial

service supplier of a Member. "It includes insurance and insurance-related services, such as life and non-life direct insurance, insurance intermediation and claim settlement services, as well as banking and other financial services (excluding insurance), such as acceptance of deposits, lending of all types, trading for the account of customers and asset management" (Leroux 2002: 428-429). The WTO identifies four large categories of financial services: 1) insurance services; 2) banking services: 3) Investment and Security Services; and 4) other services (financial information and financial advisory) (Lipke/Vander Stichele 2003). Finally, a financial service supplier is identified as a natural or juridicial person engaged in the supply or supplying financing services, excluding a public entity[9].

The rules and disciplines for the financial services are contained in three legal instruments: The GATS ("Agreement"), the Annex on Financial Services ("Annex"), and the Understanding on Commitments in Financial Services ("Understanding"). The Agreement contains the rules and disciplines applicable to all 160 service sectors covered by GATS, while the Annex and Understanding provide sector specific rules that proved necessary for some of the services, such as financial services, telecommunications, transport, movement of natural persons (Leroux 2002).

One specific rule applying only to the financial sector contained in the "Annex" needs to be mentioned for its contradictory interpretation. In para. 2, Members and their national regulators can adopt measures to protect the integrity and stability of the financial system for prudential reasons. The **"prudential carve-out",** as it is commonly referred to, is supposed to guarantee the sovereignty rights of states (central banks and or monetary authorities) to ensure the stability and the integrity of the financial system. This exception reads as follows:

> "Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system" (Annex para. 2(a) cited in Leroux 2002: 430).

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[9] Public entities are defined as governments, central banks or state banks, or monetary authorities in a Member state.

However, within the same para. 2 (a) we find the measures accorded to individual members for "prudential reasons" are substantially weakened. The exception "shall not be used as a means of avoiding a Member's commitment or obligations under the Agreement". In plain language, it seems that the signatory states cannot use their sovereignty rights to circumvent their contractual obligations (Werner 1999). Paragraph 2(a) has yet to be interpreted, but it does seem that the specific sovereignty rights of member states to protect the integrity and stability of their financial markets are open to interpretation (Young 2003). It can be assumed that there will be a narrow interpretation of the sovereignty rights of individual nations, since the most favored national principle creates an overall framework for progressive liberalization of international trade in services (Scherrer and Yalçin 2002).

The EU as a Strategic Regional Site of Financial Globalization

The European financial service sector (banks, insurances, securities and assets) employs presently about 3.4 percent and has a share of over 6 percent of the GDP in the European Community.[10] While these numbers are not overly large, it is the potential of a profitable world-wide financial service market that is driving the progressive liberalization process. The Financial Leaders Working Group (FLWG)[11] sees in the expansion of the financial services sector an important channel for the implementation of macroeconomic policies to enhance economic growth globally, regionally and for individual countries, both developed and developing. FLWG understands the role of financial services as mobilising and distributing savings; facilitating investment; enabling reliable and efficient settlement of payments, providing means of risk management for business, and support and encourage external trade (Press release of the FLWG, n.d.).

Critics of the liberalization of the service sectors within the GATS intensely debate the likely impact financial service liberalisation will have on financial stability in many

[10] http://europa.eu/int/comm/trade/services/gats_sum.htm

[11] The Financial Leaders Working Group is a lobbying group of European-North American financial service sectors, established in 1996, to provide unified support to liberalise trade in financial services in the World Trade Organisation.

developing countries (Lipke/Vander Stichele 2003). Much less attention has been paid to the liberalization commitments made in the "White Paper" of 1985 to create a European Single Market. In fact, the strongest deregulation pressure originates from the Single European Act committing the European Union to the freedom of movement for goods, services, people and capital. In terms of the financial sector, all controls on capital movement were eliminated as a result of the Directive (Richtlinie) 88/361/EWG. In addition, the "Second Bank Regulation Coordination Directive" from December 1989 has to a large extent secured the "freedom of movement of services and the freedom of establishment of banks" from member states within the EU (Barth 1998: 55). A central element is the "European Passport", which guarantees that if a bank is properly licensed and supervised in the country of origin it can establish commercial presence in all the member states. After the registration in one of the member states, financial institutions can without restrictions create subsidiaries and engage in cross-border business activities. Branches and subsidiaries of foreign establishments without EU-registration have to fulfil stricter conditions than branches of EU-banks (Federal Association for German Banks 2001). Furthermore, the second and third "Coordination Directives for Compensation" from 1988 and 1992 regulate the right of cross-border activities for claims insurance companies which do not have a foreign licence.

Not all items of the Directives for implementing financial liberalization have been completed by the time the single internal market started in 1992. The European Community complained in June 2002 that although the climate has improved, there is still a lot to do (EC 2002). Despite this criticism of the EU, the liberalization measures proceed with greater speed and are more far-reaching in terms of financial integration than the negotiations within GATS. The European Council meeting in Lisbon has targeted 2005 as a final date for a fully integrated European financial service market. For this purpose, an Action Plan for financial services (FSAP) was issued which is largely based on the advice of the "Political Group of Financial Services" (FSPG) made up of the personal representatives of the finance ministers and the European Central Bank. Of the 42 original measures in the Action Plan for financial services, 26 have been implemented by 2002 (EC 2002). Three major strategic goals for liberalization are set forth in the Action Plan:

- Establishment of an integrated client market for financial services
- Creating an open and secure private client market
- Modernization of Supervision Rules.

Already in 2002 the European Council and the European Parliament have issued Directives to regulate the long-distance marketing of financial services, financial security, insurance intermediaries, market abuses, finance conglomerates, and the establishment of company pensions. An important additional feature is the emphasis on the integration of a securities market (referred to as the "Lamfalussy-Proposals") and the four step concept approved by the Council for the liberalization of the securities and investment services. In addition, a final rule was approved for accounting standards. In response to some of the bogus trades and criminal activities of the American energy company Enron, Worldcom, Xerox and some of the most well-known investment houses such as J.P. Morgan, Citigroup, Merril Lynch, Bank of America and others (Young/Hegelich 2003), the EU Commission decided that starting in 2005 to use the International Accounting Standards (IAS) for stock market registered companies. Further Directives for stock prospects, the handling of acquisitions, and Directives to regulate cross-border mergers are being prepared during 2003. In addition, the money laundering Directive passed after the September 11, 2001 is in the process of being revised. Also new rules for equity capital holdings for credit institutions and security firms are being changed in accordance with the new Basel II Agreement and are supposed to go into effect in 2006 (EC 2002).

Under the umbrella of virtual secrecy and exclusion of the public, the European Community is pushing the implementation of the Action Plans for financial services with great speed forward. In the EC-Progress Reports[12] on financial services, critique is voiced in regard to the slowness of the legislative procedures. The EC demands to shorten the legislative readings and urges the importance of cooperation between the institutions of the EU and suggests to shorten the process to one reading in most cases or to an accelerated second reading (EC 2002: 5).[13]

[12] The EC has issued the 6. Progress Report for financial services on June 3, 2002.
[13] Own Translation: „Auch größtmögliche Zusammenarbeit zwischen den EU-Institutionen ist von zentraler Bedeutung, soll die Annahme in möglichst vielen Fällen in einer einzigen Lesung oder in einer beschleunigten zweiten Lesung erreicht werden".

The questions arises how the stability of financial markets as a public good can be protected if liberalization negotiations are decided upon without democratic decision making procedures and are rushed through the institutions at such high-speed?

The Liberalization "Requests" and "Offers" in the GATS

While the European internal market and also the NAFTA region (US, Canada, Mexico)[14] are developing into integrated global financial markets, the US and EU GATS liberalization requests indicate a major offensive to open the markets of many developing countries resulting in all likelihood in more financial instability and fractured markets in many regions of the world. The EU and the US claim that through the reduction and elimination of restraints on foreign participation in financial service activities benefits will accrue to financial and related services. No consideration is given to the often weak domestic banking structures and security and investment markets in many of the developing countries and their inability to compete with the highly competitive foreign services industries.

Already in the GATS-Agreement of 1997, the industrial countries singled out mode 3 (commercial presence in the territory of another member state) as their targeted supply modus for financial service liberalization. International banks, investment and security firms as well as insurance companies are eager to establish subsidiaries and branches in third countries to gain financial market access in countries that had hitherto controlled capital movements and protected the domestic market from foreign incursions. Despite expressing some interest in establishing commercial presence in third countries (Mode 3), the 77 developing countries among the 102 WTO Member states remained reluctant to open the financial markets to foreign suppliers in 1999.

Industrial countries targeted the Asian markets in the 5th Protocol, which went into effect in 1999, for extensive liberalization. A second list of priority countries were large developing nations such as India, Egypt, South Africa, Brazil, Argentina as well as Chile, Mexico, Peru, Uruguay, Venezuela, Turkey and the East European

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[14] In the FTAA (Free Trade Agreement of the Americas) which includes the entire North American and South American continent, the United States is proposing further liberalization of financial services that exceed the requests already contained in the NAFTA Agreement and the WTO proposals.

transition countries. The least interest received the majority of Least Developing Countries (a group of about 70-80 countries), which produce less than 3 % of the worlds GNP (Werner 1999). Thirty of those countries did not even submit requests to the WTO. Others again, showed a willingness to open their financial markets far beyond that of industrial countries. In this context the question needs to be raised whether the poorest of the developing countries have the legal and economic expertise to interpret the highly complex and contradictory GATS document and the impact such liberalization processes would have on their domestic economy (Young 2003).

The earlier neglect of LDC's financial markets seems to have been reversed in the latest round of requests. As pointed out previously, at the 4. Ministerial Conference in Doha a time table was set for the exchange of reciprocal liberalization "requests" of WTO member states (June 2002) as well as submissions of the "initial draft offers" of member states to the WTO by March 2003 (extended to March 2004 in Cançun). The requests are aimed at individual countries to seek commitments for binding liberalisation in targeted service sectors. The EU tabled requests aimed at 109 countries in June 2002 and received in return 35 requests (27 from developing countries). As far as we know from leakages,[15] since neither the EU nor the WTO have released the full draft requests nor the 38 "initial draft offers" that had been submitted to the WTO by the time of the 5. Ministerial Meeting in Cançun, September 2003, the EU has targeted 21 of the 30 Least Developed Country WTO Members[16] for financial liberalisation and 30 requests to the 41 low income country WTO Members[17]. Altogether the EU targeted 84 countries for financial services liberalization (World Development Movement, 2003).

Below are some selected examples of the EU requests restricted to the financial service sector:

- Malaysia: the EU asks for removal of Malaysia's cap of 51 percent foreign equity participation in the insurance service.

[15] The full 109 requests have been leaked to the Canadian Polaris Institute and posted on their webpage (www.polarisinstitute.org/gats/main/htm).
[16] This definition is in accordance with the United Nations Conference on Trade and Development.
[17] Definition of the World Bank.

- Columbia: EU requests Columbia to eliminate the special conditions offered exclusively to its companies and nationals in the disposal of state holding companies.
- India: Eliminate the 15 per cent ceiling for assets of foreign banks in the total assets of the banking system.
- Barbados: EU requests the removal of the specific tax on the value of the settlement required from foreign investors purchasing or selling land or shares/stocks.
- Botswana: Eliminate the priority given to nationals in purchasing assets owned by foreigners.
- Chile: To eliminate all existing controls on capital movements. In particular, it is being asked to eliminate the rule to require foreign investors to retain capital in the country for at least two years from the date of entry. Chile enacted this regulation to limit the volatile short-term capital inflows. Chile is further asked to eliminate the legally established tax percentage on overseas capital repatriation. In addition, the EU demands market access for mode 1 (cross-border supply), mode 2 (consumption abroad) and mode 3 (commercial presence).
- Chile: Eliminate rule that investors employ 85 percent of staff of Chilean nationality
- Brazil: Eliminate restrictions on profit repatriation which enable the central bank to restrict transfer of fund abroad by foreign companies
- El Salvador: Abandon the 50 percent ceiling on the remittance of profits abroad.
- Indonesia: Indonesia's GATS restrictions state that foreign companies can only control 49 percent of a joint venture and must work through/with a local representative when setting up branches inside Indonesia. EU wants this rule to be eliminated.
- Thailand: To allow banks with off-shore licences access to the domestic financial market.
- Philippines: To permit subsidiaries of foreign offshore banks to transact their business activities in domestic currency.
- India: Open the market for derivative financial transactions.

- South Africa: Reverse ruling that limits the amount of local borrowing by companies with more than 25 percent non-resident shareholding. The EU wants the complete liberalization of capital movements and demands further to open the pension funds to foreign investors (World Development Movement 2003: 19-20; Lipke/Vander Stichele 2003; Scherrer, Fritz, Mosebach 2003: 37; European Commission 2003).

The EU has so far not received any requests from third states for the liberalization of financial services. This reflects the fact that the EU market is already largely liberalized, although the Federal Association of German Banks has indicated at a hearing in the German Parliament on GATS that it would, on the basis of the reciprocity principle, be quite willing to open even those areas in the European market that are not yet fully liberalized. But in general the abstention of requests to the EU is indicative of the low competitiveness of developing countries in financial services. This market is largely dominated by the United States and the EU. While the US has had a trade deficits in the goods market for years, in the service trade it produced a surplus of 6,3 billion US-Dollars in 2001 (Lipke/Vander Stichele 2003). It is this comparative advantage of the EU and the US that is the major driving factor in liberalizing the financial service sector.

Fractured Regionalism and Financial Instabilities

The selective list of liberalization requests clearly characterizes the EU's intent to pressure countries to abandon the existing domestic restrictions and to fully commit the financial sectors to the GATS rules irrespective of the developmental impact the removal of domestic regulations may have on the stability of the financial sector. It is only consequent when the Association of the German Insurance Sector in a written declaration during the "Public Hearing" in the German Parliament on 07.04.2003 declared that "the GATS is a Treaty to allow for easier cross-border service activities and is not an instrument for development"[18] (German Parliament 2003: 51).

[18] The German text reads: GATS ist ein Abkommen zur Erleichterung der grenzüberschreitenden Dienstleistungserbringung und nicht ein entwicklungspolitisches Instrument.

If we instead start with the security, stability and integrity of the monetary and credit institutions as a public good and suggest further that many of the developing countries cannot cope with the volatility of short-term inflows and outflows of money, as was the case in the Asian crises of 1997/98, it may be prudent - against the present conventional wisdom of the negotiators in the GATS - to retain capital controls before “more crises create more disasters” (Wyplosz 1999: 185). As a result of the widespread presence of information asymmetries between lenders and borrowers and the additional difficulty of cultural differences as well as the inability to interpret the local idiosyncrasies, the likelihood of financial market failures increase rather than decrease with financial service liberalization.

There are many possible destabilizing effects for financial markets if the GATS requests are implemented. First, there is little recognition of the national local economic, political and social dimensions of the countries and regions. All countries, irrespective of their level of economic and financial development, are treated alike in the requests. The “same treatment for all” method has been widely criticized by Stiglitz (2002) in regard to the IMF’s policies of the Structural Adjustment Programs (SAPs). The mistakes of the SAPS are repeated in the GATS. Moreover, if India or China is pressured to open its market to derivative transactions, it does not take into account that derivatives and other financial innovations are highly speculative and risky, which neither the Indian nor China’s financial markets can adequately manage.

A further destabilizing aspect is the speed with which both the EU and the GATS drive the liberalization process forward. As indicated above, the EU under the mantle of virtual secrecy intends to complete the internal financial markets by 2005. No public debate has so far taken place on the impact this progressive liberalization will have on individual member states. The acceleration of financial service liberalization is all the more problematic in that it coincides with the ongoing discussions about reforming the international financial architecture. In the aftermath of the Asian financial crises, financial experts agreed that there is a need to re-regulate the markets. Also, discussions started even within the IMF on the need for an insolvency procedure for the “highly indebted poor countries (HIPC). As of late, the discussions around these issues seem no longer to have the urgency they had after 1997/98. Surely the liberalization of financial services and reforming the international financial

architecture are not two independent projects. Finance service liberalization which is not embedded within the larger reform project of the international financial architecture is a risky endeavour and may destabilize further many of the underdeveloped financial markets of developing countries (Lipke/Vander Stichele 2003).

However devastating the impact of financial instability is on individual countries having to face unpleasant economic choices with potentially adverse political effects, and on the most vulnerable who are particularly hard hit by financial crises as was the case in Asia, Argentine and Brazil (Young 2003a), there is also the danger of international spillovers. As Wyplosz (1999) pointed out, world financial markets are a vehicle for powerful externalities. Returning once again to the Asian crises, neither the private rating agencies nor the financial markets did forecast and adequately price the risks of the crisis to come. Not only did the market fail to price the pecuniary externalities of the crisis, some externalities, such as the phenomenon of contagion, are non-pecuniary and cannot be adequately priced. “For example, as the crisis occurred in Thailand, markets reacted violently (adverse selection) and indiscriminately, spreading the crisis throughout South-East Asia and beyond to Brazil, Poland, Russia and several other countries” (Wyplosz (1999: 159). In the process of these international spillovers, entire countries, regions or enclaves of regions may, as a result of financial instabilities, face the prospect of the disintegration of regional financial markets.

Rather than envisioning the emergence and development towards global integrated financial markets, this article argues that the progressive liberalization of financial services within GATS and the EU has the potential to produce a “fractured” global financial system in which the European Union and the US are the driving force to shape and reshape the financial markets into an institutionalized “club” in which membership is contingent on the profits large financial suppliers (such as international banks, insurance companies, investment firms) can make by gaining access to the global regional and local markets of developing countries. Some regions and countries will be partially integrated into the “market-led global financial system” and face periodic financial instabilities, while many least developed countries are excluded from the international financial system. As a result, entire regions of the

world may face the intended or intended consequence of a “deglobalized” financial system.

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