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Welf Werner*

The End of Financial Services Liberalisation As We Know It

At the intersection of trade policy and finance a new field of international economic policy has emerged, which has so far received little academic attention. Since the early 1990s, financial services have become an object of modern trade policy for the first time. How are the contours of the new trade policy for the financial services defined? Which research issues are posed by this new field?

Into the early 1990s, trade policy for financial services was restricted to unilateral measures. National governments enjoyed almost complete sovereignty in determining foreign trade regulations for their financial services sectors. A significant step towards a new trade policy was made when financial services became the subject of regional and multilateral trade policy initiatives. Altogether, three modern trade policy initiatives have so far addressed financial services: the European Single Market, the North American Free Trade Agreement (NAFTA) and, as an integrative element of the World Trade Organization (WTO), the General Agreement on Trade in Services (GATS).

In the North American Free Trade Agreement and the European Single Market new trade policy measures for financial services were introduced in 1993 and 1994. In the World Trade Organization, where in 1995 only a limited interim agreement was reached, the ultimate fate of financial services has yet to be decided. Whether or not financial services should become a permanent part of the General Agreement on Trade in Services is to be decided by December 12, 1997.

As with other sectors which became subject to the discipline of regional and multilateral trade agreements in the past, this step will also involve fundamental changes for the financial services sector. In essence, the passage from unilateral to regional and multilateral trade rules means a transition from sovereign national resolutions to collective decisions taken by international organisations and forums. This involves far-reaching changes in the formulation, design and implementation of trade policy measures.

The numerous questions raised by the new trade policy initiatives for financial services appear all the more pressing since there has so far been little work published on the subject. Although numerous papers in the early 1990s considered the financial services chapter of the European Single Market programme, these papers treated the European initiative as a remarkable one-off case rather than as part of the beginning of a new trade policy era.¹ Of the three disciplines – economics, political science and legal studies – which could take on the subject of the new trade policy initiatives, so far only the field of legal studies has dealt with this subject in any depth. The work done here offers valuable assistance in reading and understanding the complex contracts involved.²

In other respects knowledge regarding the new initiatives is limited. Given that the new trade policy initiatives have been largely neglected by economists

* Free University of Berlin, John F. Kennedy Institute for North American Studies. The author would like to thank the following institutions for their generous support of his project "Financial market integration in North America and Western Europe: Trade policy initiatives and economic effects": The Center for European Studies (Harvard University), The Elliott School of International Affairs (George Washington University), The Paul H. Nitze School of Advanced International Studies (Johns Hopkins University), and The German Marshall Fund of the United States. An earlier version of this paper was presented at the fourth meeting of the Arbeitskreis für Bankgeschichte of the Gesellschaft für Unternehmensgeschichte on September 26, 1997. The author would like to thank the meeting's participants for their helpful comments and advice.

¹ One significant exception is Sidney J. Key: Financial Integration in the European Community, Board of Governors of the Federal Reserve System, International Finance Discussion Papers 349, Washington DC 1989. In this and in other papers, the author lays important foundations for analysing the new initiatives for financial services from a trade policy point of view.

and political scientists, their finance and trade policy implications remain unclear.

Contours of the New Trade Policy

As mentioned above, the essence of the new trade policy initiatives lies in the efforts made to reach a consensus. Looking back to the days of unilateral trade policy we can see that, traditionally, initiatives aimed at co-ordinating trade policy measures in the financial services sector have been extremely limited. The most important form of co-ordination between two countries were reciprocity measures. If, for example, a country decides to allow foreign financial firms to hold majority-ownership interests in domestic life insurance companies, it can limit its offer through the use of a reciprocity test to those trading partners which offer similar conditions in return. Reciprocity reduces the co-ordination of international trade policy to the simple formula "an eye for an eye, a tooth for a tooth" or "tit for tat".

Let there be no misunderstanding, however: unilateral decisions can indeed lead to national governments reaching similar or even identical trade policy decisions. The rapid globalisation of the financial services markets since the early 1970s is a good example of how countries react similarly to international economic developments. In the past 25 years, hardly a single country has evaded market liberalisation. On the other hand, it is indisputable that the individual measures taken have been very different as far as their scope, variety and consequences are concerned. Indeed, it appeared to some observers that national trade policy for the financial services sector was in such poor order that the "governability" of international financial services markets developed into a central focus of interest.³

Although modern trade policy is characterised by its attempt to strengthen the co-ordination of liberalisation measures, the co-ordination process itself can, depending on the trade policy forum in which it takes place, take on a variety of different

forms. The extent of the liberalisation commitments required of individual countries in order to reach a consensus and the chances of reaching any kind of meaningful agreement at all depend upon a number of basic institutional conditions of the trade policy forum in question.

These conditions include the number of member states, their level of liberalisation on entering negotiations as well as their willingness to participate in liberalisation measures. There are significant differences between the North American Free Trade Agreement, the European Single Market and the General Agreement on Trade in Services with regard to these characteristics.

The North American Free Trade Agreement has three member states; the European Single Market and the World Trade Organization are comprised of 15 and 131, respectively. The WTO encompasses some of the poorest developing countries as well as the richest industrialised countries. Even more importantly, the WTO member states reflect a very wide range of different philosophies regarding the regulation of the financial services sector. The WTO embraces not only the OECD countries with their relatively liberal market access conditions, but also countries such as Barbados or Guatemala whose financial services sectors were almost completely fenced off when they first entered negotiations. Any trade policy forum in which all these countries are assembled in a common effort to achieve liberalisation must inevitably allow its members a great deal of flexibility.⁴

The North American Free Trade Agreement, entered into by the USA, Canada and Mexico, also places considerable demands on co-ordination efforts but within a much smaller group of countries. The USA and Canada rank high among the world's leading industrialised countries. Both countries have highly developed financial services markets, and the aims of free market access and national treatment – the non-discrimination of foreign financial services suppliers under host country regulations – have been realised to a remarkable degree. In contrast, Mexico is an emerging economy whose borders were almost completely fenced off to foreign financial services

² In some cases, comments have also been published by members of negotiating delegations. For the Federal Republic of Germany see Dietrich Barth and Nikolai Putschner: *Liberalisierung der Finanzdienstleistungen im GATT*, in: *Die Bank* 94 (1994), pp. 132-136; and Roger Kampf: *A Step in the Right Direction: The Interim Deal on Financial Services in the GATS*, in: *International Trade Law & Regulation* 1 (1995), pp. 157-166. As of publication of this article, a study by the European Policy Forum on the WTO initiative for financial services has been published and the forthcoming publication of a monograph on the same topic has been announced. See Stephen Woolcock: *Liberalisation of Financial Services*, European Policy Forum, London 1997; and Wendy Dobson: *Financial services liberalization in the World Trade Organization*, Institute for International Economics, Washington DC 1997.

³ This aspect was developed in political science studies in particular; see for example Susan Strange: *Casino Capitalism*, Oxford 1986.

⁴ The developing countries' perspective in the General Agreement on Trade in Services is illustrated by Andrew J. Cornford: *Notes on a Possible Multilateral Framework for International Trade in Banking Services*, in: *Uruguay Round: Further Papers on Selected Issues*, (UNCTAD) New York 1990, pp. 157-201.

companies when negotiations began. At that time, for example, just one foreign bank had been issued a licence to operate in Mexico on an establishment basis.⁵

The European Union offers without doubt the best conditions for liberalising the financial services sector. This cannot be completely attributed to the similar starting positions of its member states: at the end of the 1980s there were considerable differences between individual countries such as the United Kingdom and Germany on the one hand and Portugal, Spain and Greece on the other. The decisive factor for the success of the western European initiative was, rather, the willingness of the EU member states to promote the already advanced integration process by taking another significant step forward in the form of the Single Market programme. Financial services were able to profit particularly from the willingness of the member countries to include in the Single Market

programme not only the more traditional issues of market access but also questions of how to deal with differences in the regulatory structures of the member states.

Integrated Liberalisation Programmes

Unilateral trade policy for the financial services sector has never claimed to be a comprehensive solution, neither with regard to the subsectors of the financial services sector, nor in relation to the various methods of providing services internationally. Trade policy for the financial services sector was a policy of small steps. Even large-scale initiatives such as the 1978 International Banking Act in the USA have been restricted to partial aspects of the sector's foreign trade regime. They are, as a rule, directed at one of the three subsectors – banking, investment banking and insurance – and even here they contain considerable gaps.

The three trade policy initiatives – NAFTA, the European Single Market and the General Agreement on Trade in Services – have set entirely new standards. The 1995 interim agreement for financial services is an excellent example of the new integral approach to trade policy. In this agreement, the countries are called on to propose liberalisation commitments in a total of 16 subsectors, thus covering the entire financial services sector (Table 1).

However, the GATS is also remarkably comprehensive with regard to the different methods of providing services internationally: the modes of supply. The schedules – standardised lists in which the countries put their liberalisation commitments on record – differentiate between four different modes of supply for each subsector. The two most important modes are the cross-border provision of services and the provision of services through commercial presence. In addition, the movements of consumers and company staff are also considered. Finally, for all four modes of supply, the schedules differentiate between commitments with respect to market access and national treatment (Table 2).

For each subsector, a commitment consists of a total of eight entries in the schedules. As there are 16 subsectors it is clear that, compared to unilateral measures, the WTO-initiative has radically extended the focus of trade policy for financial services. Although the framework agreement of the GATS does

Table 1
Financial Services Covered by the GATS

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| <p>A. All insurance and insurance-related services</p> <ul style="list-style-type: none"> a. Life, accident and health insurance services b. Non-life insurance services c. Reinsurance and retrocession d. Services auxiliary to insurance (including brokerage and agency services) <p>B. Banking and other financial services (excluding insurance)</p> <ul style="list-style-type: none"> a. Acceptance of deposits and other repayable funds from the public b. Lending of all types including, inter alia, consumer credit, mortgage credit, factoring and financing of commercial transactions c. Financial leasing d. All payment and money transmission services e. Guarantees and commitments f. Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following: <ul style="list-style-type: none"> ◆ money-market instruments (cheques, bills, certificates of deposit, etc.) ◆ foreign exchange ◆ derivative products including, but not limited to, futures and options ◆ exchange rate and interest rate instruments, including products such as swaps, forward rate agreements, etc. ◆ transferable securities ◆ other negotiable instruments and financial assets, including bullion g. Participation in issues of all kinds of securities, including under-writing and placement h. Money broking i. Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial depository and trust services j. Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments k. Advisory and other auxiliary financial services on activities such as credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy l. Provision and transfer of financial information and financial data processing and related software by providers of other financial services <p>C. Other</p> |
|--|

⁵ The licence was issued to the US company Citibank.

not compel the participating countries to propose liberalisation commitments for all subsectors,⁶ it represents an extensive and systematic approach which is identical for all the countries involved. This approach has given rise to a whole new form of trade policy. This new form also results from the fact that the commitments are presented by all countries involved at more or less the same time. Of 131 WTO member states, a total of 93 have so far taken part in the multilateral negotiations on financial services.

The Emancipation of Trade Policy

While trade policy has long been an important and somewhat independent policy field within the various areas of modern economic policy, this has not been the case for trade policy measures for the financial services sector. Trade policy for financial services has traditionally been very closely linked to prudential regulation, which is primarily structured by subsector within the financial services sector and trade policy considerations have never played more than a subordinate role.

Other elements of trade policy for the financial services sector have traditionally been governed by monetary and exchange rate policies. In the past, decisions to restrict the movement of capital were always taken in the context of these policy areas even though measures of this nature are also key elements of trade policy for financial services.

With the three new initiatives – NAFTA, the European Single Market and the General Agreement on Trade in Services – trade policy for financial services has developed into an independent policy field for the first time. In these forums, the liberalisation of the financial services sector is no longer directly connected to the economic policy of individual nation-states but to a far-reaching international trade policy process which, in the course of the last 20 years, has developed a certain

automatism in conquering new fields. In these new initiatives, the liberalisation of financial services is closely linked with the transition of the trade policy agenda from trade in goods to trade in services, from international trade to foreign direct investment, from tariff to non-tariff barriers, and from border-specific barriers to those created by domestic regulations. In the future, trade policy for financial services will continue to be very closely linked with these trade policy issues.

Liberalisation Commitments

The liberalisation commitments agreed upon in the new trade agreements are the subject of great interest in the daily press. Articles in the daily newspapers concentrate in particular on the question of how much progress these commitments represent compared to the situation before negotiations began. If one were to subscribe to this point of view, two of the three new initiatives could possibly appear to have failed.

Unilateral trade policy has brought about such a rapid liberalisation process in the financial services sector over the last 25 years that the new trade policy initiatives have little chance of surpassing the old liberalisation record in terms of speed. For most WTO member states, there was never any question of aiming to make progress over and above the existing state of liberalisation. The central aim of the negotiations was to animate the participating countries to record in the schedules all commitments already in existence under unilateral trade policy regimes. In numerous cases, however, it proved impossible to achieve even this modest goal.

The harshest criticism of the results of the WTO negotiations came from the USA, which in March 1994 and July 1995 opposed the completion of a permanent deal. Even today the USA is dissatisfied with the commitments made by numerous newly emerging economies in Asia and South America. American criticism is directed at states such as South Korea, India, Malaysia, Indonesia and Thailand, for example.⁷ With regard to the various modes of supply, the USA is most critical of the fact that many countries still refuse to permit foreign firms majority ownership.⁸

With regard to the commitments made in the North American Free Trade Agreement, Canada and the

Table 2
GATS Schedules

Sector or sub-sector	Mode of supply	Limitations on market access	Additional commitments on national treatment
	Cross-border		
	Commercial presence		
	Movement of consumers		
	Movement of personnel		

⁶ Indeed, numerous countries have made only very fragmentary offers. See World Trade Organization: The General Agreement on Trade in Services. Results of the Financial Services Negotiations Concluded in July 1995, Geneva 1995.

⁷ The Financial Times, 15. 7. 1997, p. 5 ("US lifts financial services hopes").

USA made only insignificant modifications to their initial positions. The two North American neighbours had no doubt already come very close to their limits in previous bilateral talks. Mexico was the only NAFTA partner to propose strong commitments, whereby the willingness of the United States' southern neighbour to implement such measures was clearly pronounced even before negotiations began. The North American Free Trade Agreement flanked a far-reaching market economy reform programme in Mexico which had been introduced by President Salinas just a few years earlier.⁹

The European Single Market programme is the only one of the three new initiatives in which all participants commit themselves to making marked progress. The extensive liberalisation success achieved by the programme is based on the largely familiar elements of harmonisation and home country control. These elements are used to remove not only discriminatory but also non-discriminatory trade barriers.

While discriminatory trade barriers put foreign companies at a disadvantage compared to domestic firms, non-discriminatory trade barriers put foreign companies from country A at a disadvantage compared with foreign companies from country B. The importance of non-discriminatory barriers is demonstrated not only by intra-European trade relationships; a relatively well-known example is also to be found in transatlantic relationships.

Following the introduction of the European Single Market in 1993, US banks enjoyed far greater freedom to carry out their business in the member states of the European Union than EU banks in the USA. Discriminatory trade barriers were not the cause, however. Great efforts were made on both sides of the Atlantic to give legal force to the national treatment principle under the respective banking regulations. The cause of the divergent treatment of foreign banks lay in the relatively restrictive statutes of US prudential regulation. Particular features, such as the McFadden Act restrictions on interstate branching and the Glass-Steagall Act restrictions on investment banking were – subject to few exceptions – equally applied to foreign banks.

Research Issues

The analysis and assessment of the liberalisation commitments of multilateral and regional negotiations represent an issue which should be central not only to the daily press but also to academic research. The

comprehensive initiatives for the financial services sector have opened up a field of considerable scope. The information contained in the agreements provides an opportunity to take stock of market access conditions in the financial services sector in a great number of countries, a task which could prove to be of interest far beyond the mere assessment of the new trade policy initiatives.

Reports in the daily newspapers on the new trade policy initiatives are usually based on statements gleaned from the negotiating delegations. In order to obtain a more objective picture of the outcome of negotiations, the wording of the commitments must be systematically evaluated, not only by country but also with regard to the various modes of supply. In the case of the World Trade Organization, this would mean evaluating a contractual work¹⁰ covering over 1500 pages.

In order to obtain a clearer picture of their economic significance, the liberalisation commitments should be presented within the context of the international financial services markets. Depending on the volume of international transactions in question, the apparent significance of some commitments may change under this analysis. Far-reaching liberalisation commitments could prove insignificant because they concern aspects of global financial markets which are, in practice, of secondary importance. Relatively modest measures could, on the other hand, result in major economic consequences.

Only a systematic analysis of the wording of the agreements can identify imbalances in the liberalisation commitments and reveal both improvements and flaws in the new trade policy initiatives. No information of this nature is available on the current status of liberalisation efforts contained in the 1995 interim agreement, which has now been valid for almost 18 months.¹¹

A further step in the evaluation of liberalisation commitments involves the determination of the welfare effects achieved, i.e. an illustration of the

⁹ The stances taken by the two most important negotiating partners at the multilateral talks, the USA and the European Union, are presented by Welf Werner: *Liberalisierung von Finanzdienstleistungen: Atlantische Positionen und Konzepte auf dem Weg zur Interimslösung im multilateralen Dienstleistungsabkommen (GATS)*, in: *Aussenwirtschaft*, 51 (1996), pp.327-362.

¹⁰ Heinz Walker-Nederkoorn: *Die Finanzdienstleistungen im NAFTA*, in: *Aussenwirtschaft*, 48 (1993), pp. 337-356.

¹¹ World Trade Organization: *The General Agreement on Trade in Services. Results of the Financial Services Negotiations Concluded in July 1995*, Geneva 1995. See also the references quoted therein.

changes in costs and prices initiated by the trade policy measures. Here, one important study has already appeared in an otherwise virgin field of research: the Cecchini Report. This well-known report, which in 1988 forecast the welfare effects of the Single Market programme, contains a detailed investigation of the financial services chapter of the programme. The study, which was produced by Price Waterhouse, came to the conclusion that no less than a third of the growth effects arising from the Single Market programme would result from the liberalisation of the financial services markets.¹²

Forecasting welfare effects is one matter, but providing empirical evidence of them is another altogether. Studies which provide evidence of welfare effects must not only – as was also the case in the Price Waterhouse study – tackle the remarkable complexity of international financial relationships. Such studies are also faced with an extraordinary challenge as a result of the immense market forces which play on international financial business. Compared to the influence of interest and exchange-rate fluctuations, changes in the profitability of the various home country markets of financial firms and the results of product innovation, and the effects of trade policy measures are very difficult to identify.¹³

Progressive Liberalisation

As important as the study and analysis of liberalisation commitments and their economic effects may be, they alone are not sufficient to form a judgement of the success of the new trade policy initiatives. When looking at liberalisation commitments, the fact that new trade policy initiatives usually require a certain amount of time before tangible results emerge is not taken into consideration. It should not be forgotten that efforts to liberalise international trade in goods did not lead to their now familiar success at the first attempt either. An evaluation of the first round of multilateral negotiations held in 1947 would surely not go far enough if it concentrated solely on tariff reductions agreed upon at that time.

Multilateral and regional trade policy forums are geared towards progressive liberalisation, i.e. a

continual process of liberalisation. In order to guarantee progress at future rounds of negotiations, modern trade agreements contain a number of elements ranging from simple arrangements such as the settlement of agendas and dates for the resumption of talks to an extensive catalogue of general rules of conduct. The question that is raised in view of the new trade policy initiatives for financial services is whether these initiatives will be able to fulfil the promise of progressive liberalisation in the future. Institutional arrangements to be scrutinised in this context include, for example, the unconditional most-favoured nation clause, the formulation of the liberalisation commitments as positive or negative lists, or the sector-specificity of negotiations.

□ The unconditional most-favoured nation clause (MFN) lies at the heart of the multilateral liberalisation efforts of the World Trade Organization. This obligation is also used in the General Agreement on Trade in Services to ensure non-discrimination in treatment of trading partners (Art. II, GATS). For example, if a country makes certain liberalisation commitments as a result of bilateral negotiations, this country must offer the same commitments to all WTO members. As a major counterweight to the reciprocity measures employed in unilateral trade policy, unconditional national treatment has a particularly strong influence on the course of liberalisation efforts within the WTO.

□ The question of whether liberalisation commitments are worded as negative lists or as positive lists in the schedules is a good example of the way in which procedural details are often of decisive importance in modern trade policy. While in positive lists, as applied in the 1995 interim agreement, records must only be made in the schedules if countries declare their support for liberalisation principles for certain modes of supply, negative lists would compel the participants to make detailed statements for cases in which they do not wish to make commitments, thus bringing much more transparency to the problem areas of the agreement.

□ The sector-specificity of negotiations reminds us that modern trade policy is not just about brokering

¹¹ Summaries of the commitments made in the General Agreement on Trade in Services, which include those concerning the financial services sector are provided i.a. in the following papers: Bernard M. Hoekman: *Tentative First Steps: An Assessment of the Uruguay Round Agreement on Services*; Centre for Economic Policy Research: Discussion Paper 1150, London 1995; Pierre Sauvé: *Assessing the General Agreement on Trade in Services. Half-Full or Half-Empty?*, in: *Journal of World Trade*, 29 (1995), pp. 125-145.

¹² The study concentrates on the first six years after the introduction of the Single Market programme. See: Commission of the European Communities: *The "Cost of Non-Europe", Basic Findings, Volume 9: The "Cost of Non-Europe" in Financial Services*, Brussels 1988.

¹³ For the Single European Market programme these problems are discussed by Edward P. M. Gardener: *Banking Strategies in the European Union: Financial Services Firms After the Cecchini Report*, in: *Institute of European Finance: Research Papers in Banking and Finance 95/7*, University of Wales, Bangor 1995.

agreements between the interests of sovereign states. The history of multilateral and regional liberalisation efforts demonstrates that modern trade policy forums have better chances of reaching meaningful agreements if they also address the problems of the decision-making process that takes place within the states. Given the protectionist influences of the industries being considered for liberalisation, the chances of accomplishing far-reaching agreements can clearly be increased if trade talks are held not on a sector-specific but on an economy-wide level, as was successfully done in several rounds of the General Agreement on Trade and Tariffs.

In the case of financial services liberalisation in the GATS there are two opposing views on the question of the sector-specificity of negotiations. On the one hand the GATS negotiations are known for their notorious lack of an economy-wide perspective: talks were held industry by industry with no opportunities for cross-issue trade-offs, and with the door wide open to concerns and interests of the main players in each industry. On the other hand, in the case of financial services – as was pointed out above – the GATS initiative has broadened the focus of negotiations dramatically compared to unilateral trade policy measures.

Multilateralism versus Regionalism

While there are numerous similarities between multilateral and regional initiatives as opposed to unilateral trade policy, taken individually they also have significant differences. A whole range of further research issues arises if the new initiatives are regarded as trade policy alternatives which are to a certain extent interchangeable. In keeping with a famous controversy of trade policy we must, for example, ask if regional initiatives for financial services are building or stumbling blocks of the world trade order.

For some time now there has been a broad consensus among research experts that regional agreements have exerted many positive influences –

experts such as the American WTO purist Jagdish Bhagwati¹⁴ represent a very definite minority nowadays. However, in a constantly progressing policy process it is necessary to reassess the advantages and disadvantages of regional agreements with each new step these initiatives take. Studies of this nature must address two issues in particular. Firstly, what is the situation regarding the notorious weakness of regional trade policy initiatives, namely the discrimination of third countries? And secondly, does the regional initiative introduce liberalisation concepts which have not yet been feasible at the multilateral level?¹⁵

Finally, research on the various alternatives of modern trade policy should not be limited to those examples already in practice. In addition to the international organisations and trade policy forums which are already engaged in the new trade policy initiatives, other institutions could become involved in the liberalisation process in the future. In addition to the classic trade policy forums discussed here, for example, the OECD has also been active in this field. Although commitments made under the OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations are not legally enforceable since the OECD lacks a strong mechanism to settle disputes, they certainly represent another subject worthy of investigation.

Regardless of the twists and turns the trade policy process might take in the future, it would be interesting to develop normative principles for determining the qualities and characteristics of an ideal trade policy forum for the liberalisation of financial services.¹⁶ The liberalisation of financial services has so far taken place exclusively within forums which are not primarily concerned with this particular task. Normative analyses could, for example, consider the question of how to decide between the rival aims of “extensive” and “intensive” liberalisation. Two extreme variants already exist as practical illustrative material. While the OECD, with its limited group of relatively like-minded countries, would offer good opportunities for “intensive” integration of the financial services sector, efforts on a multilateral level will certainly lead to an “extensive” form of integration in the foreseeable future.

Intersecting Policy Areas

A range of questions arises as a result of the numerous points of intersection between trade policy initiatives for financial services and neighbouring policy areas. There are, for example, close affinities

¹⁴ See for example Jagdish N. Bhagwati: Regionalism and multilateralism: an overview, in: Jaime de Melo et al. (eds.): New Dimensions in Regional Integration. Cambridge 1993, pp. 22–51.

¹⁵ A comparative study limited to the architecture of multilateral and regional agreements for financial services is provided by Welf Werner: Handelspolitische Alternativen zur Liberalisierung von Finanzdienstleistungen: Multilateralismus und Regionalismus, in: Konjunkturpolitik, 43 (1997), pp. 177–211.

¹⁶ Some reflections along these lines are made by Sidney J. Key and Hal S. Scott: International Trade in Banking Services: A Conceptual Framework, in: Group of Thirty: Occasional Papers 35, Washington DC 1991.

with issues concerning the safety and soundness of international financial markets and with monetary and exchange-rate policies.

Where international financial services markets are concerned, liberalisation on the one hand and safety and soundness on the other are in many ways competing goals. This is particularly true of the rapid globalisation of the financial services markets seen in the past 25 years. The international community has reacted to the new challenges confronting prudential supervision with the foundation of the Committee on Banking Regulation and Supervisory Practices in Basle. Since its establishment in 1974, the Basel Committee has taken several measures to enhance the safety and soundness of international financial markets and to co-ordinate national efforts in this task.¹⁷

The gradual extension of the Basel Committee's authority on the one hand and the further development of the new trade policy initiatives on the other outline two pillars of an international constitution for the financial services sector.¹⁸ Should these pillars prove sound enough, numerous questions relating to the interaction between them will arise in the future, whereby there is more to their relationship than rivalry alone.

An important element of future initiatives in which the interests of both policy areas will run largely parallel is the removal of non-discriminatory trade barriers. In both cases the harmonisation and co-ordination of prudential regulation are major goals. This is particularly evident in the European Single Market programme, the only one of the three trade policy initiatives so far to have addressed the issue of non-discriminatory trade barriers. In harmonising the prudential regulation of its member states, the EU has in certain cases – such as the Own Funds and Solvency Ratio Directives – fallen back directly on the recommendations of the Bank for International Settlements.

As mentioned earlier, trade policy for the financial services sector is very closely interwoven with monetary and exchange-rate policies. Wording the passages in the trade agreements in which the relationship between these policy areas is defined is an extraordinarily difficult task. These passages

represent a tightrope walk between guaranteeing the autonomy of monetary and exchange-rate policies on the one hand and safeguarding trade policy commitments on the other. How the compromises are worded in the agreements and whether they prove themselves in practice will remain the subject of future analysis.

Summary and Outlook

This paper could be concluded with a quotation from Bertolt Brecht: "Here we stand most disenchanted, the curtain drawn and nothing answered."¹⁹ However, in view of the numerous questions raised by the new trade policy initiatives for financial services there is one question that still remains: Is there a central theme in this new field of work?

Looking at the new initiatives in their direct historical context of the turbulent, largely market-driven liberalisation process of the 1970s and 1980s, the dominant question could be whether or not it has been possible, by means of co-operation in international organisations and forums, to strengthen the position of the state in the face of the potency of market forces. Those sceptical of international co-operation will ask whether the new initiatives have done any good at all in this respect.

In order to answer this question it is not sufficient to consider the progress made with respect to liberalisation commitments. As was pointed out above, an important aspect of the new beginning in trade policy for the financial services sector lies in its chances for long-term development. In the financial services sector, moreover, the desire to achieve rapid progress with liberalisation commitments faces constraints which stem from numerous other objectives. Guaranteeing the safety and soundness of the international financial services markets is surely the most important of these objectives. One of the main criteria for judging new initiatives will be their success in forging a link to this important policy area. If this task were neglected, negative consequences for the liberalisation process would certainly have to be expected in the long-term.

As far as the speed of the liberalisation process is concerned, the financial services sector has entered the age of modern trade policy under very special, indeed almost unique, conditions. Whereas in the

¹⁷ Much has been written on this aspect of international policy coordination. Compare the overview in William R. White: *International Agreements in the Area of Banking and Finance: Accomplishments and Outstanding Issues*, in: Bank for International Settlements: Working Paper 38, Basel 1996.

¹⁸ As in other parts of this paper, investment banking and insurance are not included here for reasons of clarity.

¹⁹ Translated from: Bertolt Brecht: *Der gute Mensch von Sezuan*, in: *Gesammelte Werke*: Stuecke, Frankfurt am Main 1967, p. 1607.

past other industries took this step in order to set in motion a trade policy process which had been extremely unsatisfactory under a unilateral trade policy regime, the financial services sector found itself in a completely different situation at the start of the 1990s. Since the early 1970s unilateral trade policy had led to such far-reaching results in the financial services sector that the implementation of modern trade policy instruments will not be capable of increasing the speed of the liberalisation process in this sector in the foreseeable future.

The harsh criticism of the modest liberalisation commitments achieved in the WTO negotiations, as exemplified most vividly in the US position, is only understandable in the face of the extraordinary developments of the recent past. Since the WTO initiative has so far not gone beyond existing levels of liberalisation in any meaningful way, critics of the new trade policy might ask if such an agreement is necessary at all. In light of the powerful unilateral liberalisation process the WTO agreement might look rather like a bureaucratic roadblock to an otherwise extremely dynamic process.

The unique situation brought about by the spectacularly rapid liberalisation process of the past, however, is also open to a very different interpretation. The high level of liberalisation achieved over the last 25 years could also mean that safeguarding the status quo against setbacks is in itself a remarkable success. Following this line of thought, the great opportunity which the WTO initiative can offer to the financial services sector is to consolidate liberalisation achievements multilaterally on an outstandingly high level. Such arguments become more convincing the more the instabilities of unilateral trade policy regimes and of global financial markets are considered.

Of the many questions raised by the new trade policy initiatives, there is only one thing that seems certain at present. In order to come up with answers in this new research field it will be necessary for some time to come to combine knowledge from two different research areas: finance and trade policy. For the trade policy specialist this means coming to grips with questions of finance. Finance experts, on the other hand, will need to get acquainted with trade policy.

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Operationalization and Priority of Joint Implementation Projects

The inclusion of joint implementation (JI) in the United Nations Framework Convention on Climate Change is a breakthrough for international cooperation on climate actions.

The following paper discusses the economic rationale for the industrialized countries to invest in JI projects in developing countries by analysing the economic effects of carbon emission limits for China. Some operational issues of JI are addressed and potential areas for JI projects that may be in China's interest are discussed.

In 1992, the Norwegian delegation introduced the concept of joint implementation into the negotiations for the Framework Convention on Climate Change (FCCC, hereafter also referred to as the Climate Convention) aimed, in the long term, at stabilizing greenhouse gas (GHG) concentrations in the

atmosphere. At the United Nations Conference on Environment and Development in Rio de Janeiro in 1992, JI was put into the final text of Article 4.2 of the FCCC that over 150 countries have already ratified. This is deemed a breakthrough for JI as a climate policy instrument. The inclusion of JI in the Climate Convention can also be regarded as a first step towards a global regime of tradable emission permits.

The industrialized countries are currently responsible for the majority of global GHG emissions,

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