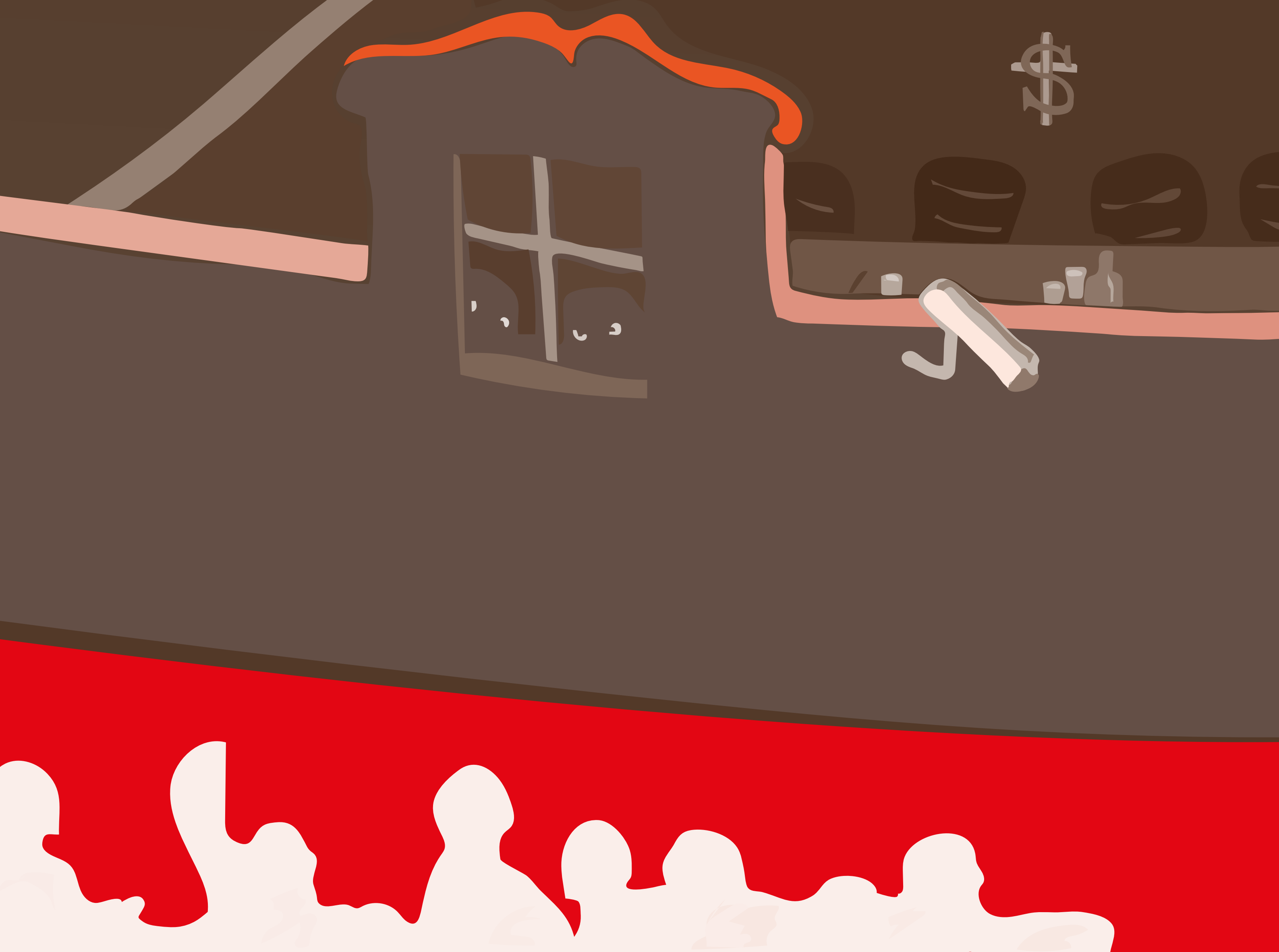
ROSA LUXEMBURG STIFTUNG BRUSSELS OFFICE

UNPACKING TRADE & INVESTMENT

10

WHAT INFLUENCE WILL TiSA HAVE ON INTERNATIONAL FINANCIAL MARKETS?



10 What influence will TiSA have on international financial markets?

Constantin Groll

TiSA WHAT WE KNOW – WHAT WE CAN EXPECT

TiSA (Trade in Services Agreement) is a plurilateral trade agreement that aims to liberalize the worldwide trade of services such as banking, health care and transport. Currently, 51 WTO member states[1] – the so-called 'Really Good Friends (of Services)' – are secretly negotiating the agreement in Geneva. Part of the TiSA negotiations is an annex that specifies the trade in financial services (*Financial Services Annex*). This *Financial Services Annex* contains the form of trade in which financial services – defined as a broad and non-exclusive concept, including life and non-life insurance, reinsurance, retrocession, banking, trading derivatives and foreign exchange, funds management, credit ratings, financial advice and data processing – will be liberalized between the countries. Liberalization includes financial services that are either supplied through foreign direct investment (*commercial establishment*), or via an offshore provision by remote delivery or services purchased in another country (*cross-border*).

The ultimate goal of TiSA and it's *Financial Services Annex* is not only to critically amplify unregulated trade of services among contract countries in contrast to already existing possibilities within the GATS (*General Agreement of Trade in Services*) framework, but to ultimately *lock-in* any achieved trade liberalization deregulation measures, so that national governments cannot reverse such measures unilaterally and regulate service provision (by foreign service providers) in the future.

TiSA negotiations are secret and non-transparent. Thus, many aspects of TISA are yet to be determined and the likely final outcome of the agreement is unknown. However, thanks to leaked documents published by *Wikileaks*[2] the first results of the negotiation were made public.

Although secret negotiations are common for negotiations on Free Trade Agreements (e.g. the negotiations on TTIP), this is undemocratic, as it prevents governments being held accountable by citizens and legislative bodies for negotiating positions and outcomes.

Negotiations take place in Geneva but outside the WTO. Although, in theory, WTO members are invited to join the negotiations, China's request to form part of the TiSA negotiation group was 'postponed', due to US intervention, and is still being considered by the group. Other WTO members, like Brazil and India, have rejected the entire practice of conducting plurilateral negotiations outside the WTO and its multilateral track. Their concerns are well-founded: a signed TiSA would

1 Current WTO parties negotiating TISA are: Australia, Canada, Chile, Chinese Taipei (Taiwan), Colombia, Costa Rica, Hong Kong, Iceland, Israel, Japan, Liechtenstein, Mexico, New Zealand, Norway, Pakistan, Panama, Paraguay, Peru, South Korea, Switzerland, Turkey, the United States, and the European Union, which includes its 28 member states Austria, Belgium, Bulgaria, Cyprus, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.
These countries, which account for approx. 68.2% of world trade in services. Swiss National Center for Competence in Research: A Plurilateral Agenda for Services?: Assessing the Case for a Trade in Services Agreement, Working Paper No. 2013/29, May 2013, p. 10.

2 For more information of the leaked documents see: https://wikileaks.org/tisa/

3 This disclosure rule even exceeds the 4 years secrecy rule of the documents of the highly secret TTIP negotiations.

encompass a mayor economic trading zone and other countries would sooner or later experience severe pressure to join the agreement. Thus, although TiSA stands in steep contrast to the WTO, paradoxically it may become the general standard for all WTO member states, ultimately amplifying GATS or even replacing it. TiSA calls the multilateral approach to world trade into question, leaving critical voices of developing countries, like India or Brazil, outside the negotiation. Because negotiations are carried out in secret, democratic accountability and the influence of social groups are undermined. This secrecy applies not only to the negotiations, but also to the final document. Leaked documents are labelled with a note that a five-year period after TiSA comes into force, or the negotiations are otherwise closed, must be exceeded before the documents will be declassified and made public.[3]

WHAT IS AT STAKE?

Principles of (leaked) TiSA and the Financial Services Annex

It is important to understand the basic principles of the core text of TiSA and its differences to the existing GATS agreement in order to assess the full effect of worldwide deregulation of trade in (financial) services. The regulatory content of TiSA is quite similar to GATS, even using the same basic concepts to facilitate a later replacement of it within the WTO. However, it is very likely that TiSA amplifies the magnitude of trade liberalization significantly. As GATS, TiSA uses the concepts of ***market access*** and ***national treatment***, but with a very different approach.

One general difference between GATS and TiSA are their approaches to formulate exceptions from the primary goal of trade liberalization. While the GATS agreement used a '**positive list**' approach – that is services, countries may choose and list which services to liberalize – the TiSA agreement uses a combination of a '**positive**' and '**negative list**' approach. This approach, in combination with additional regulations, is likely to effectively tie the hands of elected governments in the regulation of financial service provision in their countries.

1. Similarly to GATS, countries have to list (positive list) all services sectors to be brought under **market access**. This means that **market access** – which prohibits the use of most of the market-entry barriers (tariffs, etc.) – only applies to a sector that is explicitly committed, and is subject to any limitations that are specified.

2. With respect to the **national treatment** rule, TiSA introduces a crucial and a serious deviation from GATS. The national treatment rule requires that governments guarantee foreign service providers (or investors) the same treatment given to domestic service providers (or investors). In other words, foreign services providers will have free access to foreign domestic markets at 'no less favourable' conditions than domestic suppliers. TiSA introduces a negative list approach to national treatment. This means that all foreign services providers and their products will receive **national treatment**, except for those services of a sector specified in an exemption list.

3. However, there are some important additions to the national treatment rule that deserve particular attention. TiSA includes a **ratchet** clause. The **ratchet** clause means that in the case of a government's decision to reduce restrictions on foreign financial firms, services or products, those changes would automatically be locked in. Autonomous elimination of regulatory measures that could be considered discriminatory would be automatically become part of the TISA agreement. This is highly important: in the case a national government decides to deregulate the provision of financial products (for example via the privatization of its pension system), the hands of a succeeding government are tied and it won't be able to reverse deregulation. In other words, this means proponents of liberalization only have to win once, opponents of deregulation have to win every battle against liberalization.

4. TiSA also introduces a **standstill** clause within the sectors committed to national treatment. This principle commits governments to the existing level of liberalization. Ultimately, it binds governments to introduce new restrictions in the future in specific trade sectors. This is of special importance for financial services, because of the possibility that the financial sector introduces new financial products. Regulation of these products by domestic governments would be extremely difficult under TiSA.

5. Finally, although not well-specified in the leaked documents, TiSA is likely to introduce an **Investor-State Dispute Settlement** (ISDS) mechanism, similar to existing mechanism within GATS. The ISDS is an institutional framework which rules – outside domestic law – over disputes between investors (mainly large corporations) and states in the case that investors see their rights mistreated. ISDS side-lines European courts, empowers service providers to sue governments over measures to protect consumers and might entail that taxpayer money has to be paid to compensate corporations, including for missed future profits.

TiSA AND ITS (LIKELY) CONSEQUENCES FOR FINANCIAL MARKET DEREGULATION

In order to assess the effect of TiSA on international financial markets, it is essential to reflect on the extent of deregulation of international finance within and outside the WTO over the last three decades. In fact, deregulation of international financial flows has been one of the cornerstones of the rise of the global neo-liberal economic turn since the 1980's. This deregulation was either undertaken voluntarily by countries, due to conditionalities in programs designed by Bretton Woods Organizations (IMF, World Bank), or in the realm of the WTO. Within the WTO, a cornerstone of liberalization of trade in financial services is the *Financial Service Agreement,* signed at the end of the Uruguay round of WTO negotiations in 1997, principally due to pressure from the US. Today, this agreement is part of GATS and applies to all WTO members. It is estimated that the final agreement within WTO covered 95% of international trade in banking, securities, insurance, and information services as measured in revenue. However, within the GATS, thanks to the 'positive list' approach, WTO member countries could restrict their commitments to financial service liberalization, which some of them effectively did. India, for example bound foreign equity participation in financial services companies at 51 percent.

As a consequence of the stalled process of increased trade liberalization within the Doha Round of WTO trade negotiations, several countries initiated bilateral or plurilateral free trade agreements (FTA). Some FTA increased the deregulation for trade in financial services significantly (although limited to the participating countries). Of these FTA, the North American Free Trade Agreement

(NAFTA) is one of the most important, as it introduced new principles, such as enhanced rights for foreign investors (*bilateral investment rules*) and the negative list approach, mentioned above, to exceptions to deregulation. Another example is the not-yet-signed trade agreement between Canada and the European Union (CETA), which will give financial investors and investments the right to sue a state before an international private arbiters' panel (see above) in case they consider they have not been treated fairly and equitably, equal to national or third-party investors or investments, or their financial cross-border payments have been hindered, amongst others. A concrete example can be the case of sovereign bond restructuring of a country due to a financial crisis. Note that Belgium, Greece and Cyprus have been sued for measures they took during the financial crisis on the basis of WTO dispute settlement rules.

It is important to remember that deregulation of international financial markets was one of the main causes for the existence and global spread of the Global Financial Crisis (GFC). In fact, the risk-based model of financial regulation and the Basel II standards for prudential regulation of banks, issued by the Basel Committee on Banking Supervision, allowed the industry itself to become the frontline regulators. Together with the lack of control over new toxic financial products (like Credit Default Swaps, or CDS) in the US, this provided the fertile soil for one of the worst financial and economic crisis in history. As different as one would have expected, domestic and multilateral measures for regulation of international financial markets have been, although existent, slow and reluctant. A global approach to the regulation of financial markets is still missing. The most important reforms that have taken place were introduced in three areas: market structure (Dodd-Frank Wall Street Reform and Consumer Protection Act; European Markets and Infrastructure Regulation), bank structure (the US Dodd-Frank Act Volcker Rule; UK banking reform) and capital and liquidity (Basel III). However, a more encompassing, multilateral approach to regulation of international capital is still missing and some authors even conclude that there is little evidence of improvement, that the financial system today is even more dominated by large banks and the leverage is still too high for safety (Admati 2015). Due to the pressure of global financial corporations, more far-reaching initiatives to international financial market regulation have been stalled. However, with TiSA, even the timidly reached regulations could be reversed.

NEGATIVE EFFECTS OF DEREGULATION OF FINANCIAL MARKETS WITHIN TiSA

As outlined above, the core principles of TiSA are similar to GATS. This is the case with market access (MA) and most favored nation (MFN) rules, but they are amplified due to the mixed 'negative and positive list' approach and because of the existence of the ratchet and standstill clauses. These rules cause substantive new restrictions to the ability of governments to initiate regulation of financial markets and services. In addition, due to the changes in formulating exemptions of liberalization of trade in financial services (negative list approach), more financial services will fall under the core principles of non-discrimination (MFN) and market access (MA). For example, this will hinder domestic government ability to restrict the size, shape of, and foreign presence of providers of financial services (banks, insurance, etc.) in the country. Moreover, as a consequence of the standstill clause, in the future it will be difficult, if not impossible, to impose more restrictive regulations for financial innovations, like toxic financial products.

With respect to financial services, these new regulations may have some very concrete effects and can include that governments won't be able to:

Set limits to the size of financial institutions. This is important, as the banks were principally rescued with huge sums of public money during the GFC with the argument that they were 'too big to fail', i.e. that a bank failure would cause a breakdown of the entire financial system (systemic risk).

Enact restrictions on the activities of banks. For example, that deposit-taking banks are restricted to trading on their own account.

Requiring foreign investments to be pursued by the companies' subsidiaries, which can be regulated by the host country, rather than via branches, which are subject to regulation of their parent country.

Demanding that financial data, for example data on a person's financial record, is held onshore, i.e. within the jurisprudence of the country. The protection of consumer data is especially put into question by TiSA and its *Financial Services Annex*. TiSA may allow ending the requirement of (consumer) data to be processed and stored locally. If data is stored offshore, it is almost impossible for states to (legally) control data usage and impose legal liability. This is of particular importance for financial services and the finance industry, because today, in times of a digital world, we know that 'finance is data'.

Reserve the provision of financial services to state monopolies. For example, in the case of pension funds or disaster insurance. In fully committed sectors (that is, if a country does not claim an exception) the TiSA would prohibit public monopolies and exclusive service suppliers (even on a regional or local level). Once a government deregulates financial service provision, for example via the privatization of pension funds, a future government will be unable to reverse this process because deregulation measures are effectively 'locked in' (ratchet clause). It is true that this clause would not in itself prohibit public monopolies, but the creation of public monopolies in sectors that are currently open to private sector competition would be prohibited (standstill clause).

Provide regulation of credit rating agencies or financial advisers. This is important as the Big Three rating agencies (Standard & Poor's, Moody's and Fitch Group) hold a collective market share of 95% and were key enablers for the GFC financial meltdown.

Request disclosure requirements on offshore operations in tax havens. Especially in the light of the Panama Papers, this point is crucial, as it would hinder governments effectively fighting tax evasion.

Require that certain transactions must be conducted through public exchanges, rather than as invisible over-the-counter operations (OTC). Over-the-counter trading is a significant part of the world global finance. It is done directly between two parties, without any supervision of an exchange and is a core threat to market stability in times of crisis.

Establish controls on speculative and short-term hot-money capital inflows and outflows. Hot money outflows were a principal cause of the 1997 East Asian financial crisis, causing a collapse in asset prices and exchange rates, ultimately leading to a breakdown of the financial system.

Demand authorization and regulation of hedge funds, etc.

Finally, TiSA is likely to imply a dispute settlement procedure. In the worst case, investors can sue states against any regulation of the financial services they provide. Prudential measures taken by governments – even if they are consistent with international standards, like Basel IIII – could be put in question by financial institutions because they are said to be a regulatory taking or indirect expropriation of investor's assets. Indirectly, this can lead to a *regulatory chill,* i.e. that the threat of a dispute can prevent governments from even thinking of regulation measures in the first place.

Bibliography:

Admati, Anat (2015): The missed opportunity and challenge of capital regulation, in Rock Centener of Corporate Governance Working Paper Series No.16, Stanford University.

Rosa-Luxemburg-Stiftung,
Brussels Office
Avenue Michel-Ange 11
1000 Brussels, Belgium
www.rosalux.eu

AUTHOR Constantin Groll
DESIGN Ricardo Santos
PRODUCTION HDMH sprl

Brussels, January 2017
Funded by the German Federal ministry for economic Cooperation and Development.

ROSA LUXEMBURG STIFTUNG
BRUSSELS OFFICE

UNPACKING TRADE & INVESTMENT

A SERIES OF 11 FACT BOOKLETS ABOUT THE WTO DOHA ROUND, FTAs, BITs, ISDS, CETA, TTIP, TiSA AND THE CORPORATE POWER GRAB.