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The New WTO Agreement on Financial Services and Chapter 14 of NAFTA: Has Free Trade in Banking Finally Arrived?

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The New WTO Agreement on Financial Services and Chapter 14 of NAFTA: Has Free Trade in Banking Finally Arrived?

*Constance Z. Wagner**

ABSTRACT

This article discusses the U.S. policy rationale for seeking free international trade in financial services and assesses whether U.S. policy goals have been met through recent trade agreement negotiations. Free trade in financial services has been a goal of U.S. trade policy since the early 1980s. Over a period of fifteen years, the United States concluded several agreements on financial services with key trading partners. The most significant agreements are the World Trade Organization (WTO) Agreement on Financial Services (FSA) and Chapter 14 of the North American Free Trade Agreement (NAFTA) on Financial Services. In both of these trade agreements, U.S. negotiators succeeded at least partially in achieving the U.S. goals of establishing a framework of principles for financial services trade and achieving national treatment and greater market access for U.S. financial institutions in key markets. Neither trade agreement, however, achieves full liberalization. In the case of the FSA, the framework of principles is subject to significant exceptions and only partial market access concessions have been made by many countries. NAFTA achieved both a firmer framework of principles and more concrete market opening results than the FSA, but some barriers to trade still remain. These results are not surprising given the special status of the financial services industry in the view of national governments and the enormous gap in development of financial markets between the United States and other countries, especially developing countries. FSA and NAFTA Chapter 14 can best be viewed as tentative first steps towards achievement of U.S. policy goals that will only be fully realized after further negotiations on sensitive issues of regulatory policy have been undertaken.

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I. Introduction. Globalization and New Trade Disciplines.

Any reader of a daily newspaper in the United States these days would surely agree that the world is growing ever smaller and access to information and new technology is driving economic growth.[1] Our economy, in which globalization is a fact of life, is becoming services-based.[2] These twin trends have led to an important new development in U.S. trade policy - adding services as an agenda item in trade agreement negotiations. This development is not unique. Globalization has also fueled U.S. efforts to impose trade agreement disciplines on other governments in order to protect foreign investment[3] and intellectual property,[4] two other areas that were traditionally viewed as falling outside the realm of trade matters.

Financial services, one of a far larger category of services traded by the United States, can be singled out as perhaps the quintessential modern service industry. Nothing is "produced" in the sense of widgets being turned out on an assembly line, yet it has become one of the most important U.S. industries in terms of national employment and gross domestic product (GDP) figures and a significant contributor to improving the otherwise dismal U.S. trade balance.[5] Moreover, the financial services sector lends itself well to internationalization. Since it deals in intangibles, money and information, the movement of such ser-

1. *See* Matt Murray & Raju Narisetti, *Bank Mergers' Hidden Engine: Technology*, WALL ST. J., Apr. 23, 1998, at B1; *see also* Richard B. Schmitt, *The Technology Gamble: Although New Technology is Risky and Expensive, Global Competitors Can't Afford to Fall Behind*, WALL ST. J., Sept. 29, 1986, at B1.
2. The United States in 1994 had a surplus of $8.1 billion in U.S. affiliate transactions in financial services. Affiliate transactions in financial services include those services which are sold through affiliates established in foreign markets by multinational corporations. In 1995, the United States had a $4.4 billion surplus in cross-border financial transactions. Cross-border trade involves sending individuals, information, or money across national borders. In cross-border financial services transactions, the United States possesses a surplus with all other countries on a bilateral basis. Because of the developments in the global capital markets and the internationalization of industries, the activities of U.S. financial services firms are expanding increasingly overseas. *See Recent Trends in U.S. Services Trade: 1997 Annual Report*, USITC PUB., Inv. no. 332-345, 3-21, 3-25 (May 1997), *available in* ITC LEXIS 204.
3. NAFTA Chapter 11 and the WTO Agreement on Trade-Related Investment Measures (TRIMS) both provide for the protection of foreign investment. In addition, the OECD Multilateral Agreement on Investment (MAI), which is currently being negotiated, would provide for a comprehensive framework for international investment. The MAI negotiations are to resume in Paris in October with talks focusing on either completing the negotiations within a specified time frame or shifting talks to the WTO. Michelle Sforza, *A Bad Trade Deal*, WASH. POST, Sept. 6, 1998, at C6.
4. Intellectual property provisions were included in Chapter 17 of NAFTA, as well as the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).
5. During Congressional hearings on the results of the Uruguay Round of General Agreement on Tariffs and Trade (GATT) negotiations, statistical data was presented on the importance of financial services and services generally to the U.S. economy. In 1992, the U.S. service sector employed 80% of the U.S. workforce, created 70% of GDP, and ran a record $61 billion trade surplus in 1992, that offset by two-thirds the U.S. $96 billion deficit in merchandise. Financial services alone is more than 6% of GDP. *Hearings on Trade Agreements Resulting from the Uruguay Round of Multilateral Trade Negotiations Before the Subcomm. on Trade of the House Comm. on Ways and Means*, 103rd Cong. 120 (1994) (statement of Marc E. Lackritz, President, Securities Industry Association on behalf of U.S. Coalition of Service Industries, Inc., Financial Services Group).

vices is not hindered by geographic distances and, in principle at least, they should travel easily across national borders. Until recently, however, such cross-border movement of financial services was not permitted on a global basis. In essence, a national passport was required by many countries in order to provide financial services under competitive conditions and in some cases, to conduct a financial services business at all.

This treatment of financial services providers in international markets was of great concern to the U.S. financial services industry,[6] which looked to the global economy as its future market.[7] Lobbying groups composed of the most influential financial institutions sought to put financial services regulation affecting foreign providers under the discipline of international rules, to enter closed foreign markets and to obtain for U.S. institutions abroad the same type of treatment, namely national treatment, that was afforded foreign financial institutions in the United States. The U.S. Government, cognizant of the significance of financial services to international trade figures, took up the cause and elevated financial services to a high priority item in trade agreement talks.

The most recent development in this U.S. effort was the announcement by the WTO[8] on December 12, 1997 of the successful conclusion of a new round of negotiations on free trade in financial services.[9] The FSA, which will become effective no later than March 1,

6. *Hearing Before the Senate Comm. on Banking, Housing and Urban Affairs: Status of Financial Services Negotiations Now Underway Under the GATS of the WTO*, 104th Cong. 29 (1995) (statement of James F. Gwaltney, Executive Director, Ford Financial Services Group) ("The markets in the newly emerging, as well as some of the developed countries of the world, represent a significant business opportunity for many of our member companies. Yet, these countries restrict the ability of U.S.-based financial services companies from gaining market access.") [hereinafter *Senate FSA Hearing*].
7. *Id.* at 44 (statement of Robert E. Rubin, Secretary, U.S. Department of the Treasury) ("We are working very hard...to win new opportunities for our firms to compete worldwide. Our goal is to gain commitments from the key developed and developing countries that they will open their markets to our financial services firms...").
8. The WTO is the successor organization to the GATT. It came into existence on January 1, 1995, pursuant to the Marrakesh Agreement Establishing the World Trade Organization of April 15, 1994. 33 I.L.M. 1125 (1994) [hereinafter WTO Agreement]. The WTO has substantially expanded powers and a larger organizational structure than the GATT. *See* John H. Jackson, *The World Trade Organization: Watershed Innovation or Cautious Small Step Forward?*, 18 WORLD ECON. 11 (1995), for a description of the WTO and a comparison to the GATT. The GATT was one of three international organizations for the conduct of international economic relations created at the Bretton Woods, New Hampshire Conference of World Powers in 1947. The other two were the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank). GATT has come to refer to both the international institution headquartered in Geneva, Switzerland and to the multilateral agreement that embodies the results of the various negotiating rounds among the contracting parties in reducing tariff and non-tariff barriers to trade. The International Trade Organization, which was intended to be the international organization dedicated to trade matters with broader powers than the GATT, never came into existence due to political opposition in the United States and other contracting parties. *See* ROBERT E. HUDEC, THE GATT LEGAL SYSTEM AND WORLD TRADE DIPLOMACY (2d ed. 1990), (detailed history of the GATT); *see also* JOHN H. JACKSON, THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS (2d ed. 1997).
9. WTO PRESS RELEASE/86, SUCCESSFUL CONCLUSION OF THE WTO'S FINANCIAL SERVICES NEGOTIATIONS Dec. 12, 1997 <http://www.wto.org/wto/services/press86.htm> [hereinafter WTO PRESS/86]; *see also* PRESS STATEMENT BY WTO DIRECTOR-GENERAL RENATO RUGGIERO ON THE AGREEMENT ON FINANCIAL SERVICES, Dec. 12, 1997 <http://www.wto.org/wto/services/fsdg.htm>.

1999, is the culmination of a negotiating effort led by the United States to liberalize financial services trade that extended over some fifteen years.[10] The FSA has been heralded by the United States as a noteworthy achievement because of the greatly increased market access to certain foreign markets now available to U.S. financial service providers.[11] The other significant achievement of the United States in achieving free trade in financial services was the negotiation of Chapter 14 of NAFTA,[12] which became effective on January 1, 1994. Chapter 14 succeeded in opening the Mexican market to both U.S. and Canadian banks and is lauded by the United States as a model for future liberalization efforts in the Western Hemisphere and elsewhere.

This article will examine U.S. efforts to liberalize financial services trade by tracing the development of relevant trade agreement provisions negotiated by the United States in the period from the early 1980s to the present. It will assess U.S. policy motives for aggressively pursuing such negotiations and whether the trade agreements have been successful in obtaining what the United States sought to achieve. Although financial services is defined broadly in recent trade agreements to include banking, securities, insurance and other financial services,[13] this article will have a special emphasis on banking, the financial services sector of greatest significance in most national economies.[14]

Part II will examine the development of the U.S. policy agenda on free trade in financial services. It will set forth the economic arguments in favor of free trade in financial services, as well as some countervailing arguments. It will also explore the political economy of trade agreement negotiations and highlight several new trends in U.S. trade policy that were evident during the FSA and NAFTA Chapter 14 negotiations. Part III will analyze the U.S. policy agenda for, and the contents of provisions resulting from, the financial services negotiations in the U.S.-Israel Free Trade Agreement (IFTA), the U.S.-Canada Free Trade

10. The FSA forms part of the General Agreement on Trade in Services (GATS) concluded at the end of the Uruguay Round of GATT negotiations, which ended in December 1993. General Agreement on Trade in Services, Apr. 15, 1994, 108 Stat. 4809, 33 I.L.M. 1167 [hereinafter GATS]. Agreement on the FSA could not be reached at the end of the Uruguay Round and negotiations were extended.
11. In the White House press release that announced the FSA, Treasury Secretary Robert E. Rubin and United States Trade Representative Charlene Barshefsky praised the agreement as one of three WTO agreements concluded in 1997 that would provide new growth opportunities for U.S. companies. The other two agreements are the Information Technology Agreement and the Agreement on Telecommunications. They stated:

    > All three agreements cover sectors where the United States is the most competitive producer and service provider in the world. All three unlock new opportunities for our companies and workers at the moment they are the most competitive. All three come in areas where the United States has minimal or non-existent trade barriers, but the rest of the world -- particularly the fastest growing markets of the world -- present substantial market entry barriers for our companies.

    See THE WHITE HOUSE, OFFICE OF THE PRESS SECRETARY, DECEMBER 13, 1997, STATEMENT BY SECRETARY RUBIN AND AMBASSADOR BARSHEFSKY REGARDING THE SUCCESSFUL CONCLUSION OF WTO FINANCIAL SERVICES NEGOTIATIONS, Dec. 13, 1997 [hereinafter Rubin and Barshefsky].
12. North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., 32 I.L.M. 605 (entered into force Jan. 1, 1994) [hereinafter NAFTA].
13. "Other financial services" is a catch-all phrase encompassing the activities of consumer finance, leasing and factoring companies.
14. The term "banking" is defined here to mean traditional commercial banking services, such as deposit-taking and lending.

Agreement (CFTA), Chapter 14 of NAFTA and the FSA. Part IV will discuss the strengths and weaknesses of Chapter 14 of NAFTA and the FSA. Part V will highlight current trends in U.S. policy on the future development of free trade in financial services. Part VI will offer some concluding comments on U.S. policy on free trade in financial services, including the importance of multilateralism.

This article concludes that the trade agreements did not achieve the ambitious goals of the United States. This was due both to the exceedingly high expectations of the U.S. financial services industry, which was a primary moving force behind the negotiations, as well as to opposition from certain developing countries, which did not share the U.S. enthusiasm for this trade agenda item. Further negotiations will need to be undertaken to complete the project of creating free trade in financial services. Like free trade in goods, which took more than fifty years and eight GATT[15] negotiating rounds to achieve,[16] free trade in financial services must be viewed as a long-term goal.

II. Development of the U.S. Policy Agenda on Free Trade in Financial Services.

A. Economic Theory of Free Trade in Financial Services.

1. *The Theory of Comparative Advantage.*

Until the mid-1980s, services were ignored in trade agreements. Services were traditionally regarded as valueless from an economic perspective.[17] The reason for this is not hard to understand, given the conventional description of services as intangible, invisible,

15. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT]. One of the agreements accepted as part of the WTO Agreement was an amended version of GATT. *See* General Agreement on Tariffs and Trade 1994, Annex 1A to WTO Agreement, *supra* note 8.
16. The Uruguay Round marks the eighth time since World War II that the contracting parties of GATT have negotiated a reduction of trade barriers in a multilateral framework. The success of this multilateral forum in reducing protection has been remarkable. Average tariffs in major industrial countries declined from about 40% in the mid-1940s to less than 5% after the Tokyo Round (1974-1979). Robert E. Baldwin, *Multilateral Liberalization, in* THE URUGUAY ROUND: A HANDBOOK ON THE MULTILATERAL TRADE NEGOTIATIONS 37 (J. Michael Finger & Andrzej Olechowski eds., 1987).
17. Adam Smith viewed service activities as unproductive labor and saw service workers as a burden on society.

> The labour of some of the most respectable orders in the society is . . . unproductive of any value, and does not fix or realize itself in any permanent subject, or vendible commodity, which endures after that labour is past, and for which an equal quantity of labour could afterwards be procured. [*sic*] [T]he work of all of them perishes in the very instant of its production.

ADAM SMITH, THE WEALTH OF NATIONS bk II, ch. 3 (Ernest Rhys ed., 1910); *see also* William J. Drake & Kalypso Nicolaides, *Ideas, Interests and Institutionalization: "Trade in Services" and the Uruguay Round*, 46 INT'L ORG. 37 (1992), (discussion of the conventional view of services as unproductive).

and perishable, as compared to goods, which are tangible, visible, and storable.[18] As a result, services were not considered to be tradeable like goods, but rather something to be consumed at the exact moment in time and physical location of production.[19]

In the 1970s and 1980s, trade economists began to reexamine the services sector. One important area of inquiry was whether the traditional argument in favor of free trade in goods, namely the theory of comparative advantage,[20] could be applied to trade in services. The theory of comparative advantage states that, given certain conditions,[21] each country can improve its own productive efficiency and increase its national income (and consumption possibilities) by specializing in the production of those commodities in which it has a relative cost advantage and trading with other countries to obtain commodities in which it does not have a comparative advantage.[22] By each country pursuing this strategy, it was projected that global economic welfare would be enhanced for all trading nations.[23] Under this theory, trade barriers should be eliminated since they stand in the way of enhanced economic efficiency and global economic welfare.[24] Although modern economic theory has refined the theories of the classical economists, this notion of the universal benefits of specialization based on comparative costs has remained the central feature of liberal trade theory.[25]

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18. U.N. CONFERENCE ON TRADE AND DEVELOPMENT AND THE WORLD BANK, LIBERALIZING INTERNATIONAL TRANSACTIONS IN SERVICES: A HANDBOOK, at 1, U.N. Doc. UNCTAD/DTCI/7, U.N. Sales No. E.94.11.A.11 (1994) [hereinafter LIBERALIZING].
19. GEZA FEKETEKUTY, INTERNATIONAL TRADE IN SERVICES: AN OVERVIEW AND BLUEPRINT FOR NEGOTIATIONS 67 (1988). The economist T.P. Hill has observed that:

    > Services are consumed as they are produced in the sense that the change in the condition of the consumer unit must occur simultaneously with the production of that change by the producer: they are one, and the same change . . . the fact that services must be acquired by consumers as they are produced means that they cannot be put into stock by producers.

    T.P. Hill, *On Goods and Services*, 43 REV. OF INCOME & WEALTH 337 (1997).
20. The theory of comparative advantage or cost was posited in DAVID RICARDO, THE PRINCIPLES OF POLITICAL ECONOMY AND TAXATION ch. 7 (Ernest Rhys ed., E.P. Dutton & Co. 1911) (1817), as an argument in favor of free trade. Ricardo's work built on Adam Smith's argument in SMITH, *supra* note 17, bk. IV, ch. 9, against trade barriers and in favor of specialization by countries in the areas of production in which they held an absolute cost advantage, meaning that an exporter with a given amount of resources was able to produce a greater output at a lesser cost than any competitor. Ricardo demonstrated that the driving force behind trade is the relative (not absolute) costs of the goods produced. Producers in a country will specialize in those commodities whose costs are lowest compared to those of producers in other countries. RICARDO, *supra*, at 81.
21. The essential conditions are a market economy and an efficient price system. "[S]upply and demand in the two [trading] countries [must be] determined on the basis of market competition [*sic*] and prices [*sic*] [must be reflective of] the value of services to society." FEKETEKUTY, *supra* note 19, at 96.
22. ROBERT GILPIN, THE POLITICAL ECONOMY OF INTERNATIONAL RELATIONS 172-173 (1987).
23. PETER B. KENEN, THE INTERNATIONAL ECONOMY 19 (3d ed. 1994).
24. Brian Hindley & Alasdair Smith, *Comparative Advantage and Trade in Services*, 7 WORLD ECON. 369, 373 (1984).
25. GILPIN, *supra* note 22, at 172-173.

2. Application of the Theory of Comparative Advantage to Financial Services Trade.

The application of the doctrine to services trade was viewed by some as problematic due to the lack of a well-developed theory of trade in services addressing issues such as the differences between goods and services and how to define when trade in services in fact has occurred.[26] In spite of such conceptual difficulties, trade economists generally concur that the doctrine of comparative advantage can be applied to services.[27] Several points made in the economic literature are worth noting here.

a. Cross-Border Trade.

The notion that services are non-tradeable, due to the need for physical proximity of supplier and consumer, has been abandoned. Economists have noted that some services trade, using bank lending transactions as one of the most prominent examples, can occur without such proximity due to the use of mail or telephone.[28] Such services are referred to by economists as "separated" services because the service is separated from both factors of production (capital and labor) and consumers of the service, and are traded much the same way that goods are traded. They represent a relatively small category of traded services.[29] However, rapidly developing information and telecommunications technologies have increased the possibility of such cross-border services trade occurring without physical movement of consumers or producers or other factors of production.[30]

b. Foreign Investment and Capital Movements.

In addition to separated services, services transactions can also occur in three other ways: through movement of the consumer of services, through movement of a factor of production (capital or labor), or through movement of both the factors of production and the consumer of the service.[31] In order for such "non-separated" services to be tradeable,

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26. FEKETEKUTY, *supra* note 19, at 76-79, 94-95.
27. *See* Hindley & Smith, *supra* note 24, at 386; *see also* ALAN V. DEARDORFF, *Comparative Advantage and International Trade and Investment in Services, in* TRADE AND INVESTMENT IN SERVICES: CANADA/U.S. PERSPECTIVES 68-69 (Robert M. Stern ed., 1985).
28. Jagdish N. Bhagwati, *International Trade in Services and its Relevance for Economic Development, in* THE EMERGING SERVICE ECONOMY 8 (Orio Giarini ed., 1987).
29. Gary P. Sampson & Richard H. Snape, *Identifying the Issues in Trade in Services,* 8 WORLD ECON. 171, 173 (1985).
30. Jagdish N. Bhagwati, *Splintering and Disembodiment of Services and Developing Nations, in* WRITINGS ON INTERNATIONAL ECONOMICS 433-446 (V. N. Balasubramanyam ed., 1997). A study by the United Nations Conference on Trade and Development, Programme on Transnational Corporations, entitled THE TRADABILITY OF BANKING SERVICES: IMPACT AND IMPLICATIONS at 127, U.N. Doc. ST/CTC/168, U.N. Sales No. E.94.II.A12 (1994) [hereinafter TRADABILITY] analyzed the policy implications for developing countries of the increased tradability of banking services, concluding that there was some limited potential for increased participation by such countries due to developments in information and telecommunications technologies.
31. Sampson & Snape, *supra* note 29, at 172-73. Bhagwati, *supra* note 28, at 7-8. Sampson and Snape point out that for separated services, the standard theories of international trade which assume the international immobility of factors of production apply. The other three categories of services are not addressed by theories which assume the immobility of factors of production or consumers between countries. This "non-separation" feature is the essential difference between trade in goods and trade in some services. Sampson & Snape, *supra* note 29, at 174.

capital and labor must be allowed to move freely across national boundaries, and consumers must be free to purchase services in another country if they travel cross-border.[32] U.S. policy has been to support free capital movements, including funds used for foreign investment purposes, and to oppose free movement of labor.

Which of these movements is of greatest significance will vary from service to service. In the financial services sector, the issue of foreign investment is a critical issue since many service providers would like to set up a permanent establishment in the form of a representative office, agency, branch, joint venture, or subsidiary in a foreign country. Free movement of capital is also an important issue both in order to effect financial transactions and transfers from the foreign investment. Freedom of movement for employees of financial institutions and the right of consumers to buy financial services abroad are of lesser importance for financial services.

c. Liberalization and Efficiency Gains.

Free trade in services requires freedom of movement of factors of production, of "separated" services, and of consumers of services. Economic theory concludes that the broader the front across which the liberalization of trade operates, the more likely efficient allocation of resources will result, and that liberalizing trade in some modes of service delivery, but not others, will not necessarily improve the allocation of resources.[33]

The typology of classifying services according to mode of supply, which was developed by economists, has been adopted by trade negotiators and incorporated into the language of trade agreements. However, the classification system has been modified and refers to cross-border trade, commercial presence, movement of personnel of the provider and movement of consumers. International financial services trade occurs through all four supply modes.[34] In the trade agreements analyzed in this article, commitments to liberalize trade are offered separately according to each mode of supply and liberalization is not uniform across all modes.

3. *Limiting Cases: The Arguments in Favor of Protectionism and the Special Needs of Developing Countries.*

If one accepts the normative doctrine of comparative advantage as applied to services trade,[35] the only logical policy position to adopt is that all trade barriers to services trade

32. For the argument that discussions of trade in services are only about the right of establishment and the ability to move factors of production internationally, *see* Herbert G. Grubel, *There is No Direct International Trade in Services*, AM. ECON. REV., PAPERS & PROCEEDINGS (1987).

33. Sampson & Snape, *supra* note 29, at 177-78.

34. Fariborz Moshirian, *Trade in Financial Services*, 17 THE WORLD ECON. 347, 357-361.

35. Comparative advantage theory is composed of two parts: one is normative or prescriptive and the other is positive or descriptive. Normative theory seeks to answer the question of whether the pattern of specialization of production on the basis of comparative cost advantage is economically efficient and socially desirable and what government policies regarding international trade should be. Positive theory seeks to determine why certain countries have a comparative advantage in some commodities and what causes the flow of exports and imports among countries. Hindley & Smith, *supra* note 24, at 370.

must be removed because they interfere with maximization of global economic welfare.[36] From the perspective of individual countries, however, trade restrictions may be desirable instruments of national policy. This is especially, although not exclusively, true of those countries that the positive doctrine of comparative advantage suggests will not be competitive in services industries.[37] Those countries will seek to restrict trade in a variety of ways. While there are some economic arguments in favor of protectionism,[38] the most common justification is that other compelling interests outweigh the efficiency gains to be had from free trade.[39] The primary arguments that are advanced in the financial services sector against removal of trade barriers are the following: (1) the need for national control over monetary policy, which is often implemented through commercial bank operations; (2) the desire that access to capital remain under domestic ownership and domestic political control; (3) the need to protect fledgling financial service firms from ruinous foreign competition from large multinational financial institutions; (4) the need to protect domestic consumers through prudential regulatory objectives that may be undermined by the entry of foreign financial institutions; and (5) the need to provide balance-of-payments support to avoid shortages of foreign exchange.[40]

In financial services, developed countries will often have a comparative advantage because the industry is dependent on both highly educated workers and access to advanced information and data processing technology.[41] Developing countries often lack

36. There are two other arguments against trade barriers to financial services trade, apart from the efficiency gains that will result from a more efficient allocation of resources. First, an undesirable redistribution of income from users of financial services to protected local institutions will occur. This will happen because users will be required to pay more for financial services than if there is foreign competition in the market. If the user of financial services is a producer of goods and other services, the higher costs will result in correspondingly higher costs for the end product or service. Second, limiting users of financial services to substandard or inefficient services provided by protected local institutions will retard the economic development process. This is due in part to higher transaction costs that may discourage economic activity. The presence of foreign financial institutions will force local institutions to become more competitive, thereby leading to allocational and dynamic gains for the economy as a whole. *See* INGO WALTER, GLOBAL COMPETITION IN FINANCIAL SERVICES: MARKET STRUCTURE, PROTECTION AND TRADE LIBERALIZATION 119-120 (1988).

37. *Id.* at 117.

38. Most studies call into serious question the viability of such arguments. *See* Hindley & Smith, *supra* note 24, at 373, 383 (discussing positive optimal tariff argument and infant industry argument); BRIAN GRIFFITHS, INVISIBLE BARRIERS TO INVISIBLE TRADE 70-73 (1975) (discussing infant industry argument); WALTER, *supra* note 36, at 114 (discussing terms-of trade argument).

39. Some developing countries might choose social or development goals over efficiency gains when there is a conflict. *See* LIBERALIZING, *supra* note 18, at 45-47. Some models of the political economy of protectionism explain trade barriers in terms of rent-seeking behavior on the part of market participants, who may find it less costly to lobby for government protection than to adapt to marketplace changes. For a discussion of the literature, see WALTER, *supra* note 36, at 115.

40. WALTER, *supra* note 36, at 116-21; *see also* MARIO KAKABADSE, INTERNATIONAL TRADE IN SERVICES: PROSPECTS FOR LIBERALISATION IN THE 1990S 63-66 (1987) (arguing for protectionism in financial services); GRIFFITHS, *supra* note 38, at 70-81 (arguing for protectionism in services generally).

41. *See* WALTER, *supra* note 36, at 107; *see also* U.S. CONGRESS, OFFICE OF TECHNOLOGY ASSESSMENT, INTERNATIONAL COMPETITION IN SERVICES 71 (1987) (suggesting that continuing surpluses in service industries suggests that the United States has a comparative advantage in most service sectors). For a discussion of comparative advantage in financial services, *see* H.W. Arndt, Comparative

these factors and therefore will have a comparative disadvantage.[42] For this reason, developing countries may become highly protectionistic.[43] However, as the development process continues, one would expect such countries to increasingly favor liberalization of the financial services sector as their comparative advantage positions change and they become aware of the real economic costs of protectionism.[44]

B. The Political Economy of Trade Agreement Negotiations.

1. *The Language of Trade Negotiations.*

Trade economists and trade negotiators speak in different tongues. The doctrine of comparative advantage posits mutual gains for both exporting and importing countries. Indeed, it predicts efficiency gains in the event of a unilateral lowering of trade barriers.[45] This is at odds with the position taken by trade negotiators, which sees the negotiation process as a zero sum game in which opening import markets is viewed as a cost which must be traded off against the gains achieved by exacting concessions from other countries.[46] This is the language of the GATT negotiations, which economists scoff at.[47]

In the context of the FSA talks, negotiators from the United States and other developed countries emphasized to developing countries the virtues in economic terms of free trade in financial services and the gains to producers and exporters in such countries of importing cheaper and more efficient banking and insurance services.[48] Such negotiations often reached an impasse because these economic arguments were not compelling to trade negotiators used to talking in terms of gains and losses. Developing countries viewed these arguments as attempts by the developed countries to exact concessions with little or no corresponding gains, particularly given the strong competitive position of the U.S. financial services sector. The United States, in turn, began to emphasize reciprocity as the means to achieve gains in free trade.

Advantage in Financial Services (Australia Japan Research Centre, Pacific Economic Papers, No. 160, June 1988). Arndt concludes that the source of comparative advantage in all the major financial service exporting countries was due to a large domestic market for financial services and consequent economies of scale and development of specialized skills. *Id.* at 19.

42. *See* Murray Gibbs & Mina Mashahekhi, *Elements of a Multilateral Framework for Trade in Services,* 14 N.C.J. Int'l. L. & Com. Reg. 1 (1989). But *see* Bhagwati, *supra* note 28, at 31 (stating that it cannot be said with certainty that developing countries will not have a comparative advantage in banking and insurance since there may be opportunities for trade in similar services); Tradability, *supra* note 30, at 127 (developing countries that develop the proper technological infrastructure may find increased trade opportunities in banking).
43. Walter, *supra* note 36, at 114.
44. *Id.* However, it has also been argued that developing countries will not have significantly increased opportunities even if liberalized trade occurs due to the fact that comparative advantage is embodied in the stock of human capital and that the comparative advantage of developed countries will continue to hold. Cillian Ryan, *Trade Liberalisation and Financial Services,* 13 The World Econ. 349, 365 (September 1990).
45. Jackson, *supra* note 8, at 147.
46. Brian Hindley, *International Trade in Services: Comments, in* The Emerging Service Economy 26 (Orio Giarini ed., 1987).
47. *Id.*
48. Bhagwati, *supra* note 28, at 27.

It seems clear from the FSA negotiations that the maximization of global economic welfare is not the primary goal of the WTO. Political objectives of the Members are equally important in the negotiating process. Unfortunately, economic analysis offers no solution to the political problem addressed by concessions in the GATT process.

2. *The Role of Interest Groups.*

The negotiations over the liberalization of financial services trade illustrate several new trends in U.S. trade policy, namely, the important role played by interest groups and the rise of reciprocity and regionalism. Each of these trends will be discussed in turn.

Interest groups played an important role in the financial services trade negotiations. This took two forms: (1) services industry advisory committees provided advice on negotiating positions and rendered opinions on the results of trade negotiations pursuant to a mandate contained in U.S. trade legislation; and (2) U.S. financial services industry groups and individual firms provided information about trade barriers and gave advice on negotiating issues through the lobbying process. Pursuant to the Trade Act of 1974, the President is required to establish industry advisory committees on trade matters for all important sectors of the economy, including services.[49] The role of such advisory committees in connection with the negotiation of trade agreements is to consult on negotiating objectives and bargaining positions and to render an advisory opinion at the end of negotiations on whether the results promote the economic interests of the United States, fulfill U.S. negotiating objectives, and provide for equity and reciprocity.[50] The most important advisory committees covering the services negotiations under NAFTA and GATS, including financial services, were the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13) and the Services Policy Advisory Committee (SPAC). The members of ISAC 13 and SPAC were high-ranking officials of financial services firms and industry associations.

The lobbying groups that were active included the U.S. Coalition of Service Industries, Financial Services Group, the Bankers Association for Foreign Trade, the Securities Industry Association, the Investment Company Institute, and the American Financial Services Association.[51] Many large multinational financial services firms were also active on an individual basis in the lobbying effort. In addition to providing information and advice to the U.S. trade negotiators, the industry groups often sent representatives to Congress to testify on private sector concerns in the NAFTA Chapter 14 and FSA negotiations.

The clear focus of these interest groups was on achieving substantial market opening concessions from key trading partners. Industry groups pooled information received from their members on trade barriers in countries of significant commercial interest and submitted to U.S. trade negotiators lists of the most significant barriers they sought to have eliminated. In addition, the ISAC 13 and SPAC reports on the NAFTA Chapter 14 and FSA negotiations made clear that such groups were scrutinizing the results of the negotiations and were conditioning their endorsement of the trade agreements on achievement of adequate market opening concessions. These sorts of activities by interest groups put pressure on the U.S. Government to seek very specific concessions from its trading partners.

49. 19 U.S.C. § 2155(c) (1994).
50. 19 U.S.C. § 2155(a), (e) (1994).
51. *See infra* note 270.

3. *The Rise of Reciprocity.*

The term "reciprocity" will be familiar to travelers through the trade literature landscape. There are at least two current uses of the term. One use signifies the practice of according the same treatment to a foreign financial institution doing business in a host country as financial institutions of the host country receive in the home country of the foreign financial institution in question. This is the approach taken by the European Union (EU) in the Second Banking Directive. That is not the meaning of the term as used here, because the U.S. Government has consistently opposed this type of reciprocity.[52]

A second meaning of the term and the one used here refers to the process of requiring equivalent concessions from other countries in exchange for making concessions in trade negotiations.[53] This process was observable in the FSA negotiations when the United States refused to bind its market-opening concessions on a most-favored-nation (MFN) basis unless a critical mass of commercially important countries agreed to open their borders to foreign financial service providers.

This approach is different than the one taken by the United States in prior GATT negotiations involving tariff cutting in the goods sectors. Seeking reciprocity in some form has always been part of the trade negotiating process. Previously, however, the U.S. position was to seek concessions from other countries over the course of successive GATT negotiating rounds and the decision to accept an offer in any one round was based on a rough estimate of whether equivalent trade expansion opportunities were being offered.[54] In effect, the United States measured trade concessions in terms of their overall effect, not in terms of specific and equivalent concessions that were made in return for U.S. concessions. This phenomenon has been observed in trade negotiations and trade disputes outside of the financial services sector.[55] It has been referred to in various ways. One prominent commentator has referred to it as full reciprocity, which emphasizes reciprocal market access and level playing fields.[56] It has also been termed a shift from diffuse to specific reciprocity.[57] The predicted impact of a policy of specific reciprocity is a greater sectoral and country-specific focus and an analysis of whether effective market access has been reciprocally achieved.[58] Both of these tendencies were evident during the FSA negotiations. The danger of such a policy is that it limits negotiating flexibility allowing trade-offs among sectors.[59]

This movement in the U.S. policy position has been attributed to a decline in U.S. economic power and an accompanying shift in global power relationships.[60] As a consequence, the United States has shifted its focus away from its traditional concern with broad geopolitical goals, namely the maintenance of global political and economic welfare through an international trading system containing a code of conduct and a dispute settle-

52. The United States has instead adopted a policy of national treatment of foreign financial institutions in its federal banking legislation. *See infra* note 114.
53. WILLIAM R. CLINE, "RECIPROCITY": A NEW APPROACH TO WORLD TRADE POLICY? 7 (1982).
54. PATRICK LOW, Trading Free: THE GATT AND U.S. TRADE POLICY 29 (1993).
55. *Id.* at 29-30 (tracing this form of reciprocity to the Tokyo Round negotiations on non-tariff trade barriers).
56. Jagdish N. Bhagwati & Douglas A. Irwin, *The Return of the Reciprotarians: U.S. Trade Policy Today,* 10 WORLD ECON. 117 (1987).
57. Ahnlid, *infra* note 550, at 72-73.
58. LOW, *supra* note 54, at 30.
59. CLINE, *supra* note 53, at 31.
60. LOW, *supra* note 54, at 15-19.

ment system.[61] In the area of financial services, at least, the United States is now pursuing concrete economic objectives, namely an improvement in its trade balance, by seeking reciprocal trade concessions in this sector on a country by country basis.[62]

4. The Rise of Regionalism.

Another trend is the U.S. willingness to negotiate financial services trade agreements on a bilateral and regional level, in addition to pursuing multilateral liberalization through the WTO. In addition to the bilateral IFTA and CFTA, the United States negotiated bilateral agreements with Japan in 1995 covering insurance and other financial services.[63] In addition to NAFTA, the United States is pursuing other regional initiatives that will involve financial services liberalization under the Free Trade Area of the Americas and the Asia-Pacific Economic Cooperation forum.

There are both political and economic arguments against regional trading arrangements. In the political sphere, prior U.S. policy had been to avoid regional trading arrangements on the grounds that they were inherently discriminatory and would lead to the break-up of the world trading system into regional groupings pursuing protectionist policies.[64] The U.S. policy was instead to pursue trade liberalization on a multilateral basis only through the GATT mechanism.[65] The multilateral GATT system is in principle nondiscriminatory because the most-favored-nation (MFN) principle prevents a preferential system in which some WTO Members receive concessions that are denied to other WTO Members.[66] The inherently discriminatory nature of regional trade agreements is confirmed by the fact that they are deemed a violation of the MFN principle, unless they fall within the exception[67] for

61. For a discussion of the traditional U.S. goals, *see* KENNETH W. DAM, THE GATT: LAW AND INTERNATIONAL ECONOMIC ORGANIZATION 12-13 (1970).
62. The following interchange occurred during Senate Banking Committee hearings on the FSA in 1995: Senator Shelby: "... we've shown goodwill ...we want reciprocity. Isn't that the bottom line?" Treasury Secretary Rubin: "... we have remarkably open markets and we feel that this should be matched by other countries in the world" ... " for free trade to, both substantively and to be politically sustainable around the world, it has to be two-way free trade... " *Senate FSA Hearing, supra* note 6, at 21, 28.
63. Measures by the Government of Japan and the Government of the United States Regarding Insurance, Oct. 1, 1994, Japan-U.S., 34 I.L.M. 661 (1995) [hereinafter Insurance Measures]. Measures by the Government of Japan and the Government of the United States Regarding Financial Services, May 1995, Japan-U.S., 34 I.L.M. 617 (1995) [hereinafter Financial Services Measures]. Bowing to pressure from WTO Members, including the United States, Japan bound these commitments on a multilateral basis in the FSA. Schedule of Japan.
64. Jagdish Bhagwati, *Regionalism and Multilateralism: An Overview, Columbia University Department of Economic Discussion Paper Series*, No. 693 (1992), at 1.
65. JACKSON, *supra* note 8, at 158.
66. There are exceptions to this principle. For example, the Generalized System of Preferences grants special advantages to developing countries with respect to tariffs and is an exception to the MFN principle in article I of GATT. GATT, *supra* note 15, pt. IV.
67. In the absence of the exception contained in Article XXIV, a free trade area like IFTA would violate the article I MFN undertaking because trade concessions made to other members of the regional arrangement by parties to the free trade agreement who are also WTO Members are not unconditionally extended to other WTO Members. For a more detailed discussion of compatibility of free trade areas with GATT Article XXIV, *see* Andreas Lowenfeld, *What the GATT Says (Or Does Not Say) in* BILATERALISM, MULTILATERALISM AND CANADA IN U.S. TRADE POLICY (William Diebold, Jr., ed., 1988).

free trade areas (FTA)[68] and customs unions[69] contained in Article XXIV of GATT.[70] The United States has taken the position that IFTA, CFTA and NAFTA are consistent with Article XXIV of GATT.[71]

In the area of services, regional trading arrangements are permitted pursuant to Article V of GATS.[72] The shift in U.S. trade policy towards pursuing free trade through regional trading arrangements in the services sector was due to frustration over the slow pace of GATT negotiations on services and growing doubt that the GATT was a viable mechanism for achieving the results that the United States sought. Such policy shift is a change from the official position taken by the U.S. Government in preparation for services negotiations in the GATT Uruguay Round that a multilateral agreement covering all sectors was preferable to other pathways to liberalization.[73] Bilateral agreements were rejected by the U.S. at that time on a number of grounds, including the fact that they would lead to discriminatory rules and divergent bodies of rules.[74]

In the economic sphere, some economists have argued against regional trading arrangements on the grounds that they would lead to reduced global economic welfare.[75] The argu-

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68. A free trade area is a group of two or more customs territories in which the duties and other restrictive regulations of commerce are eliminated. GATT, *supra* note 15, art. XXIV, § 8(b).
69. A customs union is the substitution of one customs territory for two or more existing territories so that the duties and other restrictive regulations of commerce among the members are eliminated and a common external tariff is put into place. *Id.* art XXIV, § 8(a).
70. The conditions that must be met to qualify for the Article XXIV exception are the following: duties and other regulations of commerce are eliminated on substantially all trade among the parties to the customs union or free trade area (*Id.* art. XXIV, § 8(a),(b)), duties and other regulations of commerce are not on the whole higher or more restrictive with respect to third party countries than what the constituent countries imposed prior to formation of the customs union or free trade area (*Id.* art. XXIV, § 5(a),(b)), any interim plan for the formation of a customs union or free trade area shall include a timetable for completion within a reasonable period of time (*Id.* art. XXIV, § 5(c)), and the contracting parties must be notified and approve of the formation of the free trade area or customs union (*Id.* art. XXIV, § 7).
71. No such arrangements notified to GATT (now WTO) have ever been challenged on the grounds of non-compatibility with the MFN principle. John H. Jackson, *Regional Trade Blocs and the GATT*, 16 WORLD ECON. 121, 127 (1993). This fact does not confirm that all such regional trading arrangements are in fact GATT-compatible but simply that the GATT parties have failed to challenge the agreements. This may have been done for reasons other than the fact that the GATT parties found them to satisfy the requirements of section XXIV. For example, the United States failed to challenge some of the early European Community (EC) arrangements, presumably on the grounds that the United States believed that economic integration would foster European recovery efforts after World War II.
72. WTO Members may enter into regional economic integration agreements covering trade in services provided that certain conditions are met. GATS, *supra* note 10, art. V. These conditions are that the agreement covers substantially all service sectors and all modes of supply (*Id.* art. V (1)(a)) and that existing discriminatory measures are eliminated and new or more discriminatory measures are prohibited. *Id.* art. V(1)(b). Any such agreement must be designed to facilitate trade among the parties to the agreement and not to raise additional trade barriers to Members outside the regional grouping. *Id.* art. V(4). Such arrangements must be notified to the Council for Trade in Services. *Id.* art. V (7).
73. U.S. NATIONAL STUDY ON TRADE IN SERVICES 55 (1984) [hereinafter SERVICES STUDY].
74. *Id.* at 54-55.
75. Bhagwati, *supra* note 64, at 18.

ment is that regionalism, defined as preferential trading arrangements (PTA) among groups of nations, can lead both to trade creation and trade diversion.[76] Viewed in global terms, trade-creating PTAs increase trade among member countries, but do not decrease trade between the region and the rest of the world. Trade-diverting PTAs increase trade among partners at the expense of third countries as a result of protectionist policies on a regional level. Support for regionalism comes from economists who view PTAs as trade-creating while opposition comes from those who believe the effects are trade-diverting.[77] Economic theory does not provide any conclusive answers as to whether regional trading arrangements augment or detract from global economic welfare.[78]

C. LEGAL CONDITIONS FOR FREE TRADE IN FINANCIAL SERVICES.

In order to liberalize trade in financial services, trade barriers must be identified, a method for removing them devised and a forum for negotiating such changes chosen. The U.S. Government, as well as academics, international economic policy think tanks and international organizations, conducted studies on this topic, from which three important conclusions emerged: (1) the nature of trade barriers in the services sectors is different than in the goods sectors, (2) the process of negotiating services trade liberalization will be even more difficult than for goods trade, and (3) there is no ideal international forum for negotiating removal of services trade liberalization, although GATT is the most likely forum due to its large membership and familiarity with trade issues. These points will be discussed in turn below.

76. Jacob Viner introduced the concepts of "trade creation" and "trade diversion" to explain the economic effects of customs unions and free trade areas. Jacob Viner, THE CUSTOMS UNION ISSUE 40 (1950). Regional integration arrangements may, but do not necessarily, produce increases in welfare, either for member countries or for the world as a whole. Whether welfare increases or not depends on production patterns prior to integration. One commentator has offered the following illustration. Assume that the United States and Mexico form a FTA in which they agree to eliminate all tariffs between themselves but maintain tariffs on products imported from third countries. As a result, the United States begins to import shoes from Mexico. We can assume that, if the United States produced shoes before the FTA, its production costs must have been higher than those in Mexico. The result of the FTA will be that production shifts from higher to lower cost producers, resulting in trade creation and a gain in welfare. If, on the other hand, shoes were originally imported by the United States from Korea, we can assume that both the United States and Mexico were producing shoes at higher costs. The result of the FTA will be to encourage the United States to import from Mexico, even though it is a higher cost producer, because of the effects of the tariff on shoes imported from Korea. In this case, the FTA will have a trade diversionary effect, because trade is diverted from a lower cost to a higher cost producer, resulting in a decline in welfare. Jaime De Melo & Arvind Panagariya, *Introduction*, *in* NEW DIMENSIONS IN REGIONAL INTEGRATION 6-7 (De Melo & Panagariya eds., 1993).

77. *Id.* at 7.

78. ROBERT Z. LAWRENCE, REGIONALISM, MULTILATERALISM AND DEEPER INTEGRATION 4 (1996). There is a substantial body of economic literature discussing the recent trend in U.S. policy towards concluding regional trading arrangements. For a critical view of this tendency, *see* JAGDISH BHAGWATI & ANNE O. KRUEGER, THE DANGEROUS DRIFT TO PREFERENTIAL TRADE ARRANGEMENTS (1995). For an examination of both sides of the issue, *see* LAWRENCE, *supra*, at 1-9.

1. Barriers to Trade in Financial Services.

The chief barriers to free trade in goods are tariffs[79] (taxes imposed at national borders on imported goods that make such goods more expensive than their domestically produced counterparts or substitutes) and non-tariff barriers (such as quotas which operate to restrict the flow of imported goods by limiting the amount of such goods that are allowed into a country or limiting the amount that may be imported at a favorable tariff rate).[80] Trade agreements have traditionally focused on reducing such tariff and non-tariff barriers to trade in goods through a process of negotiation of mutual concessions among trading partners.[81] This was the way that the GATT process worked for many years. Substantial tariff reductions were achieved among GATT (now WTO) members through eight successive rounds of negotiations extending over a fifty year period. Beginning with the Tokyo Round in 1973, the GATT membership began to focus on non-tariff barriers to trade (NTBs). The effects of NTBs are much less transparent than those caused by tariffs. The Tokyo Round achieved some success in reducing NTBs with the establishment of codes in such areas as standards, import licensing procedures, customs valuation, and government procurement.[82]

In contrast, barriers to trade in services are not taxes and volume limitations on imports, but rather, national laws and regulations that restrict, impede, or prohibit the inward flow of services from foreign providers. Just as service movements are invisible since no tangible goods are involved, the regulatory regimes that impede free flow of services are often difficult to detect. When they are detected, they are very often tied up with sensitive public policy issues that make it difficult, if not unthinkable, to remove them.

Services trade barriers can be classified into two general categories: those prohibiting cross-border trade and those restricting cross-border factor movements.[83] An additional distinction can be drawn between discriminatory and nondiscriminatory measures.[84] Nondiscriminatory barriers are those which are imposed generally on all persons, compa-

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79. The first significant study on the topic, entitled *Invisible Barriers to Invisible Trade*, was written for the Trade Policy Research Council in London by economist Brian Griffiths in 1975. This study identified banking as one of the service sectors most in need of liberalization and included a tabular listing on a country by country basis of restrictive measures in banking imposed by a group of developed and developing countries. This study revealed that most of the countries regulated foreign banks with respect to the establishment of new branches, capital requirements, asset portfolio composition, maximum interest rates payable on deposit liabilities, repatriation of profits and employment of nationals. Some countries prohibited the entry of foreign banks entirely. *See* GRIFFITHS, *supra* note 38, at app. 1; *see also* INGO WALTER, BARRIERS TO TRADE IN BANKING AND FINANCIAL SERVICES (1985); WALTER, *supra* note 36; KAKABADSE, *supra* note 40; PHEDON NICOLAIDES, LIBERALIZING TRADE IN SERVICES: STRATEGIES FOR SUCCESS (1989); FEKETEKUTY, *supra* note 19; WORLD BANK AND U.N. CENTRE ON TRANSNATIONAL CORPORATIONS, THE URUGUAY ROUND: SERVICES IN THE WORLD ECONOMY (1990).
80. *See* MELVYN B. KRAUSS, THE NEW PROTECTIONISM 6-7, 13-14 (1978); *see also* JACKSON, *supra* note 8, at 154-55 (1997).
81. *See* Hindley, *supra* note 46, at 35-36.
82. Robert Stern and Bernard Hoekman, *The Codes Approach in* Finger & Olechowski, *supra* note 16, at 59.
83. NICOLAIDES, *supra* note 79, at 55.
84. GRIFFITHS, *supra* note 38, at 34.

nies and financial institutions, but which do not discriminate, either in law or in effect, between foreign and domestic enterprises.[85] Discriminatory measures are those imposed on foreign enterprises, resulting in more favorable treatment of domestic competitors.[86] An illustration of the difference is a national law requiring banks to maintain a certain percentage of their assets in a liquid form paying less interest than other alternative investments. If such a measure, which is a common form of bank regulation, is imposed equally on all banks, regardless of nationality, it is a nondiscriminatory measure. On the other hand, if foreign banks are required to hold a larger percentage of their assets in a lower-yielding form than domestic banks, the measure is discriminatory.[87] Although both types of measures may impede trade, the extent to which efforts should be made to remove nondiscriminatory as well as discriminatory trade barriers remains an open issue for governments in trade negotiations.[88]

In the financial services sector, protectionism most often takes one of two forms: (1) exchange control restrictions, which hinder or prevent the capital flows that are necessary in many financial transactions, including bank lending,[89] and (2) restrictions on the establishment of foreign banking affiliates, including discriminatory barriers to entry and discriminatory operating constraints.[90] The traditional view is that the first category of restrictions falls within the jurisdiction of the IMF while the second category is within the jurisdiction of the GATT (now WTO). However, this distinction has come under attack from those calling for increased international coordination on monetary and trade issues.[91]

All countries regulate market entry by banks and imposing conditions on such entry is not viewed as a trade barrier per se. Examples of nondiscriminatory entry requirements include minimum capital requirements and requirements of management integrity and

85. *Id.*
86. *Id.*
87. *Id.* at 34-35.
88. The FSA and Chapter 14 of NAFTA address discriminatory barriers. The EU, however, has mandated removal of nondiscriminatory barriers in the area of banking as well. *See* Sydney J. Kay, *Is National Treatment Still Viable? U.S. Policy in Theory and Practice*, 5 J. INT'L BANKING L. 365, 367 (1990).
89. Exchange control restrictions serve the purpose of protecting the financial resources of a country. The weakest form of control is a requirement to notify all foreign exchange transactions to the government, mainly for statistical purposes. A moderate form of control is government action in the market affecting the supply and demand to keep the value of its currency (with respect to that of its trading partners) within a predetermined range. The strongest form of exchange control is comprehensive control with government setting the rate and handling all currency exchange transaction. *See* RALPH H. FOLSOM ET AL., INTERNATIONAL BUSINESS TRANSACTIONS 613-616 (3d ed. 1995). The Articles of Agreement of the IMF regulate the use of exchange control restrictions for current transactions but not for capital transactions of IMF members. IMF Articles of Agreement, art. VIII § 2(a), art. XIV § 2. June 22, 1944, 60 Stat. 1401, T.I.A.S. No. 1501 (current version at 29 U.S.T. 2203, T.I.A.S. No. 8937) [hereinafter IMF ARTICLES]. *See* Kenneth Dam, THE RULES OF THE GAME, REFORM AND EVOLUTION IN THE INTERNATIONAL MONETARY SYSTEM 98 (1982).
90. *See* ALAN H. GELB & SYLVIA B. SAGARI, *BANKING* IN THE URUGUAY ROUND: SERVICES IN THE WORLD ECONOMY 52 (1990).
91. *See* Sir Joseph Gold, Legal and Institutional Aspects of the INTERNATIONAL MONETARY SYSTEM: SELECTED ESSAYS 23 (1979) (discussing the issue of IMF jurisdiction on exchange control issues; John H. Jackson, *Managing the Trading System: The WTO and Post-Uruguay Round GATT Agenda* in MANAGING THE WORLD ECONOMY: FIFTY YEARS AFTER BRETTON WOODS 142-143 (Peter B. Kenen ed. 1994) (calling for increased international coordination on monetary and trade issues).

competence.[92] However, regulations intended to keep out foreign competition are considered unacceptable. These range from absolute prohibitions on foreign bank entry to limitations on equity participation in domestic institutions.

A similar distinction can be drawn in connection with operating restrictions. Only those that affect the ability of foreign banks to compete with domestic banks can properly be viewed as trade barriers. These discriminatory regulations can be grouped into three types: (1) intentional operational constraints, (2) accidental operational constraints, and (3) preferential treatment measures.[93] Intentional operational constraints are those that explicitly discriminate against foreign banks and are often intended to limit foreign bank operations to certain segments of the financial market while preserving other segments entirely for domestic banks.[94] Examples include restrictions on deposit-taking activities from the public, restrictions on the number or location of foreign banks, requirements that government funds be held on deposit only at domestic financial institutions, regulations that restrict foreign bank access to central bank discount operations, and restrictions on ability to offer certain banking services other than deposit-taking and lending, such as securities underwriting.[95] Accidental operational constraints are those regulations that are applied equally to foreign and domestic banking operations, but have a negative impact on the ability of foreign banks to compete with domestic institutions because of the different nature of their operations.[96] Examples are limits on maximum permissible asset-capital ratios and lending limits on loans to individual borrowers, which are based on the amount of capital that a bank maintains.[97] These may have a differential impact on foreign banks because they treat affiliates of foreign banks as independent legal entities and take into consideration only the capital kept on deposit by the foreign bank affiliate, which is often a small percentage of the total capital of the foreign bank. The effect is to constrain foreign bank business operations in some circumstances. Preferential treatment measures refer to measures that have a favorable impact on foreign banks due to the nature of their operations.[98] An example is a regulation that imposes lower reserve requirements on foreign currency or non-resident deposits. This type of regulation favors foreign banks that normally hold a greater proportion of foreign currency liabilities than do domestic banks.[99]

It should be noted that barriers to the establishment of financial service firms are imposed by countries at all levels of development and not exclusively by developing countries.[100] Exchange controls, which also may serve as a trade barrier, are still used for economic policy reasons in developing countries, but they were also commonly used in industrialized countries in the post-World War II era.[101]

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92. *See* 12 U.S.C. §§ 21-27 (1994).
93. *See* GELB & SAGARI, *supra* note 90, at 56.
94. *Id.* at 52.
95. *Id.* at 56.
96. *Id.* at 52.
97. *Id.* at 56-57.
98. *Id.* at 57.
99. *Id.*
100. A U.S Government study released in 1979 noted that none of the highly developed, industrial countries completely excluded foreign commercial banking presence and most of them had liberal entry policy. Restrictions did not follow geographic patterns and did not correspond to levels of economic development of the country or of its banking system. DEPT. OF THE TREAS., REPORT TO CONGRESS ON FOREIGN GOVERNMENT TREATMENT OF U.S. COMMERCIAL BANKING ORGANIZATIONS 24 (1979) [hereinafter 1979 Study].
101. *See* GELB & SAGARI, *supra* note 90, at 52.

2. *Removing Barriers to Trade in Financial Services.*

The national laws and regulations that impede free trade in services are in the nature of NTBs in trade in goods. Prior to the GATS and FSA negotiations, experts predicted that removing services trade barriers would be a long and arduous process. This was based on the experience of negotiating the removal of NTBs in the GATT, which has been only partially successful.[102]

Financial services was considered an especially sensitive area because of political opposition to interfering with the exercise of sovereign legislative power in an area where there is a felt need for regulation.[103] It is a widely held view that banks hold a special position within a national economy.[104] Although banks are organized as private, for-profit institutions in many countries, they also serve a quasi-governmental function due to the role they play in implementation of national monetary policy.[105] In addition, since banks often hold funds on deposit for individuals, governments, and businesses and perform other important financial intermediation services, there is a high degree of interest in regulating to protect depositors and the safety and soundness of both individual banks and the banking system as a whole.[106] This is referred to as prudential regulation and is the basis for most restrictions on bank operations. The primary legal issue that arises in liberalizing trade in financial services is how to dismantle discriminatory laws that impede free trade without interfering with the legitimate right of governments to regulate based on prudential concerns.

Removing barriers to trade in services by requiring national laws and regulations to be changed does not imply complete deregulation. The issue of permissible regulation has been addressed in trade agreements through the so-called prudential regulation exception. The prudential regulation exception permits national governments to maintain regulatory restrictions if they can be tied to legitimate policy goals and are not designed simply to keep foreigners out.[107] The issue of national economic policy concerns has been addressed in trade agreements through exceptions for emergency economic measures taken for balance of payments purposes tied to permissible exchange control measures permitted by the IMF Articles[108] and through exceptions for nondiscriminatory measures taken for monetary control purposes.[109]

102. The effects of NTBs are difficult to quantify and, therefore, equivalent concessions are hard to calculate. In addition, removing such barriers often intruded on economic policy objectives of the GATT contracting parties. *See* Hindley, *supra* note 46, at 39.
103. *See* WALTER, *supra* note 36, at 114.
104. *See id.*
105. *See* MARCIA STIGUM, THE MONEY MARKET 20-23 (3d ed. 1990) (description of U.S. Federal Reserve Board implementation of monetary policy objectives through controls on U.S. commercial banks).
106. *See* GERALD CORRIGAN, ARE BANKS SPECIAL?, FEDERAL RESERVE BANK OF MINNEAPOLIS, 1982 ANNUAL REPORT 5-18 (1982).
107. *See* GATS, *supra* note 10, Annex on Financial Services, cl. 2; NAFTA, *supra* note 12, art. 1410(1).
108. *See* GATS, *supra* note 10, Art. XII (1)(2). The IMF Articles of Agreement prohibit restrictions on current transactions except: (1) in the event of scarcity of a foreign currency or (2) in the event an IMF member elected to maintain restrictions in effect on the date it became a member, pursuant to the transitional arrangements provisions of article XIV. IMF ARTICLES, *supra* note 89, art. VIII § 2.
109. NAFTA, *supra* note 12, art 1410 (2).

The prudential regulation exception merely acknowledges the continued ability of governments to regulate for safety and soundness reasons on a nondiscriminatory basis. It does not address the manner in which the trade liberalization process should address the issue of differences in national regulation. The preferred method would be adoption of an international set of rules to govern financial services. This would require amendment or repeal of national laws. The likelihood of standardization is low due to the differences among national regulatory systems and the political resistance that would be encountered in attempting to make such changes.[110] A less intrusive approach would be mutual recognition of laws, regulations, and administrative practices of other countries and is the approach taken by the EC.[111] However, this approach presumes agreement on certain minimum regulatory requirements and changes to national laws to conform to such requirements.[112] The most widely accepted approach is national treatment, which is the principle that foreign institutions will be accorded treatment that is no less favorable than that accorded domestic institutions. This is the policy position that is consistently advocated by the U.S. Government.[113] It is also the standard embodied in U.S. law.[114] An alternative approach is reciprocity, which accords foreign financial institutions from a particular country the same treatment that a domestic institution would be accorded in that foreign country. This is the position adopted by many countries in their banking regulation, including the EU countries.[115] Although

110. An example from U.S. banking regulation is the attempt to amend or repeal the Glass-Steagall Act restrictions on engaging in both the commercial banking and securities businesses, which has been unsuccessful due to opposition from securities industry lobbyists. The Financial Services Competition Act of 1997 introduced as H.R. 10 attempted to repeal the Glass-Steagall Act. *See* Financial Services Competition Act of 1997, in H.R. Rep. No. 105-64 (1997). However, the Act did not pass. Financial services modernization is now being considered again by Congress with the bill entitled the Financial Services Act of 1998. H.R. 10, 105th Cong., 2d Sess. (1998).

111. Sydney J. Key, *Mutual Recognition: Integration of the Financial Sector in the European Community*, 75 Fed. Res. Bull. 591, 602 (1989).

112. *Id.*

113. *See National Treatment of Banks: Hearing on S.2193 Before the Senate Comm. on Banking, Housing and Urban Affairs*, 98th Cong. 24, 29 (1984) [hereinafter *1984 National Treatment Hearing*] (statement of Secretary of Treasury Donald T. Regan).

114. *See* International Banking Act of 1978, 12 U.S.C. §§ 3101 et seq. (1994) [hereinafter IBA]; Foreign Bank Supervision Enhancement Act of 1991, 12 U.S.C. §§ 3101-3111 (1994) [hereinafter FBSEA]. The legislative history of the IBA indicated that the U.S. policy regarding foreign enterprises doing business in the United States had been national treatment. The IBA established the principle of parity of treatment between foreign and domestic banks in like circumstances. S. Rep. No. 1073, 95th Cong., 2nd Sess. 1-2 (1978). The FBSEA introduced enhanced regulation of foreign banks operating in the United States and is generally consistent with the national treatment principle.

115. The reciprocity requirement of the EC's Second Banking Directive contains two elements: (1) effective market access; and (2) national treatment. Effective market access requires EU banks to receive access comparable to that given by the European Union countries to third country banks operating in their markets. The national treatment standard the European Union has adopted is reciprocal national treatment rather than unconditional national treatment. The national treatment provision provides that an EU bank operating in a third country should receive the same treatment as that country's domestic banks. The requirement of reciprocity only applies to subsidiaries of foreign banks and not branches. *See* Council Directive 89/646, art. 9 on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Business of Credit Institutions; Hal S. Scott, *Reciprocity and the Second Banking Directive*, *in* THE SINGLE MARKET AND THE LAW OF BANKING 97-194 (Ross Cranston ed., 2d. ed. 1995).

there have been attempts made in the United States to adopt legislation changing the legal standard to reciprocity, such proposed legislation has been consistently opposed by the U.S. Department of the Treasury[116] and has never passed Congress.[117]

3. *Forum for Financial Services Negotiations.*

Multilateral efforts were favored over other options, such as bilateral negotiations.[118] GATT was considered the most appropriate forum for such discussions,[119] although the Organization for Economic Cooperation and Development (OECD)[120] and the Bank for

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116. Secretary of the Treasury Donald T. Regan stated that a policy of national treatment rather than reciprocity was supported by the U.S. Department of the Treasury because a policy of reciprocity would be nearly impossible to administer, might provoke retaliation against the U.S. and would hinder financial services liberalization in other countries. *See 1984 National Treatment Hearing, supra* note 113, at 14-16.
117. The Fair Trade in Financial Services Act of 1993 (FTFSA) was an attempt to change the U.S. policy of unconditional national treatment to a policy of reciprocal national treatment in order to open up foreign financial markets. S.1527, 103rd Cong. (1993). The FTFSA legislation was not passed as a result of disagreements between House and Senate conference committee members. *See Financial Services Fair-Trade Stripped From Banking Bill*, 199 JEI Rep. 29 (1994). The National Treatment in Banking Act of 1994 was introduced to replace the FTFSA. H.R. 4926, 103rd Cong. (1994). The new measure was different from the FTFSA in that it only focused on the overseas entry and expansion opportunities available to U.S. banks and not on securities firms and insurance companies. The bill passed the House on September 30, 1994, but the legislation was not passed in the Senate due to lack of time at the end of the session. *See House Passes National Treatment in Banking Bill, Senate Fate Unclear*, 63 BANKING REP. (BNA) 476 (Oct. 3, 1994).
118. *See* GRIFFITHS, *supra* note 38, at 91-97 (favoring multilateral codes as best way to promote liberalization); WALTER, *supra* note 36, at 220 (favoring GATT-style framework of principles and code on financial services); SERVICES STUDY *supra* note 73, at 54-57 (1984) (strongly favoring a multilateral agreement with a framework of principles and sector specific agreements under auspices of GATT).
119. *Id.* at 54-57 (GATT favored due to large number of member countries and contractually binding nature of framework of principles).
120. Since its founding in 1961, the OECD has promoted the liberalization of trade in services, as well as goods, and free capital flows. Convention on the Organisation for Economic Co-operation and Development, Dec. 14, 1960, art. 2, 12 U.S.T. 1728, 88 U.N.T.S. 179. These policy goals are reflected in the CODE OF LIBERALIZATION OF CURRENT INVISIBLE OPERATIONS AND THE CODE OF LIBERALIZATION OF CAPITAL MOVEMENTS (collectively "Codes"), which are legally binding obligations of members to maintain the existing level of liberalization and to pursue further liberalization in the future. The Codes were substantially revised in the 1980s to cover new financial services and technological developments. *See* OECD, CODE OF LIBERALIZATION OF CURRENT INVISIBLE OPERATIONS (1992); OECD, CODE OF LIBERALIZATION OF CAPITAL MOVEMENTS (1992). For an analysis of the updates to the Codes, see OECD, LIBERALIZATION OF CAPITAL MOVEMENTS AND FINANCIAL SERVICES IN THE OECD AREA (1990). The results were not wide-ranging due to the limited size of the membership of the OECD, which is composed of the 24 most developed countries. These members include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. Other reasons for the lack of success of these OECD efforts were the large number of reservations that members took and failure to apply the Codes by members. *See* GRIFFITHS, *supra* note 38, at 87-91. The OECD has conducted a number of studies on trade liberalization. *See* REPORT BY THE HIGH LEVEL GROUP ON TRADE AND RELATED PROBLEMS TO THE SECRETARY-GEN. OECD, POLICY PERSPECTIVES FOR INTERNATIONAL TRADE AND

International Settlements (BIS)[121] were mentioned as possible alternative forums for financial services talks.[122]

4. U.S. Policy on Removing Barriers to Financial Services Trade.

U.S. policy goals on financial services were set forth in U.S. National Treatment Studies on banking produced between 1979 and 1994 and the U.S. National Study on Trade in Services produced in 1984 for GATT. These studies also provided information regarding trade barriers in selected countries that were used in trade agreement negotiations.

a. U.S. National Treatment Studies.

National treatment studies of banking institutions were conducted in 1979, 1984, 1986, 1990, and 1994 by the U.S. Department of the Treasury[123] pursuant to Congressional mandates.[124] The Studies examined national laws impeding financial ser-

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ECONOMIC RELATIONS (1972). In the areas of financial services, see COMM. ON FIN. MATTERS, OECD, INTERNATIONAL TRADE IN SERVICES: BANKING 3 (1984) [hereinafter BANKING]; COMM. ON FIN. MATTERS, OECD, INTERNATIONAL TRADE IN SERVICES: SECURITIES 9-10 (1987) [hereinafter SECURITIES]. The OECD report on banking discussed the restrictive practices of the OECD member countries and concluded that national policies limiting the right of establishment were the most significant obstacle to trade in banking services. The report on securities identified three general categories of barriers: (1) official government policies limiting the participation of foreigners in the securities market; (2) official regulations or officially accepted private practices which exclude foreign interests from the domestic market; and (3) obstacles to cross-border activities in securities. SECURITIES, *supra*, at 9. Nondiscriminatory measures were viewed as significant trade barriers. *See id.* at 10.

121. BIS is a cooperative forum for central banks from leading industrial countries and developing countries that addresses bank regulatory issues of international interest through the Basle Committee on Banking Supervision (Basle Committee). Its recommendations are not legally binding on members. The most successful effort of the Basle Committee has been in the capital adequacy area. *See* Lawrence Lee, *The Basle Accords as Soft Law: Strengthening International Banking Supervision*, 39 VA. J. INT'L. L. 1 (1998) (recent survey of work on the Basle Committee).

122. *See* WALTER, *supra* note 36, at 220 (discussing OECD); GELB & SAGARI, *supra* note 90, at 55 (discussing BIS); Sydney J. Key and Hal S. Scott, *International Trade in Banking Services: A Conceptual Framework, in* THE INTERNATIONALISATION OF CAPITAL MARKETS AND THE REGULATORY RESPONSE 39 (John Fingleton ed., 1992) (discussing GATT, OECD and BIS).

123. 1979 Study, *supra* note 100; U.S. DEPT. OF THE TREASURY, REPORT TO CONGRESS ON FOREIGN GOVERNMENT TREATMENT OF U.S. COMMERCIAL BANKING ORGANIZATIONS (1984 Update) [hereinafter 1984 Study]; U.S. DEPT. OF THE TREASURY, REPORT TO CONGRESS ON FOREIGN GOVERNMENT TREATMENT OF U.S. COMMERCIAL BANKING ORGANIZATIONS (1986 Update) [hereinafter 1986 Study]; U.S. DEPT. OF THE TREASURY, NATIONAL TREATMENT STUDY: REPORT TO CONGRESS ON FOREIGN TREATMENT OF U.S. FINANCIAL INSTITUTIONS (1990) [hereinafter 1990 Study]; U.S. DEPT. OF THE TREASURY, NATIONAL TREATMENT STUDY: REPORT TO CONGRESS ON FOREIGN TREATMENT OF U.S. FINANCIAL INSTITUTIONS (1994) [hereinafter 1994 Study].

124. The 1979 Study was mandated by section 9 of the International Banking Act of 1978, which required the Secretary of the Treasury in conjunction with other Federal banking agencies to conduct a study of the extent to which U.S. banks were granted or denied national treatment abroad. The 1984 and 1986 Studies were updates to the 1979 Study and were prepared at the request of Senator Jake Garn, the ranking Republican of the Senate Committee on Banking, Housing and Urban Affairs. The 1990 and 1994 Studies were prepared pursuant to the Financial Reports Act of 1988, 22 U.S.C. §§ 5351-5352 (1988), which instructs the Secretary of the Treasury to report to the

vices trade of countries that the United States considered commercially important[125] and set forth policy recommendations for U.S. action to seek to remove such trade barriers.[126] Only banking activities were examined in the 1979 and 1984 Studies, but the later reports also covered securities activities. The 1990 and 1994 Studies also examined whether the United States accorded national treatment to foreign financial service providers. An important conclusion of the 1979 Study was that U.S. banks generally received equitable treatment abroad and therefore, the U.S. Government should enter into negotiations on lowering barriers in those countries where U.S. institutions did not receive national treatment and competitive equality.[127] Between 1979 and 1990, the Studies showed a lowering of trade barriers in the countries examined.[128]

Congress every four years beginning December 1, 1990, on foreign financial institutions in the United States and the kinds of services they offer, and the extent to which foreign countries deny national treatment to U.S. banks and securities firms, including U.S. efforts to eliminate discrimination. *See* 1990 Study, *supra* note 123, at 3.

125. In 1979, 140 countries (21 individual and 6 groups) were selected for the study. *See* 1990 Study, *supra* note 123, at 3. The countries chosen had a significant banking presence in the United States, represented potential opportunities for growth and expansion by U.S. banks and were the home countries of foreign banks with a significant international and U.S. presence. *See* 1979 Study, *supra* note 100, at 31-33. Sixteen countries were chosen for review for the 1984 Study where U.S. banks were previously not afforded national treatment, but desired an active presence. *See* 1984 Study, *supra* note 123, at ix. The 1986 Study covered 18 banking markets and extended coverage for the first time to 8 securities markets, chosen on the basis of their importance as financial centers. *See* 1986 Study, *supra* note 123, at 2. The 1990 Study covered 21 banking and 18 securities markets in 27 countries or regions. *See* 1990 Study, *supra* note 123, at 2. The 1990 Study was broader and more detailed than the previous studies. *Id.* In 1994, the Study covered banking and securities in 30 countries. *See* 1994 Study, *supra* note 123, at 1.

126. In 1979 and 1984, the recommendations for U.S. action included: (1) remedial action should be taken towards those countries in which U.S. banks are not given national treatment; (2) continue to encourage and support the principle of national treatment through bilateral contacts and multilateral forums; and (3) the Treasury and other governmental agencies should continue its efforts in gathering information about the banking policies, practices, and regulatory and legislative developments of foreign countries in order to determine the appropriate action to be taken. *See* 1984 Study, *supra* note 123, at xii. In the 1990 Study, there was discussion that even though the United States is committed to the principle of national treatment, Congress was feeling the pressure to take some type of action because of the movement by several countries toward a policy of reciprocity or reciprocal national treatment and the slow progress in some Asian and Latin American financial markets. *See* 1990 Study, *supra* note 123, at 7. The 1994 Study identified a three-pronged strategy for future liberalization: (1) GATS (2) intensive bilateral discussions; and (3) other initiatives that promote capital market development and integration. *See* 1994 Study, *supra* note 123, at 10-12.

127. *See* 1979 Study, *supra* note 100, at 136.

128. From 1979 to 1984, the level of national treatment received by U.S. financial institutions improved. During that five year period from 1979 to 1984, Canada, Finland, Japan and Spain significantly decreased their barriers to foreign banks. Canada passed its 1980 Bank Act that allowed foreign banks to establish commercial banking subsidiaries in Canada and Spain enacted legislation in 1978 that reopened Spain to foreign banks for the first time in 40 years. *See* 1984 Study, *supra* note 123, at vi, vii. By 1990, significant improvements had been achieved in Canada with the CFTA and in the European Community under the Second Banking, the Investment Services and the other financial services directives. *See* 1990 Study, *supra* note 123, at 10.

The 1994 Study indicated that significant improvements had been made since 1990 in according national treatment to U.S. firms providing financial services abroad due to intensive multilateral and bilateral negotiations by the United States with various trading partners, citing in particular NAFTA, bilateral negotiations with Japan, China, Korea, and Taiwan, and the GATS negotiations in the Uruguay Round.[129] Also cited as a reason for the improvement was the implementation of the EU single market in financial services.[130]

In the 1994 study, the remaining problem areas in banking[131] were restrictions on foreign bank establishment,[132] discriminatory requirements regarding maintenance of bank capital,[133] high concentration of the banking industry and official tolerance of restrictive business practices by private banks,[134] and lack of transparency in developing and implementing laws and regulations.[135] In securities, the remaining problem areas[136] were restrictions on entry,[137] discriminatory capital requirements,[138] limitations on market share imposed after establishment,[139] limitations on stock exchange memberships for foreigners,[140] exchange controls and restrictions on foreign investment,[141] and limitations on

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129. *See* Cover letter from Lloyd Bentsen, Secretary of the Treasury, to Al Gore, President of the Senate, and Thomas S. Foley, Speaker of the House of Representatives (Dec. 1, 1994), *in* 1994 Study, *supra* note 123.
130. *See id.*
131. *See* 1994 Study, *supra* note 123, at 7, 8.
132. Examples cited included complete prohibition on new entry (Brazil), formal moratoria on issuance of new domestic banking licenses (Chile, Czech Republic, Malaysia, Singapore and Thailand), requirement of establishment of subsidiaries (Canada and Mexico), discouraging use of branches (Colombia, Hungary, Indonesia, Poland, Russia, South Africa), requirement of a joint venture thereby effectively prohibiting 100% foreign ownership and with higher capital requirements than domestic institutions (Indonesia), limits on establishment of branches (China, Hong Kong, Indonesia, Malaysia, the Philippines, Singapore, Thailand), reciprocity requirements (India), prohibition on participation in local currency business (China, Russia), global ceilings on foreign banks' share of total banking system assets (Canada) and investment screening with no transparency on criteria for review. *Id.*
133. Examples included tying limits on lending and foreign exchange transactions to locally held (dotation) capital (EU - applies to branches of EU banks but not branches of banks of EU member countries) and unduly high requirements for foreign institutions (Brazil, Korea, Turkey). *Id.* at 8.
134. Examples included Singapore and Malaysia; where foreign banks were not allowed to use local ATM networks nor to establish their own networks. *Id.* at 8, 9.
135. *Id.* at 9.
136. *See id.* at 9, 10.
137. Examples included complete prohibition on new entry (Brazil), no issuance of new brokerage licenses (Malaysia and Turkey), prohibition on the entry of foreign securities firms in any form other than unlicensed "nameplate" operations (South Africa), and prohibition of wholly foreign owned securities subsidiaries (Korea, Malaysia, and Pakistan). *See id.* at 9.
138. An example cited was Indonesia where foreigners can only enter the market through joint ventures, which are subject to discriminatory capital requirements. *See id.*
139. An example is the severe limitations placed on foreign investment advisers management of public and private pension funds in Japan. *See id.*
140. In Malaysia, Singapore, and Thailand, access to the local stock exchanges is unavailable or access is extremely limited by numerical limitations or reciprocity requirements. *See id.* at 10.
141. Examples of restrictions on foreign access to securities listed on local stock exchanges included: ceilings on the percentage of foreign ownership, prohibitions on purchases by foreign individuals and ceilings on the purchases made by foreign institutional investors (China, India, Indonesia, Korea, Taiwan, and Thailand). *See id.*

foreign firm participation in domestic capital market activities.[142] The 1994 Study also examined U.S. laws on banking, securities, and insurance with respect to foreign competitors and concluded that such laws generally provided national treatment.[143]

The recommended course of action for the United States in the 1994 Study had three elements.[144] First, the United States planned to continue to seek substantially full market access and national treatment on a multilateral basis in the GATS for U.S. financial institutions in a broad range of commercially important developed and developing countries.[145] Second, the United States planned to continue to conduct bilateral financial market discussions with certain East Asian trading partners, including Japan, China, Korea, and Taiwan.[146] Finally, the United States planned to work within international organizations to encourage development of financial markets in other countries.[147] In addition, the United States planned to promote development of financial markets and integration on a regional basis through regulatory cooperation in the Western Hemisphere and in Asia.[148]

b. U.S. National Study on Trade in Services.

The U.S. National Study on Trade in Services (Services Study)[149] was prepared in 1984 for submission to GATT and was intended to serve as a medium for exchange of information with other governments regarding issues in liberalizing such trade.[150] The Services Study focused on key issues in services trade[151] and key service sectors.[152]

Banking was an important focus of the Services Study, with a separate section devoted to the types of restrictions that existed.[153] The three main categories of restrictions were

142. Examples cited were the restrictive regulation on the issuance of corporate securities and the broad administrative measures on capital account transactions imposed by Japan. *See id.*

143. *Id.* at 67.

144. *Id.* at 10-12.

145. The United States conducted intensive discussions with certain key countries, including Japan, Korea, Singapore, Thailand, Malaysia, Indonesia, Philippines, Hong Kong, Argentina, Brazil, Chile, Venezuela, India and Egypt, where there were significant barriers to market access and national treatment or where countries were unwilling to bind current practices and laws providing liberal treatment. *See id.* at 95, 96. Negotiations were also held with Eastern European countries that were developing market-oriented economies, including Poland, Hungary, Czech and Slovak Republics, Romania, and with South Africa, which was rejoining the international economic community as political conditions changed. *See id.* at 96. Another set of important negotiations were conducted with OECD member countries on areas where significant barriers remained. *See id.*

146. It was hoped by the United States that the agreements reached on a bilateral basis with these countries would be extended to other countries on an MFN basis in the Uruguay Round GATT negotiations. *See id.* at 11.

147. The World Bank, the IMF and the OECD were named. *See id.* at 11.

148. The two areas of geographic focus were Latin America and Asia. *See id.* at 12.

149. *See* SERVICES STUDY, *supra* note 73.

150. *Id.* at 1.

151. The major issues for examination were 1) competition between private firms and government monopolies; 2) distinguishing trade in services from investment in services, and 3) the role of immigration and labor in trade in services. *Id.*

152. Ten service industries were examined: accounting, telecommunications, banking, insurance, motion pictures, franchising, aviation, travel agents, legal services and maritime. *Id.*

153. *Id.* at 137.

identified[154] as (1) restrictions on entry,[155] (2) discriminatory regulations that imposed larger operating costs on foreign banks or that denied competitive opportunities to foreign banks,[156] and (3) nondiscriminatory government regulations aimed at non-banking objectives that hindered the operations of foreign banks.[157] The Services Study concluded that the United States should pursue the development of international rules that accord national treatment and market access to foreign financial service providers.[158] Several important conclusions and underlying themes of the Services Study are relevant here. The Services Study argued for dropping the traditional distinction that governments have made between trade and investment issues and covering investment by services firms within the GATT framework.[159] While recognizing that international trade depends on movement of people, the Services Study also argued against negotiating immigration or labor issues within the GATT, arguing that GATT was an inappropriate forum and immigration rules should not be subordinated to trade rules.[160] The Services Study recommended a multilateral agreement covering all sectors[161] and incorporating the following general principles: national treatment, least restrictive regulations, nondiscrimination, market access, transparency, due process, and dispute settlement.[162]

D. From GATT to GATS: Theorizing a Framework for Financial Services Liberalization.

Beginning in the 1980s, the United States lobbied strenuously to include services as a negotiating item in a new GATT round and was joined by some members of the OECD.[163] The United States threatened to abandon the GATT if trade in services was not placed on the negotiating table.[164] A group of developing countries led by India and Brazil agreed to a new round of GATT negotiations in a position paper presented to the GATT on the condition that services not be included.[165] After several years of effort on the part of the

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154. *Id.*
155. Examples of entry restrictions included: prohibiting the establishment of any presence by a foreign bank or limiting the level of foreign equity participation in domestic banks. *See id.* at 138.
156. Regulations that discriminated against foreign banks included: limits on government deposits, restrictions on the type of financial assets that can be acquired, or restrictions on local retail banking. *See id.*
157. Nondiscriminatory government regulations hindering the operation of foreign banks included: foreign exchange controls, immigration controls and professional licensing requirements. *See id.*
158. *Id.* at 141.
159. *Id.* at 38.
160. *Id.* at 39.
161. The other alternative structures that were examined were multilateral understandings for individual sectors, bilateral agreements for individual sectors, and bilateral agreements covering all sectors. These approaches were rejected for a variety of reasons, including the fact that such approaches would deviate from the concept of MFN treatment in favor of a preferential system based on reciprocal opportunities and would not lead to a uniform body of rules to govern services trade. *Id.* at 54-55.
162. *Id.* at 55-57.
163. *See* Trade Comm., INT'L ECON. REV. May 1985, at 14, 15.
164. *See* Terrence G. Berg, *Trade in Services: Toward a Development Round of GATT Negotiations Benefitting Both Developing and Industrialized States*, 28 HARV. INT'L. L.J. 1 (1987).
165. *See* Trade Comm., INT'L ECON. REV. July 1985 at 12.

United States, the GATT contracting parties had agreed in principle to include services in the new GATT round, as set forth in the Ministerial Declaration delivered at Punta del Este, Uruguay in September 1986.[166] A Group of Negotiations on Services was established and it was within that forum that the decision was made to separate the services negotiations from the GATT negotiations and to produce a separate agreement for the services sectors.[167] This compromise was acceptable to the developing countries who feared a trade-off between concessions in the goods and services sectors.[168]

In the financial services sector, the U.S. Treasury Department lobbied actively against including financial services within the general services agreement and sought a separate sectoral agreement, arguing that regulation of financial institutions was substantially different from that governing other services.[169] The negotiations were held within the specialized forum of the Committee on Trade in Financial Services.[170]

Although the GATS negotiations were severed from the very beginning from the GATT negotiations in the Uruguay Round, the structural model of GATT had a strong hold over the thinking of both theoreticians and trade negotiators. The chief theorist was John H. Jackson, but other writers supported the same structure,[171] and their position became the initial U.S. negotiating position.

Jackson posited a three-tier structure. Tier one was to be composed of an umbrella agreement that incorporated certain basic principles, such as MFN treatment, national treatment, transparency and measures dealing with institutional structures, and dispute settlement. Tier two was to be composed of an optional protocol in which a core group of like-minded nations agreed on a more significant set of obligations that would apply to many service sectors. Tier three was to be composed of various sectoral agreements to be negotiated over a period of decades that would conform to the umbrella agreement, but would contain provisions addressed specifically to reducing the trade barriers found in specific industries.[172]

One significant deviation of the GATS from this theoretical model will be noted here. In the course of the negotiations, developing countries opposed the concept of a principles-based approach for services, and the most important principles (national treatment and market access) were removed from the umbrella agreement and relegated to scheduled

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166. The Punta del Este Declaration, which marked the official beginning of the Uruguay Round, stated that the objectives of the services negotiations were to establish a multilateral framework of principles and rules for trade in services, produce an elaboration of possible disciplines for individual sectors, conduct the negotiations under conditions of transparency and progressive liberalization as a means of economic development for all countries, and ensure that the framework should respect the policy objectives of national laws and regulations applying to services, and take into account the work of relevant international organizations. *Ministerial Declaration on the Uruguay Round*, GATT Doc. No. MIN.DEC, at 10 Sept. 20 (1986).

167. *See* The Gatt Uruguay Round: A Negotiating History (1986-1992) 2359 (Terence P. Stewart ed., 1993).

168. *See* Jagdish Bhagwati, *Services*, *in* The Uruguay Round: A Handbook on the Multilateral Trade Negotiations 207 (J. Michael Finger & Andrzej Olechowski eds., 1987).

169. *See* Stewart, *supra* note 167, at 2355.

170. *See* International Trade Commission, Recent Trends in U.S. Services Trade, 1997 Annual Report 4-6 (1997).

171. *See* Feketekuty, *supra* note 19, at ch. 10, 11; Walter, *supra* note 36, at ch. 9.

172. John H. Jackson, International Competition in Services: A Constitutional Framework 17-18 (1988).

commitments of countries, subject to reciprocal concession negotiations.[173] The practice of negotiating separate sectoral agreements was initiated, with the FSA being an example.

III. U.S. Policy and the Evolution of Trade Agreement Provisions on Free Trade in Financial Services.

A. The Negotiating Agenda for Trade in Services.

Congress mandated negotiations on trade in services and set forth a negotiating agenda for services in various pieces of U.S. trade legislation in the 1970s and 1980s. The term "services" in this legislation was apparently intended to cover many service sectors.[174] Individual sectors, such as financial services, were not enumerated in the statutory definitions.

The first U.S. trade legislation to include a reference to trade in services was the Trade Act of 1974,[175] which expanded the definition of international trade to include services and foreign direct investment related to trade in goods or services.[176] Pursuant to the Trade and Tariff Act of 1984, a stated objective of U.S. trade negotiations was to encourage the expansion of international trade in services through the negotiation of agreements (both bilateral and multilateral) that reduce or eliminate barriers to international trade in services and U.S. service industries in foreign commerce.[177] The U.S. negotiating objectives for services trade were (1) to reduce or eliminate barriers that denied national treatment and restricted establishment and operation for U.S. service providers in foreign markets and (2) to develop internationally agreed rules, including dispute settlement procedures, consistent with U.S. commercial policy, which would reduce or eliminate such barriers or distortions and help ensure open international trade in services.[178] Both negotiating objectives were expressly made subject to certain enumerated domestic objectives, including consumer protection.[179] This has remained the negotiating agenda for the United States in the area of trade in services, including trade in financial services. These objectives are repeated in the Omnibus Trade and Competitiveness Act of 1988,[180] which provided authority for the President to participate in the Uruguay Round of GATT trade negotiations.[181]

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173. *See* Bhagwati, *supra* note 30, at 469-473.
174. *See e.g.*, Staffs of the Senate Comm. on Finance and the House Comm. on Ways and Means, 93rd Cong., Report on Trade Act of 1974 (Comm. Print 1974) (services included, but were not limited to, shipping, aviation, and insurance).
175. Trade Act of 1974, Pub. L. No. 93-618, 88 Stat. 1982, 1986 (1975). The Trade Act of 1974 granted negotiating authority to the executive branch to participate in the Tokyo Round of GATT negotiations.
176. *See* 19 U.S.C. § 2411(d)(1) (1994).
177. Trade and Tariff Act of 1984, Pub. L. 98-573, 98 Stat. 2948, 3000, 3001 (1984) (codified at 19 U.S.C. § 2102(3) (1994)).
178. *See* 19 U.S.C. § 2114a(a) (1994). A similar provision was included for foreign direct investment, requiring removal of trade barriers, expansion of the national treatment principle and reduction of unreasonable barriers to establishment. 19 U.S.C. § 2114a(b)(1) (1994).
179. *See* 19 U.S.C. § 2114a(a)(2) (1994). A similar provision was included for foreign direct investment. *See* 19 U.S.C. § 2114a(b)(2) (1994).
180. Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107, 1121-25 (1988) (codified at 19 U.S.C. § 2901(9)) (1994).
181. *See* 19 U.S.C. § 2902(e) (1994).

B. U.S.-Israel Free Trade Agreement.

The first time the United States incorporated provisions on financial services in a trade treaty was in the 1985 Agreement on the Establishment of a Free Trade Area between the United States of America and the Government of Israel (the U.S.-Israel Free Trade Agreement or IFTA).[182] IFTA was a first for the United States in at least one other important respect, namely it was the first free trade agreement signed by the United States that purported to cover all trade sectors and sought to reduce both tariff and non-tariff barriers.[183]

These two "firsts" were the product of important U.S. trade policy concerns. One concern was the significant positive impact of services on both U.S. gross domestic product and balance of trade figures. This led U.S. policymakers to seek liberalization in services trade in trade negotiations as a means of furthering this trend. The second concern was with the continued viability of the multilateral GATT system as a means for reducing trade barriers in all areas, including services trade. This led the United States to pursue free trade agreements, both bilateral and regional, which included services trade provisions. Both of these policy concerns are repeated in later trade negotiations on services. A third element of IFTA that is relevant to a better understanding of the later trade agreements is the framework of principles that it developed. Although IFTA covered only a very limited category of banking services, and the parties agreed to abide by the provisions on a best-efforts basis only,[184] meaning that they were not legally binding, most of the important principles developed in IFTA negotiations were incorporated in and expanded on in later treaties. A study of IFTA is therefore instructive in understanding later treaties. These points will be discussed in turn.

1. *Developing Disciplines for Services Trade.*

It was the United States that proposed including provisions on trade in services in IFTA. At the time of the negotiations, the volume of services trade between the United States and Israel was relatively small, with the exception of tourism, and not a source of

182. *See* Free Trade Agreement, Apr. 22, 1985, U.S.-Isr., 24 I.L.M. 653. Negotiations on IFTA were concluded on February 26, 1985 and the agreement was signed on April 22, 1985. IFTA was negotiated by the United States under negotiating authority granted in Title IV of the Trade and Tariff Act of 1984. *See* 19 U.S.C. § 2112 (1985). It was implemented into U.S. law pursuant to the United States-Israel Free Trade Area Implementation Act of 1985, Pub. L. No. 99-47 (codified at 19 U.S.C. § 2112 (1985) on June 11, 1985). It became effective after Israeli government approval and notice to GATT on August 11, 1985. The bill that led to passage of the IFTA Implementation Act was H.R. 2268, which passed the House on May 7, 1985 and the Senate on May 23, 1985. Details of the legislative history are presented in H.R. Rep. No. 99-64, 99th Cong. (1985), reprinted in 1985 U.S.C.C.A.N. 61.

183. The only similar effort had been a reduction of automobile tariffs under the U.S.-Canada Automotive Pact in 1966. Agreement Concerning Automotive Products, Sept. 16, 1966, U.S.-Can., 17 U.S.T. 1372 T.I.A.S. No. 6093. In addition, the United States had entered into a unilateral free trade arrangement in the Caribbean Basin Initiative, in which it granted one-way trade concessions to certain Caribbean countries. Caribbean Basin Economic Recovery Act, 19 U.S.C. §§ 2701-2706 (Supp. I 1983).

184. After the IFTA was concluded, there was an attempt made to negotiate legally binding provisions for the insurance sector, as well as certain other non-financial service sectors. *See infra* Part III. B.3., note 224.

trade disputes.[185] However, both sides anticipated an increase in services exports as a result of IFTA and therefore had an interest in lowering trade barriers.[186]

The United States had other motivations for seeking to include services in IFTA apart from wanting to maintain a good relationship with Israel. Achieving an agreement on free trade in services would further highlight for the world trading community the importance of this issue.[187] In addition, the negotiations would be used as a test run for further negotiations to be conducted within the GATT framework.[188] Not only would such an exercise highlight problem areas that needed to be addressed, but it would give the United States latitude to experiment in an arena where there was relatively little to lose if the effort backfired.[189] Finally, the IFTA provisions could be used as a model for future treaties that covered services trade.[190]

There was dissension within the U.S. Government, with some officials taking the position that including trade in services in the negotiations would slow down the process since this was the first time the United States had negotiated a free trade agreement, as well as the first time it was attempting to liberalize barriers to services trade.[191] In the end, however, the importance of the services issue to the United States took precedence, and provisions on services were included.

2. *Trend Towards Regionalism.*

IFTA represented a dramatic departure in trade policy for the United States, which up until this time had strenuously pursued a policy of multilateralism through the GATT mechanism. The United States had been in favor of including rules for trade in services within the multilateral framework of GATT since the early 1980s. It recognized that the absence of such a regime was limiting access by U.S. service providers to foreign markets[192] and took the initiative within the GATT framework to call attention to the need for rules in this area. By the time a free trade agreement with Israel was proposed, several concrete steps had been taken. The United States had succeeded at the GATT Ministerial meeting in November 1982 in having an informal group established to study trade in services. At the meeting of the GATT contracting parties in November 1984, the United States received approval for a formal consideration of broadening GATT to cover services.[193]

Despite these achievements, the United States was disappointed with the pace of progress towards a new round of GATT negotiations and especially with the failure of the GATT contracting parties to make greater progress towards a negotiating agenda at the

185. *See* Carol Balassa, *Negotiation of Services in the U.S.-Israel Free Trade Area in* THE U.S.-ISRAEL FREE TRADE AREA AGREEMENT 5.01, 5.02 (Andrew James Samet & Moishe Goldberg eds., 1989); *see also* FEKETEKUTY, *supra* note 19, at 176, 181-83.
186. *See* Balassa, *supra* note 185, at 5.03.
187. *See id.*
188. *See id.*
189. *See id.*
190. *Id.* at 5.02; *see also* Doral Cooper & Nancy Adams, *Overview of the U.S.-Israel Free Trade Area Negotiations: An American Perspective, in* THE U.S.-ISRAEL FREE TRADE AREA AGREEMENT 1.04 (Andrew James Samet & Moishe Goldberg eds., 1989).
191. Balassa, *supra* note 185, at 5.02.
192. Balassa, *supra* note 185, at 5.01, 5.02.
193. *Id.*

November 1982 GATT Ministerial meeting.[194] As a result, some U.S. Government officials began to question the future viability of the multilateral GATT process.[195] When Israel suggested a free trade area in 1983, the United States was therefore willing to begin preliminary negotiations on the issue.[196] United States Trade Representative William E. Brock favored liberalizing trade on a bilateral basis as a means to stimulate the GATT process and so strengthen the GATT system.[197]

Some commentators have interpreted the United States entry into regional trade agreements like IFTA as a turning away from multilateralism and the MFN principle. The United States in fact had reasons for entering into IFTA that had nothing to do with multilateralism.[198] Nonetheless, IFTA represented a new trend of negotiating broad-based bilateral and regional free trade agreements, which have become an important component of U.S. trade policy.

3. *Framework Agreement for Trade in Services.*

IFTA has been described as "an experiment in bilateral free trade for the United States."[199] The United States was writing on a blank slate, not having any prior U.S. trade agreement to look to for guidance. In the area of financial services, the tentative nature of the provisions, their non-binding character, and their incomplete coverage, compared to later trade agreements, can be explained at least in part by this fact.

Trade in services was covered in a non-legally binding Declaration on Trade in Services (Declaration) referred to in Article 16 of IFTA.[200] Although the United States had intended

194. Cooper & Adams, *supra* note 190, at 1.02.

195. *United States-Israel Free Trade Area Agreement: Hearing Before the House Comm. on Ways and Means*, 99th Cong. 10-11 (1985)[hereinafter *Free Trade Area Agreement*] (statement of Congressman Gingrich).

196. Cooper & Adams, *supra* note 190, at 1.02. For a negotiating history of IFTA, *see* ORIT FRENKEL, CONSTRAINTS AND COMPROMISES: TRADE POLICY IN A DEMOCRACY: THE CASE OF THE U.S.-ISRAEL FREE TRADE AREA 110-121 (1990).

197. *See* Cooper & Adams, *supra* note 190, at 1.02 (statement by Doral Cooper, Assistant USTR for Bilateral Affairs). Ms. Cooper stated that since the United States began negotiations with Israel, there has been more enthusiasm expressed by other trading partners in liberalizing trade on a multilateral basis. *Id.*

198. The United States had an economic incentive to enter into IFTA, namely that it feared losing export trade with Israel as a result of a free trade agreement entered into between Israel and the European Economic Community. *Free Trade Area Agreement, supra* note 195, at 11 (statement of Rep. Frenzel). *See* FRENKEL, *supra* note 196, at 82-83; Cooper & Adams, *supra* note 190, at 1.03, 1.05. The United States also had political motivations, namely the need to strengthen its relationship with its only stable ally in the Middle East. This entailed providing support for Israel's troubled economy. *See* PEGGY BLAIR, A U.S.-ISRAEL FREE TRADE AREA 77 (1985), *reprinted in Free Trade Area Agreement, supra* note 195. A free trade agreement that would stimulate trade was viewed as a better alternative to the politically controversial proposal to increase foreign aid. Charles Sawyer & Richard Sprinkle, *U.S.-Israel Free Trade Area, Trade Expansion Effects of the Agreement,* 220 J. WORLD TRADE 528, 529 (1986).

199. Alexander Platt, *Free Trade with Israel: A Legislative History, in* THE U.S.-ISRAEL FREE TRADE AGREEMENT 2.02 (Andrew James Samet & Moishe Goldberg eds., 1989).

200. Section 16 recognizes the need to minimize restrictions on exports and binds the parties to develop means to cooperate towards this end in accordance with the Declaration on Trade in Services. *See* Declaration on Trade in Services, Apr. 22, 1985, U.S.-Isr., reprinted in 24 I.L.M. 679 (1985) [hereinafter Declaration].

to negotiate legally binding commitments,[201] uncertainty about whether U.S. negotiators could bind the states to a specific course of action on services regulation[202] led the parties to reduce their commitments to best-efforts undertakings.[203]

A broad range of services was covered by the Declaration, which defined trade in services as the export of a service from a supplier nation and the import of the service by another nation.[204] The various modes of supply are not enumerated. Although the language is ambiguous, the negotiating history suggests that only three of the four modes of supply covered in the later trade agreements were intended to be covered in IFTA, namely cross-border movement of services, consumption abroad, and temporary movement of personnel of service providers. It did not refer to permanent establishments in the host country as a mode of supply.[205] The exclusion appears to have been intentional due to concerns about the possibility of overlap and conflicts if investment issues were included in IFTA in view of the 1952 Treaty of Friendship, Commerce and Navigation between the United States and Israel, which arguably already covered investments in services.[206]

Financial services are covered by the Declaration, which sets forth banking services, insurance, and other financial activities in a non-exhaustive listing of covered sectors.[207] However, covered banking services are limited to the activities of representative offices,[208] and the activities of agencies, branches or subsidiaries are not included.[209] There were two reasons for this limited treatment of banking. First, the negotiators were concerned that there were certain aspects of American banking law in which foreign banks were not granted national treatment with respect to branches and subsidiaries.[210] An example was the International Banking Act of 1978 requirement that all directors of a foreign bank be U.S.

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201. Balassa, *supra* note 185, at 5.03.

202. The problem arose due to the significant regulatory authority of the states in such important service areas as banking and insurance. Without the best-efforts undertaking, Israel would have been asked to take on greater obligations than the United States because the services sectors regulated at the state level in the United States would have fallen outside the scope of IFTA. *See id.* at 5.12-5.15; FEKETEKUTY, *supra* note 19, at 180-181. Where state and local governments regulated services trade, the parties agreed to consult with such political units to assure their compliance with the terms of the Declaration. Declaration, *supra* note 200, § 4.

203. This approach was based on a precedent in the Tokyo Round of GATT negotiations when, faced with a similar issue in the Standards and Government Procurement Codes, the United States reduced its commitments to best-efforts undertakings. Balassa, *supra* note 185, at 5.12.

204. Declaration, *supra* note 200, § 1.

205. *See* Feketekuty, *supra* note 19, at 180. "Establishment issues are . . . covered only insofar as a commercial presence is required in the other country to carry out cross-border trade." *Id.*

206. Israel and U.S. Treaty of Friendship, Commerce and Navigation, Aug. 23, 1951, 217 U.N.T.S. 252. The solution was to focus the IFTA services provisions on trade, rather than investment issues, which were the focus of the FCN Treaty. *See* Balassa, *supra* note 185, at 5.05, 5.08.

207. Declaration, *supra* note 200, § 1.

208. *Id.*

209. A representative office may only provide information regarding the services offered by the bank but may not engage in any banking business. An agency is usually limited to making loans. A branch may make loans and accept deposits. Representative offices, agencies and branches are extensions of the bank in question. In contrast, a subsidiary is incorporated under the laws of the host country and is a separate legal entity.

210. Balassa, *supra* note 185, at 5.09-5.10.

citizens.[211] Second, there was concern that even if there were no violation of federal banking statutes, including all foreign banking services would limit the discretionary authority of banking regulators.[212] IFTA began the practice of segregating banking issues into a special category of sensitive issues for negotiation that was continued in later trade agreements.

There are three framework principles set forth: open market access,[213] national treatment,[214] and transparency.[215] Open market access, although not defined in the Declaration, is generally understood to mean that national laws that prohibit entry by foreign suppliers must be eliminated. Harmonization or standardization of national laws is not contemplated. Instead, IFTA states that differences in national regulatory regimes in specific sectors will be taken into account in the liberalization process.[216] National treatment means that foreign suppliers will be able to market or distribute on the same basis as nationals, including a commercial presence where necessary to facilitate export or required by the host country.[217] Transparency means that the parties will publish laws and regulations relating to trade in services and will notify the other side of discriminatory provisions. In addition, foreign service suppliers will have access to domestic channels for judicial review.[218]

In addition to these core principles, three other important issues are addressed. First, although no dispute settlement provisions are included, consistent with the non-legally binding nature of the Declaration, periodic consultation and regulatory review procedures are established.[219] Second, the issue of discriminatory treatment of foreign service suppliers through the exercise of administrative agency discretion is addressed by requiring the parties to consult with their regulatory agencies to assure that they accord national treatment to foreign service suppliers.[220] Third, public monopolies may not discriminate against foreign suppliers in activities outside their area of special reserved rights.[221]

Further liberalization was contemplated at the time of treaty signing, with both sides agreeing to explore the possibility of undertaking legally binding obligations for services within eighteen months after the signing of the Declaration.[222] This review occurred in the fall of 1986 and negotiations were initiated on legally-binding sectoral annotations for tourism, telecommunications, and insurance.[223] These agreements were never finalized.[224] By 1986, negotiations had commenced in the GATT Uruguay Round, which would cover services. It was felt that because Israel was a GATT contracting party, further IFTA negotiations would be redundant.

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211. 12 U.S.C. § 72 (1994).
212. Balassa, *supra* note 185, at 5.11.
213. Declaration, *supra* note 200, § 2.
214. *Id.* § 3.
215. *Id.* § 7.
216. *Id.* § 2.
217. *Id.* § 3.
218. *Id.* § 3.
219. *Id.* § 8.
220. *Id.* § 5.
221. *Id.* § 6.
222. *Id.* § 9.
223. FEKETEKUTY, *supra* note 19, at 178, 181-83.
224. This information was supplied in a conversation on July 22, 1998, with the Office of the U.S. Trade Representative (David Ranz, Israel Desk, reporting on a conversation with Carol Balassa of the USTR, and an IFTA negotiator for the United States).

IFTA established several important precedents for services trade that were adopted and further refined in later trade agreements. First, it set forth a framework of broad principles that were to be applied across a wide range of service sectors. These principles included market access, national treatment, and transparency. Second, IFTA recognized the special regulatory problems associated with banking. However, IFTA avoided dealing with the difficult issues by severely limiting the banking services to which it applied. Third, IFTA envisioned future negotiations on important service sectors in which the sensitive regulatory issues of such sectors would be addressed and separate sectoral annexes in which the resulting liberalizing concessions would be set forth.

C. U.S.-Canada Free Trade Agreement.

Three and one-half years after IFTA, the United States and Canada incorporated legally binding provisions on financial services in the 1989 U.S.-Canada Free Trade Agreement (CFTA).[225] CFTA was a significant agreement in another respect – it created the world's largest free trade area[226] between two large industrialized countries that were each other's best trading partners.[227] Although the concept of financial services liberalization was novel, the idea of a free trade agreement between the parties had surfaced on several occasions in the past, but had never been consummated due to political opposi-

225. *See* United States-Canada Free Trade Agreement, Dec. 22, 1987-Jan. 2, 1988, U.S.-Can., 27 I.L.M. 281 [hereinafter CFTA]. Although preliminary discussions were held as early as 1983, formal negotiations were not commenced until May 1986. They were concluded in October 1987, with the final draft of the CFTA completed in December 1987. *See* Jane Sneddon Little, *At Stake in the U.S.-Canada Free Trade Agreement: Modest Gains or a Significant Setback, in* International Economics and International Policy 192 (Philip King ed., 1990). United States President Ronald Reagan and Canadian Prime Minister Brian Mulroney signed the CFTA on January 2, 1988. The CFTA was negotiated by the United States under authority granted in the Trade and Tariff Act of 1984. 19 U.S.C. § 2114 (1994). It was implemented into U.S. law pursuant to the United States-Canada Free Trade Agreement Implementation Act of 1988, Pub. L. No. 100-449, 102 Stat. 1851, 1988 U.S.C.C.A.N. (102 Stat.) (codified at 19 U.S.C. § 2112 (1994)). CFTA became effective on January 1, 1989. The bill that led to passage of the USCFTA Implementation Act was H.R. 5090, which passed the House on August 9, 1988 and the Senate on September 19, 1988. Details of the legislative history are presented in S. Rep. No. 509, 100th Cong. (1988), reprinted in 1988 U.S.C.C.A.N. 2395.

226. In 1987, merchandise trade between Canada and the United States totaled almost $133 billion, with U.S. exports of $60 billion and U.S. imports of $73 billion. Bilateral trade in services was also significant and approached $31 billion in 1987, with U.S. exports of $20.5 billion and imports of $10.2 billion. *See* U.S. Dep't of Com., Bureau of the Census, Advance Rep. of U.S. Merchandise Trade, Dec. 1987.

227. There is an important difference in the significance of bilateral trade to the two economies. In 1987, U.S. trade with Canada accounted for less than one-fourth of U.S. exports and less than one-fifth of U.S. imports. U.S. exports to Canada, expressed as a percentage of total U.S. exports, grew during the 1980s from 18% in 1980 to 23.6% in 1987. By contrast, in 1987, the United States accounted for almost three-fourths and two-thirds of Canadian exports and imports, respectively. *See id.* The U.S. market has also been of growing importance for Canadian exports, accounting for almost 77% in 1985-1986, compared to 62% in 1980. Canadian exports to the United States account for almost 20% of Canadian GNP, while U.S. exports to Canada represent only 1.3% of U.S. GNP. *See* IMF, Int'l Fin. Stats., Feb. 1988; Direction of Trade Stats. Y.B., 1987.

tion on both sides.[228] By the early 1980s, both sides had developed political support for a free trade agenda and were able to overcome earlier reluctance to such a pact.[229] In the area of trade in services, the United States was anxious to develop a set of rules that would guide future trade relations and prevent a return to protectionist trade policies in Canada.[230] The United States sought to achieve progress in a bilateral context, where multilateral trade negotiations under the auspices of GATT on trade in services and investment issues had met with resistance, with the hope that the resulting agreements could later be applied in a multilateral context.[231]

1. Negotiating Objectives.

CFTA continued the U.S. policy trend begun in IFTA of extending trade agreement disciplines to services in a regional context. However, CFTA placed far greater emphasis on achieving concrete results in liberalizing financial services trade. In fact, removing barriers to financial services trade was a condition to U.S. acceptance of a free trade agreement.[232] This was the result of the significance of financial services to both economies.[233]

Like IFTA, CFTA recognized that there were special regulatory problems in the area of financial services. CFTA treated banking and securities as a special case of services trade in

228. One commentator has characterized the failure to reach an accord earlier as the product of protectionist sentiments on the U.S. side and nationalist sentiments on the Canadian side. *See* Murray G. Smith, *The Free Trade Agreement in Context: A Canadian Perspective, in* THE CANADA-U.S. FREE TRADE AGREEMENT: THE GLOBAL IMPACT 37 (Jeffrey J. Schott & Murray G. Smith eds., 1988). For a detailed history of the negotiations prior to CFTA, *see* Sperry Lea, *A Historical Perspective, in* PERSPECTIVES ON A U.S.-CANADIAN FREE TRADE AGREEMENT 11-29 (Robert M. Stern et al. eds., 1987).
229. The negotiations for the FTA were initiated at the request of the government of Canada. The Canadian motivation for seeking closer ties with the United States in the 1980s was based on concerns about the disadvantages of Canada's small domestic market, its increasing dependence on the U.S. economy, and growing protectionist activity in the United States. From the United States' side, its agreement to negotiate was an acknowledgement of the importance of its trading relationship with Canada. For a detailed negotiating history of the USCFTA, *see* Jeffrey J. Schott, *The Free Trade Agreement: A U.S. Assessment in* The Canada-U.S. Free Trade Agreement: The Global Impact 7-12 (Jeffrey J. Schott & Murray G. Smith eds., 1988).
230. In the early 1980s, economic relations between the two countries were strained due to the introduction by the Trudeau administration of national programs designed to assert Canada's economic sovereignty in the face of majority foreign ownership in several sectors of the economy. One of these programs, the Foreign Investment Review Agency (FIRA) was designed to ensure that only foreign investment proposals of significant economic interest to Canada could be allowed to proceed. This program led to several years of disinvestment activity that did not cease until the Canadian Government replaced FIRA with the Investment Canada program, which was much more receptive to foreign investment. *See* Earl Fry, *The Canada-U.S. Free Trade Agreement: An Overview, in* THE CANADA-U.S. FREE TRADE AGREEMENT: THE IMPACT ON SERVICE INDUSTRIES 1-2 (Earl H. Fry & Lee H. Radebaugh eds., 1988).
231. *See* Little, *supra* note 225, at 192; Schott, *supra* note 229, at 1.
232. David Ruth, *The U.S.-Canada Services Agreement: Review and Assessment, in* THE CANADA-U.S. FREE TRADE AGREEMENT: THE IMPACT ON SERVICE INDUSTRIES 56 (Earl H. Fry & Lee H. Radebaugh eds., 1988).
233. DEBRA P. STEGER, A CONCISE GUIDE TO THE CANADA-U.S. FREE TRADE AGREEMENT 53 (1988).

a separate Chapter 17.[234] All other covered sectors, including insurance,[235] were subject to rules set forth in Chapters 14, 15 and 16.[236] While Chapter 17, by its express terms, is self-contained, certain provisions contained in other chapters have limited applicability to financial services.[237]

There are a number of reasons that the negotiators wanted to treat financial services in a separate chapter. First, each country had a special agenda in the area of financial services that it did not want to lose sight of in the course of negotiating an agreement on other types of services.[238] The U.S. goal was to remove for U.S. banks some of the restrictions applicable generally to foreign banks operating in Canada. The Canadian negotiators focused on restrictive U.S. legislation that prevented Canadian banks from engaging in the United States in the sort of full-service, national banking operation they were used to pursuing in Canada. Second, both parties acknowledged that financial services is a sensitive area and involves a unique set of issues not common to other service areas. Therefore, both countries favored having the agreement negotiated by financial services experts. Third, the United States did not want to entrust dispute resolution in the area of financial services to a tribunal with no expertise in this area, and was especially concerned that decisions by U.S. banking regulators, such as the Federal Reserve Board, would be overruled by the Canada-U.S. Free Trade Commission, which was created to handle dispute resolution, among other matters.[239] As a result, dispute resolution involving financial services was to be handled separately by consultation between the Canadian Ministry of Finance and the U.S. Department of the Treasury.[240]

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234. *See* CFTA, *supra* note 225, art. 1706. Article 1706 defines a financial service broadly as any service of a financial nature offered by a company authorized to do a financial institution's business by either Canada or the United States (or a political subdivision thereof) or a holding company thereof, except for underwriting and selling insurance policies.
235. *See* CFTA, *supra* note 225, at annex 1408.
236. Chapter 14, the general services chapter of CFTA, contains a framework of principles, including national treatment. Chapter 15 deals with the temporary entry of business persons and Chapter 16 contains investment provisions.
237. *See* CFTA, *supra* note 225, art. 1701(1), which states that no other provision of CFTA applied to financial services, with certain limited exceptions. These exceptions include the Article 1601(2) commitment to remove certain investment restrictions related to foreign ownership of Canadian controlled financial institutions. *See id.* art. 1601(2). While the enumerated exceptions do not include Chapter 15, by its terms that chapter applies to entry of professional personnel in the banking and financial services industry engaging in commercial transactions. *See id.* annex 1502.1, sched. 1. Certain provisions of Chapter 20 ("Other Provisions") are also made applicable and operate as limitations on the liberalizing commitments made in Chapter 17. *See id.* ch. 20, *see also id.*, ch. 17. These relate to measures impacting on 1980 Tax Convention between the parties, restrictions imposed reasons for balance of payments taken in accordance with enumerated international law obligations, or actions taken in the interests of national security. *See id.* arts. 2001-2003. Monopolies may be established, but may not engage in discriminatory sales practices or anticompetitive practices. *See id.* art. 2010. Chapter 21 provisions relating to collection of statistical data, amendment of the agreement, entry into force, duration and termination are also applicable to Chapter 17 financial services activities. *See id.* arts. 2101, 2104-2106.
238. *See* Andre Saumier, *The Canada-U.S. Free Trade Agreement and the Services Sector, in* TRADE-OFFS ON FREE TRADE: THE CANADA-U.S. FREE TRADE AGREEMENT 327-29 (Mark Gold & David Leyton-Brown eds., 1988).
239. CFTA, *supra* note 225, art. 1802. Disputes must first be submitted to the Free Trade Commission for resolution. If no resolution is reached, the next step is arbitration. *Id.* arts 1805-1806.
240. *See* CFTA, *supra* note 225, art. 1704(2).

2. *The Structure of the Financial Services Provisions.*

Unlike IFTA, Chapter 17 of CFTA does not contain a framework of principles that will guide future dealings between the parties. Instead, it addresses specific trade barriers in the banking and securities sectors that the parties regarded as particularly significant and agreed to eliminate. In the language of trade negotiators, Chapter 17 succeeded in achieving a rollback of trade barriers relating to the right of commercial establishment and certain operating restrictions applicable to foreign banks,[241] rather than a mere standstill, i.e., agreeing to maintain the status quo and to avoid imposing new trade barriers in the future.[242] In the area of cross-border services trade, a standstill was agreed to but no attempt was made to liberalize existing rules.[243] Another limitation is that Chapter 17 is not applicable to state and local governments.[244] Therefore, it does not seek to remove all barriers to free trade, but only the most significant ones at the federal level.

The negotiating process in the financial services area focused on removing as many national laws that inhibited free trade in financial services as possible. This was a challenging process since the structure of banking regulation in the two countries is very different. Regulatory barriers to free trade existed under the laws of both countries. In the case of Canada, the Canada Bank Act[245] sought to limit the size and operations of the foreign banking sector due to protectionist motives.[246] In the case of the United States, foreign banks were able to enter and operate freely.[247] However, outmoded legislation applicable to both U.S. and foreign banks restricted securities activities[248] and interstate

241. *See* CFTA, *supra* note 225, arts. 1702, 1703.
242. *But see id.* ch. 14, art. 1402(8).
243. *See id.* arts. 1702(4), 1703(4). This standstill provision is subject to a carve-out for prudential regulation. *Id.*
244. *See id.* art. 1701(2).
245. Foreign banks operating in Canada were subject to special rules on size of assets, capital requirements, branching restrictions and transactions with related entities that were not applicable to domestic banks. Canada Bank Act of 1980, § 302 (asset cap), § 116 (capital rules), § 48 (branching) and §174 (transactions with affiliates). Foreign ownership of Canadian banks was also limited. Canada Bank Act of 1980, § 110.
246. John W. Swendsen, *A Banking Perspective: Will It Make a Difference?, in* THE CANADA-U.S. FREE TRADE AGREEMENT: THE IMPACT ON SERVICE INDUSTRIES 184-85 (Earl H. Fry & Lee H. Radebaugh eds., 1988).
247. Prior to the passage of the IBA in 1978, foreign banks in the United States operated at a comparative advantage to domestic banks. Among other things, they were not subject to the McFadden Act, which restricted interstate banking. This advantage was eliminated by the IBA.
248. The Glass-Steagall Act, part of the Banking Act of 1933, consists of four provisions that create a legal separation between commercial banking and investment banking. These sections are section 16, which prevents national banks from underwriting, selling and dealing in securities, 12 U.S.C. § 24(7) (1994), section 21, which prohibits investment banks from taking deposits and engaging in commercial banking, 12 U.S.C. § 378(a)(1) (1994), section 20, which prohibits affiliations between commercial banks and firms engaged principally in the underwriting of stocks or other securities, 12 U.S.C. § 377 (1994), and section 32, which prevents an individual involved in investment banking from serving as an officer, director or employee of a bank, 12 U.S.C. § 78 (1994). Commercial banks and non-bank subsidiaries of bank holding companies have in many instances been granted regulatory approvals to engage in certain aspects of the securities business, including sponsoring mutual funds, operating discount and full-service brokerage businesses, and underwriting and dealing in a wide range of securities, including corporate debt and corporate equity.

banking.[249] Canadian banks argued that this legislation made it impossible for them to conduct in the United States the sort of full-service, nationwide banking they were able to carry on in Canada and the Canadian negotiators sought to have such restrictions removed.[250] The U.S. negotiators, however, took the position that it was impossible to change such legislation due to political opposition.[251] These U.S. restrictions continue to be an issue in trade agreement negotiations.

The United States made four commitments. First, the United States permitted Canadian banks, as well as all other foreign banks operating in the United States, and American banks to deal, underwrite, and purchase debt obligations of Canadian Government entities, to the same extent that domestic and foreign banks in the United States were permitted to deal, underwrite, and purchase debt obligations of U.S. Government entities.[252] This was a compromise that the United States offered in response to the Canadian request to amend the

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249. Prior to enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal Act), commercial banks were prevented from branching interstate due to the McFadden Act, 12 U.S.C. § 36 (1994), and state law. Under the McFadden Act, national banks were limited to operating branches in the municipality where they were headquartered or anywhere else in their headquarters state, provided the relevant state law allowed them to do so. This provision applied to state chartered banks that are members of the Federal Reserve System. 12 U.S.C. § 321 (1994). There was no federal law prohibiting interstate branching by state-chartered banks that were not members of the Federal Reserve System. However, state laws in many cases prohibited out-of-state banks from opening up branches within their borders. The Riegle-Neal Act changed this regulatory scheme and now permits both national and state banks to open interstate branches (a) by opening new branches if a state has passed legislation expressly permitting all out-of-state banks to open de novo branches and (b) through mergers between insured banks with different home states without regard to whether such mergers are prohibited by any state law. A state had the option to opt out of this regulatory scheme by passing laws that applied equally to all out-of-state banks and that expressly involved merger transactions involving out-of-state banks. Similarly, prior to passage of the Riegle-Neal Act, interstate banking, referring to the ability of bank holding companies to own bank subsidiaries in more than one state, was limited by the Douglas Amendment to the Bank Holding Company Act, 12 U.S.C. § 1842 (d)(1998), which prohibited a bank holding company operating a bank in one state from owning a bank located in a different state, unless the law of the second state expressly permitted a foreign bank holding company to make such an acquisition. No state law permitted this until the 1980s when regional interstate banking compacts came into existence. Such compacts permitted foreign bank holding companies from one state in a region that was a party to the compact to enter another state also party to the compact. The Riegle-Neal Act revised this system by repealing the Douglas Amendment and allowing interstate acquisitions by bank holding companies to proceed without regard to whether state law prohibits such a transaction.
250. *See* Ruth, *supra* note 232, at 56.
251. *See id.*, at 57; Jeffrey J. Schott and Murray G. Smith, *Services and Investment in* THE CANADA-U.S. FREE TRADE AGREEMENT: THE GLOBAL IMPACT 143 (Jeffrey J. Schott and Murray G. Smith, eds., 1988); *The United States-Canada Free Trade Agreement, 1988: Hearing on H.R. 5090 Before the Senate Comm. on Banking, Housing, and Urban Affairs,* 100th Cong. 81-82 (1988) (statement of Peter A. Lefkin, Counsel, American Ins. Assn.).
252. *See* CFTA, *supra* note 225, art. 1702(1).

Glass-Steagall Act.[253] This compromise was satisfactory to the Canadians, since it captured most of the business that Canadian banks wanted to conduct in the United States.[254]

Second, the United States guaranteed Canadian banks operating in the United States the right to maintain interstate branches that were originally grandfathered under the IBA.[255] The major Canadian banks had a significant number of units that benefitted from this provision and thus, in effect, enjoyed greater interstate banking rights than American banks. Since the IBA was subject to review after ten years, the U.S. CFTA provided safeguards that the interstate branching privileges of Canadian banks would be retained.

Third, the United States extended to Canadian banks the benefits of any future amendments to the Glass-Steagall Act.[256] The fourth commitment, which was identical for both countries, required each country to continue to provide the other's financial institutions with the rights and privileges they enjoyed as a result of existing law and policy, subject to (1) normal regulatory and prudential considerations, and (2) the obligation of each country to consult, to liberalize further the rules governing its markets, and to extend the benefits of such liberalization to the other's financial institutions.[257]

Canada also made four commitments, which were responsive to U.S. negotiators attempts to receive national treatment and market access for U.S. banks.[258] First, U.S. persons were no longer subject to legal restrictions that limited foreign ownership of Canadian-controlled financial institutions.[259]

Second, U.S.-controlled Canadian bank subsidiaries were no longer subject to certain provisions of the Canada Bank Act regarding asset size, capital, branching and affiliate transactions that discriminated against foreign banks.

Third, Canada guaranteed that it would not use its review powers governing U.S. bank entry in a manner inconsistent with CFTA. The fourth commitment was the same as the fourth U.S. commitment discussed above.

The significance of the CFTA financial services provisions for an understanding of later treaty negotiations is the heavy emphasis placed on achieving concrete market access through a roll-back of existing regulatory barriers, rather than setting up a framework of principles that would guide future liberalization. While some principles are discernible,[260] it was clear that it was bilateral concessions that the parties were after. The resulting approach has a piecemeal look to it. The text of Chapter 17 failed to address the significant

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253. Carl J. Lohmann & William C. Murden, *Politics for the Treatment of Foreign Participation in Financial Markets and their application in U.S.-Canada Free Trade Agreement, in* UNDERSTANDING THE FREE TRADE AGREEMENT 157 (Donald M. McRae & Debra P. Steger eds., 1988).
254. *See* Lohmann & Murden, *supra* note 253.
255. CFTA, *supra* note 225, art. 1702(2).
256. *Id.* art. 1702(3).
257. *Id.* art. 1702(4).
258. *Id.* art. 1703(1)-(4).
259. As concerns banks, the twenty-five percent ceiling on total non-resident shareholdings was lifted for American residents, but the ten percent limit on shares held by any one person, resident or non-resident, remained in place.
260. These are transparency, (CFTA, *supra* note 225, art. 1704 (1)), and consultations among financial services regulators on issues arising under Chapter 17, (*Id.* art. 1704(2)). There are no other dispute settlement provisions in Chapter 17.

regulatory barriers in a comprehensive manner or provide helpful guidance on the course that future trade negotiations in this sector would take. Fortunately, NAFTA, which was concluded only a few years after CFTA, filled some of these gaps.

D. THE NORTH AMERICAN FREE TRADE AGREEMENT.

Building upon the financial services provisions of CFTA, the 1994 North American Free Trade Agreement among the United States, Mexico and Canada (NAFTA)[261] succeeded in achieving substantial liberalization of financial services investment and a standstill agreement on financial services trade. The agreement was considered significant in that Mexico agreed to open up its financial services markets, which had been historically closed to foreign trade and investment. Liberalization was to occur over a six year transition period. In return, the United States and Canada agreed to extend some of the benefits negotiated under CFTA to Mexico. With respect to the United States and Canada, the provisions of CFTA were incorporated by reference,[262] but no further liberalization occurred. NAFTA, which created the world's largest free trade area,[263] was heralded as an important step towards Western Hemisphere economic integration.[264]

1. *Negotiating Objectives.*

As in the case of CFTA, achieving success in the financial services sector was considered of paramount importance to the United States during the negotiations.[265] The United

261. *See* NAFTA, *supra* note 12. Negotiations were commenced on February 5, 1991 and concluded on August 12, 1992, and the agreement was signed on December 17, 1992. NAFTA was negotiated by the United States under negotiating authority granted in the Omnibus Trade and Competitiveness Act of 1988. 19 U.S.C. § 2902 (1994). It was implemented into U.S. law pursuant to the North American Free Trade Agreement Implementation Act of 1993, Pub.L. 103 182, 107 Stat. 2057 (Dec. 8, 1993). 19 U.S.C. § 3301 (1998). It became effective on January 1, 1994. The bill that led to passage of the NAFTA Implementation Act was H.R. 3450, which passed the House on November 17, 1993 and the Senate on November 20, 1993. Details of the legislative history are presented in 1993 U.S.C.C.A.N. 2552.

262. NAFTA, *supra* note 12, art. 1401(4), annex 1401.4.

263. It was estimated at the time of implementation that the NAFTA countries generated over U.S. $6 trillion in annual output and were populated by more than 360 million producers, workers and consumers. ECON. REP. PRESIDENT 310. The North American services market was also sizeable, estimated to be as large as U.S. $4.2 trillion. Jan. 1993 NEWSLETTER, U.S. Coalition for Service Industries.

264. Writers on regional economic integration have likened NAFTA to the founding of the European Economic Community (EEC), suggesting that NAFTA, like the Treaty of Rome that established the EEC in 1957, is only a first step in a much longer journey towards full economic integration and monetary union, which will be accomplished in fits and starts over several decades. *See* GARY CLYDE HUFBAUER & JEFFREY J. SCHOTT, WESTERN HEMISPHERE ECONOMIC INTEGRATION 1-3 (1994). It should be noted that NAFTA does not by its terms contemplate a deeper form of integration such as establishment of a customs union, although it does provide for further liberalization of trade and investment and accession of additional parties. *See* NAFTA, *supra* note 12, arts. 1403(3), 1404(4), 2204.

265. Telephone Interview with Barry S. Newman, Deputy Assistant Secretary of the Treasury for International Monetary and Financial Policy during the NAFTA negotiations (Sept. 15, 1998) [hereinafter Newman Interview]. *See United States-Mexico Free Trade Agreement: Hearings Before the Senate Comm. on Fin.*, 102d Cong. 450, 474 (1991) (submitted material by the USITC) (stating that the United States had a strong interest in liberalization of Mexican financial services law that would allow greater access by U.S. firms) [hereinafter FTA Hearing].

States had two primary motives in achieving a financial services agreement in NAFTA – (1) to gain access to the Mexican market and (2) to encourage economic and legal reforms as a precondition to increased integration in the Western Hemisphere.

a. Market Access.

U.S. financial institutions had a strong interest in seeking market access to the newly privatized and underdeveloped Mexican financial services markets.[266] Economic projections indicated that there would be gains for the U.S. financial services industry as a result of a free trade agreement with Mexico.[267] During Congressional debate on NAFTA, one member of the House of Representatives expressed the view that it was the financial services industry that was the driving force behind NAFTA.[268] Indeed, there was a marked involvement by the U.S. financial services industry in the negotiations. The U.S. negotiators[269] engaged in numerous briefings of industry groups[270] throughout the negotiations and solicited individ-

266. REPORT OF THE INDUSTRY SECTOR ADVISORY COMMITTEE ON SERVICES (ISAC 13) ON THE NORTH AMERICAN FREE TRADE AGREEMENT 18 (Sept. 14, 1992) [hereinafter ISAC REPORT].

267. FTA Hearing, *supra* note 265, at 474. In the banking sector, it was predicted that U.S. exports of services to Mexico would likely expand at a moderate rate if an FTA removed Mexican foreign investment restrictions and if Mexico continued to reform its financial service industry. In insurance, the likely impact was a significant increase in U.S. investment in Mexico if certain barriers to foreign investment were removed, leading to a moderate increase in U.S. exports. In contrast, the overall impact on the U.S. services sector of increased trade with Mexico was predicted to be negligible due to the small size of exports to Mexico as a proportion of U.S. services trade. *See also* CONGRESSIONAL BUDGET OFFICE, BUDGETARY AND ECONOMIC ANALYSIS OF NAFTA 163-64 (July 1993) (economic effects on U.S. providers in financial services likely to be very small but positive).

268. Congressman Henry Gonzalez expressed the view during House of Representatives hearings on NAFTA that, although the financial services provisions had not been the focus of the debate, such provisions were "the driving force" behind NAFTA, due to the amount of money that banks would make as a result. He went on to say:

> [w]hile proponents of NAFTA couch their support in the lofty ideology of so-called 'free trade' what we actually have in NAFTA are fat cats who see fatter profits from their investments in Mexico ... banks will gain a lot from this, and at the same time they will avoid a lot of American regulation, which got the savings and loans and in some cases the banks into the problems that were so expensive for this country and for this congress and for this society in the 1980s.

See 139 Cong. Rec. H8552-01, H8558 (daily ed. Oct. 27, 1993) (letter by Rep. Henry Gonzalez read in the record).

269. The U.S. Treasury Department took the lead on negotiating the provisions on banking and securities, while the Commerce Department handled insurance matters. Experts from the Federal Reserve, the Comptroller of the Currency, the Commodity Futures Trading Commission and the Securities and Exchange Commission advised the negotiators and participated in the negotiations. The Office of the U.S. Trade Representative and the Department of State were also involved. In addition, certain state regulators and Congressional staff were consulted throughout the negotiations. *Financial Services Chapter of NAFTA: Hearing Before the House Comm. on Banking, Fin. and Urban Affairs*, 103rd Cong. 116 (1993) [hereinafter *Financial Services Hearing*] (letter of Barry S. Newman, Deputy Assistant Secretary of the Treasury for International Monetary and Financial Policy, to Rep. Henry Gonzalez dated Oct. 25, 1993 included as an addendum to the Hearing).

270. These included the U.S. Coalition of Service Industries, Financial Services Group, Bankers Association for Foreign Trade, Texas Bankers Association, Securities Industry Association, Investment Company Institute and American Financial Services Association. *Id.* at 118.

ual points of view in preparing negotiating documents and positions.[271] In addition, Treasury Department and Commerce Department officials consulted regularly with the official industry trade advisory groups that federal legislation mandated be included in all trade negotiations, primarily the Services Policy Advisory Committee (SPAC) and the Industry Sector Advisory Committee on Services (ISAC-13).[272] In the view of one of the chief Treasury Department officials in the financial services chapter, this cooperative process explained the success of the financial services negotiations for the United States.[273]

Not all observers took such a benign view of this alliance between the U.S. trade negotiators and private industry. In Congressional debate, Congressman Henry Gonzalez stated that the financial services chapter was written by "all the leading, most powerful megabanks and their attorneys" and questioned whether such a group was capable of acting "to protect the general interest."[274] Congressional hearings were held to address concerns about the potential for evasion of American financial regulation by U.S. banks operating in Mexico, which might lead to losses that would have to be paid for by U.S. taxpayers[275] and charges of widespread corruption in Mexican banks and the absence of effective banking regulation in Mexico.[276] The evidence presented was apparently not strong enough to defeat the NAFTA.

b. Western Hemisphere Economic and Financial Law Reform.

The second motive of the United States was to consolidate and encourage the expansion of recent Mexican economic and banking law reforms[277] that indicated a movement to a free market orientation.[278] The NAFTA financial services provisions were also viewed

271. *Id.* at 112 (statement of Barry S. Newman). Private industry provided information regarding the types of trade barriers that hindered or prevented entry and operations by U.S. institutions. Such information was used by the U.S. to establish negotiating priorities. Newman Interview, *supra* note 265.

272. *Id.* at 114 (letter of Barry S. Newman).

273. *Id.* at 112 (statement of Barry S. Newman).

274. 139 Cong. Rec. H9661-01, H9661 (daily ed. Nov. 15, 1993) (statement of Rep. Henry Gonzalez).

275. Federal banking and securities regulators and a state insurance regulator provided testimony to Congress that NAFTA would not permit U.S. financial institutions to evade regulation and would not jeopardize the safety and soundness of such institutions. *See Financial Services Hearing, supra* note 269, at 74-78 (statement of John P. LaWare, Member of the Board of Governors of Federal Reserve Board); *Id.* at 87 (statement of Mary L. Schapiro, commissioner, U.S. Securities and Exchange Commission); *Id.* at 98 (statement of Allene D. Evans, Board Member, Texas State Board of Insurance, and Chairperson of the National Association of Insurance Commissioners).

276. *See The North American Free Trade Agreement: Hearing Before the House Comm. on Banking, Fin. and Urban Affairs,* 103rd Cong. 89 156-160 (1993) (statement of Steven Davidson) (raising the possibility of additional risk because of new activities for banks in Mexico not permitted under U.S. law and inadequacy of Mexican banking regulation); (statement of Jack Guenther) (stating that Mexican banking regulation adequate); *see also Abuses Within the Mexican Political Regulatory and Judicial Systems and Implications for the North American Free Trade Agreement: Hearing Before the House Comm. on Banking, Fin. and Urban Affairs,* 103rd Cong. (1993).

277. Mexico had recently privatized its banking sector and made significant changes to its foreign investment laws. Carlos M. Nalda, *NAFTA, Foreign Investment and the Mexican Banking System,* 26 GEO. WASH. J. INT'L L. & ECON. 379, 392 (1992).

278. OLIN WETHINGTON, FINANCIAL MARKET LIBERALIZATION: THE NAFTA FRAMEWORK 8 (1994).

by the United States as providing an incentive for market-oriented economic reforms in other Latin American countries that had begun to show renewed interest in regional economic integration and free trade agreements.[279] Such reforms were regarded by the United States as a precondition to removing trade and investment barriers in those countries and establishing a hemispheric free trade area.[280] In this regard, the United States was cognizant of the precedential value of a financial services agreement for other integration efforts in the Western Hemisphere.[281]

c. The Negotiating Agenda.

The United States had three major goals for the financial services provisions of NAFTA: (1) to provide a comprehensive set of rules to govern trade and investment in financial services;[282] (2) to guarantee substantial market access to Mexico for U.S. banks, securities firms, insurance companies, and other financial institutions;[283] and (3) to preserve the stability and integrity of financial markets by upholding the right of U.S. regulators to oversee financial service activities.[284] These three goals were satisfied (1) by incorporating core principles, the most significant for the United States being national treatment (including equal competitive opportunity)[285] and the right of establishment for all financial service sectors; (2) by providing "immediate and significant" market access to U.S. firms as of the date of entry into force of NAFTA;[286] and (3) by incorporating an exception to the obligation to remove trade barriers for nondiscriminatory prudential regulation.[287] These points will be discussed in turn in the next section.

2. The Structure of the Financial Services Provisions.

a. Comparison to CFTA.

Like CFTA, NAFTA treated financial services as a specialized service industry, with a

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279. *Id.* at 8, 9. Examples of such regional integration were the Andean Pact, Caricom, the Central American Common Market and MERCOSUR. HUFBAUER & SCHOTT, *supra* note 264, at 97-129.

280. HUFBAUER & SCHOTT, *supra* note 264, at 2.

281. WETHINGTON, *supra* note 278, at 11; *see* HUFBAUER & SCHOTT, *supra* note 264, at 146. "NAFTA provisions on financial . . . services will likely provide a model for hemispheric talks." *Id.*

282. While national treatment and right of establishment were considered key objectives, other principles were also sought by the United States, including the right to conduct cross-border trade, MFN treatment, the right to offer new financial products and transfer data abroad for data processing, the right to staff with home country nationals, and transparency of regulation. *See Financial Services Hearing*, *supra* note 269, at 107-109 (statement of Barry Newman).

283. *Id.* at 107-112.

284. *Id.*

285. Equal competitive opportunity refers to the obligation to remove facially neutral, *i.e.*, non-discriminatory, laws that operate to place foreign competitors at a competitive disadvantage. *See* WETHINGTON, *supra* note 278, at 11.

286. *Id.* at 12. (U.S. Treasury negotiators took the position that no permanent market share limitations on the size or scope of U.S. operations in Mexico and Canada were acceptable).

287. NAFTA, *supra* note 12, art. 1410(1).

separate Chapter 14 devoted to that topic.[288] Following the CFTA model, the U.S. negotiators emphasized immediate and substantial market access in Mexico, which was achieved.[289] Additional market access concessions were not obtained by U.S. service providers in Canada.[290]

However, in most other respects, NAFTA Chapter 14 represented a significant departure from the CFTA approach, achieving a far more comprehensive financial services accord. Most importantly, it succeeded in establishing a framework of principles that would be used to guide future trade and investment in financial services.[291] Second, NAFTA dealt more comprehensively with the issue of cross-border trade in financial services than did the CFTA.[292] Third, Chapter 14 covers all financial services, including insurance.[293] Fourth, Chapter 14 undertakings apply to state and provincial governments, not just to the federal government.[294] Finally, Chapter 14 contains provisions for dispute resolution and enforcement.[295] NAFTA therefore represents a more principled and unified approach to financial services liberalization with greater potential for effective compliance than CFTA.

b. Sector Coverage.

The scope of Chapter 14 is very broad, covering any service of a financial nature, including insurance, as well as incidental services.[296] All four modes of supply are covered. The right of establishment provision[297] covers the commercial presence mode. The cross-border trade provision[298] covers cross-border supply, consumption abroad and presence of natural persons.

NAFTA binds the Parties directly at the federal level of government and the Parties have undertaken to ensure that state and provincial governments and certain self-regulato-

288. Chapter 14 is contained in Part Five of NAFTA ("Investment, Services and Related Matters"), which also includes chapters covering cross-border trade in services (Chapter 12), foreign direct investment (Chapter 11), and temporary entry of business persons (Chapter 16). Those other chapters were based in large part upon the comparable chapters in CFTA, with some notable additions, as in the case of a detailed dispute settlement mechanism for investment disputes in Chapter 11. Chapter 14 on financial services is not self-contained. Other sections of NAFTA are also applicable, either by specific cross-reference within Chapter 14 or elsewhere or because they are generally applicable. Of particular importance are rules of origin contained in Chapter 12, a number of the investment provisions of Chapter 11, including the dispute resolution provisions, rules for temporary entry of financial service personnel contained in chapter 16 and the dispute resolution provisions of Chapter 20 (as modified by the more specialized dispute resolution provisions of Chapter 14). *See* NAFTA, *supra* note 12, chs. 11, 12, 14, 16, 20.

289. *Id.* annex VII, Schedule of Mexico.

290. The U.S. attempts to seek further liberalization in the areas of direct branching by U.S. financial institutions and cross-border trade were rejected by Canada. Newman Interview, *supra* note 265.

291. *Id.* arts. 1401-1415.

292. *Id.* art. 1404.

293. *Id.* arts. 1401, 1416.

294. *Id.* art. 105.

295. *Id.* arts. 1413-1415.

296. *Id.* art. 1416, def. of "financial service."

297. *Id.* art. 1403.

298. *Id.* arts. 1404, 1416.

ry organizations comply with the provisions of NAFTA.[299] Local governments and other non-governmental organizations (NGOs) are not so bound. The activities of public entities, i.e., a central bank, monetary authority, or financial institution owned or controlled by a Party, are excluded from the provisions of Chapter 14.[300]

c. Framework of Principles.

The development of a framework of principles was important for several reasons. First, NAFTA did not liberalize all trade in financial services among the three parties and a framework was therefore needed to guide future negotiations among the parties. Second, in view of the fact that NAFTA is styled as a multilateral agreement with a provision for accession by other state parties,[301] a framework was necessary to guide negotiations with new entrants. Finally, a framework places NAFTA squarely within the GATT tradition of a nondiscriminatory and principles-based approach to trade liberalization, which has proved conducive to the process of trade liberalization.

There are two types of principles set forth – substantive and procedural. The most important principles established by Chapter 14 from the U.S. perspective were substantive rights -- the right of establishment[302] and the right to national treatment.[303] Other substantive principles were the right to maintain cross-border trade,[304] the right to most-favored-nation treatment,[305] the right to offer new financial products and to transfer information for data processing purposes,[306] and the right to select senior management and boards of directors without onerous nationality requirements.[307] The principles included in the framework are in many instances compromised by country-specific reservations that each Party was allowed to take.[308] The applicability of the principles

299. *Id.* arts. 105, 1402. The self-regulatory organizations covered are those that a foreign provider would need access to in order to provide financial services.

300. *Id.* arts. 1401(3), 1416, def. of "public entities." The excluded activities included the operation of a public retirement plan and fiscal operations of a Party or its public entities.

301. *Id.* art. 2204.

302. *Id.* art. 1403.

303. *Id.* art. 1405.

304. *Id.* art. 1404.

305. *Id.* art. 1406.

306. *Id.* art. 1407.

307. *Id.* art. 1408.

308. Pursuant to article 1409, these reservations were set forth in schedules for each of the NAFTA Parties (Schedule(s)) attached to Annex VII. NAFTA, *supra* note 12, annex VII, Schedules of Mexico, Canada and United States. There are three parts to each Schedule. Part A contained reservations in effect on January 1, 1994, the date of NAFTA implementation, that do not conform to the provisions of Articles 1403-1408. Federal non-conforming measures had to be scheduled by January 1, 1994. U.S. state and Canadian provincial measures could be reserved if scheduled by January 1, 1994 (or by January 1, 1995, in the case of certain U.S. states). *Id.* Annex 1409.1. Part B contained negotiated exceptions to Articles 1403-1408. The important market opening concessions made by Mexico were set forth in Part B of its Schedule. Part C contained additional commitments of a NAFTA Party that modify or expand its obligations under Chapter 14. The rationale for categorizing a particular item as a reservation or as an additional commitment is not always clear. The purpose of these reservations was to grandfather, i.e., preserve, certain existing discriminatory or non-conforming measures or to take exceptions to specific provisions. Grandfathering meant that inconsistent laws were not required to be amended or repealed.

is also limited by the operation of across-the-board exceptions, including the prudential regulation exception[309] and an exception for nondiscriminatory measures taken for monetary and exchange rate policy reasons.[310] In addition to these substantive principles, there are two important procedural principles established – transparency[311] and dispute resolution.[312]

(i) Substantive Principles.

(a) Right of Establishment.

Financial service providers of a NAFTA Party may establish a commercial presence in another NAFTA Party through one or more separate financial institutions, may expand geographically, and may own financial institutions without being subject to special ownership requirements for foreigners,[313] subject to reservations listed in the Schedules.[314] Although NAFTA recognized the principle that financial institutions should have the right to decide the form of juridical entity through which they conduct business,[315] the Parties retained the right to require a subsidiary form of organization until such time as U.S. law permits nationwide branching.[316] Canada and Mexico required this provision due to U.S. laws restricting interstate branching, which they viewed as a significant barrier to market access.[317] After the date of entry into force of NAFTA, the United States liberalized these restrictions through passage of the Riegle-Neal Act.[318] The NAFTA Parties have agreed to reconsider the subsidiary form of organization requirement in view of this change in U.S. law.[319]

The right of establishment was strengthened by importing into Chapter 14 many of the protections afforded investors under Chapter 11.[320] These protections include the

309. *Id.* art. 1410(1).
310. *Id.* art. 1410(2). This provision was included at the request of Mexico. Newman Interview, *supra* note 265.
311. *Id.* art. 1411.
312. *Id.* art. 1412-1416.
313. Article 1211 contains the rules of origin which apply by cross-reference and limit the right of establishment and other rights granted under Chapter 14. Such rights may be denied if, for example, the service is being provided by an enterprise owned or controlled by nationals of a non-Party and that enterprise does not have substantial business activities within a Party's territory. *Id.* art. 1211(2). Canada has imposed a more stringent requirement that an enterprise be controlled by one or more residents of the other Party. *Id.* annex VII(B), Schedule of Canada.
314. *Id.* annex VII, Schedules of Canada, Mexico and United States.
315. *Id.* art. 1403(1).
316. *Id.* art. 1403(3).
317. WETHINGTON, *supra* note 278, at 3. If U.S. banks were allowed to branch into Mexico and Canada, which did not have restrictive branching laws, they would have had a competitive advantage over Mexican and Canadian banks entering the United States.
318. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, § 114, 108 Stat. 2238, 2366 (codified at 12 U.S.C. § 43 (1994)).
319. NAFTA, *supra* note 12, art. 1403. The Financial Services Committee of NAFTA plans to consider this revision in the light of the Riegle-Neal Act. Canada Department of Foreign Affairs and International Trade, *Report for the NAFTA Commission Meeting* (Sept. 1998), <http://www.infoexport.gc.ca/nafta/1412-e.asp>. The branch form of establishment is more desirable than a subsidiary because it requires commitment of less capital.
320. NAFTA, *supra* note 12, art. 1401(2).

right to repatriate capital in hard currency,[321] subject to a balance of payments crisis exception,[322] freedom from unlawful expropriation, and the right to receive full, fair and effective compensation in the event of expropriation.[323] An investor in the financial services sector may have recourse against a NAFTA party through application of the dispute settlement provisions of Chapter 11.[324] These provisions are the product of U.S. concerns about foreign direct investment and reflect the U.S. view of adequate compensation in the event of expropriation.[325]

(b) National Treatment.

NAFTA provides for national treatment requiring that investors in financial institutions, financial institutions, and cross-border providers of financial services are to be accorded treatment no less favorable than that provided to domestic persons in like circumstances.[326] This undertaking is subject to substantial reservations taken in national schedules.[327] National treatment must grant equal competitive opportunities[328] to foreign service providers and may be achieved by either different or identical treatment.[329]

(c) Most-Favored-Nation Treatment.

In the event that a NAFTA party grants better than national treatment to a non-NAFTA party, it must grant the same treatment to the investors in financial institutions and their investments, financial institutions, and cross-border financial service providers of other NAFTA parties under the MFN principle.[330] A special case of this type of treatment is the recognition of prudential regulatory measures by a NAFTA party. If such recognition occurs, other NAFTA parties must have the right to demonstrate that they maintain equivalent regulation and receive similar treatment.[331]

(d) Cross-Border Trade.

Like the CFTA, NAFTA only succeeded in achieving a standstill with respect to cross-border trade, meaning that the status quo was frozen as of the effective date. New measures

321. *Id.* art. 1109.
322. *Id.* art. 2104.
323. *Id.* art. 1110.
324. *Id.* arts. 1115-1138.
325. For a comparison of the U.S. position and the evolving international standard, *see* Patrick M. Norton, *A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation*, 85 AM. J. INT'L L. 474 (1991).
326. NAFTA, *supra* note 12, art. 1405.
327. *Id.* annex VII, Schedules of Canada, Mexico and United States.
328. *Id.* art. 1405(6).
329. *Id.* art. 1405(5). This provision recognizes that identical treatment may disadvantage foreign providers.
330. *Id.* art. 1406(1). This might occur if a NAFTA party entered into a bilateral treaty with a non-NAFTA party granting better treatment.
331. An example is the Canada-U.S. Multijurisdictional Accord on Securities Offerings, which is intended to facilitate cross-border securities offerings by allowing Canadian firms to use, for U.S. securities law offerings, financial statements prepared in accordance with Canadian accounting standards. SEC Release No. 33-6902, International Series Release No. 291 (June 13, 1991); Release No. 34-29355, International Series Release No. 292 (June 21, 1991). WETHINGTON, *supra* note 278, at 111.

restricting cross-border trade may not be adopted, subject to the right of the parties to take reservations in their Schedules.[332] Both the United States and Canada have reserved the right to take any measure restricting cross-border trade with the other,[333] and Mexico has also reserved the right to take specified measures restricting cross-border trade in the future.[334] The reason for the lack of progress on this issue was the reluctance of Canada and Mexico to permit an increase in the delivery of financial services without a commercial presence subject to local regulatory controls.[335]

Despite these limitations, NAFTA moved beyond CFTA in two respects. First, Chapter 14 sets forth the principle that consumers may freely purchase financial services when visiting another NAFTA party.[336] However, NAFTA countries are not required to permit financial services providers of another NAFTA country to do business or to solicit business within their territories.[337] Therefore, this principle is weaker than it appears on its face. Second, Chapter 14 contained a commitment to consult on future liberalization of cross-border trade, and also set forth a definite time frame[338] and a partial agenda for such talks.[339]

(e) Other Substantive Principles.

New financial services may be provided and information transferred across borders for purposes of data processing.[340] Nationality requirements for senior management may not be imposed and no more than a simple majority of the board of directors must be composed of nationals of the host country.[341]

(ii) Procedural Principles.

(a) Transparency.

While CFTA contained a bare-bones requirement that government procedures be made transparent, Chapter 14 of NAFTA contains assurances of greater disclosure and expedited treatment in government action with respect to foreign financial service providers.[342] The two main areas covered are promulgation of financial services regulations and processing of applications.[343] In the case of regulations, interested persons must be given an opportunity

332. NAFTA, *supra* note 12, art. 1404(1).
333. *Id.* annex VII(B), Schedule of Canada and United States. The purpose of this reservation was to exclude securities trade between U.S. and Canada from the standstill. WETHINGTON, *supra* note 278, at 115.
334. *Id.* annex VII(B), Schedule of Mexico.
335. Newman Interview, *supra* note 265.
336. *Id.* art. 1404(2).
337. *Id.*
338. Such talks must occur no later than January 1, 2000. *Id.* art. 1404(4), annex 1404.4.
339. Expanding the scope of cross-border trade in insurance services and removing Mexican limitations on cross-border insurance trade were on the agenda. *See id.* annex 1404.4.
340. *Id.* art. 1407. This provision takes account of the rapid rate of change in this industry due to technology and was considered necessary to allow parties to introduce innovative financial products without the need to enter into further negotiations. *See* WETHINGTON, *supra* note 278, at 118-119.
341. *See* NAFTA, *supra* note 12, art. 1408.
342. *Id.* art. 1411.
343. *See id.*

to review proposed regulations and comment on them.[344] This requirement will prevent NAFTA parties from enacting rules adverse to a foreign party's interest without giving that party an adequate opportunity to participate in the rule-making process. In the case of applications, regulatory agencies must disclose the requirements for application and must act on applications within a specified number of days.[345] This will alleviate the problem of abuse of regulatory agency discretion that disadvantages foreign service providers.

(b) Dispute Resolution and Remedies.

Providing for dispute settlement by financial services experts was an important issue during the negotiations.[346] Unlike CFTA, which merely provided for the possibility of consultations between the parties on issues arising under the financial services chapter, NAFTA Chapter 14 sets up an institutional mechanism for government-to-government settlement of financial services disputes and enforcement of awards.[347] First, Chapter 14 sets up a Financial Services Committee to supervise implementation of Chapter 14, to consider issues referred to it by a NAFTA party and to participate in dispute settlement.[348] Second, the general dispute settlement provisions of Chapter 20 are made applicable to financial services except as expressly modified by Chapter 14.[349] A three-tier procedure is established, consisting of (1) consultations among the parties with the optional participation of financial regulatory officials,[350] (2) conciliation and mediation through the Fair Trade Commission,[351] the primary administrative body under NAFTA,[352] and (3) formal arbitration in front of a panel of financial services experts.[353] Parties are required to follow these steps in order and utilize arbitration only if the more informal methods have been tried and failed.[354] Third, remedies are provided for enforcement of arbitration awards. A final report of an arbitral panel is binding on a NAFTA party,[355] but if such Party does not comply with its terms, a complaining Party may suspend application of benefits under NAFTA.[356] This suspension may only apply to the financial services sector.[357] In other words, cross-retaliation is not permitted.[358]

As discussed previously, the specialized dispute settlement provisions of Chapter 11 apply with respect to financial services investment disputes between investors and NAFTA parties. It is therefore an exception to the rule that NAFTA provides only government-to-government dispute settlement and is desirable for U.S. investors in financial services

344. *See id.* art. 1411(1).
345. *See id.* art. 1411(2)-(4).
346. Newman Interview, *supra* note 265.
347. *See* NAFTA, *supra* note 12, ch. 14.
348. *Id.* art. 1412.
349. *See id.* art. 1414(1).
350. *See id.* arts. 1413, 2006, annexes 1412.1, 1413.6.
351. *See id.* art. 2007.
352. *Id.* art. 2001.
353. *See id.* arts. 1414, 2008-17.
354. *See id.*
355. *Id.* art. 2018.
356. *See id.* art. 2019.
357. *See id.* art. 1414(5).
358. *See id.* art. 2019(2) (regarding cross-retaliation).

because it provides recourse in the event of nationalization or expropriation. The investment dispute settlement provisions call for binding international arbitration under the rules of the International Center for Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL), two widely accepted bodies of rules for international arbitration.[359]

d. Market Access Achieved in Mexico.

The success of U.S. efforts to achieve market access in Mexico can be judged by analyzing Mexico's Schedule to Annex VII.[360] The market opening concessions made by Mexico were substantial. From the perspective of U.S. financial service providers and investors, the most significant provisions were those permitting investors to apply to acquire or establish Mexican-chartered financial institutions.[361] Such institutions are referred to in Mexico's Schedule as "foreign financial affiliates." Foreign financial affiliates in the banking, securities, and insurance industries were allowed to enter in stages over a transition period ending on January 1, 2000.[362] During that transition period, foreign financial affiliates were subject to various limitations on market access including the following: (1) limits on individual firm size for banks, securities firms, and insurance companies, expressed as maximum capital limits, (2) limits on aggregate market share for all banks, securities firms, and insurance companies, and (3) limits on the maximum amount of acquisitions, which means that the largest Mexican financial institutions are off-limits to foreign ownership.[363]

The purpose of the transition period was to permit the Mexican financial services industry to adjust to recent changes in domestic law, including the privatization of Mexican banks that occurred in the early 1980s. This approach was lauded by one of the U.S. financial services lobbying groups as a good compromise that responded to Mexico's desire for a phased approach to market penetration while at the same time satisfying the U.S. business community's need for predictability.[364]

Another provision of special interest was the possibility for a U.S. financial institution, once lawfully established in Mexico, to set up a financial group holding company under Mexican law, which would be permitted to establish or acquire institutions engaging in a full range of financial activities, including banking, securities, insurance, factoring, leasing, bonding, and trust services.[365]

359. *See id.* art. 1120.
360. *See id.* annex VII, Schedule of Mexico.
361. *Id.* annex VII(B),Schedule of Mexico.
362. *Id.* annex VII(B), Schedule of Mexico. Providers of foreign exchange, bonding and general deposit warehousing services were able to enter immediately.
363. *Id.*
364. *Trade Agreements Resulting from the Uruguay Round of Multilateral Trade Negotiations: Hearings Before the Subcomm. on Trade of the House Comm. on Ways and Means,* 103rd Cong., 2d Sess. 122 (1994) (testimony and statement of Mark E. Lackritz, President, Securities Industry Association, on behalf of U.S. Coalition of Service Industries, Financial Services Group) [hereinafter *1994 House Hearing*].
365. NAFTA, *supra* note 12, annex VII(C)(5), Schedule of Mexico.

e. Prudential Regulation.

U.S. financial regulatory authorities were concerned about the need to continue to regulate financial institutions based on consumer protection concerns and safety and soundness concerns with respect to individual financial institutions and the financial system generally.[366] As a result, there is a carve-out for prudential regulation that limits the applicability of other provisions of Chapter 14.[367] The prudential regulation exception permits a Party to take reasonable measures consistent with the undertakings of Chapter 14 to protect the integrity of the financial system, the safety and soundness of financial institutions, and investors, depositors and other financial market participants.[368] While this provision has not yet been tested, it could justify measures denying the right of establishment, national treatment or other obligation undertaken by a Party.

E. WTO AGREEMENT ON FINANCIAL SERVICES.

1. *The Long Road to a Financial Services Agreement.*

Unlike CFTA and NAFTA, which contained separate chapters on financial services that were accepted by the United States as part of a complete trade agreement package at the conclusion of negotiations, the GATS Agreement on Financial Services (FSA) was not completed at the end of the Uruguay Round of GATT negotiations in 1993.[369] Rather, it took four more years of negotiations devoted to financial services to produce an agreement that the United States was prepared to accept.

366. *Financial Services Hearing, supra* note 269, at 68-81, 82-94 (statements of John P. LaWare, Federal Reserve Board and Mary Schapiro, Securities and Exchange Commission).

367. *See* NAFTA, *supra* note 12, art. 1410(1).

368. *Id.*

369. Pursuant to the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations dated April 15, 1994, the negotiating parties agreed to submit to their competent authorities for approval the WTO Agreement to which were annexed the texts of each of the agreements reached at the conclusion of the Uruguay Round in December 1993 and to adopt certain Ministerial declarations and decisions. They also recommended the acceptance by Uruguay Round participants of the WTO Agreement and its entry into force by January 1, 1995. Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS THE LEGAL TEXTS (1994), 33 I.L.M. 1125 (1994) [hereinafter FINAL ACT]. The Uruguay Round negotiations were commenced pursuant to the Punta del Este Ministerial Declaration of September 20, 1986, were reviewed at Ministerial meetings held in Montreal, Canada in December 1988 and Brussels, Belgium in December 1990, and were substantially concluded in December 1993. It was agreed that negotiations would be continued in a number of service sectors, including financial services, telecommunications and movement of natural persons. The Uruguay Round agreements were negotiated by the United States under negotiating authority granted in the Trade and Tariff Act of 1984. 19 U.S.C. § 1654 (1994). It was implemented into U.S. law pursuant to the Uruguay Round Agreements Act, Pub.L. 103-465. 19 U.S.C. § 3511 (1994). It became effective on January 1, 1995. The bill that led to passage of the Uruguay Round Agreements Act was H.R. 5110, which passed the House on November 29, 1994, and the Senate on December 1, 1994. Details of the legislative history are presented in 1995 U.S.C.C.A.N. 3773.

a. Status of FSA at Close of the Uruguay Round Negotiations.

In the Uruguay Round negotiations, the United States sought full market access and national treatment commitments that would benefit U.S. financial service providers. As will be discussed below, the United States was concerned about the problem of free-riders – namely those countries that refused to make liberalizing commitments themselves yet were entitled to the benefits of concessions made by others pursuant to operation of the MFN clause in GATS. By the end of the Uruguay Round in 1993, commitments made by key countries in the areas of banking and other financial services (excluding insurance) fell short of the standard set by the United States.[370] Given these shortcomings, the United States responded by reducing its commitments. As discussed below, market access and national treatment are binding principles in the FSA only to the extent set forth in national schedules prepared by each WTO Member. In addition, while MFN treatment is in theory a general principle in the FSA, WTO Members are in fact allowed to take exceptions for nonconforming measures. The United States limited its own concessions in two ways. The United States took a reservation in its national schedule for new access and new powers in banking and other financial services (excluding insurance).[371] It also took a corresponding MFN exemption in those segments of the U.S. markets.[372] The purpose of the reservation

370. U.S. DEP'T OF THE TREASURY, REPORT TO CONGRESS ON STATUS OF FINANCIAL SERVICES NEGOTIATIONS UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES 1 dated Apr. 30, 1995 [hereinafter 1995 TREASURY FSA REPORT], (pursuant to Statement of Administrative Action, p. 309, accompanying the Uruguay Round Agreements Act (Pub. L. 103-465)). As of the end of December 1993, 60 countries, including the United States and the European Union on behalf of its 12 member states, submitted schedules in banking, securities, and other financial services including insurance. Eleven additional countries scheduled commitments in the insurance sector. The United States evaluated 39 of these commitments, choosing those that were submitted by commercially important developed and developing countries, countries with which the United States conducted active negotiations and countries of special geographic, political or other interest (excluding Canada and Mexico which were covered under NAFTA). Only five of these country schedules contained what the United States considered "high quality" commitments and they were submitted by countries characterized as having relatively open markets to begin with, including the European Union. The largest group of schedules, including many Eastern European countries, contained "a few major flaws", namely omission or unclear coverage of some sectors and retention of one or two important barriers to market access and national treatment. A final group of countries, including Japan, economically significant countries in Latin America, and the newly industrialized countries of Asia, submitted unacceptable schedules with limited sectoral coverage and failure to address significant market access and national treatment barriers. Some of these countries also took MFN exemptions for all or part of their financial services sector, meaning that their best available treatment would not be accorded to other WTO members. *See id.* at 4-6.

371. U.S. Schedule of Commitments and List of MFN Exemptions, WTO Doc. GATS/SC/90 Suppl. 3 (Feb. 26, 1998).

372. *See id.* The United States argued that with its relatively open financial services market and the absence of substantial market access commitments by particular developing countries, application of the GATS MFN rule in the financial services sector would work to its disadvantage. The United States maintained the disadvantage would occur because in future negotiations to open other markets around the world it would have no leverage due to automatic application of the MFN rule requiring the United States to maintain its high level of market access. Furthermore, the MFN rule would not prevent those same countries from maintaining their current restriction against foreign firms, including those against the United States. 1995 TREASURY FSA REPORT, *supra* note 370, at 4-6.

and MFN exemption was to allow the United States to differentiate among countries seeking future access to U.S. markets, the expansion of existing U.S. operations, or the benefit from new U.S. activities legislation.[373] Several other countries also took MFN exemptions in financial services for the same reason.[374]

As part of the Final Act, the parties agreed to an extended negotiation period for financial services, ending six months after entry into force of the WTO Agreement on January 1, 1995.[375] After December 1993, the United States continued to negotiate with commercially important developed and developing countries.[376] The United States made some progress in bilateral negotiations with Japan, which resulted in an October 1994 agreement on insurance[377] and a January 1995 agreement on financial services.[378]

b. 1995 Interim FSA.

By June 30, 1995, the end of the six-month period after entry into force of the WTO Agreement, the United States was still not satisfied with the level of commitments made by certain developing countries to open their financial services markets.[379] The United States

373. 1995 TREASURY FSA REPORT, *supra* note 370, at 6, 7.

374. See *id.* at 7. In the area of insurance, the overall level of commitments was deemed inadequate, but the United States did not take a reservation or MFN exemption, although it retained the right to do so later. *Id.*

375. FINAL ACT, *supra* note 369. This extension was granted pursuant to the Second Annex on Financial Services and Decision on Financial Services. During that period, WTO Members were free to improve, modify or withdraw all or part of their commitments and to finalize their positions relating to MFN exemptions. They further agreed not to apply the MFN exemptions they had taken pursuant to the Annex on Article II Exemptions that were conditioned on the level of commitments undertaken by other participants.

376. 1995 TREASURY FSA REPORT, *supra* note 370, at 8-16.

377. *See* Insurance Measures, *supra* note 63.

378. *See* Financial Services Measures, *supra* note 63. This agreement focused on three areas in which foreign financial institutions were most disadvantaged, namely investment management of pension funds, corporate securities underwriting and cross-border financial services. *Id.* at 618.

379. The United States was dissatisfied with the offers of a handful of developing countries, including Brazil and several Asian nations. Frances Williams et al., *Global Trade Deal Agreed Over Financial Services: Japan and South Korea Join to Open Markets*, FIN. TIMES, July 27, 1995, at 18, *available in* LEXIS, NEWS Library, Fintime file [hereinafter Global Trade Deal]. In Congressional hearings on the FSA in June 1995, Treasury Secretary Robert E. Rubin stated the U.S. negotiating position as follows:

> A few parties to the negotiations made offers that would have provided what we were seeking. However, many offers did not provide acceptable market access and national treatment commitments. Countries sought to maintain a range of restrictions - from prohibitions on new licenses for foreign firms to discriminatory regulatory and legal requirements - that could not be justified, except as a way of keeping foreign firms out. Some also held back from committing themselves to allowing U.S. firms now in their markets to continue operations on current terms. In the end, we could not commit ourselves to granting essentially full market access and national treatment to firms from other countries that would not open their markets to our firms and commit to keeping them open.

Senate FSA Hearing, supra note 6, at 45 (statement of Robert E. Rubin, Secretary, U.S. Department of the Treasury).

announced its intention to remove most of its offer in financial services and to take an MFN exemption for the whole of the financial services sector with respect to new entrants, expansion, and new activities.[380] In essence, this meant that the United States was allowed to discriminate among foreign financial service providers, offering more access to those trading partners who opened their markets on a reciprocal basis.[381] This was considered a surprise decision by the United States for "this [was] the first time a global trade agreement ha[d] been reached without the U.S. and the first time the U.S. ha[d] negotiated a deal and then walked away from it."[382]

The negotiations were extended at the suggestion of the European Union for an additional one-month period in an attempt to salvage the FSA. The other WTO Members agreed to an interim FSA that was implemented for an initial period up to November 1, 1997. At that time, WTO Members would have an opportunity during the following sixty days to modify or improve their offers on financial service schedules and to take MFN exemptions in financial services.[383] This was termed a "second best result" by the WTO Director-General due to the failure of the United States to enter binding commitments.[384] The WTO Director-General expressed the hope that the United States would reenter the multilateral MFN framework at the expiration of the interim FSA, if not sooner.[385]

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380. U.S. Schedule of Specific Commitments, WTO Doc. GATS/SC/90/Suppl. 1, App. A (July 28, 1995); *see* WTO Press Release (Press/18) (July 26, 1995) <http://www.wto.org/wto/archives/addpr3.htm> [hereinafter WTO Press Release]. Secretary Rubin stated in testimony before Congress on the FSA in June 1995:

> To be sure, the decision to accept or refuse an MFN obligation is a tough one. The benefits of accepting an MFN obligation could be substantial. Countries which have made attractive market-opening commitments would bind those commitments through the GATS. U.S. firms would be assured of important new opportunities to compete in exciting new markets....But there would be a serious downside to our irrevocably accepting an MFN obligation, assuming that commercially significant countries continued to retain restrictions against foreign firms. GATS most favored nation rules would not allow us to treat countries which do not open their markets to us any differently from those that do. All WTO member countries' firms would be entitled to full market access and national treatment in the United States. In other words, the few closed markets would be able to free-ride on the agreement we reach with other market-opening WTO members, such as the European Union. We would lose the leverage we now have to open markets by taking other countries' practices into account when their firms apply to do business over here.

See id. Senate FSA Hearing, supra note 6, at 46-47.

381. *See* WTO Press Release, *supra* note 380. Unlike the European Union, the United States had not written the concept of conditional reciprocity (matching terms offered by other countries) into its law.

382. Frances Williams, *Financial Services Deal Sidelines the U.S.-European Union Seizes World Trade Leadership; Washington Downplays Controversy; Japan Treads Carefully* FIN. TIMES, July 27, 1995, at 6 (quoting an unnamed senior trade official), available in LEXIS, New Library, Fintime File. [hereinafter *Financial Services Deal*].

383. Second Protocol to *General Agreement on Trade in Services* (July 24, 1995), 35 I.L.M. 199 <http://www.wto.org/wto/services/2-prote.htm>.

384 *See* WTO Press Release, *supra* note 380 (quoting WTO Director-General Renato Ruggiero).

385. *See id.*

The interim FSA commitments were described by the WTO Director-General as "substantial."[386] This statement may be considered accurate if the number of commitments, rather than the contents of such commitments, is the criterion for evaluation. However, other assessments were less praiseworthy, with a leading financial newspaper terming it "a deal which offers some genuine market-opening beyond existing practice . . . [but which] is mostly 'guarantees' of existing market access as a basis for further liberali[z]ation."[387] The interim FSA was also praised for its symbolic significance, in addition to the economic benefits it might produce, and was termed a "declaration of support by WTO Members for the principle of multilateralism," with the role of the European Union in "wresting . . . international trade leadership away from the U.S." duly noted.[388]

c. 1997 FSA.

Upon the expiration of the interim FSA on November 1, 1997, WTO Members were again free to table new commitments. On December 12, 1997, the day before the negotiating deadline for new offers, the United States circulated a document entitled "Revised Conditional Offer on Financial Services."[389] In that document, the United States set forth its offer to fully liberalize its financial services markets, which consisted of two changes to its existing FSA schedule. First, the United States offered to remove the limitation on its commitments with respect to new entrants, expansion of existing activities, and the conduct of new activities.[390] Second, the United States offered to delete language permitting differential treatment by it of countries based on reciprocity measures or certain international agreements.[391] The United States stated that its offer was conditioned upon other negotiating parties undertaking comprehensive commitments to preserve foreign firms' existing ownership and activities and to provide substantially full market access and national treatment on an MFN basis in their financial services sectors. A phase-in of national treatment and market access commitments over time was considered acceptable.[392] The U.S. strategy of forcing the

386. *See id.* According to the WTO, 76 WTO Members made commitments in financial services, with approximately 30 (counting the EU as one) offering improvements. WTO Press Release, *supra* note 380. The advantages of the interim FSA were described as (1) bringing new opportunities and greater security and predictability for investors in banking, insurance and other financial services activities; (2) promoting merchandise and services trade where access to financial services is needed; (3) facilitating new financial flows to developing and transition economies. *Id.*

387. *See Financial Services Deal, supra* note 382. Among the achievements cited were promises of increased liberalization in the Asian and Latin American markets, including Thailand and Brazil, and concessions by Japan and South Korea in the insurance and securities sector. *See Global Trade Deal, supra* note 379.

388. *See Financial Services Deal, supra* note 382.

389. WTO, COMMITTEE ON TRADE IN FINANCIAL SERVICES, COMMUNICATION FROM THE UNITED STATES OF AMERICA, REVISED CONDITIONAL OFFER ON FINANCIAL SERVICES, S/FIN/W/12/Add.5/Rev.2 (Dec. 12, 1997) <http://www.ustr.gov/agreements/index.html> [hereinafter Revised Conditional Offer].

390. This restriction was contained in headnote 2 to its 1995 Schedule. In addition, the Revised Conditional Offer dropped a number of state restrictions with respect to issuances of licenses to non-residents and residency or citizenship requirements and provided national treatment with respect to the costs of Federal Reserve examinations. The revised offer also extended to foreign firms the benefits of the Riegle-Neal Act. *See id.*

391. *See id.*

392. *See id.*

hands of recalcitrant countries apparently worked, for the United States announced its intention of tabling its improved commitments the next day.

Seventy countries made either new or improved offers to allow foreign financial firms to expand or maintain access to their national markets.[393] In response, the United States announced its intention to enter into the agreement, noting that the United States had led the successful effort to conclude the multilateral FSA and secured an agreement that was "dramatically improved" from the 1995 interim FSA.[394] The new and improved offers were annexed to the Fifth Protocol to the GATS,[395] which will remain open for governments to accept until January 29, 1999, and will enter into force no later than March 1, 1999.[396] On that date, commitments of 102 WTO Members will become effective covering (in U.S. dollars) $17.8 trillion in global securities assets, $38 trillion in global bank lending and $2.2 trillion in worldwide insurance premiums.[397] The WTO estimated that the FSA would cover ninety-five percent of world trade in banking, insurance, and securities.[398]

2. Negotiating Objectives.

Achieving an agreement in trade in services was a top priority for the United States in the Uruguay Round[399] and putting in place rules in banking and insurance was considered of paramount interest to the United States.[400] Financial services was one of the most difficult service sectors for liberalization efforts due to the wide range of industries covered, including banking, securities, insurance, and other financial services.[401]

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393. There were fifty-six offers tabled, with the proposals of the fifteen nations comprising the European Union being counted as one offer. WTO Press/86, *supra* note 9.

394. *See* Rubin and Barshefsky, *supra* note 11.

395. The Schedules of Specific Commitments and Lists of Article II Exemptions of individual countries can be found at the WTO Web Site <http://www.wto.org/wto/services/finsched.htm> (viewed 10/8/98).

396. Some countries will be able to phase in their commitments over time. The United States stated that it will continue to negotiate with countries like South Korea and Malaysia to improve their offers. Transcript: U.S. Briefing on Financial Services Accord (statement of United States Trade Representative Charlene Barshefsky) (Dec. 14, 1997) <http://www.usia.gov/topical/econ/wto/wtxt125c.htm> (viewed 10/8/98) [hereinafter Transcript].

397. *See* Rubin and Barshefsky, *supra* note 11.

398. *See* WTO Press/86, *supra* note 9.

399. The U.S. negotiating objectives for the GATT Uruguay Round were set forth in a communication prepared by the Office of the United States Trade Representative dated November 30, 1988 in connection with the Montreal Mid-Term Review. The purpose of the Mid-Term Review was to assess progress made in the first two years of the Uruguay Round negotiations and to outline the objectives for the remaining two years. The U.S. negotiating objectives were listed, in order of importance, as better rules for trade in agriculture, the first ever GATT rules for trade in services, adequate protection in the GATT for intellectual property rights, elimination of trade-related investment restrictions, better market access for U.S. exporters and stronger provisions for resolving trade disputes. OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, GATT, URUGUAY ROUND PROGRESS REPORT, at 23 (Nov. 30, 1988) [hereinafter U.S. MID-TERM REVIEW LETTER]. At the same time, it was recognized that services trade liberalization presented some of the most difficult issues. *See id.* at 2.

400. *See id.* at 6.

401. REPORT OF THE SERVICES POLICY ADVISORY COMMITTEE (SPAC) ON THE RESULTS OF THE GATT URUGUAY ROUND NEGOTIATION, at 8 (Jan. 12, 1994) [hereinafter SPAC].

The United States had two major motivations for pursuing a financial services agreement through the WTO. Testifying in Congressional hearings held in 1995 on the FSA, Treasury Secretary Robert E. Rubin stated that the United States was placing emphasis on the financial services negotiations (1) to help the U.S. economy and advance the interests of the U.S. financial services industry, and (2) to advance the development of international capital markets.[402]

a. Market Access.

Congressional hearings on the FSA reflected the views of private industry and U.S Government officials that U.S. financial service providers were disadvantaged in operating in foreign markets that offered the greatest opportunities for growth. Except in the OECD countries, these markets were plagued by a lack of trade disciplines on government action. It was believed that broadly applicable international rules would enable U.S. firms operating abroad to compete more effectively with foreign financial institutions.[403] The openness of the U.S. market to foreign financial service providers was often contrasted with the treatment received by U.S. financial firms that sought to do business in other countries. A frequently repeated theme was the need for greater fairness and reciprocal opening of markets by other countries, sometimes expressed as the need for a "level playing field."[404]

U.S. market access efforts focused on key countries where significant markets existed, but U.S. suppliers faced discriminatory barriers, primarily the newly-industrialized countries of Asia, as well as Japan and Latin American countries.[405] The United States also sought assurances that U.S. firms would not be closed out of the EU market and requested bindings under EC financial services directives issued as part of the 1992 EC Single Market initiative.[406]

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402. *See Senate FSA Hearing, supra* note 6, at 10-12, 44-47 (statement and testimony of Treasury Secretary, Robert E. Rubin).

403. *Uruguay Round Negotiations on Financial Services: Hearing before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance, Task Force on International Competitiveness of U.S. Financial Institutions of the House Comm. on Banking, Finance and Urban Affairs,* 101st Cong. 47 (1990) (testimony and statement of William E. Barreda, Deputy Assistant Secretary of Treasury for Trade and Investment) [hereinafter Hearing on Uruguay Round Negotiations].

404. In connection with the U.S. unwillingness to accept the results of the 1995 FSA negotiations, United States Trade Representative Michael Kantor noted that the United States would continue to insist that other countries begin to "level the playing field" for U.S. companies, "not only in financial services but in trade generally." Gary C. Yerkey and Melissa Pozsgay, *Services: U.S. Still Disappointed With Offers in Financial Services Talks at WTO,* 12 INT'L TRADE REP. 1231, July 19, 1995.

405. SPAC, *supra* note 401, at 8. At the start of the 1997 FSA negotiations, U.S. Trade Representative Charlene Barshefsky stated: "For the financial service negotiations to be successful, it is absolutely critical that we see significantly improved offers from a critical mass of countries, particularly in Asia and Latin America." Gary G. Yerkey, *Services: U.S. Major Trading Partners Urge Others to Improve Offers in Financial Services Talks,* 14 INT'L TRADE REP. 1811, May 7, 1997.

406. *Id.* at 8-9. In insurance, the priority countries where the United States believed that liberalizing commitments were feasible consisted of two groups: (1) OECD countries (comprising 90% of the global market) and (2) emerging industrial countries, including those in Latin America and Asia (comprising 7% of the global market). The important countries in this latter group were the following: Asia and the Middle East: Korea, India, Indonesia, Malaysia, Philippines, Singapore, Thailand, Pakistan, and Egypt; Eastern Europe: Czech Republic, Poland, and Hungary; Latin America: Argentina, Brazil, Chile, Colombia, Mexico, and Venezuela. REPORT OF THE INDUSTRY SECTOR ADVISORY COMMITTEE ON SERVICES FOR TRADE POLICY MATTERS (ISAC 13) ON THE URUGUAY ROUND MULTILATERAL TRADE AGREEMENTS, at 16-17 (Jan. 15, 1994) [hereinafter ISAC].

As in the case of the NAFTA negotiations, individual financial services firms, lobbying groups for the financial services industry, and industry advisory groups were actively involved in the negotiation process. This involvement consisted of periodic briefings by the U.S. Government and solicitation of views on important issues that arose during the negotiations. U.S. lobbying groups provided information to U.S. Government negotiators about market access barriers faced by U.S. firms operating abroad and this information was used in the negotiating process.[407] Industry advisory groups conditioned their support of the FSA on achievement of an acceptable level of market access commitments.[408] They made it clear that private industry was looking for significant market-opening concessions and that standstill commitments, which merely locked in existing levels of liberalization, but did not contain commitments to liberalize further, were not sufficient.[409] Another concern was the problem of free-riders. It became apparent during the negotiations that many emerging market governments were extremely reluctant to open their financial services markets by making commitments expanding national treatment or market access.[410] At the same time, these countries were entitled to the benefits of market-opening concessions made by other WTO Members, including the United States, through operation of the MFN clause in GATS.[411] The perception that certain other countries were free-riding on the largesse of the United States and should be required to make liberalizing commitments of their own became a type of rallying cry in the later stages of the FSA negotiations.[412]

The United States considered a number of responses to the perceived problem of free-riders.[413] Most of these proposals received no support from other

407. Telephone Interview with Peter Russell, Senior Vice President, Government Relations, Chase Manhattan Bank (September 15, 1998) [hereinafter Russell Interview].

408. ISAC, *supra* note 406, at 21.

409. *Id.*

410. This was attributed to the conservative views of finance ministries and central banks. SPAC, *supra* note 401, at 9. Another explanation was that there was little interest on the part of these countries in entering the U.S. market and to the extent there was interest, the U.S. market was already open. Telephone Interview with Thomas Farmer, General Counsel, Bankers Association for Foreign Trade (August 20, 1998) [hereinafter Farmer Interview].

411. SPAC, *supra* note 401, at 9.

412. ISAC, *supra* note 406, at 3.

413. In Congressional hearings in 1993, the Financial Services Group (FSG) of the U.S. Coalition of Service Industries reported that the following options were proposed: (1) sectoral non-application of GATS (United States was isolated in this position and FSG abandoned it), (2) refusal to sign final services agreement (unlikely to be exercised if agreement was deemed to provide significant benefits to other service sectors), (3) invoking global non-application by not applying entire services agreement to a particular country (may prove unworkable for same reason), and (4) invoking an MFN exemption for one or more financial service sectors in the event of insufficient liberalization commitments (enormous uncertainty about how this mechanism would work - U.S. and GATT officials gave conflicting views). *Hearing on Draft Final Text of the Results of the Uruguay Round of Multilateral Trade Negotiations (Dunkel Draft)*, Serial 102-81 (Jan. 23, 1992) (testimony and written statement of Oakley Johnson, Financial Services Group, U.S. Coalition of Service Industries, Inc. and Vice President, Corporate and International Affairs, American International Group). The United States also proposed a "two-tier" MFN approach for banking and securities. SPAC, *supra* note 401, at 9. Under this approach, the United States would have made a limited lower tier commitment to all WTO Members and enhanced commitments to an upper tier of countries who had themselves agreed to extend substantially full market access and

countries.[414] The free-rider problem was discussed with the industry and an MFN exemption was agreed upon as the most viable option.[415] It was felt that any other course of action would lead to U.S. markets being "frozen open" by MFN obligations indefinitely, with Asian and Latin American countries having won all the market access they needed. There would be no incentive for the hold-out countries to make market access commitments in the future. The purpose of the MFN exemption was not to shrink foreign competitors' presence in the U.S. market, but to preserve leverage for lowering foreign barriers to U.S. financial service providers.[416]

b. Development of International Capital Markets.

The process of globalization has heightened awareness of the interrelationship among national economies. The benefits of financial reform and development of capital markets worldwide, and the necessity for such steps to accompany trade liberalization, are now acknowledged not only by economists,[417] but also by the U.S. Government and the U.S. financial services industry.

The U.S. Government has consistently supported global financial reform and capital market development in the context of promoting free trade in financial services. In the 1994 National Treatment Study prepared by the Department of the Treasury, one component of the U.S. strategy for further liberalization was supporting other initiatives to promote capital market development and integration in emerging financial markets and to build the regulatory infrastructure in such markets as a complement to the liberalization process.[418] Public statements by high-ranking U.S. Government officials also endorsed this policy. Secretary Rubin had stated publicly at the time of the 1995 interim FSA that "[t]he development of global financial markets has a significance which goes beyond their importance to specific firms. More than ever before, well-functioning capital markets are essential to the health of the world economy. Capital needs in emerging markets are outstripping the capacity of traditional financial systems."[419] When the 1997 FSA was announced, Assistant Treasury Secretary Lawrence Summers praised the agreement, stating that it represented a recognition of the important benefits of global financial markets to economic growth and stability in a time of financial uncertainty.[420] He stated that the participation of foreign financial institutions was critical to growth in emerging markets, providing the benefits of know-how, a capital base, and important services to local businesses and entrepreneurs.[421]

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national treatment. This approach was rejected by most other countries as a violation of the MFN principle and the United States abandoned it. Sydney J. Key, FINANCIAL SERVICES IN THE URUGUAY ROUND AND THE WTO 52 (Group of Thirty Occasional Papers No. 54, 1997).

414. *See id.*

415. *See* ISAC, *supra* note 406, at 15.

416. *See id.* at 9.

417. WENDY DOBSON & PIERRE JACQUET, FINANCIAL SERVICES LIBERALIZATION IN THE WTO 15-30 (1998). *See* WTO, OPENING MARKETS IN FINANCIAL SERVICES AND THE ROLE OF THE GATS 23-35 (1997).

418. The United States planned to support efforts by the World Bank and other regional developments banks, the IMF and the OECD, as well as cooperative efforts among regulatory agencies involving countries in Latin America and Asia. 1994 Study, *supra* note 123, at 11-12.

419. *See* Nancy Dunne, *White House Says Bargaining Power Boosted*, FIN. TIMES, July 27, 1995, at 6.

420. Transcript, *supra* note 396.

421. *See id.*

U.S. private industry also understood the importance of strengthening financial markets and institutions in other countries. U.S. financial institutions viewed such developments as complementing their plans for international expansion,[422] perhaps because well-functioning financial markets would increase the chances for success of their own international businesses.

c. The Negotiating Agenda.

The U.S. negotiating agenda shifted over the course of the FSA negotiations. Initially, the United States sought to achieve a strong framework of principles based on the GATT model, with certain embellishments to take account of the special nature of services trade. Over time, it became apparent that developing countries were not in agreement with the U.S. program and would be willing to offer only a low level of commitments. The U.S. focus then shifted to locking in those commitments, while at the same time preserving leverage for future negotiations at which additional concessions would be sought.

From the beginning of the Uruguay Round, the United States sought a principled agreement on financial services trade that would subject all GATT contracting parties to the same rules. At the time of the Montreal Mid-Term Review, the United States stated that it hoped to achieve agreement on four basic principles for services trade: national treatment, right of establishment, transparency, and nondiscrimination.[423] The United States also sought provisions on consultation and dispute settlement, a negotiating timetable, procedures for sectoral coverage, and flexibility in allowing reservations by individual countries.[424] The United States observed that while most other developed and some developing countries agreed with the U.S. approach of negotiating a broadly-based services agreement, a group of developing countries questioned the value of liberalizing trade in services. These countries sought to narrow the scope of the negotiations and to push their own agendas regarding preferential market access, restrictive business practices, transfer of technology rules, and priority sectors.[425] The U.S. position was to recognize the needs of these countries by allowing reservations and phase-in periods, but it was not prepared to accept special and differential treatment that would perpetuate trade distorting practices or create a two-tiered trading system in services.[426]

By the end of the Uruguay Round, when it became clear that the FSA would not be completed at that time and additional talks on financial services were agreed to, the United States stated its negotiating position to be that mandated in the Uruguay Round implementing legislation for the extended negotiations, namely to secure commitments to reduce or eliminate barriers to the supply of financial services, including those that denied national treatment or market access, as a condition for the United States offering national treatment and market access in each of the financial services sub-sectors on an MFN basis.[427]

One of the services industry advisory groups, ISAC 13, initially took the position that GATS should contain a universal set of rules that would be applicable to all signatories, with only limited derogations by individual countries allowed.[428] It recommended includ-

422. Russell Interview, *supra* note 407.
423. *See* U.S. MID-TERM REVIEW LETTER, *supra* note 399, at 6.
424. *See id.*
425. *See id.*
426. *See id.* at 6, 7.
427. *See* Uruguay Round Agreements Act § 135, 19 U.S.C. § 3555 (1994).
428. *See* ISAC, *supra* note 406, at 2.

ing the principles of market access (covering cross-border sales, contractual arrangements, and commercial establishment, as determined by the service provider), national treatment, transparency, licensing and certification decisions based on competence and ability to provide services, and efficient and effective dispute resolution procedures for violations of GATS.[429] The Uruguay Round negotiations ultimately adopted a different approach, in which some of the above-mentioned disciplines would apply to all countries, but other crucial commitments, most notably market access and national treatment, would only apply to countries to the extent they were incorporated for a specific sector in national schedules. At that point, ISAC 13 shifted its focus to monitoring the extent of liberalization of commitments made in these schedules.[430]

3. *The Structure of the FSA.*

a. The Fragmented Structure of the FSA.

Unlike the earlier trade agreements discussed in this article, the FSA is not a single agreement. In fact, the FSA is composed of several different parts, namely (i) General Agreement on Trade in Services (GATS);[431] (ii) Annex on Article II Exemptions (Article II Annex); (iii) First Annex on Financial Services (Financial Services Annex); (iv) certain GATS Ministerial Decisions relating to financial services (Ministerial Decisions);[432] (v) National Schedules of Commitments on Financial Services (Schedules); and (vi) Understanding on Commitments in Financial Services (Understanding). These various components must be read together as a whole, admittedly a difficult task. The FSA is the product of two separate negotiations – the GATS negotiations, which were handled by the Office of the United States Trade Representative, and the financial services negotiations, in which the U.S. Treasury Department was responsible for banking and securities issues and the U.S. Commerce Department covered insurance issues.

GATS is a framework agreement that sets forth general principles for trade in services for covered sectors, including financial services. GATS incorporates by reference[433] the WTO Dispute Settlement Understanding (DSU),[434] thereby making the DSU procedures applicable to financial services disputes. The Article II Annex, the Financial Services Annex and the Ministerial Decisions modify both GATS and the DSU with respect to financial services matters. Finally, the Schedules set forth the commitments of WTO Members in the areas of national treatment and market access under Part III of GATS.[435] These are not general principles in the FSA, meaning that a WTO Member is not bound to accord such treatment to foreign financial service providers unless such Member has given an under-

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429. *Id.*
430. *Id.* at 3.
431. GATS is Annex 1B to the WTO Agreement, *supra* note 8, and is binding on all WTO members.
432. The Decision on Institutional Arrangements for GATS established the Committee on Trade in Financial Services, which, among other things, is important for the institutional role it played in furthering the financial services negotiations. The Decision on Certain Dispute Settlement Procedures for GATS required financial services expertise in dispute settlement matters involving that sector.
433. GATS, *supra* note 10, art. XXIII.
434. The DSU is Annex 2 to the WTO Agreement, *supra* note 8.
435. *Id.* arts. XVI, XVII, XX.

taking to do so in its Schedule. Certain WTO Members have adopted an alternative approach to scheduling their commitments under Part III of GATS in the Understanding.

By its terms, GATS contemplates progressive liberalization of the services sector through successive rounds of multilateral negotiations beginning no later than January 1, 2000, in which Members will seek to remove measures that hinder effective market access.[436] The goal of such liberalization is economic growth of all Members and development of developing country Members. The national policy objectives of Members in regulating their service sectors are to be given due respect. Developing countries are to be accorded special status, allowing them to maintain discriminatory legislation in place as protectionist measures for a longer period than developed countries.[437]

b. Sector Coverage.

The coverage of the FSA is potentially very broad. The term "financial services" is defined to mean any service of a financial nature offered by a financial service supplier of a Member.[438] Financial services are divided into two categories: insurance and insurance-related services and banking and other financial services, and covered activities for each sector are listed.[439] The second category covers activities that in the United States are conducted by the banking and securities businesses. Core banking activities such as deposit-taking and lending are covered, as well as classic securities industry activities such as underwriting, dealing, brokerage services, and investment advisory functions.[440] Activities of leasing companies, factoring companies, and consumer finance companies are also covered.[441]

The term "financial service supplier" covers both natural and juridical persons, but does not cover public entities.[442] Public entities include a government, central bank or monetary authority or other entity owned or controlled by the government that is principally engaged in carrying out government functions. Private entities performing functions normally provided by a central bank or monetary authority may also be excluded.[443]

The FSA covers all four modes of delivery of trade in financial services, namely cross-border trade, movement of consumers, commercial establishment, and movement of natural persons employed by the service supplier.[444] As will be noted below, in spite of the language

436. GATS, *supra* note 10, at pmbl., art. XIX.
437. *Id.*
438. GATS, Financial Services Annex, *supra* note 10, cl. 5(a).
439. *Id.*
440. *Id.* cls. 5(a)(v)-(xvi).
441. *Id.* cls. 5(a)(vi), (vii).
442. *Id.* cls. 5(b), (c).
443. In addition to these provisions, the Financial Services Annex refers back to the exception from coverage in Article I of GATS for government activities and clarifies that the following types of governmental entities are not subject to the FSA: central bank, monetary authority or other public entity conducting monetary or exchange rate policy; social security or public retirement plans; and other public entities where the government is financially responsible for its activities. *Id.* cl. 1(b). The exception referred to in the preceding sentence is not available for the latter two categories of services if private sector providers are permitted to compete with the government in supplying such services. *Id.* cl. 1(c).
444. *Id.* cl. 1(a); GATS, *supra* note 10, art. I(2).

regarding coverage contained in the Financial Services Annex, the FSA does not automatically cover all modes of supply or all financial service sectors of all Members. Rather, only those modes of supply and sectors set forth in each Member's Schedule are covered.[445]

The FSA binds WTO Members directly, but not their regional and local units of government or non-governmental organizations (NGOs) within their borders. The Members agree to use best efforts ("reasonable measures") to ensure observance by such sub-units and NGOs.[446] However, it is conceivable that such entities may not be in compliance with the terms of the FSA. This is a concern for countries with a federal system of government in which state or provincial governments play a significant regulatory role for financial services.

c. Framework of Principles.

The framework of principles for the FSA is set forth in GATS. There are two types of principles - those that are generally binding on all WTO Members and those that become binding only if, and to the extent that, a Member has made a commitment in its Schedule.

(i) General Principles.

Both substantive and procedural principles are included. The most significant general principles are MFN treatment, transparency and impartial administration of national laws, and dispute settlement. The operation of the principles may be limited by the operation of exceptions for prudential regulation[447] and for restrictions imposed to redress balance of payments difficulties.[448]

(a) Most-Favored-Nation Treatment.

The most-favored-nation clause is patterned after Article I of GATT and requires Members to accord on an unconditional basis the same concessions to all Members that it extends to any other country.[449] The undertaking is weaker than the comparable GATT clause, however, due to the possibility of taking exemptions for non-conforming measures, provided they comply with the conditions of, and are entered on lists attached to, the Article II Annex.[450] The exemptions fall into two categories – those agreed as part of the Uruguay Round negotiations[451] and new exemptions added after the date of entry into force of the WTO

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445. GATS, *supra* note 10, arts. XVI, XVII.
446. *Id.* art. I(3)(a).
447. GATS, Financial Services Annex, *supra* note 10, cl. 2.
448. GATS, *supra* note 10, art. XII. In general, restrictions on international payments and transfers for current transactions are not allowed, except for exchange actions permitted by the IMF Articles of Agreement. *Id.* art. XI.
449. *Id.* art. II(1).
450. *Id.* art. II(2).
451. Such exemptions are contained in lists attached to the Annex for each country that negotiated exemptions. Sixty-one countries listed Article II exemptions, counting the European Union as one country. The United States exemptions for banking relate primarily to state law requirements of reciprocity for establishment of branches, agencies, representative offices or commercial banking subsidiaries. *United States, List of Article II (MFN) Exemptions*, WTO Doc. GATS/El/90/Suppl.3, (February 26, 1998). This list replaced the financial services section contained in WTO document GATS/EL/90/Suppl.1.

Agreement.[452] Exemptions are granted for limited time periods and in no case for more than ten years.[453] Members shall notify the Council for Trade in Services at the end of such term that non-conforming measures have been brought into conformity.[454]

(b) Transparency and Impartial Administration of Laws.

The transparency provision requires publication of all relevant generally applicable measures, as well as international agreements, relating to trade in financial services.[455] No requirements as to the type of publication are imposed, suggesting that publication in a local newspaper of limited circulation could satisfy the publication requirement, even though it would be of no assistance to a foreign service provider. Members must respond to requests from other Members for information about such measures and international agreements.[456] Members must inform the Council on Trade in Services of the introduction or amendment of any laws, regulations or administrative guidelines affecting its specific commitments on market access and national treatment.[457]

Recognizing that discrimination may be the product not just of national laws, but of their administration in a discriminatory fashion, domestic regulations that affect trade in services are required to be applied in an impartial manner.[458] Members shall ensure they have institutional mechanisms in place for the review of administrative decisions on trade in financial services that affect foreign service suppliers.[459]

(c) Dispute Settlement.

Financial services disputes are subject to the DSU procedures,[460] which require Members to utilize informal consultations or mediation to attempt to resolve disputes.[461]If such efforts prove fruitless, formal arbitration[462] in front of a panel of financial services experts[463] is mandated. Members must comply with the recommendations set forth in the panel's report or become subject to additional sanctions, including the payment of compensation or the suspension of concessions.[464]

452. Such additions require the consent of the WTO Ministerial Council, which receives a recommendation from the Council on Trade in Services. GATS, Article II Annex, *supra* note 10, cl. 2; WTO Agreement, *supra* note 8, arts. IX(3), (4).
453. GATS, Article II Annex, *supra* note 10, cls. 5, 6. All exemptions put in place for more than five years are to be reviewed by the Council for Trade in Services and a determination made as to whether such exemptions shall be continued and subject to further review. *Id.* cls. 3, 4.
454. *Id.* cl. 7.
455. GATS, *supra* note 10, art. III(1).
456. *Id.* art. III(4).
457. *Id.* art. III(3).
458. *Id.* art. VI(1).
459. *Id.* art. VI(2).
460. *Id.* art. XXIII(1).
461. DSU, *supra* note 434, arts. 4, 5.
462. *Id.* art. 6.
463. GATS, Financial Services Annex, *supra* note 10, cl. 4.
464. GATS, *supra* note 10, arts. XXIII(2), (3); DSU, *supra* note 434, art. 22.

(d) Other General Principles.

Members are also generally bound by the following principles: prohibition on certain payment and capital transfer restrictions,[465] recognition of licensing of foreign service providers,[466] non-disclosure of confidential information[467] and special treatment of developing countries.[468] Other generally applicable provisions deal with the problems of monopoly service providers[469] and restrictive business practices.[470]

(ii) Principles Subject to Specific Commitments.

Although the United States sought to include market access and national treatment as general obligations, opposition from developing countries led to their inclusion in a very limited form, i.e., only to the extent commitments are set forth in a Member's Schedule.[471]

(a) Market Access.

Members are prohibited from imposing certain types of measures that restrict entry of foreign suppliers: limits on the number of service suppliers, limits on the total value of transactions or assets, limits on the total number of operations or quantity of output, limits on the total number of natural persons that may be employed in a particular service sector, limits on the legal form for supply of services, and limits on participation of foreign capital expressed as a percentage of total shareholding or investment.[472] Market access

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465. GATS, *supra* note 10, art. XI(1). Members are prohibited from imposing restrictions on international transfers and payments for current transactions in areas where they have made specific commitments regarding market access and national treatment. Exchange controls allowed by the IMF Articles of Agreement are permitted as long as they do not violate specific commitments, unless they fall under the GATS Article XII exception for safeguarding the balance of payments or the IMF requests that they be imposed. *Id.* art. XI.
466. *Id.* art. VII(1). This may take the form of harmonization by agreement with another Member or may be undertaken unilaterally by a Member.
467. *Id.* art. III bis.
468. *Id.* art. IV.
469. *Id.* art. VIII.
470. *Id.* art. IX.
471. *Id.* arts. XVI(1), XVII(1), XX. Members are also permitted to set forth additional commitments on other matters, such as qualifications and licensing, in their Schedules. A comparison of the proposed drafts of the GATS submitted at the end of 1989 and the beginning of 1990 by the United States, the European Union and a group of developing countries led by Brazil, reveal the differences in the negotiating stances that led to the compromise treatment of market access and national treatment. The United States sought a "comprehensive, ambitious and enforceable set of international rules" applicable to all governments, including rules on market access and national treatment. The European Union took a more limited approach, with market access and national treatment principles automatically binding, except to the extent not inconsistent with existing laws, regulations and international agreements. Other concessions could be negotiated through the request/offer process. The developing country position was that neither market access nor national treatment should be automatic obligations and that any market access concessions should be made through a positive list approach. STATUS OF NEGOTIATIONS ON THE STRUCTURE OF A GENERAL SERVICES AGREEMENT (Presentation to the Services Policy Advisory Committee, Mar. 1, 1990) [hereinafter 1990 SPAC Briefing], *reprinted in* Hearing on Uruguay Round Negotiations, *supra* note 403, at 197-204.
472. GATS, *supra* note 10, art. XVI.

means the absence of any of these restrictions in the four supply modes covered by the FSA. Measures that do not conform to the market access standard for a particular mode of supply within a covered sector are required to be listed. The Schedules therefore embody both a positive list approach (whether a sector is covered) and a negative list approach (measures that do not conform to the standard within a particular supply mode must be scheduled). This so-called hybrid approach[473] was the product of a negotiating compromise and differs from the negative list approach sought by the United States.[474]

(b) National Treatment.

The national treatment commitment requires each Member to treat services and service suppliers of other Members no less favorably than such Member's own like services and service suppliers.[475] The "no less favorable" language means that such treatment must not make competitive conditions more favorable for domestic versus foreign suppliers.[476] Such treatment may be achieved by treating foreign services and service suppliers either formally identically or formally differently.[477] This provision recognizes that the goal is equal results and that equivalent treatment does not automatically provide a nondiscriminatory result.

d. Market Access Achieved in Key Countries.

The extent of market access achieved under the FSA can be ascertained only through a careful study of the Member's Schedules. One such study was conducted by the Financial Leader's Group (FLG), which is composed of representatives of U.S. and European financial services firms. Evaluations conducted for 20 key countries suggest that significant progress was achieved in major areas of the negotiations. Those key countries are Argentina, Brazil, Chile, Colombia, the Czech Republic, Egypt, Hungary, India, Indonesia, South Korea, Malaysia, Mexico, Pakistan, the Philippines, Poland, Singapore, South Africa, Thailand, Turkey, and Venezuela. However, many offers were judged to be disappointing, including those of Chile (banking, asset management, and securities), Colombia (insurance), Egypt (insurance), India (all services), South Korea (all services), the Philippines (asset management and securities), Singapore (banking), Thailand (all services), and Venezuela (insurance).[478]

The Understanding was an attempt to develop a standardized approach to scheduling of commitments, which met with limited success.[479] The Understanding sets forth uni-

473. Key, *supra* note 413, 14-16.
474. *Id.* at 197.
475. GATS, *supra* note 10, art. XVII(1).
476. *Id.* art. XVII(3).
477. *Id.* art. XVII(2).
478. FLG Study cited in DOBSON & JACQUET, *supra* note 417, at 89. Another study of commitments by twenty-six WTO Members at varying levels of economic development was conducted by another private industry group. *See* Association of British Insurers, Opening Markets for Financial Services: Guide to the Financial Services Agreement in the World Trade Organization (1998).
479. The Understanding, as well as the Financial Services Annex, stem from a text originally developed by an informal group of finance officials from Canada, the European Community, Japan, Sweden, Switzerland and the United States. The group later was expanded to include selected Asian, Eastern European and Latin American countries. The provisions on which only the industrialized countries could agree became the Understanding. Key, *supra* note 413, at 18-19.

form principles of liberalization in financial services that Members may incorporate in their national schedules.[480]

The Understanding adopts a standstill on market access and national treatment issues such that new non-conforming measures will not be put into place.[481] With respect to liberalizing commitments on market access, the Understanding recognizes the right of establishment,[482] the right to provide new financial services,[483] the right to transfer information across borders,[484] the right to temporary entry of business personnel,[485] and the right to purchase financial services while travelling abroad.[486] The right to provide cross-border services is recognized with respect to a limited category of financial services, including provision and transfer of financial information and financial data processing and advisory and other auxiliary services (excluding intermediation) relating to banking and other financial services (credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy).[487]

Finally, Members agree to seek to eliminate or reform monopoly rights,[488] government procurement practices[489] and nondiscriminatory measures that have the effect of restricting market access.[490] With respect to national treatment, the Understanding grants access to payment and clearing systems operated by public entities and to official funding and refinancing facilities available in the normal course of ordinary business and will ensure that self-regulatory bodies, securities or futures exchanges or markets, clearing agencies or other organizations will extend national treatment to such suppliers if necessary to ensure equal access.[491]

e. Prudential Regulation.

The right of governments to regulate financial services for prudential policy reasons, including protection of investors, depositors, policy holders or those to whom a fiduciary duty is owed and ensuring the stability of the financial system, is preserved.[492] In addition, a Member may recognize prudential regulation of any other country in determining how to apply its own measures on financial services.[493] This may include harmonization of laws by agreement or it may be extended unilaterally by a Member. Other Members shall be permitted the opportunity to negotiate similar harmonization arrangements if they so desire.

480. There are several caveats to application of this approach, namely, that nothing therein shall conflict with the provisions of GATS, Members will be free to schedule their specific commitments in accordance with the provisions of Part III of GATS, specific commitments will be applied on an MFN basis and there is no presumption created about the degree of liberalization to which a Member has committed. GATS, Understanding, *supra* note 10, at pmbl.
481. *Id.* at para. A.
482. *Id.* at para. B5, 6.
483. *Id.* at para. B7.
484. *Id.* at para. B8.
485. *Id.* at para. B9.
486. *Id.* at para. B4.
487. *Id.* at para. B3.
488. *Id.* at para. B1.
489. *Id.* at para. B2.
490. *Id.* at para. B10.
491. *Id.* at para. C.
492. GATS, Financial Services Annex, *supra* note 10, cl. 2.
493. *Id.* cl. 3.

IV. Assessing the Results of U.S. Efforts to Liberalize Trade in Financial Services.

A. The Gaps in the Regime for Free Trade in Financial Services under NAFTA Chapter 14 and FSA.

Reading the press releases issued by the U.S. Government at the conclusion of the NAFTA and FSA[494] negotiations, it would appear that the financial services liberalization efforts of the United States were a resounding success. It cannot be denied that both trade agreements improve the outlook for global trade and investment by U.S. financial service providers and in that sense represent a clear win. Given the gloomy prognosis for such talks at their inception,[495] achieving an agreement at all was a triumph. However, both NAFTA and FSA fall short of the ambitious U.S. goals set for such negotiations.

1. *NAFTA Chapter 14.*

a. Strengths.

Chapter 14 was a noteworthy achievement in several respects. First, the scope of Chapter 14 is very broad, covering banking, securities, insurance and other financial services.[496] New financial services are also covered,[497] avoiding the need for renegotiation of NAFTA as innovations lead to the introduction of new products. State and provincial government measures are covered in addition to federal measures,[498] a significant provision because certain forms of financial services are regulated at the state and provincial level in all three NAFTA Parties.[499] These measures ensure that wide-ranging liberalization will be achieved in the long run in the sector, even though barriers may remain in the short run.

Second, the framework of principles is a significant step forward in putting financial services trade on a firmer footing and should serve well as a guide both to future liberalization efforts by the three current NAFTA Parties as well as to accessions by additional NAFTA Parties. In general, the principles are clear and well-drafted and they cover the major areas of interest to the United States. The substantive principles include those considered most significant to U.S. negotiators, namely the right of establishment[500] and the right to national treatment,[501] defined to include the right to equal competitive opportunity. Indeed, the NAFTA parties are entitled to better than national treatment under operation of

494. Rubin and Barshefsky, *supra* note 11.

495. There had been a notable lack of enthusiasm by the developing countries for the liberalization initiative in the services trade area. The developing countries felt that the comparative advantage in services belonged to the developed countries and that focusing on services would turn attention away from making progress on liberalizing trade in goods. Bhagwati, *supra* note 28, at 26-27.

496. NAFTA, *supra* note 12, art. 1416, definition of "financial service".

497. *Id.* art. 1407(1).

498. *Id.* art. 105.

499. In the United States, insurance regulation is almost exclusively a matter for state regulation. In addition, the dual banking system, allowing for both state and federal chartering and supervision of banks, persists. In Canada, certain forms of securities trading are regulated at the provincial level.

500. NAFTA, *supra* note 12, art. 1403.

501. *Id.* art. 1405.

the MFN clause in Chapter 14.[502] The procedural principles are more than mere window dressing. The transparency principle[503] provides assurances that foreign financial service providers from NAFTA countries will have meaningful access to the rule-making process in other NAFTA countries and will be freed from the problem of abuse of discretion by administrative agencies in the form of vague requirements and time delays. Moreover, the dispute settlement provisions[504] give real bite to the commitments of the parties. Binding arbitration in front of financial services experts,[505] backed by remedies to ensure enforcement of arbitral awards,[506] is mandated if more informal methods of consultation and mediation do not resolve government-to-government disputes.[507] In addition, the FSA provides for a private right of action for investment disputes[508] – a unique feature in a government-to-government trade agreement like NAFTA. Such trade agreements usually provide only government-to-government dispute settlement, as in the case of the WTO Agreement. Indeed, the investment dispute provisions that are incorporated into the FSA by reference to Chapter 11 of NAFTA bear the imprimatur of U.S. concerns about foreign investment, which it has frequently lobbied for in international fora.[509] Neither set of dispute settlement provisions has been tested yet in a financial services dispute.

Another significant feature of the institutional provisions of Chapter 14 is the establishment of a Financial Services Committee (FSC).[510] One of the functions of the FSC is to meet annually to assess the effectiveness of Chapter 14.[511] Other functions are to supervise implementation of Chapter 14, consider issues regarding financial services referred to it by a Party and to participate in dispute settlement with respect to investment disputes.[512] The FSC is composed of federal regulators in each country.[513] By providing a permanent forum composed of government officials with an expertise in financial services, the Parties have ensured that there is a mechanism for continued discussions and exchange of information. Combined with the provisions of Chapter 14 that contemplate further liberalization of trade and investment, the institutional provisions create a pathway for continued consideration of free trade in financial services.

502. *Id.* art. 1406.
503. *Id.* art. 1411.
504. *Id.* arts. 1412-14.
505. *Id.* art. 1414.
506. *Id.*
507. This form of dispute settlement was an improvement over the old style of non-binding GATT dispute settlement that was in effect prior to adoption of the WTO Agreement. For a critique of the GATT dispute settlement provisions, *see* John H. Jackson, Restructuring the GATT System 64-65 (1990).
508. NAFTA, *supra* note 12, art. 1415.
509. An example is the OECD negotiations on the MAI.
510. NAFTA, *supra* note 12, art. 1412(3).
511 *Id.*
512. *Id.* art. 1412(2).
513. *Id.* art. 1412(1). Annex 1412.1 sets forth the authorities responsible for financial services in each country. They are for Canada, the Department of Finance of Canada, for Mexico, the Secretaria de Hacienda y Crédito Publico and for the United States, the Department of the Treasury for banking and other financial services and the Department of Commerce for insurance services.

Third, Chapter 14 succeeded in achieving substantial new business opportunities in Mexico for U.S. and Canadian firms, an important achievement considering that foreign financial institutions had been closed out of the market for nearly fifty years.[514]

Fourth, the prudential regulation exception[515] ensures, at least in theory, that regulators will continue to have the right to regulate for purposes of protecting investors and depositors, the safety and soundness of individual financial institutions and the integrity and stability of the financial system as a whole. The limits of this principle have yet to be tested, however.

b. Weaknesses.

Chapter 14 does not achieve full liberalization of the financial services sector. There are several significant gaps in the structure. The language of Chapter 14 provides that some of these open issues will be discussed in negotiations to be held in the near future.

First, although all four modes of delivery of financial services are nominally covered, only partial liberalization is achieved in any of the modes. The absence of provisions liberalizing cross-border trade or permitting cross-border branching is one of the biggest flaws in Chapter 14.[516] Cross-border trade is subject to a standstill agreement only, meaning that existing rights of access are preserved but that no further liberalization was undertaken in NAFTA.[517] However, the Parties agreed to discuss this matter further no later than January 1, 2000.[518] While the right of establishment through any juridical form chosen by an investor is guaranteed in principle,[519] the Parties actually require a subsidiary form of presence.[520] Although the right of a consumer of one Party to purchase services from financial service providers of another Party, whether in the consumer's home country or abroad, is guaranteed, a NAFTA Party is not required to allow foreign service providers to do business or to solicit customers within its territory.[521] This is consistent with the standstill provision on cross-border trade but cuts back on the right of consumers to purchase services from foreign providers. Finally, although the provisions of Chapter 16 on temporary entry for business persons apply to financial services, the movement of persons under this section is severely restricted.[522] Many categories of persons who would need to move cross-border are allowed temporary entry.[523] However, under some circumstances, visas may still be required.[524] With respect to professionals, the persons who can enter on a

514. For a brief history of Mexican banking laws, *see* RALPH H. FOLSOM AND W. DAVIS FOLSOM, UNDERSTANDING NAFTA AND ITS INTERNATIONAL BUSINESS IMPLICATIONS 20-28 (1996).
515. NAFTA, *supra* note 12, art. 1410(1).
516. Newman Interview, *supra* note 265.
517. NAFTA, *supra* note 12, art. 1404(1).
518. *Id.* art. 1404(4), annex 1404.4.
519. *Id.* art. 1403(1).
520. *Id.* art. 1403(3).
521. *Id.* art. 1404(2).
522. Clearly, the reason for this is the concern of U.S. labor organizations about the effect on American workers of unfettered access to the U.S. labor market. *Id.* art. 1601 (referring to the need to enforce border security and to protect the domestic labor force and permanent employment).
523. Chapter 16 applies to, among other categories, business visitors, defined to include financial services personnel (insurers, bankers or investment brokers) and management and supervisory personnel engaging in commercial transactions for an enterprise located in the territory of another Party, as well as professionals, such as lawyers and accountants. *Id.* annex 1603(A), (D), app. 1603.A.1.
524. *Id.* annex 1603(A)(5), 1603(D)(3).

temporary basis are restricted to those holding certain educational credentials or meeting certain government licensing criteria.[525] This may have an adverse impact on a financial service provider if the delivery of the service is structured in a manner that requires movement of personnel on a temporary basis.

Second, the framework of principles in Chapter 14 is riddled with exceptions. These are set forth in the Schedules of each of the NAFTA Parties, which form part of Annex VII. The exceptions are of two types: those that grandfather existing restrictions are set forth in Section A of each Annex VII and those that grant the right to impose restrictions in the future are contained in Section B of each Annex VII.[526] The effect of these exceptions is to render the substantive principles inapplicable,[527] not only to existing non-conforming measures that were properly scheduled or otherwise exempt,[528] but also to other non-conforming measures to be adopted in the future, provided they were properly scheduled.

Third, the market access concessions of Mexico were limited by the transition periods described earlier. It should be noted that the U.S. financial services industry felt the phase-in periods were reasonable and completely justified in view of the state of development of the Mexican financial services industry.[529] The market access concessions were also limited from the U.S. perspective because they did not extend further the ability of U.S. financial institutions to do business in Canada.[530]

2. FSA.

a. Strengths.

One of the most favorable things that can be said about the FSA is that such an agreement exists at all. Given the split between the developed and developing world on the issue of whether financial services trade should be covered by multilateral rules,[531] the development of a framework of principles covering a wide range of financial services[532] and the binding of the existing degree of market access and the making of liberalizing concessions by a significant number of WTO Members was a substantial achievement. The right to regulate for legitimate purposes is also guaranteed, thereby satisfying the concern of governments that liberalization would not interfere with national regulatory goals in financial services.[533] Finally, the new, enhanced WTO dispute settlement procedures contained in

525. *Id.* app. 1603.D.1.
526. *See id.*, annex vii, Schedules of Canada, Mexico, and the United States.
527. The substantive principles are set forth in NAFTA arts. 1403-08.
528. Measures of local governments were not bound. *Id.* art. 1409(1)(a). This was not expected to have an adverse effect on liberalization because few, if any, local governments regulate financial services in any manner.
529. ISAC Report, *supra* note 266, at 18. "It addresses the desires of U.S. banks to aggressively enter the Mexican market, and it addresses the legitimate concerns of Mexican officials that their recently privatized banking industry not be suddenly crippled by an influx of foreign competition." *Id.*
530. Kenneth L. Bachman et al., *Financial Services Under the North American Free Trade Agreement: An Overview*, 28 Int'l Law. 291, 310 (1994).
531. Bhagwati, *supra* note 28, at 32-33.
532. GATS, Financial Services Annex, *supra* note 10, cl. 1(a).
533. *Id.* cl. 2.

the DSU are applicable to financial services,[534] ensuring that legally binding arbitration[535] in front of financial services experts[536] backed by remedies for enforcement[537] will be available for disputes in the sector.

Just as the GATT process of tariff cutting for trade in goods took several decades and numerous negotiating rounds to achieve, so too the process of services liberalization, in general, and financial services liberalization, more specifically, is likely to take at least as long, if not longer, due to the complexity of the issues and the political sensitivities involved.[538] Fortunately, the FSA contains a commitment to progressive liberalization and new talks are planned for further financial services liberalization for the year 2000.[539]

b. Weaknesses.

The FSA suffers from several serious weaknesses which will have to be remedied if further liberalization is to occur. At the present time, the manner in which such weaknesses will be remedied, or indeed whether they will be addressed at all in the year 2000 negotiations, is not set forth in the FSA.

First, most of the general framework principles are procedural, not substantive. Admittedly, the provisions on transparency, impartial administration of law and dispute settlement are extremely important. However, these principles are not as strong as they could be. The transparency principle suffers from two defects – publication is only required locally and no notice must be given to any WTO institution, where such information would be readily accessible to Members.[540] The provision on administration of laws provides for judicial review of administrative decision-making.[541] It also requires that administrative agencies processing applications act within a reasonable time period,[542] but it does not impose firm deadlines on administrative decision-making, as NAFTA Chapter 14 does. While the dispute settlement provisions incorporated from the DSU are an

534. GATS, *supra* note 10, art. XXIII(1).

535. DSU, *supra* note 434, art. 6.

536. GATS, Financial Services Annex, *supra* note 10, cl. 4.

537. GATS, *supra* note 10, art. XXIII(2), (3); DSU, *supra* note 434, art. 22.

538. John H. Jackson, a leading U.S. expert on trade law, has written:

> One need only look at the multiple rounds of GATT negotiations on trade in goods that took place over nearly fifty years to realize that the complexity of the issues involved in services trade may necessitate an even longer process to achieve equivalent results. The complexity, defects, and problems of the GATT system for trade in goods, when added to the much greater variety and complexity of trade in services, result in a web of cross-currents that is so difficult to organize by international rules that any person, no matter how expert, must approach the subject with great caution. Indeed in my view, it will not be possible within a few years or the time span of one GATT negotiating round to build a complete structure of such rules. It seems better to recognize this and to focus on the institutional structures that could be established.

Jackson, International Competition, *supra* note 172, at 10.

539. GATS, *supra* note 10, art. XIX.

540. *Id.* art. III(1). Paragraph (3) does, however, require notice to the Council on Trade in Services if the specific commitments of Part III of GATS would be impacted.

541. *Id.* art. VI(2).

542. *Id.* art. VI(3).

improvement over those contained in the old GATT, they fall short of providing a private right of action for financial services investment disputes, as in Chapter 14 of NAFTA. The only significant substantive principle that appears in the framework is the MFN clause.[543] The other important principles of national treatment and market access are not part of the framework itself, but rather are obligations in the FSA only to the extent that WTO Members have made binding commitments in their Schedules.[544]

Second, even though the core substantive principles of MFN treatment and national treatment are contained in the FSA, they are contained in a very weakened form, compared to GATT. These two principles of nondiscrimination are contained in a strong form in Articles I and III, respectively, of GATT[545] and are considered the cornerstone of the GATT system of multilateral trade concessions.[546] The MFN clause in Article I of GATT is unconditional in nature.[547] In contrast, the MFN principle in the FSA[548] is undermined by the fact that the parties were allowed to take exemptions for non-conforming measures at the time of entering into GATS[549] and therefore, it is a conditional undertaking. In addition, the United States was able to negotiate an MFN exemption for new entrants, expansion and new activities in connection with the negotiation of the FSA. The national treatment principle contained in Article III of GATT is binding on all WTO Members and is not subject to variation. In contrast, the national treatment principle in the FSA is optional. By making such core principles conditional or optional in nature, the FSA has substantially weakened them. In fact, one can question whether the FSA embodies the principle of non-discrimination at all. In any case, it is significantly less strong than under GATT.

Third, in spite of general language in the FSA suggesting that all financial services and all four modes of supply are covered, WTO Members are bound to extend market access and national treatment with respect to a particular financial service in any of the four supply modes only to the extent that they have made commitments in their Schedules. The extent to which WTO Members have made such commitments varies widely. If one believes the predictions of economists that the widest possible liberalization across sectors and modes of supply will lead to the greatest possible economic gains, the gains from the FSA can be expected to be quite limited.

The method used in the Schedules for setting forth negotiating concessions is open to criticism on a number of grounds. The hybrid approach used in the Schedules differs in significant respects from the negative list approach for scheduling commitments that

543. *Id.* art. II(1).

544. *Id.* arts. XVI, XVII, XX. The Understanding contains fairly strong commitments in these areas.

545. GATT, arts. 1, 3.

546. JACKSON, *supra* note 8, at 157.

547. MFN can be unconditional or conditional. The difference can be illustrated by the following example. Conditional MFN treatment means that when country #1 grants a privilege to country #3, it must grant equivalent treatment to country #2, to whom it owes MFN treatment, but only after #2 has given #1 some privilege to pay for it. Under unconditional MFN, #1 must grant equivalent privileges to #2 without receiving anything in return. It has been U.S. policy to pursue unconditional MFN treatment. Under code conditional MFN, a new form that developed under various codes and side agreements negotiated during the GATT Tokyo Round, the benefits of code treatment would only be extended to code signatories. However, no additional reciprocal benefit would be required. *Id.* at 161-162.

548. GATS, *supra* note 10, art. II.

549. *Id.* art. II(2); Annex on Article II Exemptions.

was sought by the United States during the negotiations.[550] In a negative list approach, the implied starting point is adherence to a general principle like national treatment and the negative list contains all non-conforming measures. This approach has two virtues. The list, in effect, becomes an inventory of remaining trade barriers, and this information can be usefully employed in later trade negotiations. A negative list approach is therefore more transparent than the hybrid approach.[551] The negative list is also desirable because the baseline is liberalization and maintenance of trade barriers is the exception. In the FSA, it is possible for a country to make no commitments with respect to a particular sector or mode of supply. The approach taken is that the baseline is the status quo and liberalization is the exception.

Another criticism is that the principle of market access in the GATS, and hence in the FSA, is ill-defined and seems to overlap with the principle of national treatment.[552] The result is that the Schedules are difficult to interpret and the level of commitments made by WTO Members hard to assess. This may undermine the goal of creating a secure, stable trading environment and lead to disputes among WTO Members.[553]

Fourth, the FSA does not require WTO Members to commit to a standstill in their Schedules. Even the status quo is not bound and WTO Members may withdraw measures currently in place allowing market access and national treatment and replace them with discriminatory measures.[554]

Fifth, the results of the FSA, judged from the perspective of the U.S. objective of achieving market-opening concessions, are disappointing. A recent analysis of the nature and extent of the concessions made reveals that most commitments only succeeded in binding the status quo and very few countries moved beyond the status quo to make liberalizing commitments, at least in the banking sector.[555]

Sixth, the broad scope of coverage of services industries is limited by the fact that measures of political subunits are not covered. This is in contrast with Chapter 14 of NAFTA, which is binding on state and provincial governments. This limitation is signifi-

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550. For an examination of the negotiating dynamics on this issue, *see* Anders Ahnlid, *Comparing GATT and GATS: Regime Creation Under and After Hegemony, 3 Review of International Political Economy* 80-81 (1996).

551. *See* Key, *supra* note 413, at 16.

552. Richard H. Snape & Malcolm Bosworth, Advancing Services Negotiations *in* THE WORLD TRADE SYSTEM: CHALLENGES AHEAD 201 (Jeffrey J. Schott ed., 1996) (suggesting elimination of the principle of market access as duplicative of the national treatment obligation).

553. Aaditya Mattoo, *National Treatment in the GATS: Corner Stone or Pandora's Box?*, 31 JOURNAL OF WORLD TRADE 107 (February 1997).

554. Compare the approach taken in the Understanding, which introduces a limited standstill provision. During the FSA negotiations, some countries sought to bind a lower level of liberalization than existed under their national laws. An example was Malaysia, which refused to grandfather certain existing foreign investments in the insurance sector. Malaysia, Schedule of Specific Commitments, Supplement 3, GATS/SC/52/Suppl. 3., Feb. 26, 1998.

555. DOBSON & JACQUET, *supra* note 417, at 90. More liberalization was seen in the insurance sector. *Id.* One possible explanation for this is that insurance and securities are underdeveloped services sectors in many markets around the world and making liberalizing commitments in those areas is therefore less risky than in the banking sector, which is considered far more significant in most countries. *See* Piritta Sorsa, THE GATS AGREEMENT ON FINANCIAL SERVICES—A MODEST START TO MULTILATERAL LIBERALIZATION, IMF WP/97/55 (May 1997).

cant in countries that have a federal system of government, because financial services regulation may occur at the subnational level.

3. *NAFTA Chapter 14 and FSA Compared.*

It is clear that the United States was more successful in achieving its negotiating objectives in NAFTA Chapter 14 than in the FSA. The primary negotiating objectives of the United States for financial services have remained consistent, namely (1) development of a framework of principles, including national treatment and the right of establishment, (2) achieving greater market access with respect to key trading partners, and (3) preserving the right of regulation for prudential purposes. NAFTA Chapter 14 achieved a more intact framework of principles than did the FSA. In addition, the NAFTA negotiators achieved liberalizing market access concessions relating to the right of establishment in Mexico and also achieved a standstill in the area of cross-border trade. In the FSA, most national commitments did not lead to greater liberalization with respect to the right of establishment, but merely bound the status quo in many cases. Moreover, no general standstill was achieved in the FSA, meaning that even the status quo was not bound in some cases.

There are numerous explanations for the different results under NAFTA Chapter 14 and FSA. First, the differences in levels of economic development among the NAFTA Parties was far less vast than among the WTO Members. If the notion that those countries that have a presumed comparative disadvantage in financial services trade would oppose liberalizing commitments is true, then it may explain why so few concessions were extended in the FSA. Indeed, in the FSA negotiations, even binding the status quo was deemed a concession by some WTO Members.

Second, a free trade agreement like NAFTA implies a greater depth of economic integration than the WTO Agreement. NAFTA has been viewed by some as the first step towards establishing very close economic ties among Western Hemisphere countries, possibly developing into a customs union or something more, as in the case of the European Union. NAFTA's strong provisions on new trade topics like investment and intellectual property protection certainly indicate a deeper level of commitment by Members than the WTO Agreement.[556] At this point, WTO is still a forum for reducing tariff and non-tariff barriers to trade, but does not contemplate any deeper level of integration.

Another reason for the differences is simply based on the numbers of the negotiating parties. As any lawyer who has negotiated a multiparty agreement will tell you, it is far easier to reach agreement among a handful than among a vast number of negotiators.

B. Assessments by the U.S. Government and the U.S. Financial Services Industry.

There are several different approaches that could be adopted in assessing the success of NAFTA Chapter 14 and the FSA. This author has chosen the approach of comparing negotiating objectives against actual outcomes and then analyzing the gaps in the resulting structures. On such an analysis, the outcomes can only be termed not wholly successful.

556. *See* NAFTA, *supra* note 12, at chs. 11, 17. The WTO Agreement also included provisions on investment and intellectual property. TRIMS is very weak compared to NAFTA Chapter 11 on investment. TRIPS is more successful, from the perspective of investors from developed countries, providing substantial new international protection for intellectual property.

The approach taken by the U.S. Government and private industry is somewhat different. The assessments of these groups are very similar and have focused on a comparison of the trade and investment landscape for financial services providers before and after the trade agreement negotiations. It is generally agreed that the results of NAFTA Chapter 14 were a vast improvement over the pre-NAFTA situation.[557] The major weaknesses cited were the absence of progress on cross-border trade and the failure to permit firms the right of establishment through a branch operation.[558]

Under the FSA, the binding of the status quo by many countries was considered an important achievement because it meant that existing operations of U.S. firms would be grandfathered.[559] The U.S. Government assessments have tended to emphasize the large numbers of WTO Members that made offers under the FSA.[560] Weaknesses often cited in the interviews conducted by the author were the disappointing commitments made by certain countries, and the failure of the FSA's structure to facilitate cross-sector liberalization.[561]

Another approach to assessment would be to examine trade statistics to determine if gains resulted for U.S. financial services firms from NAFTA Chapter 14 and the FSA. It will take some time before trade figures will reflect the effects of these trade agreement provisions, however.

V. U.S. Policy on the Future Development of Free Trade in Financial Services.

As for the future, U.S. policy seems to be to continue pursuing financial services liberalization on all levels – multilateral, regional and bilateral.[562] The most likely routes for financial service liberalization are discussed below.

A. NAFTA.

By its terms, NAFTA contemplates further liberalization of financial services trade and investment[563] and accession of additional parties.[564] The following steps are already on the agenda for future financial services talks: (1) develop a process for keeping Annex VII Schedules up to date; (2) review the issue of limited scope securities firms as stipulated in Mexico's Schedule to Annex VII; and (3) review the status of the Riegle-Neal Act in the

557. Farmer Interview, *supra* note 410. Telephone Interview with Robert Vastine, President, U.S. Coalition of Service Industries (August 28, 1998) [hereinafter Vastine Interview].
558. Newman Interview, *supra* note 265.
559. Russell Interview, *supra* note 407.
560. Rubin and Barshefsky, *supra* note 11.
561. Russell Interview, *supra* note 407.
562. This approach was outlined in the 1994 National Treatment Study, *supra* note 123, at 10-12. More recent statements by U.S. Government officials continue to support this position. *See Testimony Before the House Ways and Means Comm. by U.S Trade Representative Michael Kantor* (Mar. 13, 1996) <http://www.ustr.gov/testimony/Kantor_4.html>.
563. NAFTA, *supra* note 12, arts. 1403(3), 1404(4), annex 1404.4.
564. *Id.* art. 2204.

United States in the context of Article 1403 restrictions on direct branching.[565] No other information about future negotiations is currently publicly available.[566]

There are currently no talks being held regarding accession of additional NAFTA Parties, based on publicly available information. Talks undertaken in 1994 with Chile were broken off when the U.S. Congress refused to give the executive branch the fast track negotiating authority it had requested.[567] The United States and Chile formed the Chile-U.S. Commission on Trade and Investment in 1998 to serve as a forum for discussion and exchange of information on bilateral issues of interest.[568] In spite of this development, the Chilean Government continues to maintain that it will not proceed with NAFTA accession negotiations until fast-track authority is granted.[569]

B. WTO.

New financial services talks are scheduled to begin in the year 2000. United States Trade Representative Charlene Barshefsky recently reiterated the importance to the United States of these talks beginning on schedule.[570] There is no publicly available work plan for the talks. However, the author assumes that further concessions on market access and national treatment will be sought, because this has been the focus of U.S. efforts since agreement on the FSA was reached. Hopefully, other weaknesses of the FSA, such as the absence of a standstill on cross-border trade, will also be addressed.

Services industry lobbying groups are already preparing their own agenda for future WTO negotiations. The FLG has established a three point plan, namely (1) to ensure full implementation of the WTO Agreement, (2) to seek good financial service commitments from new WTO Members and (3) to prepare for the year 2000 negotiations by encouraging governments to seek new commitments that liberalize existing restrictions and move beyond the status quo, that cover cross-border trade and consumption abroad modes of supply and that remove the extensive regulatory barriers still remaining. A new coalition

565. NAFTA Financial Services Committee, *Report for the NAFTA Commission Meeting*, <http://www.infoexport.gc.ca/nafta/menu-e.asp> (viewed 8/5/98). This was the work plan adopted by the NAFTA Financial Services Committee in 1995.
566. The Financial Services Committee meets annually, but it does not publish the results of its meetings. The author understands from conversations with U.S. Government officials that the points in the work plan are under discussion, although no decisions have been reached.
567. *NAFTA: Chile Not in Rush to Join NAFTA, Foreign Minister Says*, 14 INT'L TRADE REP. 107, January 22, 1997 (statement made on January 14, 1997 of Chilean Foreign Affairs Minister Jose Miguel Insulza). Fast-track negotiating authority prevents changes to U.S. implementing legislation for a trade agreement after it is submitted to Congress for approval, although Congress is permitted extensive consultation rights during the negotiating process. For a history of fast-track negotiating authority, *see* Harold Hongju Koh, *The Fast Track and United States Trade Policy*, 18 BROOK. J. INT'L L. 143, 143-159 (1992).
568. James Langman, *Trade Policy: U.S.-Chile Commission Has Open Agenda, But Fast-Track a Must, Chilean Official Says*, 15 INT'L TRADE REP. 1018, June 10, 1998.
569. *Id.* (statement made on June 1, 1998 of Alejandro Jaro, Chilean Director of Multilateral and Bilateral Trade Negotiations).
570. Gary G. Yerkey, *WTO: WTO Ministerial Meeting Backs Open-Ended Trade Liberalization*, 15 INT'L TRADE REP. 888, May 20, 1998.
571. Financial Leaders Group, *Future Work Plan for the Financial Leaders Working Group* (February 27, 1998) (on file with the author).

called the Global Services Network has been formed to press for greater liberalization in the year 2000 services negotiations and is seeking close monitoring of ratification and implementation of the FSA.[572]

C. FTAA.

The United States is currently supporting the creation of a free trade area in the Western Hemisphere under the rubric of the Free Trade Area of the Americas (FTAA).[573] In recent years, the Western Hemisphere has had the most active agenda of free trade agreement negotiations of any region in the world.[574] Apart from NAFTA, these negotiations have not included the United States. The United States interest in the FTAA stems, at least in part, from a concern that the proliferation of sub-regional preferential trade arrangements could place American suppliers at a disadvantage.[575] The United States believes that the FTAA should go further than the WTO Agreement in liberalizing trade and investment and become the "state of the art" in regional trade agreements.[576]

Formation of the FTAA was proposed by the heads of state of thirty-four countries[577] at the Summit of the Americas held in Miami in December 1994.[578] The goal of the negotiating parties is to achieve significant progress in negotiations by 2000 and to complete negotiations by 2005.[579] FTAA negotiations were initiated at the Second Summit of the

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572. The group was formed by the U.S. Coalition of Service Industries. *Services: Companies in Several Countries Agree to Urge Further Freeing of Services Trade*, 15 INT'L TRADE REP. 728, April 29, 1998.
573. The United States is also willing to engage in bilateral negotiations, although it is not currently engaged in talks with any country in the region apart from Chile. *America's Free Trade Pact: Hearing Before the Subcomm. on Internat'l Econ. Policy and Trade of the House Comm. on Internat'l Relations*, June 11, 1997 (statement of Jeffrey M. Lang, Deputy U.S. Trade Representative).
574. Recent developments include the following: the conclusion of the Chile-Canada FTA, the MERCOSUR-Chile FTA, the MERCOSUR-Bolivia FTA, and the initiation of negotiations between Mexico and MERCOSUR, Mexico and Peru, Mexico and Ecuador, MERCOSUR and most of the Andean Community, Panama and Chile, Mexico and the Northern Triangle of Central America (Guatemala, El Salvador and Honduras), and between Central America and the islands of the Caribbean. This is in addition to other regional and bilateral trade arrangements that have been in place for some time. *See* ORGANIZATION OF AMERICAN STATES TRADE UNIT, REPORT ON PROVISIONS ON TRADE IN SERVICES IN TRADE AND INTEGRATION AGREEMENTS OF THE WESTERN HEMISPHERE, submitted to the FTAA Working Group on Services, Apr. 21, 1997. Only a few of the Western Hemisphere trade arrangements contain provisions on services generally or financial services.
575. PRESIDENT'S REPORT TO THE CONGRESS, RECOMMENDATION ON FUTURE FREE TRADE AREA NEGOTIATIONS, Sept. 25, 1997, at 2 [hereinafter FTA REPORT].
576. *Id.* at 4.
577. Thirty-four countries are involved in the attempt to integrate the economies of the Western Hemisphere. The FTAA countries are: Antigua and Barbuda, Argentina, The Bahamas, Barbados, Belize, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Dominica, The Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, The United States of America, Uruguay, and Venezuela.
578. Organization of American States, *Miami Summit of the Americas: Plan of Action* <http://www.sice.oas.org/ftaa_e.stm> (viewed 7/13/98).
579. *Id.*

Americas held in Santiago, Chile in April 1998[580] pursuant to the San Jose Ministerial Declaration of March 19, 1998.[581] The FTAA objectives for services are: (1) to establish disciplines to progressively liberalize trade in services, so as to permit the achievement of a hemispheric free trade area under conditions of certainty and transparency; and (2) to ensure the integration of similar economies into the FTAA process.[582]

A Working Group on Services (Services Group) has been established to address these issues.[583] The Services Group has met a total of five times, most recently in October 1997.[584] The Services Group has the following mandate, which was set out as part of the Belo Horizonte Ministerial Decision of May 16, 1997: (1) to undertake background work on the nature of trade in services, (2) to compile an inventory of agreements in the Western Hemisphere which affect trade in services, (3) to compile an inventory of measures affecting trade in services, (4) to create a statistical database of trade flows in services, (5) to recommend methods to promote implementation of the WTO GATS, and (6) to recommend methods for constructing the FTAA in services.[585]

The U.S. Government has not yet issued its negotiating objectives except in very general terms, namely, reducing barriers to trade and opening markets to U.S. exports.[586] The U.S. private sector has been active in supporting the FTAA. Representatives of services industries met with government negotiators at Santiago, Chile in October 1997 for the First Services Business Forum of the Americas (Forum).[587] The Forum formulated recommendations on services liberalization that it submitted to the Services Group. In the area of financial services, the Forum sought greater liberalization, easy access to capital markets, and freedom of operations.[588]

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580. San Jose Ministerial Declaration, Summit of the Americas, Fourth Trade Ministerial at para. 11, Mar. 19, 1998 [hereinafter San Jose Declaration] <http://www.alca-ftaa.org/English Version/costa-e.htm> (viewed 7/15/98). The San Jose Declaration has been compared to the 1986 Punta del Este Declaration that launched the GATT Uruguay Round negotiations in terms of breadth of the program proposed.
581. *Chronology of the FTAA Process* <http://alca-ftaa.org/ENGLISH VERSION/view_e.htm> (viewed 7/13/98).
582. San Jose Declaration, *supra* note 580, annex II.
583. *Id.* at para. 11.
584. *FTAA Negotiating Groups* <http://www.alca-ftaa.org/ENGLISH VERSION/ngserv_e.htm> (viewed 7/13/98).
585. *FTAA: Working Groups* <http://www.alca-ftaa.oas.org/ENGLISH VERSION/service.htm> (viewed 7/13/98).
586. FTA REPORT, *supra* note 575, at 6-7.
587. *Free Trade in the Western Hemisphere: Hearing Before the Subcomm. on Trade of the House Comm. on Ways and Means*, Mar. 31, 1998, 3/31/98 CONGTMY (statement of Robert Vastine, President of the Coalition of Service Industries (CSI) [hereinafter *CSI Testimony*]. The Forum was organized by the U.S. Coalition of Service Industries, the main lobbying group in the United States for service industries on trade issues, as a means for including private sector views in the negotiating process. In addition, CSI assisted in the formation of the Services Business Network of the Americas to provide private sector support for services liberalization.
588. *Services Forum Makes Recommendations on FTAA*, 14 INT'L TRADE REP., Oct. 22, 1997. In more specific terms, the Forum made the following recommendations regarding financial services: governments should liberalize capital accounts immediately and completely, eliminate currency exchange controls, eliminate restrictions on foreign investment, promote the delivery of ample financial information, facilitate registration processes for foreign mutual funds; and with respect to the

D. APEC.

The United States is also pursuing economic cooperation and trade and investment liberalization through the Asia-Pacific Economic Cooperation forum (APEC),[589] comprised of eighteen economies, which include many important Asian countries, as well as Canada, Chile, Mexico, and the United States.[590] The APEC leaders agreed at the 1994 Ministerial Summit in Bogor, Indonesia to open free trade and investment by 2010 for developed countries and by 2020 for developing countries.[591] The APEC Trade Ministers have met every year since 1989 to assess the progress being made in the region for achieving free and open trade and investment.[592] APEC is now working toward trade liberalization on a sector-by-sector basis.[593]

In January 1997, the APEC Group on Services (GOS), an informal group formed by the APEC Committee on Trade and Investment, met for the first time.[594] The focus of GOS is on (1) information gathering and analysis, (2) sharing of experiences, and (3) enhanced transparency. In addition, it supports individual Actions Plans, which are to be drafted by each country for liberalization of its service sectors.[595] As mandated by the Osaka Action Agenda (OAA), a Services Collective Action Plan was adopted by the GOS which states the collective action the APEC economies will take, the steps for implemen-

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insurance sector, provide national treatment and freedom of establishment, and promote a greater degree of liberalization in rendering cross-border insurance services, while protecting consumer rights. *CSI Testimony, supra* note 587. The Forum also recommended adoption of the following principles, among others: national treatment, nondiscrimination, reciprocity, transparency, elimination of double taxation and of double benefits (social security, health care, etc.), freedom of mobility of personnel, and freedom of establishment or non-establishment. The elimination of unnecessary customs procedures, nuisance tariffs, or tariff barriers and taxes was also requested. Requests were made for the harmonization of professional certification requirements and facilitation of work visas. *Id. See also* First Services Business Forum of the Americas, Santiago, Chile, October 1997, *Sectoral Commission Recommendations to the FTAA Services Working Group, Financial Services* <http://www.sice.oas.org/ftaa/costa/background/finrec1_e.stm> (viewed 7/15/98).

589. In addition to APEC, the United States is considering bilateral FTAs between the United States and the other APEC countries to work as a catalyst for increased market liberalization. However, no specific recommendations for FTA negotiations have been made. *Services: President Urged to Press APEC Leaders to Open Financial Services Markets to U.S.*, 14 INT'L TRADE REP. 932, May 28, 1997.

590. The APEC economies are: Australia, Brunei Darussalam, Canada, Chile, China, Hong Kong, Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Philippines, Singapore, Chinese Taipei, Thailand and the United States of America.

591. Asia-Pacific Economic Cooperation (APEC), Sixth Ministerial Meeting Joint Statement, Jakarta, Indonesia, Nov. 11-12, 1994, http://www.apecsec.org.sg/minismtg/mtgmin94.html (viewed 10/8/98).

592. *International Agreements: U.S. Convinces APEC to Support Sectoral Reforms, Trade Official Says*, 14 INT'L TRADE REP. 846, May 14, 1997 (statement of United States Trade Representative Charlene Barshefsky).

593. *Id.*

594. *APEC: Convenor Summary Report on Services* <http://www.apecsec.org.sg/cti/iva2-2.html> (viewed 7/13/98).

595. John E. Siegmund, *Services in the WTO: Recent Developments and Overview*, 119 BUS. AM. 12, Apr. 1, 1998. The United States has already drafted Individual Action Plans, but other countries are not releasing their plans for review yet.

tation and a time frame for the action.[596] The two primary objectives for the OAA Collective Action Plan in services are (a) progressively reducing restrictions on market access for trade in services and (b) progressively providing for MFN treatment and national treatment for trade in services, among other things.[597] In the future, the GOS plans to compile a list of national regulatory measures which affect, either positively or negatively, trade and investment in all service sectors.[598]

In financial services, APEC supported the successful conclusion of the WTO financial services negotiations.[599] APEC Finance Ministers also advocated sweeping reforms in the financial sector as a response to the Asian financial crisis.[600] Such crisis may have dampened liberalization efforts in the region.

VI. Conclusion: Has the United States Retreated from WTO Multilateralism and the MFN Principle?

As discussed in Part II, the U.S. efforts to liberalize financial services trade have highlighted certain new trends in U.S. trade policy, namely the role of interest groups and the rise of reciprocity and regionalism. Interest groups played a significant role during the NAFTA Chapter 14 and FSA negotiations. Their function of providing information about, and focusing attention on trade barriers was considered helpful by the U.S. Government. It may provide a good model for cooperation between private industry and government on trade issues. The importance of concrete market opening results to lobbying groups probably reinforced the U.S. tendency to focus on economic results and to seek reciprocal concessions in the negotiations.

The importance of the reciprocity issue was seen most vividly during the FSA negotiations when the United States conditioned its acceptance of the agreement on achieving a substantial level of commitments from key trading partners. The long negotiating history of the FSA outlined in Part III is testimony to the importance of this issue to the U.S. Regional trade agreements will continue to be pursued by the United States, as outlined in Part V.

Does the U.S. position evidenced during the FSA negotiations represent a turning away by the United States from its commitment to nondiscriminatory multilateral trade liberalization? The use by the United States of an exemption to MFN treatment to deal with the potential problem of free-riders certainly represents a retreat from a strong commitment to the traditional principles of the multilateral trading system. Some commentators would also see the U.S. pursuit of free trade on a regional level as a threat to the multilateral system.[601] Several comments are in order.

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596. SERVICES 1997 COLLECTIVE ACTION PLAN, <http://www.apec.sec.org.sg/cti/iva2 2.html> (viewed 7/13/98).

597. *Id.*

598. *Asia-Pacific Economic Cooperation (APEC), APEC Committees: Services* <http://www.apecsec.org.sg/committee/services.html> (viewed 7/13/98).

599. *Asia-Pacific Economic Cooperation, Ninth Ministerial Meeting Joint Statement, Vancouver, Canada, Nov. 21-22, 1997* <http://www.apecsec.org.sg/minismtg/mtgmin97.html> (viewed 10/8/98).

600. *Asia-Pacific Economic Cooperation, Draft Joint Ministerial Statement, Fifth APEC Finance Ministers Meeting, Konanaskis, Alberto, Canada, May 23-24, 1998.*

601. *See* Bhagwati, *supra* note 28.

First, the global distribution of political and economic power that existed under the old GATT regime is no longer the same today in the world of the WTO. In fact, U.S. economic welfare is tied today as it never was before to generating continued trade surpluses in the financial services and other services sectors, which partially offset the large trade deficits in the goods sectors. The U.S. position reflects modern economic reality and is more pragmatic than idealistic.

Second, perhaps the assumption that services trade can be liberalized in the same way and on the same model as goods trade is faulty. It fails to take account of the differences between the two sectors. Liberalization of financial services trade requires changes to national, legal, and regulatory structures and those changes are often very difficult for national governments to commit to make during trade negotiations. Therefore, the analogy to liberalization under GATT for trade in goods is flawed. Importing the structure of GATT and the negotiating request-offer mechanism wholesale into the realm of services may have been a mistake, but it was the only model available at the time. Indeed, the WTO may not even be the most appropriate forum for financial services talks due to the lack of expertise by experienced trade negotiators on financial services issues. However, it was (and remains) the only available forum that included all of the countries whose market access commitments the United States sought and whose Members would be legally bound by their commitments.

Certainly GATS is weaker than GATT in its commitment to nondiscriminatory principles but that is due to negotiating difficulties in the GATS that were not encountered when the GATT framework was developed. Indeed, the United States attempted to negotiate a framework of principles that included both most-favored-nation treatment and national treatment.[602] This approach would have made liberalization the baseline assumption and the maintenance of the status quo or back-pedaling the exception. Instead, through a negotiating compromise, national treatment, along with market access, were relegated to optional principles.

Third, economic theory and empirical studies are ambiguous on the conclusions to be drawn from the debate over whether regional or multilateral liberalization will result in greater gains. Even if regional efforts will not lead to the same broad gains as wholly successful multilateral liberalization would have, one could reasonably take the position, as the United States has done, that regional liberalization will surely lead to some gains. In any case, it has always been, and remains, the United States position that concessions negotiated on a bilateral and regional basis should ultimately be extended multilaterally to all WTO Members.[603]

The clear trend in U.S. policy is to favor a multilateral approach to further financial services liberalization. The U.S. financial services industry supports this view.[604] While

602. U.S. Proposal for GATS dated October 1989, reprinted in *Hearing Before the Subcomm. on Fin. Inst. Supervision, Regulation and Ins., Task Force on Internat'l Competitiveness of U.S. Fin. Inst. of the Comm. on Banking, Fin. and Urban Affairs*, H.R., 101st Cong., 2nd Sess., July 17, 1990, Serial No. 101-152.

603. An example is the U.S. request that the concessions by Japan in its bilateral agreements with the United States regarding insurance and other financial services be extended on a multilateral basis under the FSA.

604. Vastine Interview, *supra* note 557; Farmer Interview, *supra* note 410; Russell Interview, *supra* note 407.

liberalization on a bilateral and regional level will continue to be pursued by the United States, such initiatives will be viewed as complementary to the goal of broad-based liberalization through the WTO. There are a variety of reasons for this approach. The stated reason in most of the telephone interviews that the author conducted in connection with this article was that the WTO provided the most efficient mechanism for achieving liberalization due to its broad-based membership. If WTO Members continue to make liberalizing commitments under the FSA in future negotiating rounds and if additional countries like China, which represent large new markets for U.S. financial firms, are successful in becoming WTO Members, the gains for the United States could be very substantial. Another possible reason for this policy orientation is that, for the time being, the regional initiatives may have run their course. The current absence of fast-track negotiating authority and the widening global financial crises of recent months seem to have placed regional efforts by the United States on hold. As in the case of free trade in goods, which took almost fifty years of negotiations within the GATT forum to achieve, it can be expected that financial services trade liberalization will be accomplished only gradually and often in fits and starts. Chapter 14 of NAFTA and the FSA represent the beginning of the process of liberalizing trade in financial services.