

DOHA ROUND NEGOTIATIONS ON FINANCIAL SERVICES: RECENT DEVELOPMENTS

WTO and services

During the Uruguay Round launched in 1986 (the eighth in a series of multilateral trade negotiations under the auspices of GATT since 1947) the scope of global trade negotiations was broadened to include services as well as goods. The principal eventual outcome of the services negotiations was the General Agreement on Trade on Services (GATS), which was legally separate from the rules for goods trade but included within the overall framework of the World Trade Organisation (WTO). Parts I and II of the GATS consist of concepts, principles and rules applying to all trade in services. Parts III and IV provide a framework for the negotiation and subsequent modification of commitments regarding trade in services. Part V contains institutional provisions including those for the settlement and enforcement of disputes. Part VI deals with definitional issues and includes rules of origin for services designed to specify the circumstances in which benefits of the agreement can be denied to suppliers of non-member countries. There follows a series of Annexes, most of which concern particular sectors, including one for financial services that defines the activities included in such services and makes explicit reference to governments' right to take prudential measures. One Annex contains countries' schedules of negotiated commitments which are an integral part of the GATS. The 1994 Marrakesh agreement establishing the WTO also includes ministerial decisions related to the GATS and an Understanding on Commitments in Financial Services which provides an alternative framework to Part III of the GATS for negotiating commitments in accordance with a template specifying extensive liberalisation.

Two of the problems facing negotiators during the Uruguay Round were the absence of an agreed definition of "services" (as opposed to goods) and the lack of a means of determining the values of commitments to liberalisation in the form of market access and national (i.e. non-discriminatory) treatment for foreign suppliers. The solution chosen for the first problem was simply to select sectors and subsectors for the purpose of the negotiations - a solution which involved abandoning the search for a generic definition. The second problem was pushed to one side and negotiations were conducted with little reference to the values of activities covered by offers during the negotiations and the commitments in countries' schedules. Negotiators had access to information for this purpose concerning their own countries' service sectors and subsectors but not necessarily concerning those of other parties to the negotiations. At the time major developed countries did not consider deficiencies of statistical data a serious drawback. Indeed, there was a widespread conviction among policy makers in these countries that the changes required by the liberalisation of cross-border services transactions (such as increased deregulation and privatisation) would benefit not only the countries seeking improved market access but also those granting it, so that there was no conflict between the interests of their own services firms and the global interest. This was a view not widely shared among developing countries faced with the prospect of substantial losses in policy sovereignty in sectors of which some (such as finance, telecommunications, and environmental services) were infrastructural. At the same time, somewhat inconsistently and opportunistically, the same lack of data was also cited by developed countries during the Uruguay Round negotiations as a justification for insistence on reciprocity in the exchange of commitments on increased market access.

Only in 1994, the year of the conclusion of the Uruguay Round, was a Task Force set up consisting of representatives of the United Nations, OECD, the European Communities (EC), IMF, UNCTAD, and the WTO which in 2002 produced the *Manual on Statistics of International Trade in Services*. This publication surveyed the data available concerning trade in services and their limitations in the context of WTO negotiations. It also proposed guidelines for the extension of existing statistics and for the establishment of a new framework for foreign affiliate trade in services (FATS) statistics, which would cover services supplied through foreign affiliates abroad (and thus through Mode 3 of the GATS, i.e. commercial presence in the receiving country). Implementation of the *Manual's* guidelines was unavoidably going to take considerable time.

Thus as of the beginning of the Doha round in 2001 international statistics concerning key dimensions of the cross-border supply of services were still lacking. However, this summer the EC and some other countries submitted proposals for the benchmarking of countries' offers in the services negotiations on the basis of measures of liberalisation in terms of numbers of activities rather than their value with the objective of achieving greater liberalisation than that contained in countries' offers so far and of accelerating the negotiations. At the time of writing the rationale of these proposals in the context of negotiating positions remains unclear. One possibility is that they were submitted less in the expectation that they would be a major focus of the negotiations as such than that they would help to deflect pressures regarding reductions in agricultural protectionism on to other issues. Unsurprisingly developing countries have treated benchmarking and other modified variants put forward with a different nomenclature but the same thrust as proposals requiring a vigorous response in their own right. The widespread opposition from this quarter has its origins in concerns first manifested at the time of the launching of the Uruguay Round in the 1980s. These resulted from developing countries' fears as to the competitiveness of their domestic suppliers and as to the potential for intrusion of trade rules for services into sometimes areas of domestic policy. Developing countries' acceptance of services as part of the negotiations was conditional on a framework which accorded them flexibility regarding the negotiation of commitments – flexibility which was eventually incorporated in Article XIX of Part IV of the GATS.

What follows is a commentary on benchmarking together with a proposal for an alternative approach to assessing offers and commitments in WTO services negotiations. This was prepared as a background paper for negotiators, and a shorter version in two parts was published in Third World Network, *SUNS - South-North Development Monitor*, 9 and 12 December 2005.

PROPOSALS FOR BENCHMARKING OFFERS ON FINANCIAL SERVICES AND AN ALTERNATIVE

Contents of the benchmarking proposals

The proposals for benchmarking offers on services recently submitted by six countries and the EU during the current trade negotiations are intended to achieve similar objectives, although differing in detail. The stated concerns behind these proposals are the unsatisfactory character of many of the offers put forward so far and the inefficiency of the negotiating process involving multilateral requests and offers by all negotiating parties. Key features of the benchmarks are systems of evaluation or scoring. However, the techniques proposed are not based on a generally accepted approach to evaluating offers and are related to the number and not the value of the activities which would be affected by the limitations or undertakings specified. This note consists of critical commentary on the benchmarking proposals together with suggestions concerning an alternative approach to the assessment of offers and commitments in the negotiations on financial services other than insurance. Under this approach the focus of the assessment would be the value of business for different financial service activities. In view of the deficiencies of international statistics for this subject there would be recourse to the data contained in the financial statements of a country's firms undertaking these activities.

Key elements of the proposals are the following:

- *uniform classification of subsectors/activities.* For financial services this classification would be that of the Annex on Financial Services of the GATS (Annex)¹.
- *minimum new commitments.* There would be different minima for the four different modes of supply under the GATS, and the minima would also vary according to whether a country is classified as developed, developing or least developed.
- *a method for translating these commitments into operational targets.* The principal vehicle for this purpose is the number of activities/subsectors for which countries undertake commitments but the need to take account of the quality of commitments is also acknowledged.
- *credit for past commitments.*
- *recourse to plurilateral negotiations* to supplement the request-offer multilateral negotiations for a critical mass of countries prepared to undertake commitments in sectors or subsectors of particular interest to them.

The method of the benchmarking proposals for translating minimum new commitments into operational targets through counting numbers of activities poses questions concerning the relationship between limitations in countries' offers and commitments in the WTO and *the multiple functions of regulatory regimes for financial services.*

There are also other specific proposals intended to achieve the same objectives or to supplement in the six submissions. These proposals include the following: (1) specific quantitative targets for the minimum commitments for different modes of supply and different categories of country; (2) formulae in terms of which these targets are set and the limitations in countries' offers are assessed; (3) suggestions as to ways of dealing with the qualitative as opposed to quantitative dimension of limitations; (4) binding commitments at levels reflecting at least existing levels of market access and national treatment; (5) specification of economic needs tests in countries' offers including both criteria used for the tests and any discrimination

¹ For the relevant classification of the Annex see Appendix 1.

which they involve; and (6) delinking of commitments under Mode 4 (supply from one country through the presence of persons in the territory of another) from those under Mode 3 (supply from one country through commercial presence in the territory of another). The submission of Japan includes the following proposals referring specifically to financial services: (a) countries should make commitments in all subsectors; (b) commitments under Mode 1 (cross-border supply) and Mode 2 (supply in the territory of one country to the service consumer of another) should be made in accordance with the Understanding on Commitments in Financial Services (Understanding); (c) limitations on foreign equity participation under Mode 3 should be eliminated; (d) limitations on types of legal entity under Mode 3 should be eliminated; (e) limitations on total numbers of service suppliers should be eliminated; and (f) national treatment should be accorded to all foreign suppliers of services – presumably also under Mode 3, although this is not explicitly stated.

Uniform classification of activities/ subsectors

Uniformity of classification would be required as part of any system of benchmarking for offers. The actual practice as of the latest offers of major parties to the negotiations, the Quad, Brazil, and India, is worth examining to see how far it conforms to such uniformity.

Canada assigns activities from the classification of the Annex to 2 groups, one of which consists of activities usually undertaken by commercial banks or credit institutions and the other of activities also undertaken by investment banks and brokers. The limitations refer for the most part to categories of institution undertaking some or all of these activities rather than to the activities as such. The commitments in *Japan's* offer are undertaken in accordance with the Understanding whose classification of activities is that of the Annex. The commitments in the offer of *United States* are undertaken in accordance with the Understanding. However, the limitations in the country's schedule are not for the most part differentiated in accordance with the classification of the Annex. Most, including those at state level, are specified under a catch-all category, "all subsectors", and limitations typically refer to institutions classified by legal form, reflecting the importance of such forms in the country's regulations concerning market access and national treatment. The exception concerns limitations at Federal level for three activities involving trading in and participation in issues of securities.

The offer for the 25 countries of the *EC* is in two parts, one referring to 18 countries, including all the older member states and the other to 7 new member states. Although the commitments in the first part of the EC's offer are undertaken in accordance with the Understanding, limitations are not always differentiated in accordance with the classification of the Annex and there are frequent references to institutions classified by legal form. In the second part of the offer activities are mostly classified in accordance with the Annex with a limited number of exceptions and omissions. Here too the limitations also refer to institutions classified by legal form.

The offer of *Brazil* follows the classification of the Annex but breaks down some activities into constituent subsets treated separately in its regulatory regime. The country's procedures for the granting of market access and according national treatment emphasise case-by-case authorisation (presumably in practice authorisation accorded institution by institution). The offer of *India* distinguishes between the 9 sets of activities for the most part classified in accordance with the definitions in the Annex but also includes as a separate heading, "venture capital", which is not one of the activities of the Annex.

Minimum new commitments

The minimum commitments required under the benchmarking proposals would refer to all the service sectors covered by the negotiations and are expressed in terms of proportions of the total number of subsectors.² The minima presuppose uniform classification of sectors and subsectors since countries' offers otherwise could not be measured against benchmarks on a comparable basis. These proportions would vary amongst countries according to whether they are classified as developed, developing, or least developed with lower targets for the latter two categories. Since the minima refer to service subsectors as a whole, they do not imply a specific set of targets for financial services as such. Nevertheless, issues raised by these minima apply specifically to financial as well as other services.

- As many developing countries have already pointed out, the application of minima as benchmarks involves an interpretation of Article XIX of the GATS which does not command consensus among developing countries. Article XIX.2 refers to the need for "due respect for national policy objectives and the level of development" of countries. For this purpose "There shall be appropriate flexibility for individual developing country Members for opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access in line with their development situation".
- The general rationale of setting minimum commitments expressed in terms of numbers of subsectors or activities is questionable. If the objective of the negotiations is to achieve coverage of some target amount of trade in services, this target should arguably refer to values of business or transactions for subsectors or activities rather than to their numbers. Use of the latter for benchmarking would appear to be based on the view that they are an appropriate indicator of good behaviour in terms of willingness to undertake commitments to liberalization. But numbers of subsectors or activities will not necessarily be closely correlated with a measure of the value of services trade covered.
- *If the target of the negotiations were to be construed in terms of measures of the value of business covered, the case for minimum commitments for the great majority of developing countries would be weakened since the value of business involved is mostly small.* The request-offer approach in combination with the flexibility provided by Article XIX and the prudential safeguards of the Annex would appear to be more appropriate as a basis for negotiating the commitments of developing countries than the benchmarking proposals.

Regarding the specific proposals for the financial sector of *Japan* those which would eliminate restrictions on the equity participation of foreign suppliers and references in limitations to the types of legal entity involved would entail radical changes in the legal regimes of many countries, including developed ones, and would be almost certainly unacceptable in so stark a form.

Some of the proposals contained in submissions regarding benchmarking directed at services more generally may prove particularly contentious with regard to their application to financial services. This may be true, for example, of the importance attributed (by the *EC*) to the

² There are differences among the benchmarking proposals as to whether the targets refer to new commitments in the current round of negotiations - the target of the EC for which "the starting point for these commitments are Members' current schedules" - or levels of commitments undertaken in the previous as well as this round of negotiations - the apparent target of Japan for which targets should involve "articulating achieved levels of commitments, and not by specifying levels of improvements from the existing level". However, the credit for previous commitments proposed by the EC would lead to a convergence in practice of the two targets.

specification of tests of economic needs under limitations on market access since such tests are not currently included in the offers of at least some countries where they are none the less part of the regulatory framework.

The multiple functions of regulatory regimes for financial services.

The way in which the financial sector and its liberalisation are viewed is not an explicit part of the benchmarking proposals. But the implicit conceptualisation and assumptions underlying the proposals would not command general assent. This is especially evident in the assignment of negative scores or debits to each limitation for the purpose of benchmarking.

There is now widespread agreement that liberalisation of financial services through according increased market access to foreign suppliers is capable of bringing substantial benefits to an economy in the form of increased competition leading to improvements in the range and quality of services. But this is subject to important provisos concerning the regulatory framework, the availability locally of banking and supervisory skills, the strengths and weaknesses of existing domestic suppliers, and the nature of the means used by the government to influence credit allocation. Although most (if not all) countries - including those now classified as developed - have long histories of mistakes under different headings covered by this overall statement, there are no generally accepted principles for many of the issues regarding which policy choices are possible, including the desirable scale of the presence of foreign firms. The benchmarking proposals appear to be based on the view that even limitations which countries may consider integral parts of the regulatory framework for their financial sectors should be accorded negative scores or debits in the current services negotiations.

Some examples illustrate problems to which this view can lead.

- As ready noted, several offers contain limitations referring to the legal or institutional form of institutions. Restrictions which are the basis of these limitations have diverse historical origins and often reflect the performance of particular functions within a country's financial system. In some cases these restrictions reflect regulatory priorities: a country may grant market access to subsidiaries rather than branches owing to a preference for supervising entities which have been locally incorporated. The restrictions may also involve monopolistic privileges but often privileges justified by policy trade-offs - the privileges, for example, which are the quid pro quo for the acceptance regulatory restrictions.³ This suggests that there is no generalised justification for assigning negative scores or debits to limitations referring to legal or institutional form as such.⁴
- Limitations may also reflect societal differences as to key features of financial institutions and operations. One example of such differences is Islamic banking. Until now the reconciliation of such banking's practices with frameworks for multilateral agreement appears to have been addressed mainly in the context of prudential regulation (for. example, as part of the implementation of Basel II) and not in that of WTO negotiations. But this may change with the extension of WTO's membership. It would be anomalous if limitations reflecting such practices were to be accorded

³ A classic example of such a trade-off has often involved the granting to commercial banks of a monopoly in the supply of certain services.

⁴ Interestingly new regulations restricting the conditions under which banks can operate as branches as opposed to locally incorporated subsidiaries have recently been under consideration in at least one major developed country. See D.Ibison, "Japan deals blow to overseas banks", *Financial Times*, 30 June 2005.

negative scores or debits in WTO negotiations simply because they are not part of the dominant banking model in non-Islamic countries.

- There are potential clashes between the approach of the benchmarking proposals and limitations regarding prudential regulation in countries' offers. To take one example, discriminatory capital requirements for the branches of foreign banks have long been features of some countries' regulatory systems. Another example is the inclusion by some countries (such as Japan and Republic of Korea) of major features of their regimes of prudential regulation in the horizontal limitations of their offers. It may be argued that such inclusion is not required by the list of restrictions on market access in Article XVI of the GATS and is anyway unnecessary thanks to the "carve-out" for prudential measures in paragraph 2(a) of the Annex. That countries have none the less included features of their prudential regimes amongst their limitations suggests unwillingness to depend on the "carve-out" at least until its scope of has been tested in the case law of the GATS.
- The question of the appropriateness of including prudential measures points to the more general issue of what regulatory restrictions should be included in offers as limitations. If numbers of limitations are to be used as the basis for evaluating the level of countries' commitments in the negotiations, then agreement as which limitations should count for this purpose assumes aspecial importance. One approach here would be to follow the WTO's scheduling guidelines.⁵ In this case only measures belonging under headings (a)-(f) of Article XVI of the GATS would be included under limitations on market access which count for this purpose. Under such an approach horizontal limitations concerning prudential measures would not be scored as limitations in the evaluation of commitments.

Credit for past commitments

In the benchmarking proposals credit for past commitments would be assessed on the basis of the same methods used for measuring minimum commitments. Such credit would thus be open to the same methodological criticism. The proposal also raises a more general question. Countries which in past negotiations had taken advantage of flexibility as to what should be included in their schedules of commitments would be penalised by new rules which did not exist at the time when they exercised this option.

Recourse to plurilateral negotiations

Provision is made in Article XIX.4 of the GATS for recourse to plurilateral negotiations (i.e. negotiations between a group of member countries as opposed to those involving the whole WTO membership). Such recourse is included in the benchmarking proposals as a method of generating improved offers within groups of like-minded countries in the services negotiations. The main problems associated with plurilateral negotiations are not specific to financial services and involve such issues as the application of the MFN principle to benefits under agreements reached through this route and the avoidance of their use as a vehicle for bringing pressure on countries not participating to accept obligations linked to the agreements. Developments subsequent to the submission of the benchmarking proposals indicate that one of their objectives is precisely the potential of plurilateral negotiations for exercising such pressure.

⁵ See WTO, "Guidelines for the scheduling of specific commitments under the General Agreement on Trade in Services (GATS)", S/L/92, 28 March 2001, Part 1.

However, recent developments outside the WTO involving the financial sector raise the question of whether negotiations designed to accelerate WTO commitments for financial services are currently necessary or appropriate. Relevant developments under this heading include the following.

- Since the mid-1990s there have been substantial increases in the market access accorded to foreign banks in several countries and regions. In the transition economies of Eastern Europe these increases, which were typically linked to reductions or elimination of state ownership and control of the banks, in some cases have led to a dominating commercial presence for foreign banks. Similar increases in response to post-crisis reforms have also taken place in other emerging-market countries such as Mexico.
- During recent years there have also been initiatives covering several aspects of the regulation and infrastructure of the financial sector to achieve increased harmonisation of standards. These initiatives are within the overall framework of the key financial codes and standards promoted under the auspices of the Financial Stability Forum, and include revised standards for banks' capital (Basel II). The initiatives do not concern market access or national treatment for foreign banks as such. However, the enhanced supervisory cooperation and the greater regulatory certainty which can be expected to be one of their outcomes are likely eventually to have significant effects on market access and perhaps also on national treatment. The initiatives are already resulting in formidable additional demands on most countries' regulatory capacity and will continue to do so in the immediate future.
- The rules of the single EU financial market have already had substantial effects on the functioning of the financial markets of member countries, and their further development and extension to the new member countries can be expected to intensify this process.

Such developments indicate the scale of recent increases in the pace and extent of current financial liberalisation in a large number of countries and of the accompanying policy changes. The appropriate challenge here during the next few years may well be to digest these developments and to verify the adequacy of the policy responses in the light of experience rather than push for substantial new liberalisation through WTO negotiations.⁶

Alternative approach to valuation of offers and commitments

The method of translating the commitments for services offers of the benchmarking proposals into operational targets described earlier requires agreement on an appropriate way of measuring countries' commitments or limitations. As already mentioned, the benchmarking proposals would rely for this purpose principally on numbers of limitations for different

⁶ The Institute of International Finance (IIF), which represents the banking sector, recently made a plea for a "regulatory pause" or "change freeze" to facilitate banks' digestion of the adjustments due to such developments as Basel II, accounting and auditing changes, Sarbanes-Oxley (the comprehensive new United States law concerning corporate governance with extensive implications for major foreign as well as United States firms), and the Financial Services Action Plan of the EU. In the words of the IIF, "The fallout of these changes is not confined to particular jurisdictions, implementation is not simple, and not all effects and interactions are yet known. Neither the new Accord [Basel II] nor the other revolutionary changes banks face can be fully implemented or responsibly evaluated without a substantial period...during which developments can be embedded and allowed to run in a real environment for some time." Institute of International Finance, Inc. Steering Committee on Regulatory Capital, *The Implementation of Basel II*, 14 November 2005.

subsectors and activities. Only limited account in the proposals is taken of the qualitative as well as the quantitative dimension of limitations.

The principal advantage claimed for these methods is increased transparency regarding the distribution and concentration of countries' commitments among the activities in the classifications used for the different sectors. There is no claim that the procedures give lesser or greater weight to restrictions according to their relative importance in services trade. As already mentioned, this appears to indicate that in the benchmarking proposals importance is attributed more to willingness to undertake commitments than to the value of trade or business covered by commitments. However, alternative approaches to assessing offers in financial services are possible, and the rest of this article takes up one such alternative. This suggestion is not simply a possible alternative in the context of the debate on benchmarking but might also serve as part of the basis for assessing offers in negotiations conducted in accordance with the rules originally envisaged before the submission of the benchmarking proposals.

In WTO negotiations on trade in goods there are frequent references to the value of trade in different categories of goods when the effects of tariffs, subsidies and other measures affecting exports and imports are being considered. Value figures are used not only as approximate indicators of amounts of business at stake but also as inputs into models or simpler techniques of analysis of the effects of tariff reduction, the removal of other impediments to trade, and other forms of liberalisation. No such prominence has been attributed to the value of business involved in the case of trade in services. In the case of financial services an importance reason for this is the absence of the trade or balance-of-payments statistics for most of the transactions which are the subject of the negotiations. However, closer examination of the statistical deficiencies for financial services suggests that information pertinent to valuing offers or commitments is available, though much of it in sources and forms not traditionally used for this purpose. In particular this is true of measures of the value of business covered by the activities of the classification of the Annex for Mode 3, liberalisation of which has been the principal target of the negotiations.

In comparison with goods trade valuation for trade in services is complicated by the existence of the four different modes of delivery. Transactions under Mode 2 (supply in one country to the service consumer of another) do not correspond to any item in balance-of-payments or national-income statistics. However, for financial services this deficiency is not of major importance for most countries since the value of the transactions involved is unlikely to be large in comparison with those covered by Modes 1 (cross-border supply) and 3 (supply from one country through commercial presence in another). The receipts accruing to a country due to the income of persons covered by Mode 4 (through the presence of natural persons of one country in the territory of another country) will be included in statistics for current transfers in the current account of the balance of payments under the headings of *compensation of employees* and *workers' remittances*.⁷ But receipts associated with the supply of financial services cannot be distinguished separately owing to the absence of the required level of

⁷ "Compensation of employees" consists of wages, salaries, and other benefits earned by individuals in economies other than those in which they are residents for work performed for residents of those economies. "Workers' remittances" are those of migrants employed in their new economies and considered residents there (i.e. persons who stay or are expected to stay in these economies for a year or more). The distinction between these two categories can be difficult to apply in practice. See IMF, *Balance of Payments Manual* (fifth edition) (Washington, D.C.: IMF, 1993), paras. 269, 272 and 302.

disaggregation. In quantitative terms the sums involved for financial services are here too probably not especially large for most countries.

Payments due to cross-border trade in financial services (Mode 1) are part of Other Services in IMF balance-of payments statistics. The activities covered under this heading are financial intermediary and auxiliary services (except those of insurance enterprises and pension funds), and the payments and transfers between residents and non-residents in the statistics are intermediary service fees and commissions and other fees related to transactions in securities. The statistics for such payments and transfers can be considered as analogous to those for trade in goods and provide an indication of total cross-border income flows. But they are at a high degree of aggregation and thus cannot be used for analysis of transactions under Mode 1 in accordance with the classification of financial services other than insurance ((v) – (xvi)) of the Annex.

For Mode 3 (by the supplier of one country through commercial presence in the territory of another country) a role analogous to that of import statistics in negotiations on goods trade is sometimes suggested for sectoral statistics for FDI in services. But such statistics are subject to several drawbacks for this purpose. In particular there is a lack of data concerning connections between reductions in Mode 3 limitations and FDI flows as well as of generally accepted techniques for identifying such connections.

Eventually the gap in statistics for Mode 3 may be filled to a significant extent by the statistics proposed for foreign affiliates trade in services (FATS) by United Nations bodies, the EC, the IMF, the OECD, and the WTO.⁸ These statistics are intended to measure the economic importance of the commercial presence of services suppliers in foreign market markets. FATS statistics are to cover a broad range of economic indicators which will include for different countries some or all of the following: sales, employment, value added, exports and imports, number of enterprises, assets, net worth, operating surplus, capital formation, income taxes, expenditure on research and development, and compensation of employees. But the production of FATS statistics is a project which will require several years to come to fruition, and thus cannot have an impact on the current negotiations.⁹

A more promising alternative approach to valuation involving information already available could be through the financial reports of banks and other financial firms. As noted in the section on uniform classification of subsectors/activities, restrictions on market access and national treatment in many countries' regulatory regimes refer to categories of financial firms, which are the institutions whose activities are the subject of such reports. Perhaps even more importantly the form in which the reports present information provides links to the activity classification of the Annex.

The income statements of commercial banks provide data on net interest income (interest income minus interest expense), fees and commissions, trading income and investment income. The notes to the income statements may provide further detail, for example, breaking

⁸ These proposals are set out in *Manual on Statistics of International Trade in Services* (ST/ESA/STAT/SER.M/86) published jointly by the United Nations, the EC, the IMF, the OECD, UNCTAD, and the WTO.

⁹ "The aim of the *Manual* is to provide a coherent conceptual framework within which countries can structure the statistics they collect and disseminate on international services trade. It recommends a number of core and additional data items to be implemented *over time* (my italics), and in so doing recognizes the constraints under which statistical compilers operate and the need not to burden data providers unduly." (*Manual*, p.1)

down trading income into such categories as foreign exchange, interest-rate derivatives, debt securities, and equities. Net interest income is income from activities covered by (v) (acceptance of deposits and repayable funds), (vi) (lending) and (vii) (financial leasing) of the Annex. Fees and commissions include (without necessarily being coextensive with) income from (viii) (payment and money transmission services), (ix) (guarantees and commitments), (xi) (participation in securities issues), (xii) (money broking), (xiii) (asset management), (xiv) (settlement and clearance) and (xvi) (advisory, intermediation other auxiliary services). Trading income is earned from trading the instruments and securities classified under (x) (trading).

The income statements of investment banks and brokers cover sources of income classified under similar headings but sources whose relative importance differs from that for commercial banks. For example, trading income, investment banking fees and income from asset management are of greater relative importance for investment banks and brokers than for commercial banks. However, the distinction is not necessarily evident in the financial statements of large international banks which typically participate on a substantial scale in activities classified as belonging to both commercial and investment banking.

Categories of income in the income statements of commercial banks and of investment banks and brokers thus do not correspond exactly to the activities in the classification of the Annex. Moreover the quality of firms' financial reports still varies considerably among countries, although widespread improvements are taking place. This variation in quality will compromise or nullify their usefulness as a source of data on the value of business for different financial activities in some countries. However, the classification of income in financial statements provide for financial firms in many countries (including most with substantial financial sectors) is a source of information which can be used for approximate estimates of the order of magnitude of the value of business that many of these activities involve. The argument for recourse to this source is based on the absence of a better alternative in the present state of development of international statistics and on the unsatisfactory character of methods for assessing countries offers on financial services currently put forward in the benchmarking proposals and likely to be part of future proposals with alternative nomenclature but the same objectives.

To get a better idea of the value of the activities of such firms it may be possible to supplement the accounting information just described with information on turnover in the markets in which they trade since a significant part of their revenues is related to this indicator. In Appendix 2 there is more detailed discussion of ways in which accounting information and data on trading in markets for financial instruments can be used to assess the values of business under the activity headings of the Annex.

Appendix 1. Classification Banking and financial services other than insurance in the Annex on Financial Services of the GATS

- (v) Acceptance of deposits and other repayable funds from the public
- (vi) Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transactions
- (vii) Financial leasing
- (viii) Payment and money transmission services, including credit, charge and debit cards, travellers cheques, and bankers drafts
- (ix) Guarantees and commitments
- (x) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:
 - (A) money market instruments (including cheques, bills, certificates of deposit);
 - (B) foreign exchange;
 - (C) derivative products including, but not limited to, futures and options;
 - (D) exchange-rate and interest-rate instruments including such products as swaps and forward rate agreements;
 - (E) transferable securities;
 - (F) other negotiable instruments and financial assets, including bullion;
- (xi) Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues
- (xii) Money broking
- (xiii) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, and custodial, depository and trust services
- (xiv) Settlement and clearance services for financial assets, including securities, derivative products, and other negotiable instruments
- (xv) Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services
- (xvi) Advisory, intermediation and other auxiliary financial services on all activities listed in (v) through (xv), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy

Appendix 2. Data pertinent to the valuation of activities in the Annex on Financial Services of the GATS

Income statements of banks and other financial firms generally provide the following breakdown of income from different sources.

- *Net interest income.* This is interest income minus interest expense. *Interest income* consists of interest earned on loans and advances, on investments in debt securities, and from banks' leasing. Loans and advances correspond to activity (vi) of the Annex. Leasing is activity (vii) but interest income from this source is not usually shown as a separate item in banks' income statements, although it may be included in segment reporting.¹⁰ Interest on securities investment would presumably not be included in interest income due to the activities classified in the Annex because for a foreign bank such income is generated by cross-border portfolio investment (not so classified) rather than by the supply of financial services. Separate information about such income is usually available in firms' financial reports so that it can be deducted from other interest income. *Interest expense* is interest on borrowings in the form of deposits, interbank borrowing, and short- and long-term debt securities, whose relative importance amongst banks' liabilities can be verified from their balance sheets. Much of this borrowing corresponds to activity (v) of the Annex whose definition ("acceptance of deposits and other repayable funds from the public") none the less leaves unclear whether it also covers borrowing from banks.
- *Trading income.* This is profits resulting from trading in foreign exchange, debt securities, equities and derivatives not included under these headings, and corresponds to income from activity (x) of the Annex.
- *Net income from fees and commissions.* This is the difference between receipts and payments due to fees and commissions. Sources of fees and commissions include the following: (1) issuance and confirmation of letters of credit (included in activity (ix) of the Annex); (2) underwriting (included in activity (xi)); (3) securities brokerage (which covers operations included in activities (xii), (xiii), (xiv) and possibly (x)); (3) custodial services for securities (included in activity (xiii)); (4) fund management (included in activity (xiii)); (5) advice related to mergers and acquisitions (included in activity (xvi)); (6) loan syndication (presumably included in activity (vi)); (7) issuance of guarantees, standby letters of credit, and performance bonds (included in activity (ix)); (8) rental of safe deposit boxes; (9) trustee services (included in activity (xiii)); (10) cheque clearing (included in activity (viii)); and (11) provision of ATMs (included in activity (viii)).
- *Investment income.* This comprises dividend income, rental income from properties, and under some conventions for financial reporting some or all interest income on debt securities. For a foreign bank these items correspond mainly to income from cross-border portfolio investment, and presumably for this reason investment generating such income is not included in the activity classification of the Annex.

This discussion of items from the income statements of banks and other financial firms' financial reports shows that much of the information which they contain corresponds to income from activities in the Annex. The correspondence is far from perfect. For example, activities specified in the classification of the Annex such as leasing and several of those under fees and commissions are not necessarily itemised as sources of income in banks'

¹⁰ More detail will be available in the financial reports of firms specialising in leasing – principally independent specialists in this form of financing and captive subsidiaries of firms manufacturing capital goods.

income statements. Moreover use of the classification of activities in the Annex for the purpose of estimating the income associated with commitments to market access and national treatment may lead to distinctions which some may find arbitrary. This may be true, for example, of the exclusion of all interest income from investment in debt securities but the inclusion of trading income and income from lending activities.¹¹ Nevertheless, the data in banks' income statements are capable of furnishing orders of magnitude for the value of business at stake in WTO negotiations for major subsectors of financial services.

Trading activity. Part of the income from participation by investment banking and securities firms and certain other specialist firms in the trading of various financial instruments or contracts can also sometimes be inferred from turnover figures through their multiplication by percentage spreads (i.e. the percentage difference between the prices at which instruments or contracts are bought and sold) and percentage commissions on transactions. However, the resulting income estimates are generally only approximate since spreads may differ for different investors, larger investors, for example, benefitting from less than standard rates.

Turnover figures are available for organised exchanges for stocks, debt securities, and derivatives.¹² However, they are much less generally available for trading in over-the-counter, customised (OTC) contracts in a form which makes possible their assignment to a location or jurisdiction and thus usable as part of assessment of countries' offers in the WTO. A major exception here is trading in foreign exchange for which locational figures for turnover are provided in the periodic surveys carried out by the Bank for International Settlements (BIS). Such trading is concentrated in a small number of mainly developed countries.

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¹¹ An alternative measure of part of firms' income from trading activities, which excludes gains and losses, may be estimable from data on turnover on exchanges, as explained below.

¹² The great majority of countries have their own stock exchanges, though the number of stocks listed and the turnover for many of those in developing countries are small. In 1998 there were 65 futures and options exchanges of which 11 were in emerging financial markets. See N.Battley (ed.), *The World's Futures and Options Markets* (Chichester, etc: John Wiley and Sons, 2000).