CHAPTER TEN

RECONCILING LIBERALIZED TRADE IN FINANCIAL SERVICES AND DOMESTIC REGULATION*

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ABSTRACT

The paper addresses potential conflicts that stem from different regulatory concepts and policies applied to financial services, on the one hand, by the World Trade Organization (WTO) and, on the other, by national regulators, especially in the field of prudential business requirements. It analyzes the “prudential carve-out” provided by paragraph 2 of the Annex on Financial Services to the GATS and suggests methods and solutions for defining its content.

INTRODUCTION

Given the different regulatory approaches and policies of the World Trade Organization (WTO) and International Financial Institutions (IFIs), potential tensions may arise, which may also affect the national regulator.1

In the WTO context, the relationship between trade liberalization and domestic regulation is addressed by Article VI:4 GATS setting out the principles which are further specified for the financial sector in paragraph 2 of

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1 This paper relates to a research project on “Trade and Finance—The Regulatory Impact of Liberalized Financial Services” sponsored by the Swiss National Research Foundation and co-led by the authors. The research team—apart from the authors—consisted of Dr. Kern Alexander, Dr. Marion Panizzon (until 31 May 2005), Laura Paez, M.I.L.E. and Xenia Roduner, LLM.
the Annex on Financial Services, the so-called prudential carve-out. While it is undisputed that as the more specific rule, paragraph 2 of the Annex prevails over Article VI:4 GATS, its concrete content is unclear.

Some authors have argued that this provision would be overly broad and need to be interpreted strictly, others have suggested an interpretation along the lines of the Appellate Body’s jurisprudence under Article XX GATT meaning that, in order to fall under the prudential carve-out, the domestic measures would need to be reasonably related to the regulatory goal and must not be intended to evade other GATS obligations.

This paper applies a different approach: First, the prudential carve-out will be embedded into the broader framework of banking supervision as it has been established by International Financial Institutions such as among others the Bank for International Settlements (BIS) and the International Monetary Fund (IMF). An overarching analysis is not only justified, but even necessary since—which will be outlined in the paper also—domestic prudential regulation to a large extent is being influenced and formed by this international framework.

Given this foundation in international law, the paper will, in a second part, analyze the available range of domestic policy objectives by reviewing relevant WTO jurisprudence, especially the decision in US-Gambling, being the first decision applying the concept of public morals not only in the context of the GATS but WTO law as such.

A third section will then focus on the conceptual issues and address three key questions:

1. The tension between Article VI:4 GATS which allows for domestic regulation and Article XVI GATS which prohibits the establishment of market access restrictions will be analyzed in the light of US-Gambling.

2. Given the fact that other international organizations establish standards for prudential business requirements, to what extent should the WTO defer to these standards when interpreting the content of the prudential carve-out provision? The paper suggests that in the light of coherence internationally agreed standards should be applied by the WTO; this argument will be supported by reference to WTO jurisprudence.

3. What is the relationship between the prudential carve-out and the public morals exception in Article XIV (a) GATS? The paper argues that since the two kinds of restrictions of liberalized trade address different...