

CARIFORUM-EU EPA: THE LIBERALISATION OF FINANCIAL SERVICES AND IMPLICATIONS OF THE FINANCIAL CRISIS

Sheila Sabune*

World Trade Organisation

Cariforum**-EU EPA: The Liberalisation of Financial Services and Implications of the Financial Crisis

1. Introduction

As the champions of free trade resort to protectionist and other trade distorting measures, including government bailouts of companies in trouble, attention is once again drawn to the controversial signing of the Economic Partnership Agreement (EPA) between the CARIFORUM states and the European Union which is requiring liberalization of various sectors including sensitive ones like financial services. The financial crisis has shown how greed, recklessness and slack lending standards led to the collapse of prominent banks, resulting in the collapse of global stock markets, the shrinking of world trade, the loss of many people's life savings, the plummeting of demand, increased unemployment and a decrease in production as factories shut down. The financial times reported that the US economy lost more than half a million jobs in January for the third month running.

This brief examines the chain of events that led to the financial crisis and looks at the financial services chapter of the CARIFORUM - EU EPA pointing out problematic provisions in the context of the global financial crisis and the ability of countries to retain a financial sector that contributes to economic development.

2. The Overall Economic Context Related to the Financial Crisis

2.1 The subprime mortgage issue

Subprime lending involves financial institutions providing credit to borrowers who have a heightened perceived risk of default, such as those who have a history of loan delinquency, those with a recorded bankruptcy, or those with limited debt experience and encompasses a variety of credit types, including mortgages, auto loans, and credit cards. The term "subprime" under mortgage lending in the U.S, is applied to non conforming loans, defined as those

that do not meet the guidelines of the two government-backed mortgage institutions namely: Federal National Mortgage Association (**Fannie Mae**) or The Federal Home Loan Mortgage Corporation (**Freddie Mac**), using the criteria aforementioned.

However, in 2006 the *Wall Street Journal* reported that 61% of all borrowers receiving subprime loans were eligible to qualify for prime conventional loans, alleging that some lenders engaged in unorthodox lending practices such as deliberately targeting borrowers who may not have fully understood the terms of their loan, or lending to people who were never likely to afford the interest payments in the long-run. Many of these loans included exorbitant fees and hidden terms and conditions, and they frequently led to default, seizure of collateral, and foreclosure. In other situations, borrowers eligible to buy a house at the beginning when the variable interest rate was low, later failed to pay the required down payment, in the stipulated timeframe, as a result of dishonest/greedy bankers wanting to make higher returns through raising the variable interest rate. This also led to pre-mature default, seizure of collateral and foreclosure.

3. The Financial Services Chapter Of The Cariforum -EU EPA

For the Signatory CARIFORUM States, notwithstanding the initial request by the EC, the financial services sector was one of the few sectors where there was limited liberalization since it was deemed sensitive. The sectors liberalized reflect the de facto position or are sectors chosen by government to be in need of further investment. In this regard it can also be noted that with the exception of Belize all other CARIFORUM States have made GATS commitments/offers in this sector, therefore in the EPA to meet the demand of the EC, Belize scheduled a commitment in actuarial services.

Since the CARIFORUM states used the GATS format for scheduling commitments under the EPA, it is important to first understand what financial services are and the key provisions that govern them.

* The author is currently with the WTO Development Division. She was Programme Officer for services and dispute settlement at the International Centre for Trade and Sustainable Development (ICTSD) at the time the paper was commissioned by Oxfam International.

** CARIFORUM comprises the 14 independent states of Caribbean Community (CARICOM), the Dominican Republic and Cuba negotiating the Economic Partnership Agreement (EPA) on behalf of the region with the European Community.

4. Financial Services In The GATS Context

The GATS Annex on Financial Services defines Financial Services as "...any service of a financial nature offered by a financial service supplier of a Member," with the exclusion of state-owned or state controlled entities. Examples of Financial Services include banking, insurance and insurance related services, advisory services providing financial information, asset management, brokerages, to mention but a few.

Under the GATS, trade in Financial Services is governed by the obligations of Transparency, the MFN principle the Annexes on financial services (which by annexure to the GATS, are integral parts thereof and as laid out in the Articles on Market Access and National Treatment.

Liberalisation under the GATS is determined by the scope of sector specific commitments scheduled by each individual Member on the basis of provisions on Market Access and National Treatment, subject to limitations scheduled. It is important to note however that many developing countries have situations where de facto market access is more liberal than what they have bound under the GATS (which gives them room to retain policy measures that may not be consistent with the core rules mentioned here below especially as they relate to specific commitments. It is also worth noting that the recently signed CARIFORUM - EU EPA also imposes GATS PLUS obligations-which creates obligations over and above those in the GATS.

5. Core Rules, Regulation And Sector Specific Commitments of the Financial Services Chapter of Cariforum – EU EPA

The core rules of the Agreement include the Market Access (MA), National Treatment (NT) and Most Favored Nation (MFN) principles. The principle of MA requires the parties to accord to each other treatment no less favorable than that provided for in their schedule of specific commitments. In addition, similar to the GATS, it also sets out measures which either party shall not maintain or adopt unless specified in their schedules.

In accordance with Article 68 and 77 of the EPA, the Parties are required to grant National Treatment in sectors where Market Access has been scheduled. This is subject to the conditions and qualifications set out in the schedule. Therefore in all sectors scheduled, unless the Parties have regulations which discriminate in favor of their nationals and have inscribed them in its schedule, they will have to give the same treatment to non-nationals. On reading of the schedule one can see that in many cases the Signatory CARIFORUM States scheduled UNBOUND to give them the flexibility to continue to regulate the activities under the financial services sector. However, the vagueness of the term "like" within the definition of Na-

tional Treatment in Article 68 can create confusion in practice as it is unclear what level of similarity the Article contemplates – for example,. It is not clear if even micro finance institutions would be treated as 'like' banks for purposes of this article, even though they provide different services but are also majorly involved in the practice of lending money to consumers. This would widen the scope to unknown proportions.

As it pertains to the MFN principle in the EPA, the EC is to provide no less favorable treatment to the Signatory CARIFORUM States than they accord to any third country that they conclude an economic integration agreement with. The Signatory CARIFORUM States too are to provide no less favorable treatment to the EC than they may accord to any major trading economy that they conclude an economic integration agreement with. This has strong implications for potential south south trade in services as many major developing countries would be included in the mentioned thresholds.

In Chapter 5 of the EPA, which addresses the issue of regulatory framework, there are requirements similar to the GATS obliging the Parties to establish enquiry points to respond to requests on information and measures which pertain to or affect the Agreement. Also, Article 87 of this section states that where authorization is required, the competent authorities shall within a reasonable time after the submission of a complete application, inform the applicant of the decision concerning the application. This will no doubt introduce a human resource burden on the Signatory CARIFORUM States, and to Africa and Pacific if they sign on to similar Agreements and so the need for technical and financial assistance to alleviate this burden is urgent.

Specific to the regulatory framework on financial services, section 5 of the EPA goes beyond the GATS by adding provisions on effective and transparent regulations, new financial services, data processing and specific exceptions. Article 105 of the EPA, calls for effective and transparent regulation, requiring Parties to endeavor to provide in advance to all interested persons any measure of general application. In addition the Parties shall also endeavor to implement and apply internationally agreed standards for the regulation and supervision of financial services. As Sauvé and Ward put it, the provision stays a best endeavor clause 'only as CARIFORUM countries perceived it as an attempt to regulate their financial services industry through the backdoor by making them comply with OECD country standards in this area. This issue remains a sensitive one in the region owing to past tensions between some CARIFORUM states and the OECD over matters of tax policy, offshore financial market regulation and money laundering". Africa and Pacific negotiations can draw on this to ensure that the regulatory requirements that they are not in a position to adopt remain best endeavor language, giving them the regulatory space that will be

needed to develop their own required regulations.

The EC was the demander for further liberalization in Financial Services, particularly in new products hence the inclusion in the text of New Financial Services. Their level of liberalization though is inconsistent with their requests as new products such as futures and derivatives essentially require a Mode 1 commitment and all EC Member States have scheduled UNBOUND. Unlike the CARIFORUM States, the EC have an obligation to the implementation and application of the OECD regulations and therefore may have scheduled such limitations in Market Access to avoid having to grant automatic National Treatment requirements. It must also be noted that in accordance with Article 107 of the EPA, Parties are required on adoption of adequate safeguards measures to permit financial service supplies to transfer information for data processing where required. This must be taken considering that there is, like the GATS, a prudential carve-out, which allows the Parties to maintain regulations for prudential reasons and not to disclose any confidential or proprietary information in the possession of public entities.

For CARIFORUM only 7 Signatory States scheduled commitments in life, accident and health insurance services, and services auxiliary to insurance, with limitations of UNBOUND for Modes 1 and 2 in three (3) States and NONE in the other four (4). Similarly for Mode 3, there are three (3) Signatory States with no limitations and four (4) with limitations. Similar to all other CARIFORUM scheduling for most of its commitments, Mode 4 is UNBOUND except for key personnel and graduate trainees. The other areas under insurance services where there are commitments are actuarial and consultancy services.

Under banking and other financial services activities, with the exception of money broking service, Signatory CARIFORUM States have made commitments. In regard to non-life insurance services, there are seven (7) Signatory States with commitments. For Mode 1 there are four (4) Signatory States with UNBOUND and three (3) have no limitations. For Mode 2 there are (3) Signatory States with UNBOUND and four (4) with no limitations. With the exception of Dominica where it is UNBOUND and NONE from 1st January, 2018 and Jamaica where there is a regulatory requirement, Mode 3 is open. Mode 4 is as stated above in the discussion on life insurance services. The activity of Reinsurance and Retrocession is where all Signatory States, with the exception of Belize, have commitments. In this regard it must be noted that all other Signatory CARIFORUM States with the exception of Guyana and St. Kitts & Nevis have commitments/offers in this activity under the GATS.

An examination of the EC commitments in the financial services sector shows that the markets of the EC also still remain fairly closed. For Mode 1 in Insurance and

Insurance related services, with the exception of Estonia, all other EC Member States have scheduled limitations. In Mode 2, twenty-four Member States have also scheduled limitations. As it pertains to Mode 3 while there are only (12) Member States with specific limitations in Insurance and Banking services, there is an EC wide limitation for Banking and Other Financial Services. In Mode 4 only Key Personnel are allowed with limitations in only 5 Member States. In particular, when one considers the limitation on residency and nationality which requires that persons participating in these activities must either be a resident or national of an EC Member State, the lack of access is blatant. This must be considered in light of the fact that in accordance with Article 60 on objective, scope and coverage it is clearly stated that the Agreement does not apply to measures regarding citizenship, residency or employment on a permanent basis. It is therefore to the discretion of the Member states to allow access on these terms.

6. Policy Actions Taken By Developed Countries in Response to The Financial Crisis and Implications Thereof.

The report by the Director General of the WTO on trade and the financial crisis warned that even though members have not resorted to full fledged protectionism during the ongoing economic turmoil, they eventually will through raising new trade barriers to protect domestic industries, even while respecting their WTO commitments. Therefore, Governments that are trying to shield their domestic producers from the brunt of the economic crisis by closing their borders to competing markets might in due course stifle trade and serve to aggravate and prolong the economic crisis, as was evidenced by the rapid rise of protectionism in the 1930's that transformed what started as a recession into the deepest economic depression of the 20th century. Almost all developed countries have adopted policy measures to deal with the effects of the crisis to their economies – measures which will eventually restrict or distort trade as elucidated above and that also discriminate against developing countries that cannot afford to provide domestic producers support at that level. The measures taken range from nationalisation of banks and lowering lending rates, to participation in guarantee and recapitalisation schemes. A few detailed examples are listed below:

The United States has expended the greatest amount of relief. The most well known of these measures was the Troubled Asset Relief Program (TARP), which allowed for the Secretary of the Treasury to purchase troubled assets from nearly any financial institution, with US\$ 700 billion available pending additional approval. Rescue packages were issued to lending giants Fannie Mae and Freddie Mac as part of the larger Housing and Economic Recovery Act of 2008, as well as to American International Group. In return for assistance and recapitalisation totalling over US\$ 120 billion, the US received an 80% stake in AIG. Financial aid was made available to GMAC, and a capital injection / guarantee scheme for troubled assets was pro-

vided to Citicorp in the amount of approximately \$US 326 bn. Additionally, an expansion of the TARP program under former President Bush allowed for relief to the ailing American auto industry. Currently, the Congress has approved the American Recovery and Reinvestment Act of 2009, an US\$ 819 billion program aimed to provide economic stimulus in the form of money for infrastructure projects to inject cash back into local economies and stimulate job creation. The US has additionally lowered key lending rates and pressured banks to pass on low rate loans to consumers. An important feature of some of the conditions attached to these bailouts are their accessibility only to American companies. This would raise a national treatment question-which if applicable in a sector where specific commitments have been made, would be problematic. An important consideration for countries engaged in the EPA negotiations.

The EU has moved largely towards municipal rule of regulation, with individual countries taking action to enable lending, while borrowing to sustain economic growth:

- ⇒ Belgium benefited the KBC Group with a recapitalisation scheme of €3.5 billion, as well as a state guarantee for the Fortis Bank. Belgium also participated in a joint guarantee scheme for the Dexia financial group with France and Luxembourg.
- ⇒ France instituted a recapitalisation scheme capped at €21 billion, nearly half of which has already been used to recapitalise the top six French banks. Furthermore, France assisted authorised banks, including foreign subsidiaries, with credit refinancing in the amount of €265 billion. The program will specifically issue State-backed securities to promote lending to credit institutions against collateral. In February 2009, the French government proposed a €26 billion economic stimulus plan designed to make expansive improvements to French infrastructure and educational facilities.
- ⇒ Germany instituted wide ranging relief, including recapitalisation and guarantee schemes, as well as a temporary acquisition of assets totalling €500 billion for approved banks, insurers, pension funds, stock and derivative exchanges and investment companies.
- ⇒ Italian response to the crisis included both a recapitalisation of fundamentally sound banks and a guarantee for solvent banks authorised in Italy, including foreign subsidiaries.
- ⇒ In the Netherlands, the states response was the nationalisation of Fortis Bank Nederland and ABN AMRO Bank Nederland. Recapitalisation was pro-

vided to Aegon N.V., SNS REAAL, as well as to ING Groep N.V. in the cumulative amount of nearly €14 bn. The Netherlands also created a guarantee scheme for all solvent financial institutions with significant activities within the nation, including foreign subsidiaries.

Trade analysts have warned however that protectionism can manifest in various forms, one being through retaliatory actions by Members at the WTO, instigated as a result of their trading partners selling their exports at artificially low prices (an action known as dumping) through the introduction of export-subsidies during this period of turmoil. This observation was also made in the statement of the CAIRNS group to the WTO in which they call on the EU to repeal its decision to offer subsidies for dairy products leaving the EU, stating “Increasing trade-distorting measures and protectionism in a time of a crisis carries a very high price....[and is]... likely to drive international prices down to artificially low levels and, at the very least, prolong the current downturn”

7. Linking EPA Services Provisions and the Regulatory Interventions Adopted By Developed Countries in Response to The Financial Crisis

The ability of developing countries entering into an EPA to modify or withdraw their commitments in the financial services sector as a means or consequent to a policy response to a financial crisis is anchored on provisions in the agreement justifying such modification or withdrawal. In this case, Article 105 on the ‘Prudential Carve-out’ is the most relevant provision. While a similar provision in the GATS has been generally interpreted by the WTO Membership as having a very broad and comprehensive scope such that practically any type of measure applicable to the financial services sector is deemed encompassed by the carve-out, it remains an open question whether a similar interpretation will be accorded to the ‘Prudential Carve-out’ by the parties to an EPA. If a GATS-type interpretation is mutually agreed, then developing countries can seek cover under the provision when taking measures which may be inconsistent with their financial services commitments. Otherwise, such inconsistent measures may be susceptible to dispute.

The EPA could also have a negative effect on financial stability in developing countries. As mentioned above, Article 106 imposes an obligation to allow the entry of EU suppliers of new financial services if CARIFORUM states allow their own financial service suppliers to do so. This erodes a countries ability to provide preferences through favourable domestic regulation to domestic providers of new financial services, forcing them to compete with already established entities in the developed world and could also stagnate the domestic infant growth of such service providers in the CARIFORUM states. If a new financial service is made available in a Caribbean country, the country must also allow European financial institutions to supply the new service in the Caribbean country, if this finance service activity had been liberalised in the EPA. This is particularly concerning in a situation

where new financial services consists of heavily complex processes that regulators in the most efficient of jurisdictions have failed to catch up with. Africa and the Pacific where regulation is only being developed would do well to think carefully about their capacity to oversee these new financial services prior to considering the liberalisation of financial services in the EPAs.

The financial services chapter also allows for the mandatory free movement of capital and current payments and the definition of the term *financial services* also covers a wide range of activities, in insurance and banking, including trade in foreign exchange, derivatives including futures and options, exchange rate instruments, securities and asset management. All these areas have financial service activities that have been liberalised. These provisions put the onus on developing countries to undertake obligations, in market access and rules, in areas such as Government Procurement, Competition Policy and Investment, which are necessary for the development of strong regulatory rules for the financial sector and also to avoid the problem of instability that new financial services may generate. It is important to note that Government Procurement, Competition policy and investment were rejected as negotiating topics in the WTO since developing countries felt that rules in these areas would infringe on their sovereignty and the right to regulate.

Since Title II governs the provisions on Investment as well as trade in services, the fact that this EPA creates a legally binding agreement which locks in establishment rights and national treatment for foreign investment and investors is damaging to the development interests of developing countries. Also, the reservations listed by the EC where commitments were made, impose barriers to CARIFORUM financial services suppliers seeking market access in the EU.

The financial crisis itself is a lesson on the dangers of deregulation and liberalisation and the section above, which elucidates the chain of events that led to the financial crisis, shows the dangers that resulted from big economies like the U.S introducing and failing to regulate new financial services and instruments such as credit derivatives and securitised debt, as well as other activities practised by financial institutions. If a CARIFORUM country that had liberalised financial services in the EPA were for example to newly allow a hedge fund activity domestically, it would have to allow hedge funds from EU countries to enter and introduce similar services. Since the European institutions are much larger than the domestic hedge fund, the risks to the economy by this liberalisation would increase manifold.

The safeguards contained in the CARIFORUM- EU EPA in regard to financial liberalisation are not sufficient either,

as they are limited to enforcement during periods of crisis. For example, they cannot be used to limit the movement of current payments unless there is also a balance of payments crisis. At this juncture one can only advise on the importance of regulation for the financial sector, the necessity of sequencing liberalisation undertaken and the need for countries to design and develop strong policies based on their individual economic growth index.

8. Learning from the Crisis – Lessons for Ongoing ACP Negotiations

While monetary policy, e.g., interest-rate setting, are not necessarily the subject of trade liberalization commitments in the financial services sector, the entry of foreign financial institutions as a result of such liberalization can contribute to the exacerbation of some of the negative effects of undue expansionary monetary policies. For example, foreign financial institutions establishing commercial presence must generate revenue by using the capital at their disposal. In a climate of expansionary monetary policy, this translates to increased money supply being made available at easy credit terms, thus fuelling consumerist behaviour. This consumerist behaviour may of course be curbed if the regulations governing access to credit were well thought-through or even exist in the first place. If these regulations do not exist or are not yet well-developed, as is the case with many African and Pacific countries, and the establishment of commercial presence occurs under a bound commitment, the host government will have difficulty imposing regulations governing credit unless these are imposed on a non-discriminatory basis, i.e., on both domestic as well as foreign financial services suppliers.

The related experience of some countries with 'housing bubbles' provides useful lessons. In the U.S. and United Kingdom for instance, where State policies have generally encouraged home ownership, a mix of policy tools including facilitating access to credit for purposes of purchasing real property led to a situation where credit-unworthy individuals were able to obtain loans from a deregulated home mortgage industry. The ease with which housing loans could be obtained fuelled a demand for more housing and increased housing prices, thus creating the illusion of (artificially) inflated housing values. In the U.S. especially, homeowners became brazen and took out second mortgages to fund non-productive expenditures such as vacations, cars and similar consumerist spending. Translated into the context of a bound liberalized regime for the mortgage industry, re-regulating the industry may result in an inconsistency with bound commitments.

Among developing countries such as Thailand which experienced analogous 'housing bubbles' in the past,

such as that which contributed to the Asian financial crisis in the 1990s, there remains a strong reluctance to make binding commitments (in WTO negotiations) in the relevant sub-sectors under financial services because of a desire to retain the regulatory flexibility which came in handy in re-regulating and reforming the financial services sector as a way out of the crisis. Therefore, where a country has bound the existing liberalized regime without having put in place the necessary regulatory framework, or has not anticipated the harmful effects of expansionary monetary policy, the ability to regulate is restricted in the sense that any regulation must then be imposed on a non-discriminatory basis. Domestic financial institutions are then arguably disadvantaged if they have not attained a certain level of competitiveness. These domestic service suppliers for instance may have less capital and resources to cope with regulatory requirements which other, well-capitalised and resourced institutions, such as foreign financial institutions, tend to have.

Regulatory frameworks also have to allow for a certain degree of flexibility to accommodate changes in both the domestic and global business climate. This should allow revisions to regulations to be made and indeed for new regulations to be put in place. Such flexibility must however be balanced with greater transparency in the regulations in and of themselves and in the way these regulations are formulated. Often, the much-maligned element of 'consultation with interested parties' pushed by developed country trading partners in negotiations actually have significant value-added in the context of unilateral domestic policy-making and rule-making. Africa and Pacific countries engaged in EPA negotiations should therefore be cautious not only of the need to develop regulatory capacity, but also to ensure adequate flexibility within regulations so as to allow for room to respond to unforeseen circumstances such as those we see in the context of the financial crisis—a situation which seems opposed to the notion behind a full national treatment commitment for example.

The need for a degree of flexibility in regulatory formulation has a tangible example in laws dealing with securitization. Securitization provides a creative way of raising financing through collateralization of future, relatively consistent income streams. In the United States and Europe, this has allowed for instance financial institutions to raise capital through the issuance of commercial papers based on the future inflow of mortgage repayments by home buyers. Derivatives of these commercial papers are subsequently issued to raise further capital. Not only does this result in layers of financing being raised on the basis of a common income stream, but as it turns out, absence of a proper assessment of the investment risk underlying the commercial papers or securities. Increasingly, there are calls for greater regulation of these financial instruments, including rules on transparency in terms of the risk and calculation of the risk involved. This trend is one that countries engaged in services negotiations including

on financial services in the EPAs need to be cognizant of, since Europe's push for new commitments in financial services seems oblivious to this reality.

In the case of developing countries which have followed or intend to follow the developed country path towards raising financing as described above, the question arises as to whether sufficient regulation exists. Indeed if, as we have seen above, developed countries erred in regulating or lacked regulatory oversight in the issuance of these financial instruments, how much more vulnerable are developing countries in committing similar regulatory errors when they have not had the same long experience as their developed country counterparts? Or when the actual reality for most of their financial regulatory systems is that they follow the institutions as opposed to the other way round. If financial services are fully bound in multilateral or bilateral agreements, then a necessary consequence may be that the regulatory flexibility of developing countries to introduce new regulation to prevent repeating the negative experience of the U.S and Europe may be curtailed.

Financial services liberalization allows not only for the establishment of commercial presence by foreign financial services suppliers but also for the introduction of financial instruments used or practiced by these institutions in their home jurisdictions. Liberalization may for instance allow for the supply of services through establishment of commercial presence by hedge funds. Hedge funds typically generate revenues through 'shorting' or selling of stocks or securities which the fund does not as yet own, in anticipation that the price of these securities will decrease in the future, thus allowing the fund to buy the securities at a lower price vis-à-vis the price at which it sold the securities previously. This practice not only entails a lot of risk for investors, but also has the potential to de-stabilise markets or at least prices of securities that are being 'shorted.' The practice could have such egregious effects especially in times of financial volatility that even the U.S. prohibited the practice in the last quarter of 2008 in regard to financial institutions.

Viewed in the context of the push in the EPAs for new financial services, the negative implications of this are clear. In the case of developing countries, undertaking binding liberalization commitments in financial services could potentially open the door for hedge funds or similar institutions which bring in practices that may have destabilising effects on securities markets. Given the greater susceptibility of financial markets in developing countries, (in terms of knock on effects on the entire economy) it would seem that an even stronger argument is made for having appropriate regulations in place or a degree of regulatory flexibility through carefully structured liberalization commitments.

9. Conclusion

To quote the economist Aaditya Matoo, 'Good regulation is a precondition for efficient competitive markets' and the economic measures being undertaken, as a result of the financial crisis, by both central banks and governments of developed countries have assumed record-book proportions proving that the forces of demand and supply alone do not suffice in regulating markets in the real economy.

Most economies of developing countries are relatively small, have weak regulatory frameworks and a lot of the economic activity is centralised in specific industries or commodities. As a result, it is difficult for these economies to spread-out risk and absorb shocks to their financial systems. Governments therefore have an important role to play in developing effective policy for financial regulation to be able to cope with the challenges that come with liberalisation of the sector.

Many economic studies show that liberalising trade in financial services does have its advantages. For example, it reduces the unit cost through increasing competition, facilitating economies of scale and reducing price mark ups, while also raising managerial efficiency. The World Bank report of 2002 also showed that increased foreign entry to the EU, by acceding Members, acted as a catalyst for improved regulation to the domestic financial sector framework. One must however question whether this would be true for ACP states which have weak regulatory structures or none at all. One must also question whether these benefits could not be obtained by the unilateral, autonomous services liberalisation existing in these small economies without committing it in an EPA context and bringing therewith the attendant risk and obligations. During a time of financial upheaval, unilateral/autonomous services liberalisation seems a safer option for developing countries if they want to obtain the benefits mentioned above, and still retain the policy space to react to changing financial circumstances because they have not bound it in an EPA.

In the CARIFORUM - EU EPA, the right of the CARIFORUM states to regulate has been infringed and narrowed further than the GATS, the latter providing countries the lee-way to pursue domestic national policy objectives through necessary regulation and macro-economic policy, where the former would not. The MFN clause contained within the EPA is also controversial as it might restrain future ACP FTAs with other emerging economies like India, Brazil and China, that are potential future markets for CARIFORUM services providers - a fact not lost on the EU as evidenced by Commissioner Michel's explanation for the MFN clause '*... it's also a question of sovereignty for Europe.... It is difficult to say that Europe should let our partner countries treat our economic adversaries better than us. We are generous but not naïve*'. ACP negotiators should therefore keep in

mind that Europe has adopted a mercantilist attitude in the negotiations of the EPA's and must therefore practise caution in the percentage of liberalisation undertaken and the leverage they are giving Europe over their economies. ACP countries that already have ample market access through preference schemes which are the ones where their export potential is most credible (i.e trade in goods) should ensure that the constraints being faced in accessing those markets are first addressed before getting into services liberalisation specifically in sensitive sectors like financial services where necessary domestic regulatory frameworks are at best only growing.

The impact of the crisis will probably differ in magnitude among the ACP countries, based on their production rates, export structures, exposure to the international financial system and their potential to cushion the negative effects of the crisis. Since most of these countries, in particular the least developed amongst them are not exposed to the sub-prime markets in developed countries, disruption to the domestic credit markets might not be as grave. However, if multinational banks begin to withdraw funds from their subsidiaries - in a damage control mechanism (as the trends seem to show that they are-the impact would be huge since the percentage of foreign owned banks exceeds the domestic ones in a majority of these states. Other potential impacts for developing countries will be (i) negative effect on exports from developing countries due to decreased demand in industrial countries affected by the crisis (ii) inability to import capital and inputs needed for production in the domestic market (iii) low investments due to increased pressure on the exchange rate (iv) increased unemployment as companies go bankrupt and no jobs are created The Global Economic Prospects 2009 report of the World bank also predicts that 'Export opportunities for developing countries in 2009 were likely to fade rapidly because of the recession in high income countries and of shortages in export credits and the increased cost of export insurance'

The present global financial crisis has shown the importance of the finance sector, as well as the need for proper regulation. Introduction of new financial products such as credit derivatives or collateralized debt obligations and trading methods such as short selling of stocks and currencies or allowing the entry of financial agencies such as hedge funds and investment banks can destabilize a developing country's financial sector and economy. It would be prudent for the ACP countries to focus, now more than ever, on the need for and development of efficient regulation, prior to making any commitments in the EPAs. The 1990's show how many developing countries liberalized their financial systems under the IMF and World Bank conditionalities in the hope that this would reap huge development benefits. Instead, these countries experienced lack of growth and limited access to financial services. The major factor responsible for this was the inadequate sequencing of liberalisation reforms. At a time of negotiation of an Agreement grounded on similar principles, lessons from_ history should not be forgotten.

The road to the Financial Crisis - Chain of events

Triggers	Explanatory note
Increased consumerist spending because of easy access to credit, especially with the credit card culture and the facility to re-mortgage	This was caused by expansionary monetary policies pursued by banks forcing the lending rates down as a result of the industrial crisis of 2000/2001 that led central banks to believe that deflation might set in. this resulted in enormous liquidity for banks and financial markets
House buying bubble was facilitated by minimal or no down payment on housing loans and the low interest rates made the real estate market more attractive.	Spending beyond the budget cycle became unsustainable due to greater uncertainty on the ability of borrowers to re-pay at a future date. The first cracks began to show through foreclosure and seizure of property
Policies setting criteria for availing of credit through Fannie Mae and Freddie Mac (hereafter referred to as FNMA's) were encouraged. Government wanted to promote the residential markets which they felt was more attractive with low risk and huge returns	Since this was coupled with de-restricting the lending market to private sector banks and mortgage companies, it resulted in competition with the government based FNMA's, with the private companies zoning in on subprime borrowers
The practise of creative financing to clear such loans from banks' balance sheets by securitising them and selling them on the global capital market through investment banks evolved as a way to raise capital	Since the securities were structured with supposed safeguards against default by individuals, they earned the good credit rating enabling the banks' use of mortgages as collateral to back up issuance of commercial papers. Banks also began the use of derivatives of these Commercial Papers as further means of raising capital.
The prices of U.S homes rose to above average rates making banks more willing to lend, while the existence of loose rules on leverage allowed investment banks and other investment entities to purchase these attractive-looking instruments at a higher value than the actual available capital	The result being that credit availability was illusory as it was based on layers of Commercial Papers and derivatives whose actual foundation in many cases was in future cash flows, with a value that was a fraction of the present credit made available
Subprime mortgage repayments became problematic resulting in lenders to the housing market experiencing cash flow problems	The value of Commercial Papers and derivatives issued on the basis of subprime mortgages became unstable and resulted in huge actual losses for holders of these instruments
Quarterly multi-billion write downs of losses for US and non-US investment banks resulted in more cash flow problems	The credit default swap market at this point picked up the signals and the effect was a further erosion of the value of Commercial Papers, derivatives and assets held by these banks. The other huge impact was job-layoffs. With the collapse of the housing market, people were also made homeless since their homes had to be sold as collateral of the mortgage. Consumerist spending also took a nose dive.
Shorting by hedge funds of stocks of banks continued to erode the value of these banks' assets, therefore stock issuance as a way of raising financing proved impossible	This led to the collapse of Bear Stearns and Lehman Brothers. Merrill Lynch got bought by Bank of America while Goldman Sachs and Morgan Stanley got capital infusion from China.
FNMA's falter was to the brink of collapse since their bonds were securitized on future cash flows and issued to raise more funds for the housing market. They were then fully nationalised	This resulted in loss of confidence among depositors. Increased anticipation of bank runs led to banks refusing to lend to one another in a bid to safeguard their own liquidity and they refused to extend the credit line for companies, which then went bankrupt. This situation is the meaning of the term 'the credit crunch'.

References

1. Programme Officer Services Trade and Dispute Settlement at the International Centre for Trade and Sustainable Development. The views expressed in this publication are attributable to me and do not express the views of ICTSD.
2. Most of the measures being proposed by governments as 'rescue packages' constitute either a form of state aid or subsidy which in the long term may have negative spill-over effects on other markets or introduce distortions to the rules of competition
3. The World Bank in its report Global Economic prospects 2009 forecasts a drop in global export volumes of -2.1 percent, the first decline since 1982.
4. Financial Times dated 6th February estimates the number of jobs lost in January in the U.S. to have reached 598,000, while the unemployment rate - 4.4 per cent before the credit crisis - jumped to 7.6 per cent in January.
5. U.S. Department of Treasury guidelines issued in 2001.
6. Fannie Mae's purpose is to purchase and securitize mortgages in order to ensure that funds are consistently available to the institutions that lend money to home buyers
7. Freddie Mac was created to expand the secondary market for mortgages through buying mortgages on the secondary market, pooling them and selling them as mortgage-backed securities to investors on the open market
8. Rick Brooks & Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy: As Housing Boomed, Industry Pushed Loans To a Broader Market", Wall Street Journal, December 3, 2007
9. Information obtained from discussions and interviews with Johannes Bernabe (Policy Advisor at ICTSD) and Olivier Madaule (Assistant Private Banker with Vontobel Bank SA)
10. In 1998, the Federal Trade Commission estimated that 10% of new-car financing in the U.S. was provided by subprime loans, and that \$125 billion of \$859 billion total mortgage dollars were subprime - source Wikipedia
11. Expansionary monetary policy in this regard refers to situations when the Federal Reserve lowered the Funds rate to increase the money supply, thus causing mortgage rates to decline, consumers to borrow and spend and businesses to grow, which in turn led to hiring more workers who consumed even more - source <http://useconomy.about.com>.
12. Leverage being the ability to control a large amount of any financial instrument like a currency or stock using only a small amount of capital - source <http://useconomy.about.com>
13. These are financial instruments used as hedge and protection for debt holders from the risk of default. It became evident that those providing the insurance would have to pay and this heightened uncertainty across the system, as investors wondered which companies would be required to pay to cover mortgage defaults - source Wikipedia
14. A technique used by brokers/hedge funds who try to profit from a falling price of a stock through borrowing from another lender with the hope of buying the product low and reselling it at a higher value, thus retaining the profit made on the initial borrowed fee - source <http://www.investorguide.com>
15. UBS, the biggest private bank in the world in terms of managed assets, also got a capital injection from the Swiss Government.
16. Most-Favoured-Nation principle which prohibits Members from discriminatory practices among their trading partners - whatever treatment is accorded to one member must be extended to all.
17. GATS Article XVI
18. GATS Article XVII- defined as treatment no less favorable than that accorded to domestic services and services suppliers.
19. These are (a) limitations on the number of commercial presences whether in the form of numerical quotas, monopolies, exclusive rights or other commercial presence requirements such as economic needs tests; (b) limitations on the total value of transactions or assets in the form of numerical quotas or the requirement of an economic needs test; (c) limitations on the total number of operations or on the total quantity of output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test; (d) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment; and (e) measures which restrict or require specific types of commercial presence (subsidiary, branch, representative office)¹¹ or joint ventures through which an investor of the other Party may perform an economic activity. As it pertains to cross border supply of services conditions (d) & (e) are not included.
20. A "major trading economy" is defined in Article 69 (4) as any developed country, or any country accounting for a share of world merchandise exports above one (1) per cent in the year before the entry into force of the economic integration agreement referred to in paragraph 1, or any group of countries acting individually, collectively or through an economic integration agreement accounting collectively for a share of world merchandise exports above one and a half (1,5) per cent in the year before the entry into force of the economic integration agreement referred to in paragraph 1. This calculation is based of official data by the WTO on leading exporters in world merchandise trade, excluding intra-EU trade.
21. Article 86, Transparency.
22. Article 105 of the CARIFORUM-EC Economic Partnership Agreement.
23. Article 106 supra.
24. Article 107 supra.
25. Article 108 supra.
26. The EC -CARIFORUM Economic Partnership Agreement: Assessing the outcome on Services and Investment' by Pierre Sauvé and Natasha Ward available at <http://www.ecipe.org/the-ec-cariform-economic-partnership-agreement-assessing-the-outcome-on-services-and-investment/PDF>
27. An analysis of the implications of inclusion of these new financial services comes in the following chapters.
28. This section draws on reports from CNN, BBC, CNBC, Channel 4 news, the Financial Times, Wikipedia, The Economist and the report to the TPRB from the Director General of the WTO on 'the Financial and Economic Crisis And Trade Related Developments' dated 26 January 2009-
29. The report to the TPRB from the Director General of the WTO on 'the Financial and Economic Crisis And Trade Related Developments' dated 26 January 2009-
30. BRIDGES Weekly Trade News Digest, Volume 13, number 3.
31. WTO DG Pascal Lamy's interview with UK's Channel 4 news - www.channel4news.com
32. Commonly referred to as the 'Stimulus plan' or 'Stimulus package'.
33. BRIDGES Weekly Trade News Digest, Volume 13, number 3.
34. http://money.cnn.com/2009/01/28/news/international/australia_export.reut/index.htm - Reuters, January 28th 2009.
35. Article 106, 2 B.
36. Professor Jane Kelsey's analysis in her preliminary draft paper on the development implications of the CARIFORUM-EU EPA, available at <http://www.lawstaff.auckland.ac.nz>
37. Supra at 33.
38. Under the Insurance sub-sector, for Mode 4, reservations have been listed by Austria, Estonia, Spain, Italy and Finland. Under the banking sector, Belgium, Finland, Italy, Lithuania and Poland also list reservations. No commitments were made by the EU under the categories of independent professionals and contractual services suppliers.
39. Even Article 240, which is the supposed exception, stipulates that there must be a balance of payment crisis.
40. Aaditya Mattoo's overview in the book 'Services Trade and Development: The Experience of Zambia', 2007.
41. Cecchini Commission Report 1988.
42. The Annex on financial services to the GATS, paragraph 2 (a).
43. Like the EBA (Everything But Arms) for the LDCs.
44. IMF Global Stability Report, October 2008.
45. Patrick N. Osakwe 'Sub-Saharan Africa and the global financial crisis', Trade negotiations Insights, Volume 7 No. 10, December 2008.
46. CARIFORUM-EU Economic Partnership Agreement : Implications for Economic and Social Development' by Sanya Reid Smith. Supra at 45.