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Financial Services and the WTO: Liberalization in the Developing and Transition Economies

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Abstract: This paper analyses the results of the financial services negotiations under the General Agreement on Trade in Services (GATS) at the World Trade Organization (WTO). It shows that the negotiations have contributed to more stable and transparent policy regimes in many developing and transition countries. The wide range of market access and non-discrimination commitments should advance the process of progressive liberalization. The commitments do not compromise the ability of countries to pursue sound macroeconomic and regulatory policies. However, other aspects of the outcome do raise some concerns. First, there has been less emphasis on the introduction of competition through allowing new entry than on allowing (or maintaining) foreign equity participation and protecting the position of incumbents. Secondly, even where immediate introduction of competition was not deemed feasible, not much advantage has been taken of the GATS to lend credibility to liberalization programmes by precommitting to future market access.

Key words: financial services, GATS, trade liberalization

JEL classification: F13, G28, K33

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I. Introduction

After failure to agree at the end of the Uruguay Round, and an interim agreement in July 1995, the negotiations on financial services in the context of the General Agreement on Trade in Services (GATS) were finally concluded in December 1997. The largest service sector, including all banking and other financial services, and all insurance and insurance-related services, was now fully subject to multilateral trade rules. Not only did the agreement consolidate the relatively open policies of industrial countries which account for much of world trade in financial services, it also evoked wide participation from both developing countries and countries in transition. All the Eastern European Members of the WTO and over sixty developing countries have now made commitments on financial services.

It is widely recognized that, apart from the overwhelming importance of the financial services for households, the sector plays a key infrastructural role which affects overall economic performance. The realization that the efficient supply of financial services is a precondition for stable development is leading to increasing deregulation and liberalization of the sector. At the same time, the scope for international trade in financial services has grown rapidly over the last two or three decades through the development of new technologies, especially in telecommunications, and the expansion of foreign direct investment. The multilateral negotiations on financial services reflect a first attempt to consolidate this market-opening trend and to advance the process of progressive liberalization.

This paper studies the commitments on financial services made by developing countries and countries in transition. Earlier research by Kono et al. (1997), Sorsa (1997) and Kono and Low (1996) took stock of what had been achieved by July 1995. This paper both updates and deepens the previous analyses of commitments, and also examines some of the economic implications. The next section describes how financial services fit into the GATS framework, and examines whether broader economic concerns justify limiting the scope of commitments. Section III analyses the pattern of market access commitments of the developing countries and countries in transition. Section IV examines the relationship between the GATS commitments and the domestic reform process, while the implications of

these commitments for capital mobility are explored in Section V. Section VI discusses the economic implications of allowing foreign participation through equity ownership in existing financial institutions rather than through new entry. Section VII concludes the paper.

II. The GATS framework and financial services liberalization

No attempt is made here to provide a comprehensive picture of the GATS and how it works.[1] Rather, brief mention is made of those features of the Agreement that are relevant to the discussion that follows. The GATS covers all measures taken by Members affecting trade in services and all service sectors.[2] The Agreement is unusual in taking a wide view of what constitutes trade, and defines trade in services as the supply of a service through any of four modes. Mode 1 deals with cross-border supply of a service, which is analogous to international trade in goods, in that a product (service) crosses a national frontier. This category includes the taking of a loan or the purchase of insurance cover by a domestic consumer from a financial institution located abroad. Mode 2 involves consumption abroad, including the movement of consumers to the territory of suppliers. The purchase of financial services by consumers while travelling abroad falls in this category.[3] Mode 3 is of crucial significance, and entails the commercial presence of a supplier of one Member in the jurisdiction of another Member. An example of this mode is a situation in which a foreign bank or other financial institution establishes a branch or subsidiary in the territory of a country and supplies financial services. By defining trade to include sales through commercial presence, the Agreement includes in its domain foreign direct investment, which accounts for a large share of all services transactions, particularly in financial services. Mode 4 covers the supply of services through the presence of natural persons of a Member in the territory of another Member. This mode relates both to independent service suppliers and to employees of juridical persons supplying services, covering potentially the presence, for instance, of independent financial consultants as well as the intra-corporate transfer of bank managers.

[1] For fuller treatments of GATS, see Hoekman (1995), Low (1995) and Mattoo (1997).

[2] The only explicit sectoral exclusion from GATS is certain "hard" rights in the aviation sector.

[3] However, the Explanatory Note on Scheduling Commitments (GATT Document GNS/MTN/W/164) gives examples of Mode 2 which do not necessarily involve the physical movement of the consumer to the location of the supplier - for instance, when a consumer's property alone moves abroad, as in the case of ships being repaired abroad. This creates some fuzziness in

Certain GATS obligations apply across-the-board, while others depend on the sector-specific commitments assumed by individual Members. The most important of the general obligations is the *most-favoured-nation* (MFN) principle. The MFN principle prevents Members from discriminating among their trading partners. While governments generally attach importance to MFN as a fundamental principle of general application, certain sectoral sensitivities that emerged in the Uruguay Round raised the spectre of wholesale sectoral exclusions from GATS as a means of avoiding the MFN rule. In order to prevent this, governments agreed to permit limited, and in principle temporary, exemptions to MFN under GATS. Such exemptions, however, had to be taken at the time the negotiations were concluded. In the case of financial services, a number of MFN exemptions had been maintained when the preceding round of negotiations were concluded in mid-1995, some of which reserved the right to apply reciprocity as a basis for granting market access. Among them was the MFN exemption of the United States, which reserved the right to discriminate between trading partners with respect to new entry or the expansion of existing activities, in order to "protect existing activities of United States service suppliers abroad and to ensure substantially full market access and national treatment in international financial markets."[4] One of the key objectives of the extended negotiations was to achieve the removal of such exemptions and reach a full MFN-based result.

Article III on transparency is the second major obligation which applies across-the-board.[5] Each Member is required to publish promptly "all relevant measures of general application" (that is, measures other than those which involve only individual service suppliers) affecting trade in services. Members must also notify the Council for Trade in Services of new or changed laws, regulations or administrative guidelines that affect trade in services covered by their specific commitments under the agreement. By the end of 1996, each member should have *established an enquiry point*, to respond to requests from other members for information on these matters.[6]

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the distinction between Modes 1 and 2.

[4]See Key (1997).

[5]Other disciplines of general application relate to anti-competitive business practices, the creation of economic integration agreements, and recognition of standards for the authorization, licensing or certification of service suppliers.

[6]This requirement is carried further as far as enquiries from developing countries are concerned. In this case, developed countries (and other Members, if possible) are to establish contact points to which the service suppliers --not just the governments-- of developing countries can turn for information about commercial and technical aspects of the supply of

Schedules of specific commitments

The liberalizing content of the GATS depends on the extent and nature of sector-specific commitments assumed by individual Members. The core provisions of the GATS in this context relate to *market access* (Article XVI), *national treatment* (Article XVII) and *additional commitments* (Article XVIII). These provisions only apply to sectors explicitly included by a Member in its schedule of commitments and there too subject to the limitations that a Member has scheduled. The inclusion in the GATS of the principle of "progressive liberalization" (Article XIX) reflects a collective acceptance that liberalization would be gradual. The focus of attention in the negotiations was the content of national schedules of specific commitments, and to ensure that they were sufficiently improved to provide the basis for an agreement in which all Members would participate.

It is worth emphasizing that GATS commitments are guarantees, and the absence of such guarantees need not mean that access to a particular market is denied. In fact, as will be shown later, there are several markets where conditions of access are more liberal than those bound under the GATS.

The *market access* provision prohibits six types of limitations, unless they have been inscribed by a Member in its schedule. These are: (a) limitations on the number of suppliers; (b) limitations on the total value of service transactions or assets; (c) limitations on the total number of service operations or on the total quantity of service output; (d) limitations on the total number of natural persons that may be employed; (e) measures which restrict or require specific types of legal entity or joint venture; and (f) limitations on the participation of foreign capital. The existence of any of these limitation has to be indicated with respect to each of the four modes of supply, described above. As discussed in more detail below, the use made of these limitations, particularly (a) and (f), is one of the most important elements determining the economic implications of commitments.[7]

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services, professional qualifications required, and the technology available.

[7] It should, of course, be remembered that governments also have the right not to inscribe a sector at all in their schedules of specific commitments, so the quality of the market access commitment only becomes important once a government has decided to make an entry in its schedule.

National treatment is defined under Article XVII in the traditional GATT manner, as treatment no less favourable than that accorded to domestic homologues, in this case services or service suppliers. In contrast to the GATT approach, however, Members may inscribe limitations on national treatment in their schedules - with respect to each of the four modes of supply, as in the case of the market access provision. The main reason why negotiators eschewed the GATT approach of making national treatment an overarching principle of general application, as they did with MFN, is that granting market access with full national treatment is the equivalent of establishing free trade. Governments wanted the option of adopting a more gradual and conditioned approach to opening up their markets, by making national treatment something to be granted, denied or qualified, depending on the sector and signatory concerned.

Article XVIII offers the possibility for signatories to negotiate *additional commitments* not dealt with under the market access and national treatment provisions of Article XVI and Article XVII. Additional commitments must offer more open access. They cannot establish additional market barriers by detracting from MFN or from market access or national treatment commitments. Additional commitments could apply to such matters as qualifications, standards and licensing. Limited use was made of this option in the Uruguay Round negotiations.[8]

A number of countries have undertaken commitments in financial services using the Understanding on Commitments in Financial Services.[9] This document provides a standardized list of liberalization commitments in financial services and is part of the schedule of a Member adopting it as a basis for making commitments. Most notably, it includes a general standstill commitment with respect to non-conforming measures and the granting of the right to establish commercial presence to foreign financial service suppliers. It also contains a commitment not to discriminate in the government procurement of financial services and to permit an established foreign financial service supplier to offer any new financial service. Other important provisions include a commitment not to take measures that prevent transfers of information or the processing of financial information, to

[8]Certain other provisions of the GATS apply when specific commitments have been made by a Member, including provisions relating to notification requirements and the behaviour of monopolies and exclusive service suppliers.

[9]Among the countries studied here, these include Nigeria, Turkey, Bulgaria, Czech Republic, Hungary, Slovak Republic and Sri Lanka (for banking and other financial services - excluding insurance).

endeavour to limit the adverse affect on foreign services suppliers of certain non-discriminatory measures and to provide them national treatment in certain areas. Members who use the Understanding to schedule commitments are, however, not obliged to accept all its liberalizing elements and several have scheduled limitations which run counter to its provisions.

GATS commitments and wider policy concerns

What are the implications of GATS commitments for the broader policy framework relevant to the financial services sector? At least three areas of policy need to be considered: prudential regulation, macroeconomic policy management, and other domestic economic interventions.[10] A key question is whether there is reason for Members to hold back on commitments in order to retain the freedom to follow certain domestic policy objectives. The following discussion shows that commitments under GATS need not compromise the ability of governments to pursue sound macroeconomic and regulatory policies.[11]

First consider *prudential regulation*. In financial services, specific commitments are made in accordance with the Annex on financial services which complements the basic rules and definitions of the GATS taking into account the specific characteristics of financial services.[12] Of particular significance is Paragraph 2(a) which states that:

> "Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system."

The same paragraph goes on to say that where prudential measures do not conform with

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[10]Government measures to protect public morals or to maintain public order as well as national security measures may also have an impact, but are not discussed here as they are treated as general exceptions in the GATS.

[11]See Kono et al. for a more detailed discussion (1997).

[12]Sector-specific provisions in the Annex include a provision to protect individual customer information and confidential or proprietary information in the possession of public entities, a provision on the recognition of prudential measures of other countries, and a paragraph on dispute settlement stating the need to secure relevant expertise on panels for disputes in the area of financial services. The part on definitions in the Annex provides a list of financial services used in the Schedules of Members.

other provisions of the GATS, they must not be used as a means of avoiding commitments or obligations under the Agreement.[13] Prudential measures need not be inscribed in Members' schedules of specific commitments, as they are not regarded as limitations on market access or national treatment.

The Annex does not define prudential measures or provide an indicative list of such measures. Measures consistent with this provision would seem to include capital adequacy ratios, restrictions on credit concentration or portfolio allocation, and disclosure and reporting requirements, as well as licensing criteria imposed on financial institutions which are not more burdensome than necessary to ensure the solvency and the healthy operation of those institutions. Kono and Low (1997) argue that the continuing process of regulatory harmonization and enhanced cooperation between financial regulators and supervisors in the context of the BIS (Bank for International Settlements) and IOSCO (International Organization of Securities Commissions) as well as in other international fora provide useful background in maintaining discipline in the introduction and implementation of prudential measures based on this provision.

Consider now *macroeconomic policy* in general. When a central bank conducts open market operations, for example, conditions in the financial sector could be affected through the impact of such interventions on the money supply, interest rates or exchange rates. It is notable that services supplied in the exercise of governmental authority, including activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies, are excluded from the scope of the GATS.[14] Furthermore, a wide range of measures for macroeconomic management, such as reserve requirements on banks, could presumably be justified as measures to ensure the integrity and stability of the financial system under the terms of the Annex on Financial Services.

Article XI of the GATS is the key provision covering international payments and transfers. It stipulates that, except under circumstances envisaged in Article XII (described below), a Member shall not apply restrictions on international transfers and payments for current

[13]This language differs from that in Article XIV dealing with General Exceptions in that it does not require that the measures be *necessary* to achieve the stated objectives. It would, therefore, seem that Members have considerable freedom in their choice of prudential measures.

[14]Under Article I:3 of the GATS and the Annex on Financial Services.

transactions relating to its specific commitments (Article XI:1). Furthermore, Article XI:2 provides that:

> Nothing in the GATS affects the rights and obligations of the Members of the International Monetary Fund (the Fund) under the Articles of Agreement of the Fund, including the use of exchange actions which are in conformity with the Articles of Agreement, provided that a Member shall not impose restrictions on any capital transactions inconsistently with its specific commitments regarding such transactions, except under Article XII or at the request of the Fund.

Footnote 8 to Article XVI would, however, seem to narrow the range of circumstances in which a Member is obliged to allow capital transactions. This footnote states that if a Member undertakes a market access commitment in relation to the cross-border supply of a service and if the cross-border movement of capital is an essential part of the service itself, that Member is committed to allow such movement of capital. If a Member undertakes a market access commitment in relation to the supply of a service through commercial presence, that Member is committed to allow related inflows of capital into its territory. Thus the footnote would seem to relieve Members of obligations with respect to capital flows related to consumption abroad, and with respect to capital outflows related to commercial presence.[15] Although these provisions apply to all services, they are particularly relevant in the context of financial services, since a commitment to liberalize market access in financial services could be undermined without a concomitant obligation to liberalize associated capital flows.

Notwithstanding the obligations in Article XI and footnote 8 to Article XVI, a Member may impose restrictions on current or capital transactions in certain circumstances. First, in the event of serious balance-of-payments and external financial difficulties or threat thereof, Article XII permits a Member to introduce restrictions of a temporary nature on trade in services for which it has undertaken specific commitments. Such restrictions could include those on international payments or transfers related to a Member's commitments. Article XII stipulates that the restrictions shall not discriminate among Members, shall be consistent with the Articles of Agreement of the Fund, and shall be temporary and be phased out

[15] This does raise the question of whether free entry can exist in the absence of free exit.

progressively as the situation improves.[16] Secondly, the language of Paragraph 2 of the Annex on Financial Services would also seem to allow restrictions on international transactions if they were needed to ensure the integrity and stability of the financial system.

Finally, consider the *other domestic regulations* that governments maintain, which are not prudential in nature, but which nevertheless can affect the conditions of operation and competition in a market. Such measures could include, for example, a requirement to lend to certain sectors or individuals. Such lending might also be mandated on the basis of preferential interest rates. Even though such measures may not be the most efficient means of achieving particular objectives, these policies are not necessarily subject to commitments made under the GATS. Whether they are or not depends on a judgement as to whether they constitute limitations on market access or national treatment. If they are neither discriminatory nor intended to restrict the access of suppliers to a market, then such non-prudential domestic regulatory measures would normally fall within the ambit of GATS Article VI disciplines.

Article VI seeks to ensure that domestic regulations involving qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade. Article VI requires that these elements of domestic regulation are based on transparent and objective criteria, are not more burdensome than necessary to ensure the quality of the service, and in the case of licensing procedures are not in themselves a restriction on the supply of a service. Article VI does not, however, question the right of Members to pursue the public policy objectives in respect of which qualification requirements and procedures, technical standards, and licensing requirements are applied.[17]

III. Market access commitments in financial services

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[16]The procedures for invoking such measures involve notification and consultation with other Members, with the Fund playing a crucial role in the process of establishing the legality of such measures under the GATS.

[17]There has often been concern about the potential for selective servicing by foreigner suppliers. It is feared that the latter will only service profitable market segments and that the resulting underprovision of retail banking in rural areas, for example, could then have detrimental effects on the economy. It would seem possible under GATS to impose certain requirements, such as universal service obligations, as part of licensing requirements provided these do not discriminate between foreign and domestic financial institutions. Social objectives could then be met without sacrificing the efficiency benefits of competition.

This study focuses on the commitments of 105 developing and transition country Members of the WTO.[18] The countries are divided into four geographical groups: Africa (41 countries, 1.5% share of all Members' GDP), Asia and the Pacific (25 countries, 7.6% share), Eastern Europe (7 countries 1.1% share), and Latin America, including the Caribbean (32 countries, 6.2% share).

The GATS Schedules of commitments are complex documents, containing for each Member, market access, national treatment and additional commitments, on up to sixteen sub-sectors of financial services,[19] with respect to each of the four modes. In order to capture the essential elements of these commitments without complicating the analysis unduly, this paper focuses on the following:

(i) *Market access commitments*: Given the structure of the GATS and scheduling practice, the extent of guaranteed liberalization depends crucially on the market access commitments. These commitments determine whether foreign services and service suppliers are assured of the right to enter the market. Furthermore, any measures inconsistent with both Article XVI (market access) and Article XVII (national treatment) are scheduled in the market access column of the schedule in accordance with Article XX:2. As a consequence of this scheduling convention, the entries in the national treatment column only cover a residual class of measures.[20] Finally, most of the entries in the national treatment column are highly correlated with those in the market access column: liberal market access commitments are frequently accompanied by full national treatment commitments, and vice versa.[21]

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[18]At the time of writing, the WTO had a total membership of 132. Members account for 95 per cent of world GDP. China and Russia are two major countries who are not yet Members.

[19]Financial services under the GATS consist of insurance services and banking and other financial services. Insurance services encompass direct insurance (life and non-life), reinsurance and retrocession, insurance intermediation, and auxiliary insurance services (including consultancy, actuarial, risk assessment and claim settlement services). Banking and other financial services are defined under GATS to include acceptance of deposits, lending, financial leasing, payment and money transmission services, guarantees and commitments, trading (in money market instruments, foreign exchange, derivative products, exchange rate and interest rate instruments, transferable securities, and other negotiable instruments and financial assets), participation in issues of securities, money broking, asset management, settlement and clearing services, provision and transfer of financial information (including data processing), and advisory and intermediation services.

[20]It is not always clear from the entries in the market access column which measures simultaneously constitute limitations on national treatment. Furthermore, the extent to which a limitation in the market access column affects the commitment in the national treatment column is also debatable. For a discussion of these issues, see Mattoo (1997).

[21]Hoekman (1995), in his study of all Uruguay Round commitments, found that share of sectors for which the liberalization values for market access and national treatment were the same, was 89% for high income countries and 96% for other countries.

(ii) Within insurance, on *direct insurance, both life and non-life*, and within banking and other financial services, on *acceptance of deposits and lending of all types*. These services constitute the core of the financial services sector. While securities-related services are of considerable importance in the developed world, their exclusion from the current study is probably not a serious omission.

(iii) On the first three modes, *cross-border supply, consumption abroad and commercial presence*. The fourth mode, the presence of natural persons, may be less important in this sector, than in others, such as professional services. The commitments of countries on the fourth mode are, in any case, almost uniformly limited to the intra-corporate transfer of managers, executives and specialists.

In examining the level of commitments, three distinctions are made. These are between full bindings, designated as a "none" entry against a particular mode of supply in the schedule, denoting the absence of any limitations; no bindings, which are designated "unbound" against the relevant mode; and the intermediate case of "limited" bindings, which refer to those entries which are conditioned in some way by a limitation. The limitation may be on coverage (sectoral, geographical, or modal), or in the form of a restrictive measure (which can be one or more of the six types of restrictions listed in Article XVI). Many Members impose restrictions on the legal form of commercial presence, requiring, for instance, presence in the form of locally incorporated entities rather than branches. In the following analysis, it is assumed that such restrictions are less burdensome than those which limit entry or the extent of foreign equity participation.

Some Members appear to have inscribed prudential measures and other regulatory interventions in the schedules of specific commitments. An example is the frequent appearance of approval or authorization requirements which do not belong in the schedules if they are only meant to ensure that sound financial institutions enter the market. The paper attempts to make the sometimes difficult distinction between measures that restrict market access and/or national treatment, and therefore should be included in schedules, and those that pursue public policy objectives of a non-restrictive nature and should therefore be excluded from schedules.

Insurance

The results of the analysis are presented in Tables 1 and 2, with country-specific detail included in Annex 2, Tables A1-A4. As Table 1 shows, over half the countries in the group being studied, accounting for 95 per cent of the GDP of non-developed Members, made commitments on direct insurance services. In both numerical and GDP-weighted terms, country participation was highest in Eastern Europe, where all WTO Members made commitments. Participation was lowest in Africa, where, out of 41 WTO Members, only 13 made commitments - but the participating countries accounted for four-fifths of African Members' GDP. While in Latin America, the 18 (out of 32) countries which made commitments contributed 97% to the region's GDP, in Asia, the 17 (out of 25) participants accounted for 95% of regional GDP.[22]

There are significant differences between participating countries in the extent of binding and the restrictiveness of scheduled limitations. Full liberalization across all three modes is rare. Out of the 52 countries who made commitments on direct insurance, only 4 small countries, Bahrain, Gambia, Guyana and the Solomon Islands, together accounting for less than one-half per cent of participants' GDP, committed to removing all barriers. The only exception to the relative paucity of liberal commitments on the first two modes was Africa, where 5 countries, including relatively large Egypt and South Africa, guaranteed an absence of restrictions on consumption abroad.[23] Otherwise, there was also hardly any evidence that countries were more willing to make fully liberal commitments with respect to consumption abroad than to cross-border supply.[24]

In each of the regions, commercial presence is clearly the mode through which Members prefer to guarantee access to domestic markets for direct insurance services. As many as 19

[22]All percentages are calculated by using the sum of the GDP of all countries in the region *who are WTO Members*. Thus, China's GDP, for instance, does not enter the calculations.

[23]Several countries such as Hong Kong, Israel, Malaysia, Peru do not allow soliciting or advertising under cross-border supply and consumption abroad.

[24]There are several reasons to expect more liberal commitments on consumption abroad than on cross-border supply. First, it could have been presumed that governments would be less concerned (or less able to do anything) about transactions which take place outside their jurisdiction than those which take place within their jurisdiction. Secondly, as noted above, while commitments on cross-border supply carry the obligation to allow any essential movement capital, those on consumption abroad do not. However, the lack of a clear distinction between the two modes may have made government's choose a cautious approach to scheduling.

countries, accounting for nearly a quarter of participants' GDP, guaranteed the absence of restrictions (other than on legal form) on commercial presence. Even though this is not evident from the numerical summary, Eastern Europe as a region represents potentially the most liberal market for foreign investment in direct insurance. The markets of 2 Members are already free from significant restrictions: Poland (only limitations on the investment abroad of insurance funds) and Romania (partnership is required with Romanian legal or natural persons). The restrictions in several other countries are transitory. In Bulgaria, supply by foreign majority owned firms will be allowed three years after accession. The Czech and Slovak Republics have committed under the terms of the Understanding to endeavour to eliminate or reduce the scope of their monopolies for certain types of compulsory insurance. In Slovenia, branches are not allowed, and foreigners may not participate in the privatization of state-owned insurance companies, but the only restriction on new entry through subsidiaries, a 99% limit on foreign equity, will soon be eliminated. In Hungary, branches are currently not allowed, but legislation permitting them is being prepared. Even though Hungary has listed an MFN exemption based on reciprocity with respect to commercial presence, it is not clear whether this would affect access to its market given its otherwise liberal commitments.[25]

Next in degree of openness is Africa, where 7 out of the 13 countries, including Nigeria and South Africa, accounting for two-thirds of participants' GDP, impose no restrictions other than on the legal form of commercial presence.[26] Egypt, Gabon and Mauritius apply economic needs tests or discretionary procedures in allowing new entry, while Morocco has included a reciprocity condition in its schedule. Egypt is perhaps the only country in these negotiations which has specified the basis for carrying out an economics need test and has committed to relaxing the test in future. Egypt, Ghana and Kenya (in life insurance) impose equity limitations but Ghana and Kenya already allow majority foreign ownership. Egypt currently limits foreign equity to 49 per cent, but will raise the limit to 51 per cent in the year 2000 for life and 2003 for non-life insurance.

The number of assurances of fully open markets for foreign investors is higher in Asia and the Pacific (7 out of 17) than in Latin America (3 out of 18). Furthermore, several relatively

[25]Since Hungary has scheduled commitments according to the Understanding on Commitments in Financial Services, it has undertaken to grant financial service suppliers of other Members the right to establish commercial presence on an MFN basis.

[26]South Africa, for instance, requires local incorporation.

large Asian markets (including Hong Kong, Indonesia, Israel and Turkey, accounting for 32 per cent of Asian participants' GDP) have no significant restrictions on the establishment of foreign commercial presence, but this is only true for the smaller Latin American economies (Guyana, Panama and Paraguay, accounting for only 1 per cent of Latin American participants' GDP).

The nature of restrictions in place in the two regions reveal an interesting difference: the Latin group seems primarily reluctant to guarantee free entry, whereas the Asian group seems reluctant also to assure full foreign ownership. In the Latin group, 11 Members (including Argentina, Brazil and Chile)[27] do not assure fully liberal entry conditions (i.e. unbound, subject to discretionary licensing, limitations or reciprocity conditions), 2 Members (Cuba and Mexico)[28] only equity limitations, and 2 (Dominican Republic and the Honduras) both. In the Asian group, entry limitations are accompanied in 8 cases (including India[29], Malaysia, Philippines and Thailand) by restrictions on foreign equity as well, 1 Member (Korea[30]) imposes only equity limitations whereas just 1 Member (Qatar) imposes only limitations on entry. The implications of these differences are discussed more fully in a subsequent Section. However, the contrast between regions may be less stark than it appears because the discretion that Latin American countries retain to impose conditions on new entry could also apply to foreign equity participation.

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[27]Argentina has indicated that authorization of the establishment of new entities is suspended while Chile has indicated that the supply of financial services through commercial presence may be subject to an economic needs test. Brazil has indicated that the enactment of a Presidential decree is required to establish commercial presence. Such a decree is apparently necessary to overcome the constitutional barriers to the establishment of foreign enterprises and has reportedly served to facilitate entry. Nevertheless, in so far as there seems to be a need for a political decision to grant entry, the commitment cannot be regarded as fully liberal.

[28]In Cuba's case, the foreign equity limitation is listed in the horizontal commitments and applies to all sectors. In Mexico's case, the equity limitation is aggregate for the whole sector rather than for a single enterprise, but Mexican control of each enterprise is required.

[29]India is, in fact, the only participant in direct insurance which has left the commercial presence mode completely unbound. It, therefore, retains the discretion to impose any Article XVI restriction, including on entry and foreign equity.

[30]Korea does not limit the foreign equity in new direct investment. However, it has indicated in its horizontal commitments, which apply to all sectors, that the acquisition of outstanding stocks of existing domestic companies is restricted. Furthermore, foreign portfolio investment in Korean stocks is permitted only for the stocks listed on the Korean stock exchanges. While individual foreign investors can own up to 6 per cent of each company's total stock, aggregate foreign investment in each company cannot exceed 23 per cent.

Banking

The results of the analysis are presented in Tables 1 and 3, with country-specific detail included in Annex 2, Tables 5-8. It is evident from Table 1 that commitments in core banking services were greater than in insurance: nearly two-thirds of the countries in our study group, accounting for 97 per cent of the GDP of non-developed Members, made commitments on the acceptance of deposits and lending of all types. Again, in both numerical and GDP-weighted terms, country participation was highest in Eastern Europe (all WTO Members made commitments) and lowest in Africa (18 out of 41). But African participation in banking, 18 countries accounting for 84 per cent of the region's GDP, was greater than in insurance. Asian and Latin American participation in banking was marginally higher than in insurance.

The variation within participating countries in the extent of binding and the restrictiveness of scheduled limitations is again evident. Full liberalization across all three modes is slightly less rare in banking than in insurance. The 10 countries which have guaranteed virtually unconstrained access by all modes of supply, however account for only 1 per cent of participants' GDP and include only the smaller economies: 5 are in Africa (Ghana, Kenya, Malawi, Mozambique and Sierra Leone), 2 in the Pacific (Papua New Guinea and the Solomon Islands) and 3 in the Latin American group (Guyana, Haiti and Panama).

The number of liberal commitments on the first two modes was significantly higher than those in insurance. Over half of the Asian participants (including Hong Kong, Indonesia, the Philippines and the UAE) committed to liberal consumption abroad, and nearly one-third to liberal cross-border supply (including Indonesia and several smaller economies). In Africa, nearly half the participants guaranteed unrestricted access by each of the first two modes, but in Eastern Europe and Latin America, very few Members were prepared to do so. Only in Asia was there any evidence that countries were more willing to make liberal commitments with respect to consumption abroad than cross-border supply.

The number of fully liberal commitments for foreign investors in banking (mode 3) were on the whole comparable to those in insurance: 26 participants, accounting for over a fifth of participants' GDP. However, the regional pattern was different. Asia was the only region where fewer countries assured full openness under mode 3 than under each of the first two modes. In all other regions, the pattern in insurance was more or less repeated, with

commercial presence being the relatively most liberalized mode. The numerical summary reveals that 5 out of the 7 countries of Eastern Europe, accounting for 79 per cent of regional participant's GDP, already represent the most liberal markets as far as commercial presence is concerned. In Slovenia, there is an element of discretion in licensing[31] and foreigners may not participate in the privatization of state-owned insurance companies, but the first restriction is to be removed after the adoption of a new Law on Banking. Hungary's reciprocity-based MFN exemption with respect to commercial presence prevents its market from being classified as fully open.

Again, it is Africa which is next in degree of openness, with 10 out of the 18 countries, accounting for 78 per cent of the region's GDP, guaranteeing virtually unconstrained rights of commercial presence. In addition to the countries which impose no restrictions on any mode (named above), Egypt, Lesotho, Nigeria, and South Africa are fully open to investment.[32] Among the less open markets are Benin, Gabon, Mauritius and Tunisia which apply economic needs tests or discretionary procedures in allowing new entry, and Zimbabwe which imposes a 60% limit on foreign equity. Morocco applies a reciprocity condition to commercial presence as well as discretionary limits on foreign equity participation. Gambia is the only country which has left the commercial presence mode unbound in the core banking services.

The number of countries which guarantee free access to foreign investors is higher in Latin America than in Asia and the Pacific - reversing the picture in insurance. In Latin America, the 8 such markets (including Argentina, Panama and Paraguay) account for a fifth of the regional participants' GDP, whereas the 3 such markets in Asia and the Pacific (Israel, Papua New Guinea and the Solomon Islands) account for only one-twentieth of the regional participants' GDP. However, the nature of restrictions in place in the two regions mirrors that in insurance. In the Latin group, 9 Members (including Chile, Colombia, Peru and Venezuela)[33] impose only entry restrictions of some form (either unbound, limited, subject

[31]The Schedule states that the Bank of Slovenia shall, when considering issuing a license, take into account inter alia "the national economic preferences for certain banking activities."

[32]Egypt imposes no restrictions on joint venture banks, other than the requirement of approval for individual share ownership above certain limits, but it does impose an economic needs test on the branches of foreign banks.

[33]Chile and Colombia both apply an economic needs test for commercial presence. Peru has indicated in its horizontal commitments that mode 3 is unbound except for certain aspects, while Venezuela has indicated a reciprocity requirement in its schedule. Both Peru and Venezuela have also listed reciprocity-based MFN exemptions.

to discretionary licensing or a reciprocity condition), 1 Member (Mexico) only equity limitations (aggregate for the sector), and 2 (Brazil[34] and the Dominican Republic) both. In the Asian group, entry limitations are accompanied in 10 cases (including India[35], Indonesia, Korea[36], Malaysia, Pakistan[37], Philippines and Thailand) by restrictions on foreign equity as well, 1 country (Bahrain) imposes only equity limitations whereas 4 (including Hong Kong[38] and the UAE) impose only limitations on entry.

Another difference is the frequency in Asia of numerical restrictions on branches of foreign banks. In Latin America, several countries, such as Colombia and Costa Rica, do not allow entry through branches but most (with the exception of Brazil and Venezuela) do not impose any subsequent restrictions on the scale of operations. Interestingly, India is the one country which allows entry only in the form of branches of foreign banks licensed and supervised as banks in the home country. This may reflect the desire to shift the regulatory and supervisory burden to the home country.

Results of numerical analysis

Even though we have described in some detail the market access commitments of Members

[34]In Brazil's case the discretionary element is more explicit in banking than in insurance. Its commitment states that the "establishment of new branches and subsidiaries of foreign financial institutions, as well as increase in the participation of foreign persons in the capital of financial institutions incorporated under Brazilian law, is only permitted when subject to a case-by-case authorization by the Executive Branch, by means of a Presidential decree."

[35]Since India allows entry only through branches (restricted to 12 per annum), this amounts to a prohibition on foreign equity participation.

[36]The inclusion of Korea in this category may need some explanation. The foreign participation restrictions specified in Korea's horizontal commitments apply to banking as they do to insurance. The situation with respect to new entry is less clear. The relevant text states that "only branches of foreign banks which rank among the world's top 500 banks in terms of assets size or representative offices are permitted." It is not clear whether presence in the form of banking subsidiaries is allowed (particularly since the text in insurance explicitly mentions that subsidiaries are permitted.) Furthermore, it is not clear whether the restriction of branching rights to the top 500 banks should be considered a prudential measure given the performance of certain banks in this category. In any case, these issues may soon cease to be relevant if Korea's recent liberalization measures, discussed below, are reflected in its schedule.

[37]In addition to stipulating foreign equity limitations, Pakistan has included a reciprocity condition in its schedule, and also listed an MFN exemption based on reciprocity.

[38]Hong Kong imposes no restrictions on lending. However, in order to obtain a full banking license for the acceptance of deposits, the financial institution "must have been an authorized institution for at least ten years and be closely associated and identified with HKSAR." Furthermore, acquisition of an existing locally incorporated bank by an overseas bank requires the consent of the Monetary Authority.

in banking and insurance, no overall judgement was possible. For instance, we could not say whether Nigeria's commitments on banking (unbound on the first two modes, no significant restrictions on the third) were more or less liberal than Gambia's (no restriction on the first two modes, unbound on the third). Or whether Mexico' commitments on commercial presence in banking (foreign equity limitations) were more or less liberal than Chile's (economic needs test). In order to be able to make such judgements, two issues need to be addressed. The first concerns the relative importance of the modes of supply in specific sectors, and the second the relative restrictiveness of different measures.

Annex 1 describes a possible approach to this difficult problem. It attempts to obtain numerical estimates of the liberalizing content of commitments for each of the regions. The ranking of regions is broadly in accordance with the preceding discussion, but the precise numerical values should be viewed with a certain degree of caution. The overall value of the liberalization index for banking is slightly higher than that for direct insurance, but the difference is not significant. The GDP weighted indices tend to be lower than the simple averages, suggesting a tendency for smaller countries to be more forthcoming in liberal commitments than the larger countries. The results confirm the assessment that the commitments of African and Eastern European Members have a greater liberalizing content than those of the Asian and Latin American Members. African Members' willingness to make liberal commitments also on the first two modes places them ahead of the Eastern Europeans in all areas except lending services. It is also evident that the Asians have made more liberal commitments than the Latin Americans in insurance, but less liberal commitments in banking.

IV. *The role of GATS in the domestic reform process*

Why do governments participate in multilateral liberalization negotiations, exchanging legally binding commitments with respect to their present or future policy regimes? Only some aspects of this complex question are addressed here. A basic distinction can be made between external and internal factors.[39]

Unilateral liberalization versus reciprocity

[39] This discussion draws upon Low and Mattoo (1997).

In the first category falls the question whether a government seeks to use its own liberalization commitments as bargaining leverage for more open foreign markets. Economists have tended to stress that the benefits of liberalization are based primarily on the domestic gains that accrue - that is, in the efficiency and consequent income gains flowing from liberalization. This emphasis on gains to the liberalizing country is solidly backed up by empirical studies,[40] suggesting that governments should worry primarily about what they are doing, and not whether others are doing the same.

It is from this vantage point that mercantilistic bargaining alleged to underlie WTO negotiations, and concern with reciprocity, are judged inappropriate and damaging. On the other hand, countries would benefit additionally if their trading partners were also to liberalize, so a scenario can be constructed under which it would make sense to defer the benefits of unilateral liberalization up to the point where the benefits foregone would outweigh the extra benefits accruing from reciprocal action by trading partners induced through negotiation. Of course, such choices rest on delicate assumptions and judgements about the relative size of the domestic market, the discount rates of governments, and beliefs about other governments' objectives, and they may not be a very good guide to policy. Another relevant factor, however, is that from a political standpoint, governments may be able to garner greater domestic support for liberalization, including through building cross-sectoral coalitions, if other governments are also moving in the same direction at the same time.[41]

A notable feature of the WTO negotiations in financial services is that they did not take place in the usual context of a multi-sectoral and multi-issue round of negotiations. Although this had, of course, been the original intention, failure to complete the negotiations before the end of the Uruguay Round effectively turned financial services into a single-sector negotiation. This tended to divide countries into those that looked for export gains and those whose focus could only be the conditions of competition in the domestic market. Despite the absence of any possibility for cross-sectoral trade-offs, or for improvements in the policy environment facing exports for those without export potential in financial services, we have seen that many governments made significant new commitments.

[40]See, for instance, Francois et al. (1995).

[41]For an analytical exploration of some of these issues, see Bagwell and Staiger (1996).

Nevertheless, a number of countries, including Hungary, Pakistan, Peru, Philippines and Venezuela, maintained MFN exemptions in their schedules which state that access may be granted on a reciprocal basis.[42] The exemptions usually apply to all countries, are of indefinite duration and the stated objective is to obtain equal access opportunities for domestic suppliers in foreign markets. Given the structure of the GATS, regardless of the MFN exemption, the benefits of specific commitments made by these Members must be extended to all other Members on a non-discriminatory basis. Thus the exemption has meaning only where commitments have not been made, or where it is used to provide better treatment to some Members than specified in the schedules.[43]

Domestic factors and the role of GATS negotiations

One reason for the willingness of governments to make liberalization commitments, even where the only question at issue was how much foreign competition to invite into the domestic market, may well have been the realization not only that liberalization was a good idea, but that the WTO offered a useful instrument for consolidating and promoting liberalization, as well as defining and tying down future liberalization plans in a legal sense. Smaller developing countries also doubtless saw WTO commitments as a way of signalling their seriousness to potential foreign investors and strategic partners.

In broad terms, governments could have adopted three different approaches to the financial services negotiations, assuming that they participated at all. These are: i) to make binding commitments that represent less than the *status quo* in policy terms; ii) to bind the *status quo*, which may have been arrived at after liberalization, either unilateral or in the context of the negotiations; and iii) to promise future liberalization, which may or may not have been planned prior to the negotiations. These categories are not necessarily mutually exclusive when the set of a country's commitments is taken as a whole, nor is it always easy to determine the precise category in which a policy position should fall. The distinctions are useful, however, in thinking about the relationship between WTO negotiations and domestic liberalization processes.

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[42] Mauritius' maintained a reciprocity-based MFN exemption which applies only to services not included in its schedule of specific commitments.

[43]The Honduras and Nicaragua sought MFN exemptions to cover their participation in the Treaty on Central American Integration, which provides *inter alia* for the facilitation of establishment of banks and insurance companies of other parties to the Treaty.

Binding below the *status quo*

Several countries bound at less than *status quo*, at least with respect to certain aspects of their regimes. The Philippines, for example, did so with respect to foreign equity participation in commercial banks: binding at 51% when domestic law allows 60%.[44] Korea also stopped short of reflecting in its GATS offer all the present and future liberalization commitments made at the OECD: for instance, in the GATS offer foreign portfolio investment in listed companies is bound at 23%, but in the OECD Korea is committed to raising this ceiling progressively and eliminating it by the end of the year 2000.[45]

The value of a binding at below *status quo* is attenuated by the scope it gives a government to worsen existing conditions of market access without violating a GATS commitment. On the other hand, any binding at all provides an identifiable measure of security of market access.[46] Given the arguments made above, it seems doubtful that small countries can gain much by withholding commitments in the hope of extracting additional liberalization measures from other countries, particularly because the MFN principle would apply to any liberalization that might be induced in this fashion. The only other reason for holding back would appear to be the belief that existing levels of liberalization are unsustainable and may need to be reversed. It is beyond the scope of this paper to evaluate how far such concerns might be legitimate, but some aspects are considered in a subsequent section.

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[44]Where a binding involving foreign equity limitations is less than the level actually allowed to any investor subsequent to the entry into force of the commitments, the MFN principle will have the practical effect of "ratcheting up" the equity limitation commitment. This is because a new entrant could demand the same level of equity participation on MFN grounds as that granted to another supplier.

[45]Furthermore, under the terms of the IMF agreement, the de facto regime with respect to foreign capital is already more liberal than the GATS offer. For instance, the new president Kim Dae-Jung was quoted as saying that "From now on there is no need for discrimination between indigenous and foreign capital. We are living in an era where foreign investment is more important than foreign trade." (Financial Times, 29 December 1997).

[46]See Francois and Martin (1996) for a formal development of this argument in relation to tariff bindings.

Binding the *status quo*

Governments binding at the *status quo* signalled that existing market conditions are guaranteed. Even though much greater knowledge of national regimes than is available would be required to make a definitive judgement, it would seem that most of the commitments made by countries covered in this paper were of the *status quo* variety. Consolidation of the *status quo* clearly has positive value, and it is the easiest thing for governments to do while signalling a positive intent and a commitment to the trading system. The pervasiveness of *status quo* bindings has, however, been sometimes held out as evidence of the failure of the GATS to generate meaningful liberalization. But it is important to recognize that in many cases, the *status quo* itself was reached after recent liberalization, either unilateral or during the course of negotiations.[47]

The improvements in commitments by countries since the last round of negotiations ended in mid-1995 provide some idea of the extent of recent liberalization.[48] Several countries (like the Czech Republic, Slovak Republic and Slovenia) gave up the possibility of discretionary licensing in banking based on economic needs, while others (like the Czech Republic in air transport insurance) eliminated monopolies in certain areas of insurance. Some countries (like Brazil) replaced prohibitions on foreign establishment with a case-by-case authorization requirement. Several countries (like Bulgaria in insurance) allowed commercial presence through branches. Some liberalized cross-border trade (for instance, the Philippines with respect to marine hull and cargo insurance), and others both cross-border trade and consumption abroad (like Poland with respect to insurance of goods in international trade).

Many of the improvements pertained to relaxation of foreign equity limitations. For instance, Malaysia agreed to raise foreign equity limits in insurance on incorporation of existing branches (and for original owners who had been forced to divest) from 49% to 51%. Mexico raised its limits on foreign participation from 30% of common stock to 40% of common stock (plus 30% and 40% of non-voting common stock in insurance and banking,

[47]The precise impulse for liberalization is difficult to identify. In any case, as noted above, for most countries studied here, there were no immediate benefits in terms of improved access to foreign markets, so, in addition to any foreign political pressure and the promise of future rewards, the motive for liberalization must have been based on domestic policy considerations.

[48]Unless, of course, there was significant binding below the status quo in 1995, which Sorsa (1997) argues was the case. This Section relies on research by Masamichi Kono.

respectively), Kuwait allowed up to 40% foreign participation in banks and Singapore up to 49% in local insurance companies. Egypt and El Salvador completely removed the limits on foreign ownership of shares in banks (previously at 51% and 50%, respectively). Ghana removed the requirement that at least 20% of the capital of insurance companies be owned by the government and allowed foreign partners to obtain management control of local firms. Hong Kong removed a requirement that made eligibility for new full banking licenses contingent on ownership predominantly by Hong Kong interests, and Kenya no longer requires that one-third of the equity in non-life insurance companies be held by Kenyan citizens.

The "grandfather" provisions

One of the central problems in the negotiations was solved by a scheduling innovation. The conflict arose because certain countries were unwilling to make commitments which reflected the *status quo* with respect to commercial presence. Thus, they were either inclined to bind foreign ownership levels below those which currently prevailed, or insist on legal forms (local incorporation) other than those currently in the market (branches), or both. In some cases, the problem arose because domestic law had changed since the foreign firms first established commercial presence, e.g. in Malaysia, where the indigenisation policy was being implemented after the establishment of many foreign firms. In other cases domestic law became less restrictive than the binding, e.g. in the Philippines, where the law enacted in 1994 stipulates maximum foreign equity of 60% in banking but new entry is bound at 51%.

To see the nature of the problem, consider the following example. Say country A had allowed a firm from country B to establish a fully owned subsidiary in 1990. If it made a specific commitment under GATS to allow commercial presence through fully-owned foreign subsidiaries, then it would be obliged to allow firms from all Members to establish under similar conditions. The implied level of openness was apparently unacceptable for some Members in situations similar to country A. If, however, market access was bound only for, say, minority owned foreign firms, then the existing firm from country B would have no guarantee that it would not one day be asked to disinvest. Such an uncertain situation evoked significant concern in existing investors from countries in type B situations. The solution was to drive a wedge between the conditions facing firms which were already present and those which would enter when the commitments came into effect. In effect, the

situation of existing firms was "grandfathered".[49]

The three types of grandfathering provisions, *foreign equity-related, legal form-related* and *general*, which are to be found in the financial services schedules are shown in Table 4. It is evident that grandfathering was primarily an Asian phenomenon, prompted presumably by the introduction of more restrictive regimes pertaining to foreign equity and legal form than had prevailed when the foreign firms first entered. The grandfathering provisions reflect the relative emphasis in these negotiations on guaranteeing the rights of incumbents. They provide the benefits of security to investors who are already present in the market rather than to *new* investors. Furthermore, they may even place new entrants at a competitive disadvantage where differences in ownership and legal form affect firm performance. The welfare implications of guaranteeing the position of incumbents in protected markets are considered in the next section.

Precommitment to future liberalization

Finally, there is the question of the role of the GATS as a vehicle for promoting future liberalization. Consider, first, why governments may be reluctant to liberalize immediately (other than for reasons of mercantilistic hold-back). One reason is the perceived need to protect the incumbent public/national suppliers from immediate competition - either because of the infant industry type of argument or to facilitate "orderly exit". The former argument is based on considerations of potential comparative advantage, whereby currently disadvantaged national suppliers, if provided with protected markets, are expected to restructure or learn-by-doing and eventually become internationally competitive. In the financial sector, the vulnerability of domestic suppliers is related to a larger concern about the stability of the financial system. The fear is that inefficient or otherwise handicapped domestic banks, if exposed to competition, may fail and set off a chain reaction affecting other financial institutions.[50] Time is needed to strengthen domestic financial institutions, and to develop appropriate regulatory mechanisms to prevent similar weaknesses in future. It is usually recognized that once these changes are accomplished, the appropriate defence

[49]This paper does not discuss the legal implications of the grandfathering provisions.

[50]For instance, the presence of too many financial institutions is sometimes cited as an argument against liberalization in financial services trade. To the extent that this reflects concern about the viability of individual financial institutions, it is best addressed through prudential measures and measures to facilitate orderly exit from the market. In Argentina, for instance, one quarter of the country's 200 banks were liquidated in 1995 and 1996. See also Kono et al. (1997).

against financial instability is not through restrictions on entry *per se* but through adequate prudential regulation and supervision. The willingness of several countries in Latin America, like Argentina, which have substantially strengthened their prudential regulation, to liberalize entry into banking is evidence of this fact. Hence, concerns both about infant industries and financial stability are arguments not for indefinite postponement of competition, but only for delaying its introduction until domestic firms and domestic regulators are equipped to deal with it.

One reason for the failure of infant industry policies in the past, and the innumerable examples of perpetual infancy, was the inability of a government to commit itself credibly to liberalize at some future date -- either because it has a stake in the national firm's continued operation, or because it is vulnerable to pressure from interest groups which benefit from protection.[51] The GATS offers a valuable mechanism to overcome the difficulty of making credible commitments to liberalize. Commitments to provide market access and national treatment at a future date are binding under WTO law. Failure to honour these commitments would create an obligation to compensate those who are deprived of benefits. This need to compensate does in fact make the commitment more credible than a mere announcement of liberalizing intent in the national context. A precommitment to liberalize can also instil a sense of urgency in domestic reform, and in efforts to develop the necessary regulatory and supervision mechanisms.

Several governments have taken advantage of this mechanism to strike a balance between, on the one hand, their reluctance to unleash competition immediately on protected national suppliers, and, on the other hand, their desire not to be held hostage to the weakness of domestic industry in perpetuity. India and the Philippines have committed to allowing an increased number of branches rather to a change in regime (Table 5). The Czech and Slovak Republics, by virtue of their subscription to the Understanding on Financial Services, will endeavour to remove or reduce the scope of monopolies in certain areas where insurance is compulsory. Egypt and Slovenia will relax certain elements of discretionary licensing,

[51]National firms often behave as if they prefer to operate as high cost, poor quality producers in protected markets than as low cost/high quality producers facing international competition. This may be because of the profitability of protection, or the greater utility that managers and workers derive from operating in sheltered environments. In any case, when the government cannot credibly commit itself to liberalize, then national firms may have an incentive to precommit to high costs or poor quality, in an environment of slow learning and under-investment in research and development. Such behaviour by the firm, either for strategic reasons or on account of inertia, forces governments to prolong socially costly protection. Related arguments have been made in Staiger and Tabellini (1987) and Tornell (1991).

whereas Hungary, Poland and Slovenia will allow branches of financial institutions to operate. Bulgaria and Egypt have committed to allow majority foreign ownership in insurance in the near future, while Thailand has created a 10 year window of opportunity for foreign investors to acquire higher equity shares than the maximum 25% normally permitted - subject to the approval of the Ministry of Finance.[52]

The commitments by Hungary, Slovenia and Brazil are particularly interesting, as they have been made contingent on parliamentary approval of new legislation. This approval is not certain, but the current commitment has value because there is an obligation immediately to translate future domestic law into an international commitment. However, on the whole it must be said that the use of the GATS as a mechanism for lending credibility to liberalization programmes has been somewhat disappointing. The result compares unfavourably with the experience in the basic telecommunication negotiations (see Low and Mattoo, 1997), though it must be recognized that financial markets are generally much more competitive than those in basic telecommunications. It is possible that many governments were reluctant to tie their hands in the environment of financial instability in which the negotiations were concluded.

[52]The recommendation must come from the Bank of Thailand and the relaxation must be "deemed necessary to improve the condition or business of the commercial bank". This is one of the few instances in the GATS of a temporary liberalization commitment.

V. Capital mobility and specific commitments

One concern in the negotiations was about the extent to which liberalization commitments would oblige Members to allow capital movements. It may be useful to examine the specific commitments in the light of the general rules discussed in Section II. If a Member undertakes a market access commitment in relation to the cross-border supply of a service and if the cross-border movement of capital is an essential part of the service itself, that Member is committed to allow such movement of capital. Out of the 55 Members who made commitments on insurance, only 5 made fully liberal commitments on cross-border supply, and out of the 64 who made commitments on banking, 19 made fully liberal commitments on cross-border supply. Most of the liberal commitments in the cross border supply of banking were made either in Africa (8) or in Asia (6). Interestingly, Indonesia was the only country in South East Asia to make fully liberal cross-border commitments on banking, while Malaysia committed to allow lending up to RM25 million (larger loans must be undertaken jointly with banks in Malaysia). None of these countries have invoked Article XII of the GATS, which allows restrictions to safeguard the balance of payments, so unless they have been requested to impose restrictions by the IMF, they are obliged to allow movement of capital which is an essential element of the service.

In principle, commitments on commercial presence only require a Member to allow related *inflows* of capital into its territory, whereas restrictions on outflows of capital would not seem to be inconsistent with a Members' obligations. A total of 19 countries have made fully liberal commitments on commercial presence in insurance, and 26 in banking. Many other countries have made limited commitments on commercial presence, and it is rare to find the mode completely unbound. Certain countries like Poland and the Slovak Republic have imposed restrictions on the investment abroad of insurance funds. Tunisia is an example of a country which has listed limits on borrowing abroad for resident enterprises. Chile has reserved the right of its Central Bank to take measures which "ensure the stability of the currency and the normal operation of domestic and foreign payments." These include *inter alia* reserve requirements with respect to deposits, investments or credits coming from or going to a foreign country, and the stipulation that "foreign investors who participate in the financial services sector may transfer their capital abroad two years after bringing it in." It would seem that other countries which have made commitments on commercial presence but not explicitly scheduled such limitations, retain the right to impose similar restrictions, should they be needed to protect the integrity and stability of their financial systems, under

the terms of the Annex on Financial Services.

VI. Increased competition vs foreign equity participation

In this section, the focus is on two aspects of the commitments undertaken: liberalization of entry into the industry and scope for foreign ownership (and/or control). As we saw above, the pattern differs across regions: in Eastern Europe and Africa, limitations on entry are not frequent, and foreign equity limitations are even less so; in Latin America, many Members have retained discretion on whether to allow entry, but few have imposed limits on foreign equity participation;[53] in Asia, the two types of limitations are frequently encountered together. Apart from economic considerations, these differences in policy reflect differences in political attitudes to foreign direct investment, and varying degrees of concern about the prospect of foreign ownership and control in financial services.

A multilateral commitment by a government to allow entry influences the degree to which markets are contestable. Regardless of the existing market structure, established suppliers in the market are likely to behave more competitively if there are no legal barriers to entry. Increased competition brings benefits both through promoting allocative efficiency, i.e. pricing close to costs, and internal efficiency, producing at least cost. Conversely, privately efficient profit-seeking behind protective barriers cannot be expected to lead to socially efficient results. Restrictions on entry benefit producers at the expense of consumers. The earnings of producers are then greater than the social productivity of the inputs because there is a component which is a transfer from consumers. It is therefore desirable for the scope of competitive forces to be enhanced by the effective removal of barriers to entry.

In light of the emphasis in the GATS negotiations upon increasing permitted (or maintaining existing) levels of foreign equity participation, it is interesting to consider the implications of a situation in which foreign participation has been permitted, without an increase in the degree of competition allowed to occur in the market. In other words, what are the welfare consequences of foreign ownership without adequate competition? Foreign investment clearly brings benefits even in situations where it does not lead to enhanced competition. First, allowing foreign equity participation may relax a capital constraint which could

[53]It is possible that the discretionary licensing in some Latin American countries could pertain to both entry and equity participation.

otherwise result in socially suboptimal levels of investment in the sector. Furthermore, the benefits of increased investment in helping to recapitalize troubled financial institutions in many developing countries cannot be underestimated. In fact, one reason why countries may have chosen this particular combination of policies, i.e. to restrict new entry while allowing foreign equity participation, is probably because they would like new foreign capital to help strengthen weak domestic financial institutions rather than to come in the form of highly competitive new banks and insurance companies which might drive their domestic rivals out of business. Second, foreign equity participation may serve as a vehicle for transferring technology and know-how. The benefits come not only in the form of technological innovations, such as new methods of electronic banking, but also in terms of improved management and credit assessment techniques, as well as higher standards of transparency and self-regulation.

Against these benefits, there may well be costs associated with foreign direct investment when competition is restricted. If foreign investment comes simply because the returns to investment are artificially raised by restrictions on competition, then the cost to the host country may exceed the benefits, because the returns to the investor will be greater than the true social productivity of the investment. The argument may be presented in an alternative form. Aggregate national welfare in a particular sector can be seen as the sum of consumers' surplus and national producers' profits (plus government revenue). In competitive markets, welfare is greatest because marginal social benefit is equated to marginal social cost. In imperfectly competitive markets, welfare is reduced because output is restricted to a level where marginal social benefit exceeds marginal social cost. Producers gain at the expense of consumers. Now if foreign participation enhances competition, welfare may increase, but if foreign participation takes place with limited change in competition, then there is a further reduction in national welfare because of the transfer of rents from national producers to foreign producers.[54]

As noted above, in both insurance and banking, there is a tendency among Latin American

[54]To some extent rent appropriation can, of course, be prevented by profit taxation or by holding competitive auctions of licenses or equity. The rents would then accrue either to the government or to existing national shareholders. But the static and dynamic inefficiencies consequent upon lack of competition would still exist. Creating discriminatory profit tax regimes would have negative incentive effects on new foreign investment, but such regimes are ruled out, of course, where commitments are undertaken to provide national treatment. Furthermore, while equity auctions may prevent net profit transfers abroad through new acquisitions, and license auctions achieve the same vis-a-vis new entrants, neither addresses appropriation by existing foreign share owners. In this context, the grandfathering commitments assume particular significance.

countries to impose restrictions on (or not guarantee) entry, whereas in Asia, entry limitations are accompanied in many cases by restrictions on foreign equity as well. It is, of course, possible for competition to come through the other modes, cross border supply and consumption abroad, where these modes of delivery are feasible. Here again, many more Asian countries have made liberal commitments than Latin American. It could be argued that neither group has chosen the first best (at least in static terms) of liberalized entry conditions for both domestic and foreign entrants. But *given* the restrictions on entry, the Asian group's propensity to impose equity limitations may reflect an attempt to strike a balance between the benefits and costs of foreign equity in protected markets. The Latin American group, with some exceptions, seems to have revealed a preference for unconstrained foreign equity participation even in the absence of free entry conditions.

Could it be that the markets in these countries are already so competitive that liberalization of further entry would only have a limited impact on firm performance? Evidence presented in Sorsa (1997) leads to the opposite conclusion. She finds that crude concentration ratios - defined as the share of the largest bank in total banking assets - are somewhat higher in developing and transition markets than in industrial countries. Hong Kong, Mexico, Korea, Brazil and the Philippines have low concentration ratios whereas Chile, Hungary, India, Israel, Morocco and Slovakia have high ones. At the same time, profitability indicators are found to be higher in many developing and transition markets than in the OECD countries. The 1994 data indicate that South Africa, Chile, Pakistan, Malaysia, Thailand and Romania had among the most profitable banking sectors among emerging markets. These high profits may be symptomatic of limited competition, because of restrictions either on establishment or the other modes of supply. It is also relevant that spreads (lending less deposit rates) are found to be generally higher in the developing and transition country markets than in industrial countries, suggesting that there remains scope for improving efficiency of financial intermediation.[55] Finally, the share of foreign assets in total financial sector assets was already high in several countries. Poland, Egypt, Turkey, Singapore and Hong Kong already have shares of 20% or more.

Since the rent-appropriation concerns about foreign direct investment arise in imperfectly competitive situations, one question is whether such market structures are inevitable. While fully competitive markets may not exist where the optimal scale of operation is high, the

[55]The difference in spreads could of course reflect a variety of factors, including differences in the risk premium.

high degree of concentration in certain countries may be a consequence of the policy barriers to entry. The reasons for such barriers have been discussed above, and range from the inadequacies of domestic regulation to variants of the infant industry argument. But these arguments for restricting competition must be temporary. Eventually, it is sound prudential regulation and adequate supervision which must be guarantors of the stability of the financial sector rather than economically costly restraints on competition.

VII. Conclusion

The financial services negotiations under the GATS have contributed to the creation of stable and transparent policy regimes in many developing and transition countries. The range of market access and non-discrimination commitments made should advance the process of progressive liberalization. There would seem to be adequate safeguards in the GATS to ensure that liberalization commitments do not threaten macroeconomic stability or compromise the ability to pursue sound regulatory policies. Certain other aspects of the outcome, however, do raise some concerns.

There has been less emphasis on the introduction of competition through new entry than on allowing (or maintaining) foreign equity participation in existing financial institutions and protecting the position of incumbents. In some cases, the particular choice of policies may have been forced by the current financial crisis - dictating that foreign capital be allowed to enter only as an injection into weak domestic industry rather than as new competition. At the same time, few guarantees have been made of competition through cross border supply, presumably because of concerns about regulatory difficulties and the implied capital mobility. Lack of competition is undesirable in itself, but even more so when it provides an opportunity for foreign rent appropriation. This does not imply that countries should impose restrictions on foreign investment, but rather that the benefits to a country from foreign investment are likely to be greater if it does not impose restrictions on entry.

Even where immediate introduction of competition was deemed infeasible, the GATS has not been fully utilised to lend credibility to liberalization programmes by precommitting to future market access. It is conceivable that immediate liberalization was not desirable because domestic financial institutions and regulators were not equipped to deal with a high degree of competition. But commitments to liberalize in the future would have served to

confront domestic industry with a credible deadline and domestic regulators with a clear timetable to develop the necessary mechanisms for prudential regulation and supervision. While many governments may have been unwilling to tie their hands in the precarious financial situation which prevails today, the commitments themselves could have contributed to creating greater stability.[56]

This paper has concentrated on the GATS commitments of countries, apart from the brief discussion of their relationship to actual policies in Section IV. It is probable that in many cases, commitments under GATS reflect actual trade policies (i.e. countries simply bind the status quo) but, as the discussion in Section IV shows, this is not always true. In particular, when a service is not listed in a Member's schedule or a specific mode is unbound, schedules provide no clue as to what actual policies may be. Further empirical research is needed to obtain a more comprehensive picture of the policies governments actually pursue with respect to the financial sector. It should then be possible to examine more thoroughly not only the determinants of trade policy (such as the conditions in the domestic financial sector, the adequacy of regulatory mechanisms, and political economy aspects) but also what influences the relationship between actual policy and GATS commitments (benefits of binding versus the costs of giving up policy flexibility or negotiating currency). Finally, more research is needed to study the impact of trade policy choices (both national and in terms of international commitments) on the performance of the financial sector and the economy more generally.[57]

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[56]There is no evidence, however, that in the financial crisis during the final months of the negotiations governments went back on what they intended to do.

[57]An example of recent research along these lines is the paper by Clessens and Glaessner (1997).

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Annex 1: Numerical Analysis

This Annex takes some preliminary steps towards quantifying the commitments on financial services (building on the approach of Hoekman, 1995). To begin with, two issues need to be addressed. The first concerns the relative importance of the modes of supply in specific sectors, and the second the relative restrictiveness of different measures.

Modal weights

Available statistics do not enable a precise identification of even revealed patterns of trade by different modes, let alone of patterns in the absence of policy restrictions, which is what we are really interested in. The only country which reports statistics on establishment trade on a regular basis is the United States. These data are presented in following table, along with data from balance-of-payments statistics which approximate cross-border trade. In insurance, establishment trade is three and a half times greater than cross-border trade for imports, and more than six times as large as cross-border trade for exports. In banking and securities services, establishment trade is three-and a half times greater than cross-border trade for imports and more than twice as large for exports.

Table (i) United States Financial Services Trade by Modes of Supply[1], 1994
(US$ billion)

	Mode 1: Cross-border Trade		Mode 3: Commercial Presence	
	Exports	Imports	Exports	Imports
Insurance Services[2]	4.90	13.90	30.90	48.70
Banking and Securities[3] Services	6.10	1.70	14.00	5.90

Source: Survey of Current Business (1996, November), USITC (1997) .

[1]These statistics only provide an approximation to trade through the different modes of supply defined in the GATS.
[2]All trade figures for insurance services are presented on a gross basis, i.e., imports comprise premiums paid for foreign insurance coverage and exports comprise premiums received from foreign policyholders. No deductions are made for claims received from foreign insurers or payments for foreign claims because such statistics are available only for cross-border trade, and not for establishment trade. Ideally, of course, insurance services should be valued by service charges included in total premiums earned rather than by total premiums.
[3]Banking and securities services cover financial intermediary and auxiliary services (except those of insurance enterprises and pension funds). Included are intermediary service fees, such as those associated with letters of credit, bankers' acceptances, lines of credit, financial leasing, and foreign exchange transactions. Also included are commissions and fees related to transactions in securities - brokerage, placements of issues, underwritings, redemptions, and arrangements of swaps, options, and other hedging instruments; commissions of commodity futures traders; and services related to asset management, financial market operational and regulatory services, security custody services, etc.

While these statistics confirm that commercial presence is currently the most important mode of supplying financial services, its relative importance is likely to differ between sub-sectors. For instance, it would seem that consumers are much less likely to make cross-border purchases of life insurance than of freight insurance. Similarly, they are less likely to deposit money in a bank located abroad than to borrow money from a bank located abroad. We need also to consider the relative importance of cross-border supply and consumption abroad. A key difference between the two modes is that under the GATS, commitments to allow cross-border supply of a service oblige a Member to allow the necessary capital movements, while those to allow consumption abroad do not (see Section II). Therefore, the former commitments can be argued to have much greater value than the latter.

On this basis of these considerations, and broadly taking into account the differences between the sectoral coverage of the US data and our study, the modal weights presented below were used. It is recognized, of course, that these weights provide only the roughest idea of the relative importance of modes, though it can be said, in their defence, that the results were not very sensitive to changes in their values.

	Cross-border supply	Consumption abroad	Commercial presence
Insurance:			
Life	0.12	0.03	0.85
Non-life	0.20	0.05	0.75
Banking:			
Deposits	0.12	0.03	0.85
Lending	0.20	0.05	0.75

Quantifying the restrictiveness of measures

Again we adopt the simplest approach which enables us to capture the essence of the commitments. With respect to each mode, a numerical value of 0 was attached to entries of "unbound" and a value of 1 to entries of "none". The interesting question pertains to how the presence of specific restrictions is to be evaluated. In the case of the first two modes, restrictions often take the form of excluding certain sub-sectors from the scope of the commitment. It is difficult to judge the economic significance of these exclusions. Therefore, a distinction was not made and a value of 0.5 was attached in all cases of restrictions on the first two modes.

With respect to commercial presence, a slightly more sophisticated approach was adopted. This was based on first identifying the "most restrictive measure" specified, and then applying a value based on an assessment of its restrictiveness. Thus, the presence of any of the following limitations led to the indicated value being attached (regardless of whether other less restrictive measures were also applied):

No new entry or unbound for new entry	0.10
Discretionary licensing for new entry	0.25
Ceiling on foreign equity at less than 50%	0.50
Ceiling on foreign equity at more than 50%	0.75
Restrictions on the legal form of commercial presence	0.75
Other minor restrictions	0.75

Giving a higher value to the presence of restrictions than to an entry of "unbound" reflects the judgement that a binding in itself has liberalizing value (see also Francois and Martin, 1996).

The results

In each sector, the liberalization index, L, for each country,j, is defined as:

$L^j = \Sigma w_i r_i^j$ summed over i = 1, 2, 3

where w_i is the modal weight
and r_i is the numerical value of the most restrictive measure applied by country j to mode i.

The liberalization index is thus the modal weighted average of the value of the most restrictive measure applied by a country to each mode in the sector.

The regional liberalization indices were calculated either as simple averages of country indices or as GDP share weighted averages. That is:

simple $L = \Sigma L^j/n$, summed over j = 1....n,

weighted $L = \Sigma g^j L^j$ summed over j = 1....n,

where n are the number of countries in the region,

and g^j is the share of each country in the region's GDP.

Tables (ii) and (iii) present the results obtained. Higher values of the liberalization index indicate that commitments have a greater liberalizing content.

Table (ii): Liberalization indices for direct insurance services

Direct Insurance				
	Simple average		GDP weighted average	
	Life Insurance	Non-life Insurance	Life Insurance	Non-life Insurance
Africa	0.60	0.58	0.56	0.52
Asia	0.46	0.46	0.41	0.42
Europe	0.52	0.53	0.53	0.51
Latin America	0.35	0.31	0.22	0.26
All	0.47	0.45	0.35	0.37

Table (iii): Liberalization indices for banking (acceptance of deposits and lending)

Banking				
	Simple average		GDP weighted average	
	Acceptance of Deposits	Lending	Acceptance of Deposits	Lending
Africa	0.65	0.58	0.68	0.57
Asia	0.37	0.43	0.28	0.33
Europe	0.60	0.63	0.60	0.61
Latin America	0.48	0.45	0.38	0.34
All	0.51	0.50	0.37	0.37

Table 1: Numerical summary of Commitments on Modes 1, 2 and 3 in Direct Insurance and Banking (Acceptance of Deposits and Lending) (No. and % share of GDP)

Region	Total WTO Members (% share of GDP of all Members)	Members with commit-ments (% share of GDP of all Members in region)	Members with full commit-ments on all three modes	Commitments on cross border supply (mode 1)		Commitments on consn abroad (mode 2)		Commitments on commercial presence (mode 3)			
				Full	Limited	Full	Limited	Full or ltns. only on the legal form	Limited		
									no. of ssrs: U, limited, DL or R	foreign equity ltns.	other significant ltns.
Direct insurance											
Africa	41 (1.5%)	13 (80%)	1 (0%)	2 (1.7%)	5 (40%)	5 (62%)	3 (11%)	7 (66%)	3 (13%)	2 (5%)	
									1 both (16%)		
Asia and Pacific	25 (7.6%)	17 (95%)	2 (0.3%)	2 (0.3%)	8 (68%)	3 (9%)	7 (23%)	7 (32%)	1 (0.4%)	1 (24%)	1 coexists with others
									8 both (43%)		

Eastern Europe	7 (1.1%)	7 (100%)	0 (0%)	0 (0%)	5 (47%)	0 (0%)	4 (43%)	2 (53%)	3 (37%)	1 (4%)	
									1 both (6%)		
Latin America	32 (6.2%)	18 (97%)	1 (0%)	1 (0%)	3 (66%)	1 (0%)	1 (18%)	3 (1%)	11 (81%)	2 (16%)	
									2 both (1%)		
Total	105 (16.4%)	55 (95%)	4 (0.2%)	5 (0.30%)	21 (64%)	9 (9%)	15 (19%)	19 (24%)	18 (35%)	6 (18%)	
									12 both (22%)		
Banking: Acceptance of deposits and lending of all types											
Africa	41 (1.5%)	18 (84%)	5 (6%)	8 (14%)	4 (13%)	8 (14%)	3 (1.5%)	10 (78%)	5 (10%)	1 (2%)	
									2 both (10%)		
Asia and Pacific	25 (7.6%)	19 (98%)	2 (0.3%)	6 (13%)	3 (10%)	10 (26%)	2 (9%)	3 (5%)	4 (10%)	1 (0.3%)	1 (8%)
									10 both (76%)		8 coexist
Eastern Europe	7 (1.1%)	7 (100%)	0 (0%)	1 (12%)	3 (28%)	0 (0%)	4 (40%)	5 (79%)	2 (21%)	0 (0%)	
Latin America	32 (6.2%)	20 (98%)	3 (0.6%)	4 (2%)	0 (0%)	5 (19%)	0 (0%)	8 (20%)	9 (20%)	1(16%)	1 (0.6%)
									2 both (44%)		

<table>
<tr><td rowspan="2">Total</td><td rowspan="2">105
(16.4%)</td><td rowspan="2">64
(97%)</td><td rowspan="2">10
(1%)</td><td rowspan="2">19
(9%)</td><td rowspan="2">10
(8%)</td><td rowspan="2">23
(16%)</td><td rowspan="2">8
(7%)</td><td rowspan="2">26
(22%)</td><td>20 (15%)</td><td>3 (6%)</td><td rowspan="2">1 (4%)</td></tr>
<tr><td colspan="2">14 both (53%)</td></tr>
</table>

Note: Unless otherwise indicated (as in the second and third columns), percentages for each region are calculated as a share of GDP of all countries with commitments in the region. In the rows indicating the totals, percentages are calculated as a share of GDP of all countries with commitments (other than developed countries).

Table 2: Market access commitments under the GATS on insurance (life and non-life)

Region	Full commitments on first three modes	Commitments on cross border supply (mode 1)		Commitments on consumption abroad (mode 2)		Commitments on commercial presence			
		Full	Limited	Full	Limited	Full or ltns only on the legal form	Limitations on		
							only no. of suppliers (U, ltd,DL,R)	only foreign equity	both no. of ssrs. & foreign equity
Africa	Gambia	Gabon, Gambia	Egypt, Ghana, Kenya, Nigeria, Tunisia	Egypt, Gabon, Gambia, Lesotho, South Africa	Ghana, Kenya, Tunisia	Gambia, Lesotho, Nigeria, Senegal, Sierra Leone, South Africa, Tunisia	Gabon, Mauritius, Morocco,	Ghana, Kenya	Egypt
Asia and Pacific	Bahrain, Solomon Islands	Bahrain, Solomon Is.	India, Korea, Malaysia, Philippines, Qatar, Sri Lanka,	Bahrain, Solomon Is., Thailand	Brunei D., Hong Kong, Macau, Malaysia, Qatar, Sri Lanka, Turkey	Bahrain, Hong Kong, Indonesia, Israel, Macau, Solomon	Qatar	Korea	Brunei D., India, Malaysia, Pakistan, Philippines Singapore, Sri

			Thailand, Turkey			Is., Turkey			Lanka, Thailand
Eastern Europe	-	-	Bulgaria, Czech Rep., Hungary, Slovak Rep., Slovenia	-	Czech Rep., Hungary, Slovak Rep., Slovenia	Poland, Romania	Czech Rep., Hungary, Slovak Rep.	Bulgaria	Slovenia
Latin and Central America	Guyana	Guyana	Argentina, Brazil, Columbia	Guyana	Argentina	Guyana, Panama, Paraguay,	Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Jamaica, Nicara-gua, Peru, Uruguay, Venezuela	Cuba, Mexico	Dominican Rep., Honduras

Table 3: Market access commitments under the GATS on banking (acceptance of deposits and lending of all types)

Region	Full commitments on first three modes	Commitments on cross border supply (mode 1)		Commitments on consumption abroad (mode 2)		Commitments on commercial presence			
		Full	Limited	Full	Limited	Full or ltns only on the legal form	Limitations on		
							only no. of suppliers (U, ltd,DL,R)	only foreign equity	both no. of ssrs. & forn equity
Africa	Ghana, Kenya, Malawi, Mozambique,	Gambia, Ghana, Kenya, Malawi, Mozambique,	Angola, Benin, Gabon, Morocco,	Gambia, Ghana, Kenya, Malawi, Mozambique,	Benin, Gabon	Egypt, Ghana, Kenya, Lesotho, Malawi,	Angola, Benin, Gabon, Mauritius,	Zimbabwe	Gambia, Morocco,

	Sierra Leone,	Sierra Leone, Tunisia, Zimbabwe		Sierra Leone, Tunisia, Zimbabwe		Mozambique, Nigeria, Senegal, Sierra Leone, South Africa,	Tunisia,		
Asia and Pacific	PNG, Solomon Islands	Bahrain, Indonesia, PNG, Qatar, Solomon Is., UAE	Israel, Kuwait, Malaysia	Bahrain, Hong Kong, Indonesia, Kuwait, Macau, PNG, Philippines, Qatar, Solomon Is., UAE	Israel, Malaysia	Israel, PNG, Solomon Is.	Macau, UAE, Hong Kong, Qatar	Bahrain	India, Indonesia, Korea, Kuwait, Malaysia, Pakistan, Philippines, Singapore, Sri Lanka, Thailand
Eastern Europe	-	Romania	Czech Rep., Slovak Rep., Slovenia		Czech Rep., Romania, Slovak Rep., Slovenia	Bulgaria, Czech Rep., Poland, Romania, Slovak Rep.	Hungary, Slovenia		
Latin and Central America	Guyana, Haiti, Panama	Ecuador, Guyana, Haiti, Panama	-	Argentina, Ecuador, Guyana, Haiti, Panama	-	Argentina, Bolivia, Costa Rica, Guyana, Haiti,	Chile, Colombia, Ecuador, El Salvador, Honduras,	Mexico	Brazil, Dominican Rep.

						Jamaica, Panama, Paraguay,	Nicaragua, Peru, Uruguay, Venezuela		

Table 4: Grandfathering provisions in GATS Schedules on banking and insurance services

Country	Provision
Foreign equity-related	
Indonesia	*Banking and insurance*: Share ownership of foreign services suppliers is bound at the prevailing laws and regulations. The conditions of ownership and the percentage share of ownership as stipulated in the respective shareholder agreement establishing the existing individual joint venture shall be respected. No transfer of ownership shall take place without the consent of all parties in the joint venture concerned.
Malaysia	*Banking*: Entry is limited to equity participation by foreign banks in Malaysian-owned or controlled commercial and merchant banks with aggregate foreign shareholding not to exceed 30 per cent, but the thirteen wholly-foreign owned commercial banks are permitted to remain wholly-owned by their existing shareholders. Insurance: New entry is limited to equity participation by foreign insurance companies in locally incorporated insurance companies with aggregate foreign shareholding not to exceed 30%. Foreign shareholding not exceeding 51% is also permitted when (i) existing branches of foreign insurance companies are locally incorporated, which they are required to be by 30 June 1998, and (ii) for the existing foreign shareholders of locally incorporated insurance companies which were the original owners of these companies.
Pakistan	*Insurance*: Foreign shareholding in new life insurance companies is limited to 51% and in existing to 25%, but the scope of operations and equity structure of existing foreign companies is guaranteed.
Philip-pines	*Insurance and banking*: New investments of up to 51% of the voting stock, but existing investments of foreign banks will be maintained at their existing levels.
Legal form-related	
Brazil	*Banking*: Banks established before 5 October 1988, are allowed to maintain the aggregate number of branches that existed on that date. However, for banks authorized to operate after that date, the number of branches is subject to the conditions set out, in each case, at the time authorization is granted.
Hong Kong	*Banking*: The condition that branches of foreign banks are allowed to maintain offices in one main building and no more than two additional offices in separate buildings, does not apply to banks incorporated outside HKSAR licensed before May 1978 in respect of fully licensed banks

	and before April 1990 in respect of restricted licence banks.
Indonesia	*Banking*: Existing branches of foreign banks are exempted from the requirement imposed on new entrants to be in the form of locally incorporated joint venture banks.
Malaysia	*Insurance*: Branching is only permitted for direct insurance companies with aggregate foreign shareholding of less than 50 per cent but companies are permitted to maintain their existing network of branches. (See also foreign equity-related provision above.)
Pakistan	*Banking*: While new entrants are obliged to incorporate locally, the rights of existing branches of foreign banks are guaranteed.
Thailand	*Banking*: While the establishment of new branches is subject to discretionary licensing, existing foreign banks which already had the first branch office in Thailand prior to July 1995 will each be permitted to open no more than two additional branches.
General	
Philip-pines	*Insurance*: Limitations in market access listed in the specific insurance sub-sectors do not apply to existing wholly or majority foreign-owned authorized insurance/reinsurance companies as of the entry into force of the WTO Financial Services agreement.

Table 5: Precommitments to future liberalization and standstill commitments under GATS in banking and insurance

Country	Commitment
Egypt	*Insurance*: relaxation of economic needs test in the year 2000 for life and 2002 for non-life insurance; foreign equity limit increased from 49% to 51% as of 1 January 2000 for life and 1 January 2003 for non-life.
India	*Banking*: 12 branch licenses per year both for new entrants and existing banks; subject to 15% maximum share of foreign assets to the total assets of the banking system.
Indonesia	*Insurance and banking*: all limitations will be eliminated by the year 2020 subject to a similar commitment by other Members.
Korea	*Insurance and banking*: standstill for all market access limitations as of 31 August 1997.
Philippines	*Banking*: 10 new licenses for bank branches for the period 1995-2000.
Thailand	*Banking*: discretionary higher equity participation in banks than bound 25% maximum for a period of 10 years, grandfathered thereafter for the absolute amount of equity held.
Bulgaria	*Insurance*: majority foreign ownership in insurance will be allowed 3 years after accession.
Czech Republic	*Insurance*: endeavour to eliminate or reduce scope of monopoly rights in compulsory insurance under Paragraph A1 of the Understanding on Financial Services.
Hungary	*Insurance*: market access for branches of insurance companies on adoption of legislation.
Poland	*Insurance and banking*: as of 1 january 1999, market access through licensed branches of banks and insurance companies will be allowed.
Slovak Republic	*Insurance*: endeavour to eliminate or reduce scope of monopoly rights in compulsory insurance under Paragraph A1 of the Understanding on Financial Services.

Slovenia	*Insurance*: 99% limitation on foreign ownership of insurance companies will be abolished with the adoption of relevant law. *Banking*: branch banking will be allowed, and elements of discretionary licensing removed, after adoption of the new Banking Law.
Brazil	*Insurance*: commercial presence in work accident insurance, reinsurance and retrocession will be allowed within two years of adoption of legislation *Banking*: national treatment for commercial presence for services of credit cards and factoring within two years of adoption of legislation.
Nigeria, Turkey, Bulgaria, Czech Republic, Hungary, Slovak Republic	*Insurance and banking*: standstill under Paragraph A of the Understanding on Financial services.
Sri Lanka	*Banking*: standstill under Paragraph A of the Understanding on Financial services.

Annex 2: Tables A1-A8

The abbreviations used in these tables are the following:

o:	commitments from before the most recent round of negotiations
B:	branches
S:	subsidiaries
h:	restrictions in horizontal commitments
I:	local incorporation required
R:	reciprocity condition or MFN exemption
U:	unbound
DL:	discretionary licensing or economic needs test
(D)LSO:	(discretionary) limits on single ownership
G:	grandfathering provisions

Table A1: Market Access Commitments in Insurance (Direct: Life and Non-Life): Africa

Member	Ltns on Cross border	Ltns on Consn abroad	Limitations on commercial presence			
			Legal form	No. of suppliers	Equity	Other
Egypt	life: none non-life: U	none	B not allowed	DL	49%	
Gabon (o)	none	none		DL		
Gambia (o)	none	none	none			
Ghana	U except for personal effects				60%	
Kenya	U except for aviation, marine and engineering				life: two thirds of paid up capital	
Lesotho (o)	U	none	I		DLSO	
Mauritius	U	DL		DL		
Morocco (o)	U	U	local regn	R		
Nigeria	U except for aviation, maritime, space, and goods in transit	U	I			
Senegal	U	U				
Sierra Leone (o)	U	U				foreign co. estbd for 10 years
South	U	none	I		DLSO	

Africa						
Tunisia	none except local risks, residents and imports only through mode 3	none for non-residents	S as a plc or mutual society; B can only ins non-residents			

Table A2: Market Access Commitments in Insurance (Direct: Life and Non-Life): Asia & Pacific

Member	Ltns on Cross border	Ltns on Consn abroad	Limitations on commercial presence			
			Legal form	No. of suppliers	Equity	Other
Bahrain (o)	none	none	none			
Brunei Dar. (o)	U	none excl. statutory ins.	local registration	**U (h)**	**U (h)**	
Hong Kong	U	none excl statutory ins	S, B or association of underwriters			
India	U except limited freight insurance	U	U			
Indonesia	U	DL			100% of listed cos. (G)	
Israel	U	U	None			
Korea	U except marine cargo and aviation ins.	U	S, B, joint ventures (but not with K lics)		restrictions on acquisition of existing firms; foreign portfolio invt only for listed stocks, ≤ 23% (h) LSO	
Macau	U	None excl. statutory ins	S or B			
Malaysia	life: U	life: U	I	new: U	on incorpn of existing branches and for original owners: 51%; new particpn in existing 30% (DLSO)	No branches for foreign> 50% (G)
	non-life: DL	non-life: DL				
Pakistan	U	U		life: none	life new: 51%; existing: 25% (G)	
				non-life: U	non-life: (G)	
Philippines	U except for marine hull and marine cargo	U		DL	acquisition or new: 51% (G)	
Qatar (o)	none	none		frozen at 5: 1995 levels		
	no commitments on life insurance					

Singapore	U	none, excl statutory ins		New:U	existing: 49% provided no foreign party is largest shareholder	
Solomon Isl. (o)	none	none	none			
Sri Lanka	U except freight ins	U		DL	49%	
Thailand	U except for internl marine, aviation and transit	none		DL	25%	
Turkey	life: U	life: U	joint stock, mutual co. or B			
	non-life for ltd class	non-life:none for ltd. class				

Table A3: Market Access Commitments in Insurance (Direct: Life and Non-Life): Eastern Europe

<table>
<tr><th rowspan="2">Member</th><th rowspan="2">Ltns on Cross border</th><th rowspan="2">Ltns on Consn abroad</th><th colspan="4">Limitations on commercial presence</th></tr>
<tr><th>Legal form</th><th>No. of suppliers</th><th>Equity</th><th>Other</th></tr>
<tr><td>Bulgaria</td><td>U except transns between foreigners</td><td>U</td><td>joint stock co and B; separation of life and non-life</td><td></td><td>no supply by majority foreign ownership until 3 yrs after accession</td><td>branches: 5 years of authorzn in country of origin for same ins class</td></tr>
<tr><td>Czech Republic</td><td>with mode 3</td><td>none but excludes life ins of residents, property and liability ins in territory</td><td>joint stock co and B</td><td>exclusive rights for compulsory motor and health insurance</td><td></td><td></td></tr>
<tr><td>Hungary</td><td colspan="2">only for maritime, avaiation, space and goods in transit; involved in international business activity and for events occurring abroad</td><td>no B; separation of banking, ins and securities</td><td>R</td><td></td><td></td></tr>
<tr><td>Poland</td><td>U</td><td>U</td><td>joint stock co. and B as of 1 Jan. 1999</td><td></td><td></td><td>5% lt on investment abroad of ins funds</td></tr>
<tr><td>Romania</td><td>U</td><td>U</td><td>only in partnership with R legal or natural persons</td><td></td><td></td><td></td></tr>
<tr><td>Slovak Republic</td><td colspan="2">none but excludes life ins of residents, ins of property and damage or loss liability in territory, and air and maritime, covering goods, aircraft, hull and liability</td><td>joint stock co. or subs</td><td>exclusive rights for compulsory motor, air, employer and health insurance</td><td></td><td>ins funds must be deposited in a resident bank and not transferred abroad</td></tr>
<tr><td>Slovenia</td><td colspan="2">U except for maritime shipping, commercial aviation and freight</td><td>no B; only joint ventures; separation of banking, ins and securities</td><td>U for ins. cos under privatization</td><td>99%</td><td></td></tr>
</table>

Table A4: Market Access Commitments in Insurance (Direct: Life and Non-Life): Latin America

Member	Ltns on Cross border	Ltns on Consn abroad	Limitations on commercial presence			
			Legal form	No. of suppliers	Equity	Other
Argentina (o)	U except none for maritime and air insurance			U		
Bolivia	U	U	B or I	DL		
Brazil	U except for some freight ins, etc.	U	plcs	DL	DL	
Chile	U	U	I	DL		
Colombia	U except for external trade operations and foreign travel	U	affiliated cos. and S (not B)	DL		
Cuba (o)	U	U			DL for > 49% (h)	
Dominican Republic	U	U		DL	49%	
Ecuador	U	U		U		
Guyana (o)	none	none	none			
Honduras	U	U		DL	40%	
Jamaica	U	U		DL		
Mexico	U	U			40% of common stock + 30% non-voting common stock (aggregate for sector) Mexican control of enterprise reqd LSO	
Nicaragua	U	U	plcs	DL (h), R		
Panama	U	U	none			
Paraguay (o)	U	U	none			
Peru	U	U	plcs	DL (h), R		ltns on invt across finl instns
Uruguay	U	U	plcs			
			U for insurance other than freight, motor vehicle, marine, aviation and other transport services.			

Venezuela	U	U	pcs. (not B)	DL		

Table A5: Market Access Commitments in Banking (Acceptance of Deposits and Lending): Africa

Member	Ltns on Cross border	Ltns on Consn abroad	Limitations on commercial presence					
			Legal form	No. of suppliers	Equity	Number of operns (branches)	Value of transns or Assets	Other
Angola	deposits: none	DL	deposits: none					
	lending: DL		lending: U					
Benin (o)	deposits: none		deposits: normally plcs					
	DL for loans>CFAF 50m		lending: U					
Egypt	U	U	joint stock co., partnershi p	none for joint ventures; DL for B	DLSO		G for dealing through B	
Gabon (o)	none	none		DL				
	no commitments on acceptance of deposits							
Gambia (o)	none	none	U					
Ghana	none	none	none					
Kenya	none	none	none					
Lesotho (o)	U	U			DLSO			
Malawi (o)	none	none	none					
Mauritius	DL	DL		DL				
Morocco (o)	deposits: U	U		R	DL			
	lending: U except for invt and comml transns. with M							
Mozambi que (o)	none	none	none					
Nigeria	U	U	I					
Senegal	U	U	normally					DL on for.

			plc.					curr. loans
Sierra Leone (o)	none	none	I,B					
South Africa	U	U						
Tunisia	none	none		DL				
Zimbabwe (o)	none	none			60%		no lending for building	

Table A6: Market Access Commitments in Banking (Acceptance of Deposits and Lending): Asia & Pacific:

Member	Ltns on Cross border	Ltns on Consn abroad	Limitations on commercial presence					
			Legal form	No. of suppliers	Equity	Number of operns (branches)	Value of Transns or Assets	Other
Bahrain	None	None	S or B		49%			
Hong Kong	U	None	deposits: S or B	DL for acquistion of locally inc bank		For banks inc. overseas, max offices=3 (G)		For S, 10 years as authorz instn.
			Lending: none					
India	U	U	only B of banks licensed abroad	12 licenses p.a. for new and existing	only B, no S	licenses reqd for ATMs	max foreign share of total assets≤15 %	ltns on invt in other finl.cos
Indonesia	None	None	New: I, joint venture (G of old B)	new:U	acquisn of existing: 49% (G)	2 B/ aux. office		
Israel	deposits: U		None					
	lending: only through licensed authorized dealers							
Korea	U	U		only branches of top 500 banks; unclear on S	restrns on acquisn of existing firms; foreign portfolio invt only for listed stocks, and ≤23% (h) LSO		ceilings on foreign currency loans	
Kuwait	deposits: U	None		DL	40% + Kuwaiti govt or finl instn share-holding			
	lending:							

	only synd. loans through K banks or invt cos.							
Macau	U	None	S or B	deposits:DL				
Malaysia	deposits:U	None		new: U	existing: 30% (G) DLSO	U for B and ATMs of comml banks		
	Lending ≥ RM25m only with mode 3							

Member	Ltns on Cross border	Ltns on Consn abroad	Limitations on commercial presence					
			Legal form	No. of suppliers	Equity in subsidiaries	Number of operns (branches)	Value of Transns or Assets	Other
Pakistan	U	U	I (G of old B)	R	deposits:49%	3 B (G)	bound for existing vol of deposits and assets	
					lending: DL on mangmt control			
PNG (o)	none	none	none					
Philip-pines	U	none	Single form of presence + invt. in local incorp: DL	DL, R	acquisition or new: 51% (G)	10 new B (1995-2000) indvl max=6	30% max foreign share of total assets	
Qatar (o)	none	none		frozen at 1995 levels (8 B)				
Singapore	U	none		deposits new :U	deposits: 40% LSO	deposits: 1 office (incl. ATM)		
				lending: none	lending: none	lending:off premise ATM: U	lending local currency to non-res: DL	
Solomon Isl. (o)	none	none	none					
Sri Lanka	U	U	I or B	DL	49%			
Thailand	U	U	I or B	S: U B: DL	acquisition of existing: 25% (ltns. on indvl. ownership) DL on	existing banks with a B before 1995: 2 addnl Bs (G); new Bs: DL		

					>25%	ltns on ATMs		
Turkey	U	U	joint stock co. or B			DL on Bs		
UAE	none	none		new and expn of existing: U				

Table A7: Market Access Commitments in Banking (Acceptance of Deposits and Lending): Eastern Europe

Member	Ltns on Cross border	Ltns on Consn abroad	Limitations on commercial presence					
			Legal form	No. of suppliers	Equity	Number of operns (branches)	Value of transns or Assets	Other
Bulgaria	U	U			DLSO		10% ltn on participation in non-finl enterprises by a bank	
Czech Republic	deposits: U lending: none		estbd as joint stock cos, or Bs				mortgage loans not by branches	
Hungary	U	U		R	none except long-term state ownership in one bank at least 25% + 1 vote			
Poland	U	U	joint stock co. and Bs as of 1 Jan. 1999					
Romania	none	none except DL for opening foreign a/cs, etc.	none					
Slovak Republic	deposits: U lending: restrictions for short-term loans		joint stock co or B					
Slovenia	deposits:U		I	DL? U for participation in banks under privatzn			U for mortgage banks	

	lending: none						

Table A8: Market Access Commitments in Banking (Acceptance of Deposits and Lending): Latin America

Member	Ltns on Cross border	Ltns on Consn abroad	Limitations on commercial presence					
			Legal form	No. of suppliers	Equity	Number of operns (branches)	Value of transns or Assets	Other
Argentina (o)	U	none	none					
Bolivia	U	U	B or I					
Brazil	U	U	B or plc	DL	DL	DL (G)		
Chile	U	U	B or I	DL	DLSO			
Colombia	U	U	affiliated cos. and S (not B)	DL				
Costa Rica	U	U	affiliated cos. and S (not B)					
Domini-can Republic	U	U		DL	49%			
Ecuador	none	none		U				
El Salvador	U	U	U except that foreign ownership is allowed subject to certain conditions					
Guyana (o)	none	none	none					
Haiti (o)	none	none	none					
Honduras	U	U	branches: U	DL, R				
Jamaica	U	U	none					
Mexico	U	U			40% of common stock + 40% non-voting common stock (aggregate for sector) Mexican control of enterprise reqd LSO			

Member	Ltns on Cross border	Ltns on Consn abroad	Limitations on commercial presence					
			Legal form	No. of suppliers	Equity in subsi-diaries	Number of operns (branches)	Value of transns or Assets	Other
Nicara-gua	U	U	plcs; banks inc abroad only through Bs	DL (h), R				
Panama (o)	none	none	none					
Paraguay (o)	U	U	none					
Peru	U	U	plcs	DL (h), R			ltns on cross-invt between finl instns	
Uruguay	U	U	plcs.	authrzns for new banks in any year< 10% in previous year				
Venezuela	U	U	plcs or Bs	DL, R		DL on branching		