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Financial Services and the WTO: What Next?

The Financial Services Agreement (FSA) concluded in December 1997 under the auspices of the World Trade Organization's (WTO) General Agreement on Trade in Services (GATS) represented one of the hallmark achievements of the Uruguay Round. Thanks to GATS and the FSA, there is now considerable awareness that financial services are key inputs in the production of all that a nation produces, brings to market, and trades in, whether goods, ideas, and services. Simply put, financial services are the central nervous system of the body economic.[1] There is, similarly, a much greater recognition that the ability of efficient providers of financial services to deploy their competitive skills in foreign markets and contest prevailing rents is crucial for their clients' growth and commercial success in those markets. That success, in turn, serves the employment, innovation, growth, and development prospects—to say nothing of consumer welfare—of host countries.[2]

This improved understanding of the role of financial services providers has lent support to continued efforts worldwide at fostering competition-friendly domestic regulatory reform in the sector, amidst considerably

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1. Crockett (2000).
2. Levine (1996); and Jacquet (1997).

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heightened capital mobility and occasionally severe financial market turmoil. Much of that reform has been undertaken voluntarily on a unilateral basis, while some has been achieved pursuant to conditionality packages designed by the Bretton Woods organizations. An important challenge in the ongoing negotiations at the WTO is to secure such liberalization through commitments under GATS.[3]

The need for such forward momentum took on added systemic significance following the collapse of the third WTO ministerial meeting in Seattle in 1999, and the rising chorus of globaphobic sentiments directed toward the continued pursuit of services trade and investment liberalization. Governments and the private sector must today mount a more spirited defense of the strong case for sustaining liberalization's forward movement in a sector of considerable economywide importance. Although the initial set of services negotiations elicited little by way of public scrutiny (or even much interest beyond fairly narrow business, government, and academic circles), the current negotiations have drawn a loud and concerted attack by various pressure groups, especially within the member countries of the Organization for Economic Cooperation and Development (OECD). These groups allege that GATS will all at once force governments to privatize essential services, will further erode domestic regulatory sovereignty, and will oblige member states to pry open service sectors to predatory foreign multinational companies.[4] Such arguments have demonstrable political traction even when they are patently false, grossly exaggerated, or deliberately misconstrued. Proponents of the benefits of multilateral trade diplomacy must therefore engage in the debate forcefully to counteract their influence. Failing to do so could hold back or even reverse progress in opening financial markets, a process which many civil society groups see (wrongly once more) as tantamount to lifting all barriers on capital movements. These risks are likely to be amplified if WTO members are unable to launch a new, broader round of multilateral negotiations at the upcoming Qatar ministerial meeting, given the narrowness of the current negotiating mandate on agriculture and services.

An important distinguishing feature of the FSA relates to the degree of support and the political legitimacy it generated through a shared sense of transatlantic purpose and commitment on the part of the financial services industry itself. The sector was truly unique in that respect, and there is lit-

3. Sauvé and Gillespie (2000).

4. Frances Williams, "WTO Foresees Tough Talks on Opening up of Services Provision," *Financial Times,* March 16, 2001; and WTO (2001d).

tle doubt within the trade policy community that financial sector support in the European Union and the United States was a determining force in concluding the FSA.[5] The strength of those ties has not diminished since the FSA's conclusion. The industry's resolve and strategic focus is rather striking when compared with other segments of the business community.

Properly marshaling that sense of direction is a key to the success of the current negotiations and to agreement on a broader negotiating agenda in Qatar. Equally important is accessing the public and private channels of cooperation that underpin the broadly shared vision found in Canada, the European Union, Japan, and the United States (the so-called Quad countries). Doing so would do much to intensify the overall dynamic of liberalization within the WTO system as a whole and ensure that GATS remains an efficient means of overseeing the growing integration of national economies in an orderly, predictable, fair, and transparent manner.

Owing to the protracted nature of negotiations in the sector and to the implementation difficulties encountered by a number of WTO members, the GATS rules governing the financial sector only entered into effect on March 1, 1999, some twelve years after the launch of the Uruguay Round.[6] Consequently, the FSA was a mere nine months old when negotiations resumed on January 1, 2000, as scheduled under the Uruguay Round's so-called built-in agenda. Negotiations have yet to begin in earnest, however, as key players have only recently put forward their respective market access agendas. The coming negotiations will present many new challenges for the financial services community. The post–Uruguay Round negotiating agenda on financial services will, in all likelihood, be a highly differentiated one, encompassing countries at different levels of development, alternative modes of supply (cross-border trade versus establishment-related trade), competing business models (e-finance versus traditional channels), and specific market segments (banking versus securities versus insurance). The agenda must also take into account new players whose increasing ability to contest and capture the rents of traditional financial institutions is fast eroding the neat lines of demarcation that used to prevail in the market.

5. Freeman (1997); and Moore (2000).

6. Seven countries—Brazil, the Philippines, Poland, Uruguay, Bolivia, the Dominican Republic, and Jamaica—have yet to accept the GATS Fifth Protocol establishing the FSA. Of these, all are currently engaged in domestic implementation processes of varying length and complexity, on which they make regular reports to the GATS Committee on Financial Services. The Fifth Protocol was reopened briefly in December 2000 to allow Kenya and Nigeria to sign the FSA. See Sauvé and Gillespie (2000) for a description of the FSA's complex negotiating history.

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This essay addresses two central questions. First, what financial sector harvest can the GATS 2000 round realistically be expected to generate? And second, what can be done to enhance the quality and size of the achievements? To answer these questions, the essay considers the key market access issues that negotiators will likely confront in the coming talks. It then depicts and contrasts the liberalization and rulemaking challenges arising within the OECD area and in the developing world. The paper concludes with a discussion of a number of political economy issues that will influence the substantive outcome of negotiations in the financial services sector.

The essay comes to a threefold conclusion. First, although the FSA provides a solid foundation on which to pursue negotiations on trade and investment in financial services, much remains to be done to achieve increased market contestability. This is true both in developed countries, particularly with regard to cross-border transactions at the retail level, and in developing countries, where unilateral policy decisions have frequently established a degree of financial market openness that far exceeds what is currently reflected in legally bound WTO commitments. Second, important differences between developed and developing countries regarding the substantive nature of the negotiating agenda in financial services, combined with the limited export interests of most developing countries in the sector, will lessen the scope for intrasectoral bargaining. Accordingly, the financial industry in OECD countries (the main *demandeurs* in WTO talks) has an important stake in the launching a broad-based round of multilateral negotiations. Third, the important early progress that has been made in developing, promoting, implementing, and monitoring compliance with international standards for financial market supervision in the wake of recent financial market turmoil forms a strong complement to WTO-anchored attempts at advancing and securing the liberalization of financial markets. Any progress in regulatory and prudential convergence, whether coordinated through or pursued outside the WTO framework (as it currently is and should remain), will do much to enhance prospects for a greater overall degree of global competition in financial markets.

A Traditional Contestability Agenda in Financial Services

The liberalization of trade in services, in particular financial services, cannot be achieved by relying solely on the negotiated removal of border measures and the general multilateral principles on which the liberalization of

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trade in goods is based.[7] The barriers to trade in financial services are diverse and virtually always embedded in domestic regulatory practices. Such regulation may not be primarily concerned with the goals of free trade and competition, but may rather seek to promote certain social or noneconomic objectives. In the case of financial services, regulation is typically directed to limiting systemic risk, for example, by preserving the solvency of financial service providers or protecting depositors. Consequently, many measures that either directly or inadvertently pose barriers to trade in financial services cannot simply be eliminated or reduced.

As this opening section illustrates, however, many countries maintain a myriad of trade- and investment-impeding measures that might be easily amenable to negotiated reductions or to some of the traditional trade disciplines found in GATS, especially nondiscrimination principles. This is particularly the case among developing economies. Given that the dividing line between such restrictions and those with a more fundamental or systemic prudential component can at times become blurred, barriers to trade and investment in financial services might best be understood as lying along a continuum. At one extreme lie various market entry restrictions that simply bar foreign entry or limit the level of contestability by restricting the number of market entrants. At the other extreme are prudential regulations (typically of a nondiscriminatory nature) with an incidental effect on financial services trade—and often a disproportionate incidence on foreign service suppliers. Scattered in between are post-market entry measures affecting the operating conditions of financial institutions in foreign markets.

A traditional contestability agenda in financial services, as defined in this essay, would rely on negotiated reductions and nondiscrimination principles to address market entry and certain postestablishment barriers. Regarding other types of nondiscriminatory regulations, such an agenda would aim to strengthen disciplines on transparency and increase the level of regulatory convergence across borders through harmonization, recognition, and the adoption of international standards.

The first category of barriers that a traditional contestability agenda would seek to address consists of measures that act as barriers to market entry, including barriers to the cross-border supply of financial services. It also encompasses barriers to foreign entry, that is, restrictions that inhibit foreign service providers from establishing a commercial presence in a host-country market. Such restrictions typically include limits in the following four areas:

7. Trebilcock and Howse (1999).

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—The number of service suppliers. This type of restriction is usually applied through numerical quotas or economic needs tests for licenses, as well as moratoria or freezes on new licenses. The national context for such restrictions may include a nationalized domestic financial sector or a supplier that holds a monopoly or acts as an exclusive provider.

—Foreign equity participation. These measures specify the maximum share of equity in domestic financial institutions that foreign service suppliers can own.

—The type of legal entity or joint venture through which a service can be supplied. This type of restriction, which is one of the most commonly used mechanisms in emerging markets, delimits how a foreign financial institution may operate in the domestic market. For example, the rules of participation may specify only a representative office, a separately capitalized and locally incorporated subsidiary, or mandatory partnership with the government.

—The ability of residents to purchase financial services in another territory.

The second category of barriers addressed by a traditional contestability agenda consists of measures that affect the operating conditions of foreign service providers once they have established a commercial presence in the host country. Examples include limits on the total number of services operations or the total quantity of service output; the geographical range of operations; the type of services that can be provided; the number and type of natural persons to be employed in a particular sector; the value of transactions or assets being managed; and restrictions on the ownership of land or real estate. The application of taxes and subsidies (including indirect subsidies flowing from regulations that artificially reduce the cost of capital to domestic firms) may also affect the operating conditions of foreign service providers.[8]

An important element in this category of barriers concerns the issue of grandfathering the acquired rights of established operators. This issue assumed considerable importance in the final days of negotiations leading to the FSA, and it came close to derailing its conclusion. A grandfather clause protects existing investments (and investors) from commitments by

8. The Association of German Banks (2001) cites the interesting case of how public guarantees provided to the country's savings banks and their central institutions, the Landesbanken, allow such banks to fund themselves relatively cheaply on the capital market, thereby giving them a competitive edge over their domestic and foreign competitors. Competition is further distorted by the fact that in many federal states, public housing agency funds have been transferred to Landesbanken at below-market interest rates. Following a complaint filed by the European Banking Federation, the European Union is now examining the lawfulness of public guarantees under European law on state aid.

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the host country in the context of a negotiation that could adversely affect such investments' existing operating conditions.

Table 12A-1 (in appendix A) provides country-specific examples of the types of measures covered by a traditional contestability agenda for each of the three core financial services subsectors, namely, banking, securities, and insurance.[9] The bulk of measures affecting market entry are quantitative in nature and amenable to negotiated, progressive liberalization. Under GATS, the principal means for liberalizing such measures is contained in Article XVI (Market Access), which prohibits the use of most of the market-entry barriers described above in sectors in which countries agree to undertake specific commitments. Alternatively, the Understanding on Commitments in Financial Services, which is annexed to the FSA, offers a means for countries to voluntarily subscribe to a higher degree of liberalization in the sector. Articles 5 and 6 of the Understanding provide for the right of establishment, which would result in substantial liberalization of market-entry restrictions in those countries that decide to schedule specific commitments in accordance with this instrument. Articles 3 and 4 would have a similar liberalizing effect, since they require that subscribing countries allow foreign financial service providers to supply certain services on a cross-border basis and also allow residents to purchase these services abroad.

The liberalization of barriers belonging to the postestablishment category of a traditional contestability agenda is significantly more complex than the liberalization of barriers to market entry. Postestablishment barriers encompass not only measures imposed on foreign services or service providers in a discriminatory fashion, but also nondiscriminatory measures that may impede trade in financial services. While discriminatory measures fall within the scope of Article XVII (National Treatment) of GATS or Article C.1 of the Understanding on Commitments in Financial Services, nondiscriminatory measures are not caught by the national treatment discipline of either instrument. Furthering trade and investment liberalization in heavily regulated sectors like banking, securities, and insurance must therefore be based on negotiating approaches that seek to balance two potentially competing objectives: ensuring that regulation (often shading into prudential regulation) is not used to limit competition from abroad and ensuring that freer trade in financial services does not undermine the prudential objectives pursued by such regulation.

9. These lists are not intended to provide a comprehensive inventory of barriers to trade in financial services, but rather they seek to highlight the most common measures affecting trade in each of the three core subsectors of financial services.

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Two approaches have been suggested to help reconcile this twofold objective. First, in the context of work proceeding under Article VI on domestic regulation, GATS members have drawn attention to the notion of necessity and the circumstances under which domestic regulatory measures may depart from the requirement that they be the least trade restrictive possible and not needlessly burdensome.[10] Work in this area has raised acute sensitivities within regulatory circles and civil society. Many financial regulators feel that viewing regulation through a necessity prism could undermine the sound public policy rationales that underpin such regulation. To the extent that regulation, including that taken on prudential grounds (and despite the prudential carve-out found in the Annex to the FSA), remains subject to multilateral dispute settlement provisions in cases of demonstrable protectionist capture, the political costs of developing more highly codified disciplines on the issue of necessity may well outweigh any putative economic benefits.[11]

A second, and significantly more consensual, approach toward reconciling the twofold objective described above consists of designing measures to support greater regulatory transparency. The primary purpose of such measures would be to shed light on the way in which existing regulations in the financial services (and other) sectors are developed, adopted, and enforced; mechanisms would include prior notification procedures in domestic rulemaking.[12] The rationale behind such a proposal is simple and powerful: measures that are designed on the basis of broad consultations with all potential stakeholders, including foreign firms, are likely to command greater legitimacy—and hence more readily meet any implicit necessity requirements. Chances are, moreover, that measures developed and implemented through a fully transparent process are less likely, on balance, to be challenged by trading partners through dispute settlement procedures.

10. WTO Members are obliged under GATS Article VI:5 to ensure that domestic regulation is based on objective and transparent criteria, is no more burdensome than necessary, and in the case of licensing procedures, does not in itself restrict the supply of the service. The procedure for determining whether a member is in conformity with this obligation takes into account the international standards of relevant international organizations, if applied by the member. The WTO Working Party on Domestic Regulation is discussing the issue of developing regulatory disciplines as mandated under GATS Article VI:4. Such disciplines would apply to those sectors and subsectors in which members have scheduled liberalization commitments. To date, the WTO has made no attempt to develop disciplines that would apply to prudential regulation in financial services. A proposal to clarify the scope of prudential measures was recently rejected by the WTO Committee on Trade in Financial Services (Kawai, 2001).

11. This argument is seemingly strengthened by the fact that no trade disputes have been lodged so far under GATS in the field of financial services.

12. OECD (2001b).

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While increased transparency with respect to nondiscriminatory regulatory measures can prove to be a powerful instrument in promoting domestic regulatory reform, it might not be sufficient, in itself, to achieve greater market openness in the sphere of financial services. A stronger commitment to transparency may, however, serve as a springboard for initiatives that aim to minimize the impact of nondiscriminatory regulation in financial services trade. In particular, such initiatives, which include the development of rules on harmonization and mutual recognition, may help speed the adoption and diffusion of best regulatory practices and international standards. The adoption of such standards across countries is likely, in turn, to reduce the scope for commercial conflict by lessening incentives for regulatory arbitrage. In this sense, the far-reaching degree of voluntary, nonbinding regulatory convergence in prudential supervisory practices that is currently taking place in various international fora is fully compatible with—and strongly complements—efforts at progressive, legally bound, financial market opening in the WTO.

The specific elements of a traditional contestability agenda in financial services that will be at the core of the ongoing GATS 2000 negotiations can be deduced from the various proposals that have been submitted to the GATS Council. Six WTO members—Australia, Canada, the European Union, Japan, Norway, and the United States—have tabled proposals that directly address financial services (see table 12A-2 in appendix A for a summary). A priority area for all six appears to be mode 3 of GATS, which deals with commercial presence or establishment-related trade in services. Indeed, the proposals demonstrate a broad consensus on the need to further liberalize quantitative measures impairing investment in the three financial services subsectors (banking, securities, and insurance). The measures most often mentioned in this regard include constraints on foreign ownership, foreign equity participation, the legal form of establishment, and the number of service suppliers.

The different financial services proposals are somewhat less uniform with regard to the remaining GATS modes of services delivery. Only half of the proposals underscore the need to reduce restrictions on the ability of residents or firms from one territory to purchase services in another territory (GATS mode 2). With respect to cross-border trade (mode 1), some WTO members have identified specific subsectors within banking and insurance that they consider ripe for liberalization, rather than calling for across-the-board commitments as in the case of mode 3 and, to a certain extent, mode 2. For example, the European Union and the United States,

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with strong backing from the International Chamber of Commerce (ICC), propose the elimination of barriers that impede cross-border trade in financial information and advisory services; marine, aviation, and transport (so-called MAT) insurance; reinsurance and retrocession; and services auxiliary to the provision of insurance, such as consultancy, risk assessment, and claim settlement services. Norway wishes to see cross-border trade in maritime shipping insurance included in the services negotiations, while Australia and Canada do not identify any specific subsectors as candidates for cross-border liberalization. Finally, all proposals except that of Norway refer to the fourth mode of services delivery. Together, they cover a wide array of issues related to the temporary entry of natural persons, including the temporary movement of intracorporate transferees and contractual service suppliers, nationality and residency requirements for executives and employees, and the reduction of limits on the number of foreign employees.

Given that postestablishment barriers to trade in financial services are highly pervasive in developed and developing countries alike, it should come as no surprise that a majority of countries' GATS 2000 proposals devote significant attention to this type of barrier. The sheer number of postestablishment barriers listed in the proposals reflects not only their pervasive nature, but also the numerous forms that these mostly regulatory barriers can take. The diverse items that countries would like to discuss during the ongoing services round include restrictions on the number and type of products that can be offered by foreign firms in domestic markets (Australia); nondiscriminatory membership in self-regulatory bodies and in stock, securities, and futures exchanges (the European Union); nondiscriminatory tax treatment (Japan); and licensing procedures (the United States).

The six WTO members demonstrate consensus on the important role of transparency in reducing the trade effects of postestablishment regulatory barriers. All the proposals suggest putting transparency on the negotiating table, usually with a view to refining and deepening current disciplines.

A Two-by-Two Negotiating Proposal

A useful way of focusing cooperative efforts in the financial services area at both the governmental and private sector levels is to distinguish the twin challenges of liberalization and rulemaking as they concern OECD and developing countries. While both groups of countries face work on each front, the nature of that work, the technical difficulties it entails, the regu-

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Table 12-1. *Negotiating Challenges of the GATS 2000 Round in Financial Services*

Challenge	*OECD countries*	*Developing countries*
Rule-making challenges	Address the regulatory challenges of e-finance	Improve domestic prudential standards and supervisory capacities before liberalizing financial services
	Establish regulatory dialogue among trade and finance regulators in a WTO setting	Experiment with safeguards provisions specific to financial services
	Enshrine a right of nonestablishment in the Understanding on Commitments in Financial Services	Bind the regulatory status quo
	Show a readiness to experiment with a safeguards clause specific to financial services	Promote greater coherence between World Bank, IMF, and FSAP surveillance of regulatory regimes, WTO negotiations, and TPRM surveillance
	Consider scope for open, plurilateral recognition agreements in areas of greater regulatory convergence or lesser regulatory burden	
Liberalization challenges	Predominant focus on e-finance (mode 1: cross-border trade; mode 2: consumption abroad)	Predominant focus on commercial presence (mode 3)
		Secure a higher overall level of bound liberalization through the Understanding on Commitments in Financial Services
		Phase-in liberalization, with appropriate transition periods and precommitments to future liberalization
		Focus on competition and market entry rather than ownership

latory challenges it raises, and the political calculus to which it gives rise are all noticeably different. Establishing a clear, explicit hierarchy of negotiating priorities early on will be important in addressing these challenges, as will the skilful deployment of diplomatic and advocacy efforts in countries that question the wisdom, relevance, and price tag (in terms of concessions in areas of priority export interest) of forward trade and investment liberalization in the financial sector. Table 12-1 depicts this contrasted negotiating agenda in a simple two-by-two matrix, which is elaborated in the discussion below.

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Negotiating Challenges in OECD Countries

For OECD member countries, by far the greatest challenge of the coming round will be to adapt the FSA (and GATS) to the unfolding landscape of e-commerce and the possibilities it opens up for the genuine liberalization of cross-border trade in financial services. The FSA largely predated the advent of e-finance; some measure of catching up is a first-order priority if the FSA is to retain its nascent credibility. The e-finance agenda carries both rulemaking and liberalization dimensions that OECD countries must productively explore.

RULEMAKING CHALLENGES. The most pressing challenge in the area of rulemaking will be that of fostering acceptance and cooperation (sometimes called buy-in) on the part of financial regulators. Without their participation, it is difficult to see how a commercially meaningful set of liberalization commitments on cross-border trade in financial services might emerge from the GATS 2000 negotiations (particularly at the retail end of the market where much of the GATS talks will likely concentrate). The intensity and historical antecedents of regulatory cooperation across the Atlantic, together with the resulting level of mutual trust and understanding that such cooperation affords, means that both governments and private sector firms in the United States and the European Union are uniquely placed to assume a leadership role in this area.

Unlike most developing and transition economies, OECD countries generally bound the regulatory status quo in the financial sector under the FSA, and they displayed considerable regulatory caution with regard to committments on cross-border trade in financial products. As a result, commitments under GATS modes 1 and 2 (cross-border supply of services and consumption abroad) were far less common and more narrowly drawn than were liberalization commitments scheduled for trade through a commercial presence (mode 3). Most OECD countries used the Understanding on Financial Services Commitments as the basis for scheduling commitments in the sector, although the relevant obligations cover only a very limited range of insurance activities and auxiliary and advisory services—and even then, mostly on the demand side (consumption abroad) rather than on the supply side.

Winning over the regulatory community is easily preached. Doing so in practice is quite another matter. A strong push from the private sector, which has most to gain from such market opening, will likely prove instrumental in this regard. Leaders in the world's financial community must

encourage regulatory officials to launch a process of regulatory cooperation that aims to strike a sensible balance between legitimate prudential concerns, on the one hand, and the promotion of greater doses of effective market access, on the other.

Financial regulators in OECD countries are still very much in the initial stages of discovery in this area. Most countries have only just begun to address the domestic regulatory implications of the e-finance revolution, let alone their international ramifications. While efforts to come to grips with the multifaceted implications of e-finance for approaches to regulation and prudential supervision have only recently been initiated in various international forums, important avenues for deepened regulatory cooperation have already been identified (see appendix B). In the main, such work does not involve the WTO directly, whose raison d'être is not to proclaim financial market regulations or to second-guess the decisions, recommendations, norms, and best practices that flow from the ongoing dialogue among supervisory authorities in matters of e-finance. Still, there is a need for continued, deeper dialogue between the trade policy and financial regulation communities, as their core mandates are mutually supportive and strongly complementary.

The second major rulemaking challenge is promoting regulatory dialogue. Institutionalizing closer regulatory contacts between the relevant supervisory committees of the Bank for International Settlements (BIS), the International Organization of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS), trade officials, and officials responsible for developing global standards in the fields of accounting, auditing, and data privacy is key to ensuring that commitments to open up cross-border trade in financial services are underpinned by the proper set of practices and disciplines on matters of regulatory cooperation, recognition, and prudential supervision.

An important objective of GATS 2000 should thus be to set up the institutional machinery conducive to a healthy regulatory dialogue on these issues in a trade policy setting. The GATS Committee on Financial Services should create a subcommittee dedicated to this work. Stakeholders should be under no illusion that the regulatory journey ahead will be easy or lead to quick fixes. The great difficulties that members of the European Union have recently experienced in pushing financial market integration forward is a sobering reminder of the slow pace at which international regulatory cooperation often proceeds.[13] Experience shows that determined prodding

13. Paul Mentré, "Union Européenne: Difficile harmonisation des services financiers," *Le Figaro,* March 24, 2001, p. 8.

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and leadership on the part of the business sector can help encourage greater cooperation on the part of regulators and improve mutual understanding between the trade and financial policy communities.

A third rulemaking challenge for OECD countries concerns the scope for enshrining a right of nonestablishment, subject to positive (or voluntary) undertakings. That is, wherever practicable, governments should refrain from mandating the establishment of a commercial presence in the host-country market as a prerequisite for the delivery of a service. This new GATS discipline could be effected through a modification of the Understanding on Commitments in Financial Services. Such an approach was successfully pursued in the services chapter of the North American Free Trade Agreement (NAFTA), and it would be a natural complement to, or even an essential ingredient of, a stronger push on cross-border trade in financial services. It would also help focus the attention of regulators on the need to satisfy legitimate prudential concerns through means that are the least trade restrictive possible. Such channels may not always exist. Evidence indicates that a so-called click-and-mortar approach to retail e-finance, which requires some degree of physical proximity to a targeted customer base, may be an important means of overcoming consumers' reluctance to engage in pure cross-border transactions. Still, the key is to determine what may be practicable in this area.

Finally, the fourth rulemaking challenge concerns the controversial area of emergency safeguards, whose alleged liberalizing virtues (and countervailing insurance-policy features) have hitherto been championed mostly by developing countries. The community of financial regulators is likely to agree, on prudential grounds, with many of the arguments that are commonly voiced in favor of designing GATS-specific safeguard measures. Should this prove to be the case in the coming round when attention turns to cross-border issues, the financial community may prove instrumental in seeking workable solutions to negotiations that have lingered inconclusively for close to seven years.

LIBERALIZATION CHALLENGES. As noted above, the key liberalization challenge for OECD countries in the coming round will be to determine the scope for greater commitments in the area of cross-border trade in financial products. This is where the greatest restrictions to trade in financial services are currently found, particularly at the retail level, although the nature of the constraints may be more prudential than overtly discriminatory.

Candidates for speedier progress in the financial area include those areas in which regulatory convergence across countries has been greatest to date

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(such as wholesale banking; nonlife insurance, such as maritime, aviation, and travel insurance; and reinsurance) or in which the regulatory burden is relatively light (for example, information and financial advisory services). These areas also hold potential for supporting efforts at setting in motion a process of mutual recognition (foreseen under Article 7 of GATS as well as under Article 3 of the Annex on Financial Services).

Negotiating Challenges in Developing Countries

As with OECD countries, developing countries are likely to face a combination of rulemaking and liberalization challenges in the financial sector during the current GATS talks. They will probably not be offensive players in the next round of financial services negotiations, however, for several reasons, including the prevailing nature of financial regulation in emerging markets; the widespread (if slightly disingenuous and inaccurate) belief that the recent financial market turmoil may have been caused by trade and investment liberalization in the sector; the need to enhance the soundness of domestic financial markets and improve the quality of prudential oversight and financial supervision; and the absence of significant export interests in the sector in most developing countries.

RULEMAKING CHALLENGES. The first major rulemaking challenge for developing countries involves strengthening domestic standards of prudential supervision. Financial markets cannot be relied on to function satisfactorily without sound regulation and effective supervision. History shows that they are vulnerable to periodic excesses. The existence of actual or implied guarantees from governments can dull prudential incentives. The resulting instability is even more troubling in a world in which capital markets are increasingly integrated. Contagion can spread financial difficulties from country to country, and the costs can be severe: the direct costs of resolving financial crises have exceeded 10 percent of GDP in more than fifteen countries over the past two decades.[14] The indirect costs and their attendant social consequences have been even greater.

Given the financial turmoil that a number of developing countries have experienced since the conclusion of the FSA, it may be expected that some countries will place a higher priority on improving regulatory oversight systems than on deepening market liberalization. Other countries will likely find scope for speeding up domestic reform efforts by remedying structural

14. Crockett (2000); and Kaminsky and Reinhart (1995).

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weaknesses in bank balance sheets, which will entail greater financial market consolidation and a further openness toward outside capital.

OECD countries must show patience as developing countries navigate such policy cross-currents. Developing countries will need proper technical assistance to enhance their systems of prudential supervision, as well as encouragement to phase-in liberalization over appropriate transition periods. While a proper sequencing of reform holds the key to a sustainable liberalization path, the presence of foreign financial firms can contribute to raising prudential standards and improving the measurement of risk, which leads to a more efficient allocation of resources.[15] Securing precommitments to future liberalization may also be useful for ensuring that the needed strengthening of prudential supervision not become an excuse for covert trade and investment protectionism in the sector.[16]

Financial regulators play a key role in efforts to strengthen the functioning of the international financial system. They are drawing up the basic rules that should enable institutions and markets to function more stably and efficiently, and they are implementing internationally agreed rules in their national jurisdictions. It is hard to overstate the importance of this activity: while far removed from the world of multilateral trade bargaining, it is nonetheless strongly conducive to securing increased market openness.

At the international level, financial regulators have responded by setting up groupings such as the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS), the International Organization of Securities Commissions (IOSCO), the International Accounting Standards Council (IASC), and the International Association of Actuaries (IAA).[17] All of these organizations are involved in codifying principles of best practice, promoting their adoption worldwide, and monitoring compliance with such standards. Another key development in this regard was the creation of the Financial Stability Forum (FSF) in 1999, which for the first time brings together in one body the principal national and international authorities concerned with financial stability. The Compendium of Standards advocated by the FSF provides a common reference for the various economic and financial standards that are internationally accepted as relevant to sound, stable, and well-functioning financial sys-

15. Claessens and Glaessner (1998).

16. Mattoo (1998).

17. The Basel Committee, the IAIS, and IOSCO are also involved in cross-sectoral cooperation within a Joint Forum, which features annual meetings with supervisory officials from the developing world to discuss issues arising from the proliferation of financial conglomerates that span the banking, insurance, and securities industries.

tems.[18] The FSF has been described as providing an overarching framework for the international effort to strengthen financial systems.[19] Another key element in this improved international architecture of prudential supervision and regulatory cooperation stems from the joint activities of the International Monetary Fund and the World Bank, which have recently developed an organizing framework for assessing the observance of standards and relevant policies. In particular, the joint Financial Sector Assessment Program (FSAP), which might be described as the financial sector's equivalent of the WTO's Trade Policy Review Mechanism (TPRM), aims at assessing financial sector vulnerabilities and identifying developmental priorities, including an assessment of financial sector standards.[20] Another joint project is the experimental Reports on the Observance of Standards and Codes (ROSCs), which provide a vehicle for assembling summary assessments of standards across a range of areas, including financial sector standards assessed in the context of the FSAP and standards for data dissemination, fiscal transparency, and, in the future, corporate governance and accounting.[21] Taken together, these various initiatives depict a remarkable scene of rapidly expanding (if still far from complete) multilateral cooperation that is achieving de facto international harmonization through consensus building on core principles, model approaches to rulemaking, and best practices.[22] Measures are indeed becoming internationally harmonized even though formal recognition agreements are not being negotiated.[23]

Exploring the scope for overcoming differences and promoting greater coherence between the WTO negotiating process and the insights flowing from the above efforts at monitoring prudential standards could be particularly useful in promoting the progressive lock-in of domestic reform efforts. Such efforts will also remind trade policy officials (and the business

18. The compendium highlights twelve standards designated as deserving priority implementation, with an additional fifty-four considered relevant (Arkell, 2000–01). The twelve core standards are grouped under three broad headings: (1) macroeconomic fundamentals, which encompasses monetary and financial transparency, fiscal policy transparency, and data dissemination; (2) institutional and market infrastructure, namely, insolvency, corporate governance, accounting, auditing, payment and settlement, and market integrity; and (3) financial regulation and supervision, including banking supervision, securities regulation, and insurance supervision.

19. Crockett (2000).

20. The FSAP is a collaborative effort involving a range of national agencies and standard-setting bodies.

21. Financial Stability Forum (2000).

22. Litan and Santomero (2000).

23. Arkell (2000–01).

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interests that lie behind their negotiating requests) of the need for careful sequencing in market opening.

The second rulemaking challenge is experimenting with emergency safeguards. Developing countries will almost certainly link OECD country demands for further market opening to the development of a GATS-specific emergency safeguards measure (ESM), with a view to mitigating, under conditions of multilateral surveillance and nondiscrimination, any potentially adverse (and unforeseen) effects arising from the liberalization process. The financial services industry seems particularly well suited for such experimentation, given the critical need to maintain orderly conditions of competition in the sector and promote the safety and soundness of financial systems.[24] It also happens to be the sector that members of the Association of Southeast Asian Nations (ASEAN)—the key proponents of a GATS ESM—have consistently identified as justifying the need for emergency safeguard provisions.

Negotiating efforts could thus be directed to adopting, either in the GATS framework per se or in countries' schedules of committments provisions similar to those that govern the progressive liberalization of Mexico's financial markets under NAFTA. Under the terms of the latter agreement, Mexico is allowed to impose market share caps if the negotiated foreign ownership thresholds of 25 percent for banks and 30 percent for securities firms are reached before 2004. Mexico may only have recourse to such market share limitations once during the 2000–04 period and may only impose them for a three-year period. Under no circumstances may such measures be maintained after 2007.[25] It bears noting that Mexico has not made use of such provisions even as the aggregate share of foreign participation in its financial system has increased noticeably since 1994.[26] After experimenting with such measures in the financial sector, GATS members could decide to extend the logic of the approach to other sectors or indeed to develop a generic safeguards instrument.

Finally, the third rulemaking challenge for developing countries is binding the regulatory status quo. One pragmatic means of advancing a traditional contestability agenda in financial services revolves around securing the regulatory status quo, particularly in emerging markets.[27] Currently, some countries exhibit large differences between the level and quality of bound services commitments lodged under GATS and the actual openness

24. Sauvé (2001).

25. Sauvé and Gonzalez-Hermosillo (1993).

26. The latter stood at about 19 percent in December 1999 (IMF, 2000).

27. Sauvé and Wilkie (2000).

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afforded by their domestic regulatory regimes. The wedge between countries' GATS commitments and their current regulatory practices is particularly conspicuous in the area of financial services.

A preliminary assessment of the commitments of ten emerging markets under the Financial Services Agreement in December 1997 revealed that "save for actual advances in the field of insurance services, [the Financial Services Agreement] barely goes beyond binding the status quo."[28] A study by the U.S. Department of the Treasury of the principal barriers facing U.S. banks and securities firms in foreign markets in mid-1998 also found that several countries bound their commitments under the GATS at levels below their regulatory status quo. India, for example, bound foreign equity participation in financial services companies at 51 percent, whereas in practice, the government approves up to 100 percent foreign equity.[29] The Philippines bound foreign equity participation in underwriting and financial leasing services at 51 and 40 percent, respectively, while the law already allows for foreign ownership of up to 60 percent in these two areas. Hong Kong, Indonesia, and Korea also made commitments below the national status quo in both banking and securities. Examples of countries that made commitments at the level of their regulatory status quo in one or both of these industries include Argentina, the Czech Republic, Hungary, Malaysia, Singapore, Thailand (in banking only), and Venezuela. Actual practice today is, in all probability, even further removed from countries' financial services commitments, given that much liberalization has been undertaken since 1997 both in the context of IMF-brokered adjustment lending programs and through unilateral domestic reform efforts.[30]

There is thus considerable scope for binding the regulatory status quo in emerging markets under GATS and for raising the overall level of liberalization in financial services trade worldwide. Doing so, however, will require institutional alternatives that alter the costs and benefits associated with binding services and investment regimes at less than the regulatory status quo. One possibility is to close the loophole that currently allows countries to replicate in services trade a form of mercantilism long practiced in tariff negotiations. Accordingly, GATS members could seek agreement on a new framework obligation that would prospectively compel them to lock in the

28. Dobson and Jacquet (1998).

29. U.S. Department of the Treasury (1998).

30. For example, Korea failed to incorporate all of its OECD accession commitments into its GATS schedules. One such exclusion was the commitment to raise foreign portfolio investment in listed companies from 23 percent to 100 percent by the end of 2000 (Mattoo, 1998, p. 20).

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status quo in all sectors, subsectors, and modes of delivery in which they voluntarily agree to schedule liberalization commitments. Another option is to develop a NAFTA-like ratchet provision, whereby any liberalization measure—whether unilaterally decreed, negotiated in a bilateral or regional setting, or achieved between two multilateral negotiating rounds—is automatically reflected and bound in countries' GATS schedules.

Industry groups have suggested that GATS schedules should also lock in any liberalization induced by IMF or World Bank conditionality programs occurring between WTO negotiating rounds. In the WTO, however, liberalization proceeds on the basis of a broad political consensus. Thus while the liberalization induced under conditions of financial duress has been significant in recent years, any cross-conditionality with the WTO would raise serious (and largely legitimate) objections on the part of developing countries. The political legitimacy and sustainability of such reforms might thus be weakened as a result.

At present, WTO members seem to feel that the benefits they derive from binding at less than the status quo outweigh the costs. The primary benefit is presumably negotiating leverage, as in the case of goods trade. The costs, however, can be significant with regard to trade in services. Such a stance on the part of developing countries (particularly smaller ones) may well deter foreign investment by maintaining needless regulatory uncertainty.

A possible solution might lie in the design of an institutional alternative that encourages countries to narrow and eventually eliminate the mercantilistic incentive to maintain a large wedge, while at the same time providing countries with some means of engaging in the give-and-take of multilateral negotiations. For example, the WTO might grant some form of liberalizing credits to countries willing to bind the status quo or to narrow the gap between current domestic regulatory arrangements and their GATS commitments.[31] Countries receiving such credits would then decide whether to apply them toward negotiations in the area for which they were obtained or toward negotiations in another WTO sphere. Such a mechanism would offer incentives for countries to link their unilateral liberalization efforts (including, in some cases, liberalization pursuant to IMF or

31. The issue of how to treat autonomous liberalization measures already promises to be one of the thorniest issues confronting negotiators as they enter the market access bargaining phase of the GATS 2000 talks. In agreeing on the modalities that will govern market access negotiations under GATS, WTO members recently decided that "based on multilaterally agreed criteria, account shall be taken and credit shall be given in the negotiations for autonomous liberalization undertaken by Members since previous negotiations. Members shall endeavor to develop such criteria prior to the start of negotiation of specific commitments" (WTO, 2001e).

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World Bank adjustment programs) with multilateral disciplines. It would also alleviate some of the problems derived from the compartmentalization of WTO negotiations described above. Countries that are unwilling to bind their commitments at the same level as their regulatory status quo would be entirely free to continue doing so; they would simply forgo the opportunity of receiving credits.

The costs and technical complexity of implementing such an institutional alternative are admittedly nonnegligible. A credit-based mechanism would indeed require agreement by all WTO members on how to credibly measure the commercial value of liberalization and regulatory reform efforts across very diverse sectors and institutional settings. Such an endeavor might be relatively simple for sectors in which barriers primarily take the form of border measures, but it might prove exceedingly difficult for sectors such as financial services, in which barriers to trade and investment arise almost exclusively behind the border.[32]

LIBERALIZATION CHALLENGES. Developing countries face four major challenges with regard to liberalization. With the exception of countries with highly developed financial centers and a high degree of Internet penetration (such as Hong Kong, China; and Singapore), developing countries are unlikely on the whole to focus on the liberalization of cross-border trade in financial services and e-finance, despite the clear welfare gains that domestic users can derive from such services and the fact that e-finance activity is indeed picking up in a number of emerging markets. Rather, the first liberalization challenge to face developing countries in the coming round will likely encompass the more traditional contestability agenda described earlier in this essay, which consists of repealing barriers to entry and establishment and reducing discriminatory postestablishment barriers to operation in foreign financial markets. Priority will therefore be given to mode 3 of GATS dealing with commercial presence and investment, as well as to a broad set of commitments relating to national treatment (Article XVII) and market access (Article XVI).

The second liberalization challenge is achieving a higher overall level of bound liberalization. The first round of financial services negotiations yielded fairly modest liberalization in the developing world. While the FSA saw 105 WTO members initiate legally bound commitments in the sector

32. The design of a credit-based system would also need to establish the procedure whereby countries are granted credits: should it be an automatic procedure administered by, say, the WTO Secretariat, or should credit be granted only after consensus among all WTO members has been reached?

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(the second largest number after tourism services), few developing countries undertook broad commitments across all financial market segments. They showed greatest regulatory precaution with regard to cross-border trade (modes 1 and 2 of GATS), as did developed countries, and instead focused primarily on commitments on mode 3 (establishment-related trade). A few developing countries—notably India, Malaysia and the Philippines—made use of the FSA to establish precommitments to future liberalization, but most opted to codify the regulatory status quo prevailing when the agreement was concluded. As noted earlier, following the logic of mercantilistic negotiating techniques long employed in goods trade, many developing countries lodged bound commitments at a level well below the regulatory status quo.

To date, no developing country has opened domestic financial markets on the basis of the provisions contained in the Understanding on Commitments in Financial Services, which allows WTO members to voluntarily subscribe to a higher level of bound liberalization in the sector.[33] In part this reflects the collective reluctance to use an instrument brokered outside the formal GATS negotiating context by the Group of Ten countries in the early stages of the Uruguay Round. Although GATS does not specify the degree of liberalization to which a WTO member should commit itself, promoting the use of the Understanding on Commitments in Financial Services among developing countries could result in a more coherent set of GATS commitments in the sector while also raising the overall level of bound liberalization.

The third challenge involves the related processes of phasing in liberalization at an appropriate pace and securing precommitments to financial market opening. The GATS 2000 negotiations offer developing countries a good opportunity to anchor ongoing policy reforms firmly in their country schedules, so as to impart greater permanency to domestic regulatory

33. The Understanding on Commitments in Financial Services consists of a predetermined set of commitments, from which exceptions remain possible, covering the following issues: the scheduling of monopoly rights and a best endeavors commitment for their elimination; most-favored-nation and national treatment in public procurement of financial services; cross-border provision of MAT insurance, reinsurance, and retrocession, as well as services auxiliary to insurance; the transfer of financial information, financial data processing, and other auxiliary financial services, excluding intermediation; the right to purchase abroad a wide range of financial services (basically excluding direct insurance); the right of establishment and expansion of a commercial presence; permission for established suppliers to offer new financial services; permission for the entry of certain personnel of established suppliers, including senior managers and specialists, subject to certain conditions; and standstill on certain nondiscriminatory measures.

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reform. The ongoing negotiations also provide developing countries with an opportunity to exploit the considerable flexibility that is built into GATS with regard to liberalization matters, namely, by promoting the gradual, orderly opening of their financial markets. Equally important is the possibility of using GATS to forge precommitments to future market opening. With few exceptions, developing countries did not make use of the signaling properties of GATS and the FSA by announcing future market opening initiatives. Encouraging more countries to do so in the GATS 2000 round should be high on the negotiating agenda, as it would allow developing countries to pursue a sequenced approach that combines progressive market opening with a strengthening of domestic regulatory and prudential standards.

Finally, the fourth major challenge for developing countries going into the GATS 2000 round is to be clear on the economywide implications of the liberalization path that they voluntarily undertake in a GATS context. The first round of negotiations, both in financial services and elsewhere, saw a clear bias in commitments toward the promotion (and often the entrenchment) of the market position of existing domestic and foreign suppliers, rather than the advancement of new entrants. The literature on regulatory reform suggests, however, that protecting the privileged status of incumbent suppliers is not the most economically rational policy to follow. Larger welfare gains arise from an increase in competition than from a simple change of ownership, whether through the privatization of public enterprises, the transfer of domestic firms to foreign ownership, or a relaxation of restrictions on foreign equity participation in domestic firms—however much the latter course of action may be desirable given prevailing restrictions in many emerging markets.[34]

The maintenance of undue restrictions on new entry into domestic service markets is increasingly difficult to justify in the face of growing awareness of the enabling characteristics of key service industries such as finance and the mounting empirical evidence on the benefits of competition and regulatory reform in service industries.[35] The debate over entry versus ownership takes on specific characteristics in finance, since foreign entry, as well as incentives for increased market concentration, may be greatest in periods of financial market instability. Such developments may, in turn, call for heightening competition policy activism in the sector.[36]

34. Mattoo (1999).
35. OECD (2001b).
36. IMF (2000).

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Political Economy Considerations

The above discussion identified the structure and contents of a possible negotiating agenda on financial services at the WTO. Important questions remain, however, concerning the extent to which such an agenda can be usefully pursued in a multilateral setting. The traditional contestability agenda described in the essay is primarily directed at emerging countries, where most of the market-entry barriers and measures affecting the operating conditions of foreign financial service providers are found. Such an agenda contrasts quite significantly with that arising in much of the OECD area, where the core concerns are the nascent landscape of e-finance and the degree to which GATS can be harnessed to deepen cross-border liberalization of financial services. This area was left largely untapped in the FSA's first incarnation, with the exception of the very limited undertakings of OECD countries in the Understanding on Commitments on Financial Services.

The fact that the traditional contestability agenda is of greater relevance to developing countries may well limit the scope for WTO-brokered market opening. The room for reciprocal exchange, which has served as the basis for successful multilateral trade negotiations in the goods area over the past fifty years, is undoubtedly constrained in the presence of a decidedly one-way negotiating agenda.

Developing countries often feel that they alone make market opening concessions in the financial services sector. For many such countries, access to the financial markets of industrial countries is not an immediate priority.[37] The distinct possibility that a number of emerging markets could develop a comparative advantage in some financial services subsectors in the future is unlikely to change the current state of affairs in the ongoing negotiations.

The tendency for GATS negotiations to proceed along sectoral lines exacerbates the problem of the limited scope for reciprocity in a traditional contestability agenda. The compartmentalization of multilateral negotiations, coupled with the fact that financial services negotiations are typically led by finance rather than trade officials, poses additional constraints on the ability of countries to make credible offers of reciprocity.[38]

Despite its many drawbacks, however, the multilateral trading system remains uniquely positioned to promote and lock in better access to and

37. Dobson and Jacquet (1998).
38. Freeman (1997).

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presence in financial services markets around the globe. The main thrust behind greater financial sector liberalization in recent years has largely come from unilateral initiatives. Even if plagued with pitfalls, domestic financial reform has been shown to have a strong positive effect on economic growth and development, including in the OECD area.

The pace of unilateral financial reform will probably accelerate in the coming years, as emerging markets increasingly tap into foreign savings to finance their development needs, deepen their capital markets, and accelerate financial innovation to serve the needs of corporate borrowers and households. The multilateral trading system in general, and GATS in particular, can make a significant contribution toward opening financial markets. It can, under conditions of considerably heightened regulatory transparency, solidify and legitimate reform efforts undertaken unilaterally or in various regional configurations, and it can give countries the opportunity to exploit the trading system's signaling properties by announcing precommitments to future market opening.[39]

There remains, finally, the battle of convincing developing countries that they can achieve sustained improvements in growth and development prospects by making greater use of GATS as a means of anchoring past regulatory reforms and signaling future reforms.

Many developing countries face the political challenge of overcoming domestic resistance to the notion that becoming a more efficient importer of financial services can usefully serve the national interest. The financial industry must therefore stress, in mantra-like fashion, the strong economywide case to be made for a greater (albeit progressive) degree of trade and investment liberalization in the financial sector. This task is all the more important now that the very notion of market openness has come under stinging criticism, as have the institutions through which liberalization is most efficiently pursued and achieved. By assuming this key role, the industry can renew the proud tradition of leadership and foresight it established almost two decades ago in helping launch the GATS journey.[40]

39. Mattoo (1998).
40. Moore (2000).

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Appendix A: Supplementaries

Table 12A-1. *Selected Barriers to Trade in Financial Services, by Country*

Type of barrier	*Banking*	*Securities*	*Insurance*
Limit on number of service suppliers	**Brazil**: approval of foreign entry or expansion on a case-by-case basis; since 1999, foreign banks can only enter the Brazilian market by acquiring one of the state-owned banks being privatized **Chile**: licensing of foreign financial service providers subject to economic needs and national interest tests **China**: Bank of China enjoys a monopoly on forward foreign exchange contracts **India**: foreign bank branches and representative offices permitted on the basis of reciprocity and the country's perceived need for financial services; minimum of twelve new licenses for foreign bank branches issued per year **Malaysia**: freeze on licenses for banks (foreign and local) **Pakistan**: foreign banks restricted to twenty-five branches	**Brazil**: approval of foreign entry or expansion on a case-by-case basis **China**: foreign firms cannot provide services in underwriting or engage in trading in domestic stocks or bonds	**Brazil**: private insurers cannot enter the market until the Reinsurance Institute is privatized **Russia**: foreign insurance companies are not allowed to sell life insurance

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	Philippines: freeze on licenses for new bank branches; foreign banks permitted to open six offices each **Thailand**: foreign banks limited to three branches **Venezuela**: licensing of financial services firms subject to economic needs test		
Ceiling on foreign equity participation	**Philippines**: 60 percent foreign ownership of new and existing local subsidiaries	**Malaysia**: 70 percent foreign ownership in fund management companies providing services to foreigners and local investors; 49 percent foreign ownership in stockbroking companies; 30 percent in unit trusts **Philippines**: 60 percent foreign ownership in securities underwriting, factoring, and financial leasing **Thailand**: foreign firms are allowed to own majority shares (that is, greater than 49 percent) of Thai securities firms only on a case-by-case basis	**Ghana**: 60 percent foreign ownership in the entire insurance sector **India**: foreign equity in domestic insurance companies limited to 26 percent of paid-up capital **Malaysia**: 51 percent foreign ownership in locally incorporated insurance companies **Pakistan**: 51 percent foreign ownership in the life and general insurance sectors
Choice of legal structure	**Malaysia**: foreign banks must operate as locally controlled subsidiaries	**Pakistan**: foreign brokers may join one of the country's three stock exchanges only as part of a joint venture with a domestic firm	**Malaysia**: foreign insurance companies are required to incorporate locally **Romania**: foreign insurance companies are required to establish a joint venture with a domestic partner

Table 12A-1. *Continued*

Postestablishment measure	**Argentina**: lending limits for bank branches are based on local paid-in capital, not parent bank capital **China**: foreign banks can only take local currency deposits from, and make loans to, registered foreign investors **Colombia**: use of foreign personnel in the financial services sector limited to administrators, legal representatives, and technicians **Costa Rica**: to provide certain services, banks are required to lend between 10 and 17 percent of their short-term assets to state-owned commercial banks or to open branches in rural areas of the country **Korea**: a certain share of banks' loan portfolios (foreign and domestic) must be allocated to companies other than the top four chaebol; introduction of new financial products is subject to approval **Russia**: at least three-quarters of the employees and half of the management board of a foreign bank must be Russian nationals **Pakistan**: foreign banks cannot lend more than a specified amount to state-owned corporations **Philippines**: foreigners cannot participate in rural banking **Thailand**: foreign banks can only locate one branch in Bangkok; expatriate management personnel are limited to six professionals in full branches	**India**: holdings by single foreign institutional investors (such as pension funds, mutual funds, and investment trusts) are limited to 10 percent of issued capital in individual firms **Indonesia**: multifinance companies with foreign partners are required to deposit 100 percent more paid-in capital than domestically owned multifinance companies	**Chinese Taipei:** insurance companies' premium rates and policy clauses are subject to regulatory approval **Pakistan**: capital investments by foreign firms in the life and general insurance sectors cannot be repatriated **Philippines**: coverage for government-funded projects and public and private build-operate-transfer (BOT) projects can only be provided by the government insurance system

Source: U.S. Trade Representative (2001).

Table 12A-2. *GATS 2000: Summary of Negotiating Proposals in Financial Services*

Category of request	*Banking (including securities)*	*Insurance*
Reduction of scope of monopoly rights		**Japan**, International Chamber of Commerce
Cross-border trade (ability of nonresident firms to supply services)	**Australia** **Canada** **European Union**: financial information, auxiliary services (excluding intermediation) **United States**: financial information advisory services **International Chamber of Commerce**: especially trading and financial information	**Australia** **Canada** **European Union**: MAT insurance (including intermediation), reinsurance and retrocession, auxiliary services **Norway**: maritime shipping insurance **United States**: MAT insurance, reinsurance and retrocession, insurance intermediation, auxiliary services **International Chamber of Commerce:** MAT insurance, large construction risks, credit insurance, reinsurance, intermediation
Consumption abroad (ability of residents and firms to purchase services in another territory)	**Canada, European Union, United States, International Chamber of Commerce**	**Canada** **European Union**: excluding direct insurance **Norway**: maritime shipping insurance **United States** **International Chamber of Commerce**: MAT insurance, reinsurance, tourist insurance
Commercial presence (choice of legal structure and equity participation, reduction of quantitative limitations on number of service suppliers, expansion of commercial presence, grandfathering)	**Australia, Canada, European Union, Japan, Norway, United States, International Chamber of Commerce**	**Australia, Canada, European Union, Japan, Norway, United States, International Chamber of Commerce**

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Table 12A-2. *Continued*

Temporary entry of natural persons	**Australia**: transfer and employment of company personnel **Canada** **European Union**: including temporary movement of intra-corporate transferees and contractual service suppliers **Japan**: nationality and residency requirements for executives and employees; reduction of limits on number of foreign employees **United States** **International Chamber of Commerce:** definitions of key business personnel; common terms for intra-company transfers; provision for short-term movement of key business personnel
Postestablishment barriers	**Australia**: reduction of restrictions on number and type of products foreign firms can offer in domestic markets **European Union:** nondiscriminatory access to payment systems and funding and refinancing facilities; nondiscriminatory membership in self-regulatory bodies, stock/securities/futures exchange or market, clearing agency **Japan**: nondiscriminatory tax treatment **United States:** improved cross-sectoral and finance-specific disciplines pertaining to the development, adoption and application or enforcement of regulations (including licensing procedures) **International Chamber of Commerce:** nondiscriminatory enforcement of regulation (especially capital and reporting requirements); reliance on home-country supervision for legally-dependent branches of foreign firms; elimination of obstacles to repatriate earnings; elimination of restrictions on foreign exchange; reduction of restrictions on number and type of products offered by foreign firms; reduction of requirements to invest minimum percentage in specific categories of assets; adoption of accounting and auditing standards based on recognized "best policy" standards; nondiscriminatory treatment of foreign insurance firms by state-owned enterprises
Additional disciplines on transparency	**Australia** (especially licensing criteria) **Canada**: clarification of transparency disciplines specific to the financial sector **European Union** **Japan** **United States**: transparency in the development and application of regulations (including public accessibility to regulations and proposals, as well as opportunity for public comment) **International Chamber of Commerce:** transparency in regulation, particularly licensing criteria (including public accessibility to regulations and opportunity for public comment); disciplines to prevent arbitrary actions and sudden changes in regulatory environment
Elimination of most-favored-nation exceptions	**European Union, Japan, Norway**

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Table 12A-2. *Continued*

Negotiating modalities and scheduling of commitments	**Canada:** model schedules, request-offer, use of Financial Services Annex (FSA) classification in scheduling **European Union:** scheduling on the basis of the Understanding **Japan**: scheduling on the basis of the Understanding **Norway:** use of FSA classification in scheduling **United States:** use of FSA classification in scheduling

Sources: International Chamber of Commerce (2000a, 2000b); World Trade Organization, (2000a, 2000b, 2000c, 2001a, 2001b, 2001c).

Appendix B: The Emerging Landscape of Electronic Finance

Technological advances are leading to major changes in the global financial landscape. To date such changes have been felt most strongly within the OECD area. While financial institutions have communicated with each other and with their major corporate clients via electronic networks for decades, the advent of open network architectures has enabled them to broaden their activities to reach smaller enterprises and households, as well. One of the main attractions of e-finance for both entrenched financial institutions and new entrants is the long-term scope for cutting costs in the retail supply of financial services. Developments in e-finance have been largely demand driven to date, with new entrants bidding for market shares and entrenched institutions attempting to defend their client bases in areas in which consumers have shown a particularly strong willingness to purchase financial services online. The state of development of e-finance therefore differs sharply across segments of the financial sector. Clients are particularly interested in the online supply of financial services that are relatively simple, take place frequently, and, if possible, are offered at a discounted price. This palette of demand factors has been most readily satisfied by the securities sector, notably, but not exclusively, as regards discount brokering. The online delivery of a range of banking-related services, such as current accounts, bill payment, and credit cards, has also gained importance in a number of countries. Financial services that are complicated, infrequently traded, or based on lengthy contractual relationships—such as insurance contracts and mortgage loans—are rarely traded online. Institutions in these sectors have, however, begun moving parts of their value

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chains onto the Internet, including services such as price discovery and loan application.[41]

Small and medium-sized enterprises in the most Internet-advanced economies have embraced online finance as an efficient means of conducting a major part of their financial transactions, such as adjusting their positions vis-à-vis banks, asset managers, insurers, and pension funds in real time. The uptake of e-finance among households has generally been slower and more divergent across countries and market segments. The main differentiating factor is clearly the degree of Internet penetration. Differences in the structure of financial intermediation among member countries has also led to different patterns of e-finance, notably a high penetration of online equity trading in North America and a high penetration of online banking in northern Europe.

The supply of e-finance services on a purely cross-border basis has so far been limited, except, to a certain extent, for securities services. Even in the absence of formal legal or regulatory restrictions, such as within the European Economic Area, banks have generally been unwilling to solicit clients on a purely cross-border basis. The preferred strategy for expansion in other jurisdictions remains the acquisition or establishment of a small commercial presence (the so-called click-and-mortar business model).

Cross-border trade has been held back by both demand and supply factors. On the demand side, most customers continue to demand proximity and an established relationship of trust with their preferred financial institutions.[42] Also, differences among national tax systems can complicate attempts to purchase (or sell) financial products across borders. The most immediate obstacle to further development of e-finance is that most households consider that the Internet is not a safe and reliable place to do business. Part of this problem will no doubt be overcome as e-finance institutions gain experience and households get used to the new medium. Other developments could help establish trust, notably in fields such as authentication and digital signatures. Most OECD countries, for example, have either recently put in place legislation that establishes legally binding digital signatures or plan to do so shortly. In addition to acting as a confidence-building measure, this will enable e-finance institutions to offer online fulfillment in areas requiring formal contracts, such as insurance and mortgages.

41. OECD (2001a).
42. Basel Committee on Banking Supervision (2000).

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On the supply side, differences in regulatory approaches are an important factor restraining would-be suppliers. Such problems are especially acute in a cross-border setting, where technical obstacles (such as the lack of unified execution, clearance, and settlement systems) co-exist with legal and regulatory impediments. In most jurisdictions, cross-border electronic financial services do not fall neatly under the existing regulatory regime designed for traditional brick-and-mortar financial services providers, with well-designed functional and geographical borders. Cross-border e-finance providers must therefore cope with multiple sets of regulations. Financial regulation and supervision has at times been accused of holding back the development of cross-border e-finance. In some jurisdictions and areas of business, online transactions are likely to be hampered by the reluctance of financial regulators to accept electronic contracts. The cross-border selling of financial services (especially to supposedly unsophisticated clients) is severely restricted in many jurisdictions, whether in the form of e-finance or through traditional channels. Even where cross-border finance is allowed in principle, foreign providers remain subject to national consumer protection rules, as well as to national conduct-of-business rules if business is seen as being located in the host jurisdiction. A special problem relates to solicitation, which is not permitted in certain jurisdictions. Defining what constitutes solicitation in the Internet environment is not a straightforward task, and nascent efforts at regulatory co-operation across countries have yet to come up with a universally accepted definition. Financial institutions share a strong common interest in effective, even-handed regulation of e-finance. In particular, the potential for unsupervised institutions to offer financially related services in competition with traditional, regulated institutions could run the risk of creating an uneven playing field.

Various policy options are being considered in regulatory circles to help secure compliance with regulatory and supervisory requirements while allowing the continued growth of e-finance. Such options include the following: regulatory harmonization in a multilateral context, so as to provide a coherent international legal framework for cross-border e-finance; seal-of-approval labels for service providers operating from countries that meet certain international best practices in e-finance; mutual recognition of regulatory regimes in the field of e-finance on a bilateral, regional, or multilateral basis; bilateral, regional, or multilateral regulatory cooperation through the use of memorandums of understanding (MOUs) or other mechanisms such as joint surveillance and inspection arrangements; and the promotion of greater transparency and clarity in national regulatory regimes

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through increased use of guidance notes, publication of safe-harbor provisions, strengthened disclosure requirements, the issuing of no-action letters, and the like.

Technological developments will further change the face of e-finance. In addition to the continued use of personal computers, alternative future delivery technologies will include mobile phones and interactive television (iTV). Views differ on the relative importance and commercial promise of such new distribution channels. Interactive television offers undeniable promise, not least because it is likely to be available to a larger number of households than internet-connected personal computers. Not surprisingly, several large financial institutions have recently entered strategic alliances with telecom companies, with a view to developing iTV platforms. The advent of telecommunication service technologies such as the wireless application protocol (WAP) has already made it technically possible to surf the Internet on a handheld device, and the future allocation of third-generation UMTS licenses will boost the availability of this channel. Mobile phones, like iTVs, are available to a larger group of people than Internet-connected personal computers; they also have the obvious advantage of mobility.

The global reach of e-finance has the potential to change the competitive dynamics in various jurisdictions and among different groups of players in financial markets. Together with the general trend toward greater consolidation in financial industries, cross-border e-finance will likely have a major impact on competition and market structure issues. Increases in the use of e-finance could lead, for instance, to a breakdown of the value chain in parts of the financial sector. This process has arguably already started in the field of online brokerage, with specialized entities unbundling traditional brokerage services. Enabling online clients to access all their accounts from one single portal has the potential to lead to a complete commoditization of financial services, at least in principle. Such developments will pose new and potentially complex challenges for regulators in pursuing their core objectives of protecting consumers and promoting the soundness of financial systems. The inherently borderless nature of the rapidly developing e-finance landscape requires active cooperation on the part of financial market supervisors around the world in sharing information on common risks and facilitating the development of sound risk management and other assorted best regulatory practices. Reasonable prudential standards should provide for safe, sound conduct without inhibiting innovation and competition that will benefit the financial industry as well as the customers it serves.

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