

## ISSUES



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PACIFIC ECONOMIC COOPERATION COUNCIL



**Financial Services Liberalization and its  
Sequencing in the APEC Region:  
WTO and RTAS**

**ISSUES@PECC** presents the current work of PECC's three Forums on Trade, Finance and Community Building and collaborative work with other groups. Complimentary copies are available upon request from the PECC International Secretariat. It is also available on line at <http://www.pecc.net>.

#### **About this Issue**

This **ISSUES@PECC** is the summary report of the study on the subject matter undertaken in 2003 jointly by the Finance Forum and the Trade Forum of PECC. The study was undertaken at the request of the 16<sup>th</sup> APEC Finance Ministers' Technical Working Group. This report will be submitted to the 10<sup>th</sup> APEC Finance Ministers' Meeting and the APEC Finance and Central Bank Deputies' Meeting to be held in Phuket, Thailand, on September 2-5, 2003.

The PECC Finance Forum serves as an open forum for a tri-partite dialogue among the academia, government, and business sector, on the financial policy issues facing the Asia-Pacific region. The purpose of the dialogue is to assess the international environment for financial stability and development in the region, to assess progress in the promotion of financial reforms, integration and cooperation in the region, and to develop the desired vision of regional financial and monetary cooperation. For the purpose of these assessments, the Finance Forum undertakes survey-based task force studies on specific issues as well as convenes an annual conference of experts drawn from the member economies and the international financial institutions. For more information, visit [www.pecc.net/finance](http://www.pecc.net/finance).

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## **Introduction**

The efficient provision of financial services is one of the basic prerequisites for an efficient modern economy. Businesses need high quality financial services provided at a competitive cost in order to operate effectively. The range of services that an efficient financial services sector can provide is important in enabling business to manage their risks and in ensuring that the capital they require to develop and grow is available on terms and conditions tailored to their needs. Liberalization of trade in financial services is to be judged according to its contribution to enhancing these characteristics of an efficient financial services sector.

At the same time, the soundness of the financial services sector is important for the stability of the financial system and ultimately of the whole economy. Prudential considerations thus add a unique dimension to the subject of liberalization of trade in financial services. This dimension is recognized for example in the provisions on financial services in the WTO's General Agreement on Trade in Services (GATS) affirming that commitments to liberalize trade in financial services do not negate the right of governments to enact and maintain prudential measures designed to ensure the stability and integrity of the financial system, or to protect investors, depositors and insurance policy holders. The prudential dimension in turn underlines the importance of close cooperation between trade and finance officials in any negotiations on trade in financial services.

In addition to the benefits of liberalization for service importing economies,

economies with internationally competitive financial services sectors seek additional market access for their service providers in order to exploit their comparative advantage in this area.

As with other forms of trade, financial services may be liberalized on either a non-discriminatory or a preferential basis. Non-discriminatory liberalization may be undertaken either multilaterally, through commitments under the GATS, or unilaterally. Recognition of the benefits of liberalizing trade in services has encouraged a number of economies including some in the APEC region such as Korea and Singapore to undertake unilateral liberalisation in this sector. On the other hand, an advantage of the multilateral approach is that binding commitments under the GATS impart added credibility to the liberalization measures.

## **Liberalization via the GATS**

The essence of financial services trade liberalization, as with other services, is regulatory reform to provide enhanced market access and national treatment for foreign service suppliers, in this case, banks and other financial institutions. The GATS provides a detailed breakdown of subsectors within the financial services sector and also distinguishes between four possible modes of supply, listed as cross-border supply (mode 1), consumption abroad (mode 2), commercial presence (mode 3), and presence of natural persons (mode 4). In fact, modes 1,2 and 4 are all different forms of cross-border supply, in contrast with mode 3 which generally involves investment in the service-importing economy. The GATS is a very flexible agreement allowing members to

determine the sectors or subsectors, and the modes of supply within each sector or subsector, in which they are prepared to make liberalization commitments, and also to impose limitations on each commitment.

More commitments have been made in the financial services sector than in most services sector, although these commitments are generally characterised by a concern to allow foreign equity in existing institutions and to protect the position of incumbents rather than to encourage new entry of additional foreign institutions. The extent of new liberalization effected by GATS commitments on financial services is somewhat limited, with many members binding either at the level of their existing practice or at a level lower than their existing practice. In the latter cases, GATS commitments were of course a misleading indicator of the extent of liberalization that had actually taken place. Subsequent unilateral liberalization by some members widened the gap between GATS commitments and actual practice. The “binding” of such new unilateral liberalization initiatives is a possible objective in the DDA negotiations on services, and “credit” for such “autonomous liberalization” is an important negotiating issue for those economies that have engaged in it, for example, Korea.

### **Issues in Preferential Liberalization of Financial Services**

Preferential liberalization initiatives, in the form of regional trading agreements (RTAs) at the bilateral, subregional or regional level, have recently been proliferating in the Asia-Pacific region, as elsewhere in the global economy. It

has become the norm for these agreements to include provisions on trade in services, and in most cases these include provisions on financial services.

The well-known advantages and disadvantages of preferential relative to non-discriminatory liberalization apply in the case of trade in financial services as in other forms of trade. Non-discriminatory liberalization ensures that the importing economy has access to the services offered by lowest-cost, world-class providers, whereas preferential liberalization may discriminate against such suppliers. Proliferation of RTAs may create the risk of confusion arising from overlapping RTAs with mutually inconsistent provisions. At the same time, preferential liberalization, like multilateral liberalization offers the advantage of binding commitments that may enhance the credibility of the liberalisation measures. In general, in the area of financial services as in other areas, RTAs may be either “building blocks” or “stumbling blocks” for the achievement of APEC objectives and the establishment of a more open, efficient global economy, and it is important to identify the conditions under which they are more likely to serve as “building blocks”.

There are now a large number of RTAs in the Americas and East Asia. Analysis of RTAs in the Americas by Patricio Contreras and Soonhwa Yi shows that there is a wide range in the degree of liberalization achieved, from “GATS-plus” to “GATS-minus”. There is also a wide variation in the modalities adopted for liberalization of trade in financial services. In some cases, financial services are covered by a specialised text in a separate chapter or annex of the agreement, designed to take account of

the special sensitivities of the financial services sector. In other cases, financial services are covered by sector-specific disciplines of a very general nature within the chapters on services and/or investment, with a commitment to develop more detailed disciplines in future. In still other cases, financial services are covered by the general provisions on services without being specifically mentioned.

There are two main models of services trade liberalization evident in these RTAs. Some, for example, Mercosur and the EU-Chile FTA, follow a “GATS-type” model, distinguishing between the four modes of supply used in the GATS, and using the same “positive list” approach toward identifying the sectors, subsectors and modes of supply in which commitments are to be made. The alternative, more commonly found in the Americas and exemplified also by the US-Singapore FTA, is the “NAFTA-type” model, following the NAFTA approach of having one set of commitments covering all “cross-border” modes of supply (modes 1,2 and 4 in GATS terms), while “commercial presence” (GATS mode 3) is covered separately in the investment chapter. The “NAFTA-type” model also involves a “negative list” approach whereby commitments on services trade apply to all sectors and subsectors except those specifically listed as exceptions. “Hybrid models”, embodying some of the features of models, are also possible, an example being the EU-Mexico FTA. In the case of some agreements, for example, Mercosur and the Andean Community, moves have also been made toward harmonization of financial regulations.

There is considerable variation in the

degree of liberalization achieved by the financial services provisions of the RTAs analysed by Contreras and Yi. While it is possible in principle to achieve the same degree of liberalization under either model, FTAs employing the “NAFTA-type” model appear to have achieved greater liberalization in practice. In many cases, there is little new liberalization but the RTA has enabled members to “bind” their existing practice. In general, significant new liberalisation is achieved only in agreements where financial services are covered by separate specialized text. Where new liberalization has occurred, it is predominantly in the area of cross-border supply (GATS modes 1,2 and 4). Liberalization of cross-border-supply raises important questions both on regulatory cooperation and harmonization and also on the degree of capital account opening that is needed to accompany such liberalization. While regulatory cooperation may become increasingly important, and the use of international standards may help to counter regulatory confusion, it is also clear that the primary responsibility for ensuring stability and efficiency in domestic financial markets continues to rest firmly with the domestic regulatory framework.

Of the RTAs analysed by Contreras and Yi, it is the US-Chile and US-Singapore FTAs that exhibit the greatest degree of new liberalization in the financial services sector. Compared to the other RTAs analysed, these two FTAs exhibit

- deeper opening of investment, including provisions to allow branching and greater opening of the insurance sector
- deeper opening of cross-border trade
- deeper disciplines on transparency
- deeper opening of financial

services supplied by non-regulated financial institutions

- limitations on capital flow restrictions, to accompany the enhanced opening of cross-border trade

A survey of Singapore's international commitments on financial services by Chia Siow Yue indicates the wide range of commitments that may be entered into by a single economy in different contexts. Unilateral liberalization by Singapore in the wake of the East Asian crisis has proceeded well beyond its GATS commitments, which are subject to very extensive limitations. Commitments in its RTAs range from replication of its GATS commitments in its agreement with New Zealand, to modest "GATS-plus" provisions in its agreements with Japan and Australia, to much deeper commitments in its FTA with the US, as noted above.

Contreras and Yi also discuss issues relating to the choice of partner in RTAs in which financial services are to be liberalized. An FTA with a "world-class"

supplier of financial services may provide benefits similar to unilateral liberalization of financial services, although the limitation on competition from other "world-class" suppliers may be a disadvantage. Since developing economies can expect to be primarily importers of financial services, it can be argued that partnerships with developed economies are their best option, at least in relation to financial services. Questions might arise, however, as to whether the "market-opening" priorities of the developed partners will necessarily coincide with development priorities, including the need for capacity building. An alternative argument is that it may be easier to achieve regulatory cooperation and harmonisation in the context of subregional integration initiatives among developing economies, such as Mercosur and the Andean Community, and that this approach may be a useful "stepping stone", preparing the financial sectors of the developing economies for the tougher competition they will face as a result of wider regional or multilateral liberalization.

*This report stems from the discussions at the 2nd Annual Conference of the PECC Finance Forum held in Hua Hin, Thailand, on July 8-9, 2003, on the following four papers submitted to the conference:*

Chia, Siow Yue, "Provisions and Commitments on Trade in Financial Services in Trade Agreements in East Asia: Notes on Singapore's Commitments"

Contreras, Patricio, and Soonhwa Yi, "Financial Services in Trade Agreements in the Western Hemisphere".

Kim, Yun-Hwan, "Financial Opening under the WTO Agreement in Selected Asian Countries: Progress and Issues".

Scolay, Robert, "Asia-Pacific RTAs as Avenues to Achieving the Bogor Goals: Analysis and Ways Forward".

*These papers are available on line at*  
<http://www.pecc.net/finance/forum2003>.