Dissecting regional integration in financial services from the competition policy and trade policy perspectives[1]

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1. Introduction

It has been over a decade since there has been serious deliberation of Asia's regional integration, especially from the financial and monetary perspectives. Because of various domestic economic and financial issues, the progress of regional integration in financial services has been slow. However, with improved macroeconomic conditions and relatively stable markets, Asia is at an ideal juncture in which to revisit the subject and propose pragmatic avenues to follow if regional integration in financial services is to take place.[4]

The dynamism of regional integration is not globally uniform, and is strongly dependent on common philosophies being developed and various infrastructures being established within the region. The worldwide proliferation of customs unions, free trade areas and, eventually, common markets, indicates that regional integration efforts are being pursued widely to boost the economic capacity of the market and gain competitive advantage through close economic alliances.

For any of these efforts to bear fruit, however, there needs to be a presumption on the part of the participating states that competition policy will be applied actively and that the market is being used to determine the distribution of resources. Market enlargement is one of the major benefits of regional integration, enabling the region to capitalise on economies of scale and scope. Regional financial integration assumes that participating states will allow market forces to align demand for and supply of financial services in the region, creating a larger market that selects services and distributes capital according to efficiency and cost. In general, an integrated regional financial market should be better able to provide the necessary financial services and capital to those sectors and entities in need within the region, as compared to a smaller local market with a limited number of players, fewer investment opportunities and a meagre savings pool.

Thus, a precondition for regional integration in financial services is that financial markets are being gradually but steadily liberalised, both de jure and de facto, vis-à-vis other economies in the region. While the active engagement of economies in financial services trade is essential for meaningful integration, it is probably equally important to have economies liberalised within each jurisdiction, so as to maintain a competitive and innovative

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1 The views expressed herein are those of the authors and do not reflect the official views of the Financial Services Agency.

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3 At the time of writing, Dr Yokoi-Arai was with the FSA, Japan, but is currently with OECD.

4 We are aware that liberalisation of financial services is closely linked to or in some cases cannot be discussed separately from liberalisation of capital flows. However, to the extent that liberalisation of capital flows, and eventually monetary integration, cannot reasonably be attained until trade liberalisation succeeds in creating a single market in goods and services trade, and since there is still a long way to go before this happens in Asia, we focus in this paper on the liberalisation of financial services trade.

environment for financial services providers. The level of liberalisation in the financial sector will have a direct impact on the level of financial integration that can take place.

With this in mind, our paper analyses three dimensions of financial liberalisation. The fundamental dimension is the competition law environment. The competition regime demonstrates a country's overall commitment to a liberalised and market-oriented economic structure within the jurisdiction. The second dimension is the country's external commitment to liberalisation of financial services trade, which includes its schedule of commitments under the General Agreement on Trade in Services (GATS), and the commitments made in the framework of bilateral and regional free trade agreements (FTAs) or economic partnership agreements (EPAs). While there are certain exceptions, the commitments made under such agreements represent a minimum level of liberalisation in which a country is willing to engage vis-à-vis a foreign counterparty. The third dimension comprises the actual entry requirements imposed on foreign counterparties, including procedural and enforcement mechanisms. It is likely that there will be a positive or negative deviation from competition law, or from commitments to trade agreements.

Regional integration of financial markets requires harmonisation in all three dimensions.[5] After a brief analysis of the level of harmonisation in Asian countries in each of the dimensions cited above, it is argued that further progress in harmonisation efforts is necessary at all three levels, otherwise regional market integration will be surpassed by global market integration. To put it differently, global financial markets may become dominated by those countries which succeed in enhancing effective competition and innovation, perhaps even leading to disintegration of regional financial markets. In particular, we consider competition law and its aspects related to the financial sector to be a leitmotif for regional integration. In other words, without a robust competition policy, it is difficult for meaningful regional integration to take place and to benefit the regional economy.

In this sense, we consider implementation of the laws and regulations at each of the three levels of liberalisation to be as important as the rules themselves. As experience during the financial crises of 1997–98 indicates, there have been many cases in Asia where de jure and de facto rules have differed.[6] While the divergence has perhaps narrowed, it is still imperative that both the rules and their implementation be kept under scrutiny.

The examination carried out in this paper will be from two perspectives. On the one hand, a country's competition law environment, free trade commitments and actual entry requirements will be compared. On the other hand, this environment will be compared across countries to illustrate the relative level of liberalisation in the region. Owing to data and resource limitations, the research will focus on several Asian countries that represent typical milestones of financial market liberalisation, and will not draw up a comprehensive inventory for all countries.

The following section will examine various conceptual issues relating to financial liberalisation. The third section will investigate the competition policy environment of a number of Asian countries. The fourth section will look into the various commitments made under the GATS, FTAs and EPAs by a selection of Asian countries. The fifth section will scrutinise the actual entry requirements for foreign counterparties and compare this with the commitments made in regional agreements. On this basis, we hope to analyse in the sixth section the extent to

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5 This is not to say that other dimensions are or may be unimportant. Labour market regulation (which may be exempt from commitments made under free trade agreements), environmental protection laws and even education policy may constitute barriers to regional integration. Our analysis focuses only on the dimensions within the reach of financial regulators and competition policymakers.

6 See D Arner, M Yokoi-Arai and Z Zhou, *Financial crises in the 1990s*, British Institute of International and Comparative Law, 2002.

which the various levels of competition policy and trade agreements are being actively applied in the region, and the effect this may have on the progress of regional integration.

This paper seeks to demonstrate that financial services liberalisation and proactive competition policy implementation are key ingredients for regional integration in the financial services markets. Progress in this area needs to be carried out in stages, with overall implementation being sequential, but comprehensive. This represents a bottom-up approach to regional integration, in which all three dimensions possess similar importance and need for progress. We emphasise that financial liberalisation needs to be sequenced at each level, to allow the country to integrate the various measures taken and incorporate them into the market infrastructure. Safeguards must also be put in place to satisfy domestic concerns that will be a priority to any country. Such safeguards will include not only balance-of-payments or emergency protection measures to be invoked in the event of a financial crisis or threat thereof, but also domestic financial infrastructure, such as deposit insurance schemes.

2. Conceptual issues at stake

The extent to which foreign firms can operate in a certain sector affects the speed at which the financial sector develops. For both emerging and developing countries, opening their financial markets to foreign financial services providers raises the possibility of domestic financial institutions being taken over by foreign firms. This may lead eventually to the financial sector being monopolised by foreign interests. Hence, most countries do not agree to the complete opening of their financial markets, and usually place certain restrictions on their liberalisation.

The form in which the participation of foreign financial services providers is permitted will depend on the country's perception of the benefits it will derive from liberalisation. Also, the country will need to take into consideration the competitive effect that liberalisation will have. As the possible number of participants in the market increases, there will be greater competitive tension, which will equate to a more robust competition environment.

To step back slightly, the rationale for a country to restrict the financial system is twofold: developmental reasons, and rent-seeking. Rent-seeking often comes in the form of favourable interest rates and specialised financial institutions. It may also come with a high price attached, that of lax credit policies and mounting non-performing loans. Many developing countries also establish "strategic" industries to channel resources.[7] It is often taken for granted that the regulator will act in the best interest of the public.[8] However, regulators may lack appropriate and sufficient authority to enforce rules effectively.[9]

Such diverging views make it imperative that a lively discussion take place within the country to promote understanding of the rationale for financial liberalisation, its possible impact and the form in which the country wishes to achieve a liberalised market. Developed countries tend to demand the opening of markets based on mutual commitments. This is

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7 See Sourafel Girma and Anja Shortland, "The political economy of financial liberalisation", University of Leicester, Department of Economics, working paper no 05/12, October 2005, pp 4–5.

8 See James R Barth, Gerard Caprio and Ross Levine, *Rethinking bank regulation*, Cambridge University Press, 2006, pp 34–5.

9 See Sebastien Miroudot, Enrico Pinali and Nicolas Sauter, "The impact of pro-competitive reforms on trade in developing countries", *OECD Trade Policy Working Papers*, no 54, 15 June 2007, p 52. However, such a requirement is part of the Basel Core Principles. See Basel Committee on Banking Supervision, *Core principles for effective banking supervision*, Basel, October 2006, Principle I.

advantageous to countries that already have a developed and liberalised market. Negotiations in financial services have reflected this tendency, with developed financial market countries making liberalisation demands on emerging market countries, and emerging market countries compromising to reach an agreement. This is usually the result of horse-trading, with developing countries and developed countries compromising in different markets to reach an overall agreement.

A. Benefits of financial liberalisation[10]

It is essential to understand the benefits of financial services trade liberalisation in order to comprehend the influence of competition policy and GATS negotiations. No member is being forced to make specific commitments, but commitments are made for the sake of the overall welfare that might be achieved through the World Trade Organization (WTO).[11] Competition policies will enable a competition regime to be established, thereby minimising the negative effects of competitive markets and laying down the rules for fair competition.

This section considers the general benefits of trade liberalisation and those attributable to financial services. The arguments for trade liberalisation are generally applicable to finance, although there are additional factors unique to finance as well.

(1) Economic benefits

In general economic theory, the participation of foreign firms in the financial market has multiple beneficial effects and some negative ones. There are a number of barriers and restrictions when a financial institution enters a foreign financial market. Management theory predicts that since foreign firms are not familiar with the customs, information and knowledge of the local market, there will be added information and transaction costs to overcome. This is disadvantageous to foreign firms, and is called the "liability of foreignness".[12] Thus, local firms initially have a natural advantage.

Despite the difficulties that foreign firms might have in entering a local market, there is potentially great merit in permitting their entry. This has been widely appreciated for goods,[13] but not so well for services.

Financial services liberalisation would allow foreign financial institutions to participate in the market, improving competition and market efficiency. Efficiency gains in financial services would be in terms of economies of scale and scope. Economies of scale can be gained by focusing on a specific area. Fixed costs would become lower per unit, and specialisation would be possible. Economies of scope can be gained when one institution provides cross-sectoral services that take advantage of its network and resources. Such an institution would be able to respond better to the needs of consumers. Competition from foreign financial institutions that are managed more cost-consciously would prompt local institutions to review

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[10] For a concise description of the benefits of financial services trade liberalisation, see Masamichi Kono et al, "Opening markets in financial services and the role of the GATS", *WTO Special Studies*, 1997.

[11] This follows David Ricardo's theory of comparative advantage.

[12] See Lilach Nachum, "Liability of foreignness in global competition? Financial services MNEs in the City of London", ESRC Centre for Business Research, University of Cambridge, *Working Papers*, no 229, June 2002.

[13] See Jeffrey D Sachs and Andrew Warner, "Economic reform and the process of global integration", *Brookings Papers on Economic Activity*, 1995.

their management and cost structure. This would result in lower prices and better services for consumers.[14]

Research suggests a correlation between market liberalisation and economic growth.[15] The improved efficiency of local financial institutions as a result of competition from foreign financial institutions would contribute to the development of the markets through better and cheaper financial intermediation. This, in turn, would enhance the profitability of local financial institutions and increase economic growth.

Furthermore, efficiency lowers financial institutions' lending cost, possibly leading to growth.[16] Often, when foreign firms enter the market, their entry induces foreign capital inflow as well. This adds to foreign investment, a prerequisite for economic growth in a country short on domestic savings.

Liberalisation is also said to have real economic benefits, although the data are not always clear-cut. The Organisation for Economic Co-operation and Development (OECD) has estimated that gains in potential GDP per capita from pro-competitive reforms may be substantial for developing countries. As Table 1 indicates, pro-competitive trade reforms have the potential to bring substantial economic benefits on an individual basis. The World Bank estimates that more globalised developing countries generate growth averaging 5% a year, as against –1% for less globalised countries and 2% a year in high-income countries.[17]

Table 1

Gains in potential GDP per capita from pro-competitive reforms

Country	% increase in GDP per capita
China	7.9
India	7.7
Indonesia	8.4
Korea	4.7
Malaysia	6.6
Philippines	6.8
Average	7.7

Source: Sebastien Miroudot, Enrico Pinali and Nicolas Sauter, "The impact of pro-competitive reforms on trade in developing countries", *OECD Trade Policy Working Papers*, no 54, 15 June 2007, p 26.

(2) Managerial expertise

Some of the greatest advantages of market liberalisation in services, however, come from transfers of soft elements, such as information, know-how and technology. In addition, the

14 See Nihal Bayraktar and Yan Wang, "Banking sector openness and economic growth", *World Bank Policy Research Working Papers*, no 4019, October 2006, p 3.

15 See Roberto Chang, Linda Kaltani and Norman Loayza, "Openness can be good for growth: the role of policy complementarities", *World Bank Policy Research Working Papers*, no 3763, November 2005.

16 See Bayraktar and Wang, supra, footnote 14, p 21.

17 See World Bank, *Globalization, growth and poverty*, 2001, p 5.

entry of foreign financial institutions brings potential improvements in general management, accounting, database processing, and corporate governance.[18] These would all be beneficial to the consumer.

Transfer of technology, know-how and personnel would take place, contributing to the formation of a basic market infrastructure. This enables (or forces) local firms to innovate in processes and services to cater for the local market, and to become competitive in their own right.

(3) Regulatory implications

Permitting foreign firms to enter the market is often accompanied by the lowering of entry requirements and clarification of their content, or vice versa. This is to ensure that all parties are on an equal footing and will be judged according to the same criteria. It also corresponds to the specific GATS commitment regarding national treatment.[19] This helps to rule out arbitrary decisions and encourages better drafting, disclosure and scrutiny of regulatory rules.

Foreign firms enter the market either by establishing a new commercial presence or by purchasing a local business. Either way, clear entry and/or takeover requirements must be disclosed, so that the appropriate form of market participation can be determined on an economically viable basis.

If financial market liberalisation takes place too rapidly, while prudential regulation and market infrastructure are weak, the financial market could be dominated by foreign firms seeking short-term profits in a predatory manner. Accompanied by short-term capital inflows and eventually by outflows, this can lead to wide fluctuations and turbulence in domestic financial markets, and does not bode well for national sentiment. The sudden outflow of capital in times of shock, in particular, has been condemned as the root cause of the Asian financial crisis of the late 1990s, and has given rise to harsh expressions of anti-foreign sentiment.

However, the threat from foreign firms needs to be viewed in the long run and placed within a larger picture. It can be argued that countries with smaller economies will benefit from open markets, as external forces will absorb any major disruption, limiting systemic risk to domestic markets.[20] When the host country economy is either stagnant or in a crisis situation, a foreign financial institution, which often has a more diversified portfolio, can provide stability to the financial system.[21]

This can be countered by arguing that when the market is opened and foreign personnel enter the market, the host country may become susceptible to economic difficulties affecting the home country or the wider international financial market.[22] Rapid opening of the financial

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[18] This, of course, assumes that foreign firms do not lower their management and internal control standards upon entry into a developing country market. This may not prove true in cases where regulatory arbitrage is the main motive for entering new markets.

[19] See infra, Section 3.B.

[20] See Morris Goldstein and Philip Turner, "Banking crises in emerging economies: origins and policy options", *BIS Economic Papers*, no 46, Basel, November 1996.

[21] See George Clarke, Robert Cull, Maria Soledad, Martinez Peria and Susana M Sanchez, "Foreign bank entry: experiences, implications for developing economies, and agenda for further research", *World Bank Research Observer*, spring 2003, 18 (1), p 43.

[22] See Joe Peek and Eric S Rosengren, "Collateral damage: effects of the Japanese bank crisis on real activity in the United States", *American Economic Review*, 2000, 90 (1), pp 30–45.

market may have certain repercussions, and therefore appropriate measures need to be considered to limit negative effects, particularly through prudential regulation. Also, some types of financial services liberalisation are more conducive to financial stability than are others.[23]

A society-wide discussion needs to take place to promote understanding of the possible negative and positive effects that liberalisation may have on the domestic economy. This is an essential prerequisite since the initial economic outcome may be positive or negative. The market opening also needs to be carried out in a sequenced manner so that the economy can adjust to changes and a consensus can emerge on the progress taking place. A country which, for whatever reason, is reluctant to liberalise all financial services trade and capital flows immediately should still consider liberalising those types of trade which promote stability and efficiency in the financial system. Such financial services trade liberalisation (i) promotes trade in a broad array of financial instruments; (ii) allows the commercial presence or local establishment of foreign financial institutions (Mode 3 trade in GATS terms); (iii) does not unduly restrict the business operations of similar local establishments; (iv) strengthens institutional capacity (such as transparency, regulation and supervision, etc.); and (v) improves financial sector efficiency.[24] Liberalisation of this nature is also likely to promote less distorted and volatile capital flows, both directly through the types of financial flows it encourages, and indirectly through its effect on institutional capacity.[25]

Often, the possible impact of liberalising a financial market is not well perceived by the domestic economy. Protectionism can be rife, and so-called "vultures" from abroad have been criticised for abusing and even destroying the local economy and reaping excessive profits.[26] However, financial services liberalisation is not a simple question of whether or not to open the market. Liberalisation is inevitable for any economy that has either an excess or a shortage of domestic savings. Furthermore, when economies are increasingly globalised, remaining oblivious to financial services trade liberalisation is not possible. In the case of trade in goods, it is difficult to remain isolated from trade with other countries when all countries depend on trade with others for economic development. This holds equally for financial market liberalisation, since financial services are a necessary component of a growing economy through their intermediation in the flow of savings to productive investment.[27]

That being the case, preparation and planning for a well coordinated and appropriately sequenced liberalisation are what is required. This would enable countries to reap the maximum benefits from liberalisation of financial services. If diplomatic negotiations lead to liberalisation of financial services under the pressure of market forces, a country should maximise the benefits by developing well coordinated policies and implementing them in a strategic manner. Global financial services liberalisation is an opportunity to be seized, not a disaster in which the only option is the insulation of domestic markets.

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[23] For further discussion of this topic, see Masamichi Kono and Ludger Schuknecht, "How does financial services trade affect capital flows and financial stability?", in Stijn Claessens and Marion Jansen (eds), *The internationalization of financial services*, World Bank and WTO, 2001.

[24] See id, pp 147–153.

[25] Id.

[26] A case in point is the attack on the pound sterling in 1992 by the fund led by George Soros, which resulted in the United Kingdom having to leave the European Exchange Rate Mechanism.

[27] Cf Chairman Alan Greenspan's remark on BBC Radio, "Greenspan on economics", 1 October 2007.

B. Patterns and path of liberalisation

As discussed above, the advantages of financial liberalisation, and its inevitability as a result of the globalisation of financial markets, indicate the fundamental need for liberalisation. Hence, while the necessity of financial liberalisation is not disputed, the path and method of liberalisation is an area in which there is wide debate. Financial liberalisation needs to be placed in the context of wider liberalisation efforts, since the sequencing of liberalisation has become an essential factor in its success.

The pattern of liberalisation has been studied in the context of post-crisis financial restructuring programmes. In the aftermath of a financial crisis, the limitations of a relatively closed financial system become apparent. Governments have often tried to control market forces directly by imposing capital controls at the onset of a crisis, only for their efforts to end in vain.[28] Given the power of the market, what is needed is not to resist it, but to establish a financial system that is robust and resilient in the face of sudden and strong market movements. Thus, financial liberalisation must progress in parallel with the strengthening of the financial system, and sequencing must take into account the need to establish certain institutions and infrastructure.

There are two aspects of sequencing which are relevant in this section. The first is the sequencing of financial system liberalisation in terms of domestic financial institutions and markets. This is the more closely felt aspect of liberalisation, in which domestic institutions will be strongly affected. The second aspect is the sequencing of financial services trade liberalisation, which will have an impact mainly on foreign counterparties. The two are closely intertwined, but in terms of policy formulation, the distinction is important, especially for developing countries.

(1) Trade liberalisation path

Diagram 1 illustrates the relation between trade liberalisation and domestic financial liberalisation. The two are closely related, and the liberalisation programme would not be complete without both sides being achieved.

When considering trade liberalisation independently, regional integration efforts need to be taken into account. As mentioned in the introduction above, regional integration often proceeds in the sequence of customs unions, free trade areas and finally common markets. If such regional integration creates barriers to extraregional trade,[29] participating in such regional frameworks can be an obstacle to further liberalisation.

On the other hand, joining the WTO prior to entering a customs union can induce competitive accession to the WTO in a region. This could be more advantageous for small and relatively open economies.[30] WTO members will be able to extract concessions from other members within the WTO framework, something that may be difficult to attain through a bilateral or regional arrangement.

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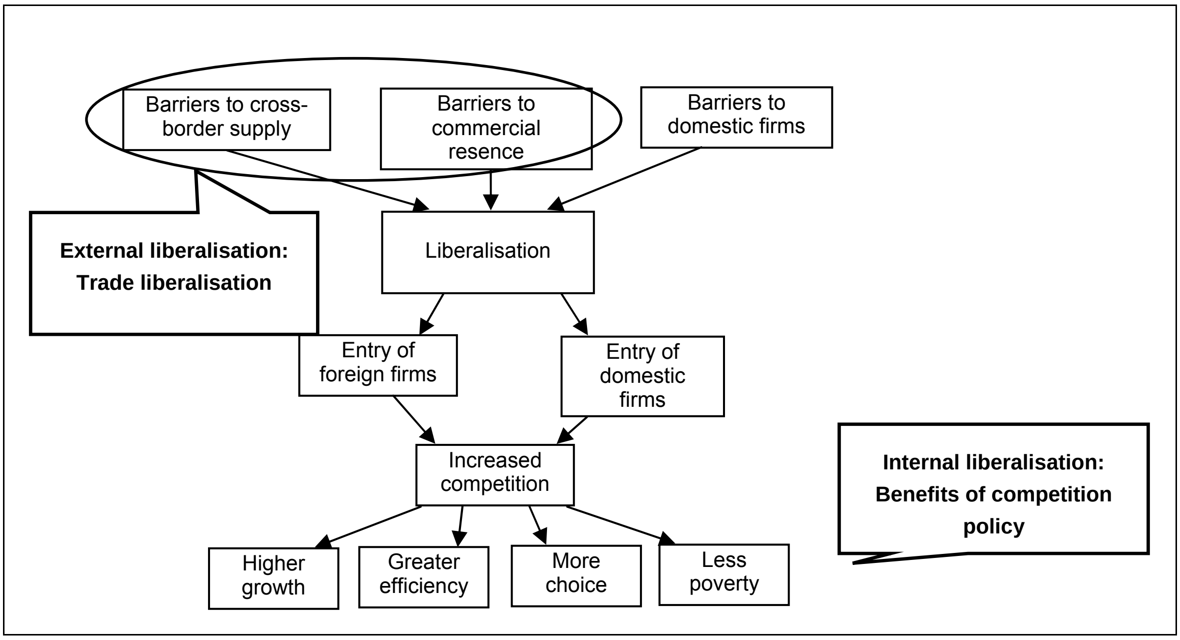
[28] See IMF, *Global financial stability report*, September 2007, p 89.

[29] Furthermore, the inclusion of most favoured nation clauses can cause trade negotiations to have a proliferating effect. See infra, Section 4. See also Patrizia Tumbarello, “Regional trade integration and WTO accession: which is the right sequencing? An application to the CIS”, *IMF Working Papers*, no 05/94, May 2005, p 4.

[30] See id, p 5.

Diagram 1

Trade liberalisation process and competition policy



Source: International Financial Services, London, “Impact of liberalising financial services”, January 2002, p 3.

Another aspect of trade in financial services is the issue of capital account liberalisation.[31] Current account liberalisation is a prerequisite of International Monetary Fund (IMF) membership,[32] and most countries in Asia are already members. Liberalisation of the capital account is related mainly to Article VI of the IMF’s Articles of Agreement. Capital account liberalisation requires removal of controls on the movement of capital both in and out of a country, and of any restrictions on currency convertibility. Capital account liberalisation may result in a large surge of capital inflows as international investors react to the improved investment environment.[33] This often helps the balance of payments, smooths temporary shocks to income and consumption, reduces the cost of borrowing and supports more rapid economic growth.[34] The problem arises when this virtuous cycle is reversed and sudden outflows of capital cause the currency to fall, forcing the economy to shrink and bringing economic growth to an abrupt halt.

(2) Sequencing of financial liberalisation

There have been two approaches to financial liberalisation in the past: the use of sequencing discussed here, and shock or big bang therapy. The shock approach to financial liberalisation and regional integration is more or less applied within the European Union.[35]

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[31] For an account of the distinction between liberalisation of financial services trade and liberalisation of capital flows, see Kono and Schuknecht, supra, footnote 23.

[32] See IMF Articles of Agreement, Art VIII, para 2.

[33] See Barry Johnston, “Sequencing capital account liberalizations and financial sector reform”, *IMF Papers on Policy Analysis and Assessment,* no 98/8, July 1998, p 1.

[34] See id, p 2.

[35] See Brigid Gavin, “The role of the European Union in global financial governance”, *United Nations University – Comparative Regional Integration Studies Working Papers*, no O-2002/01, 2002, p 5.

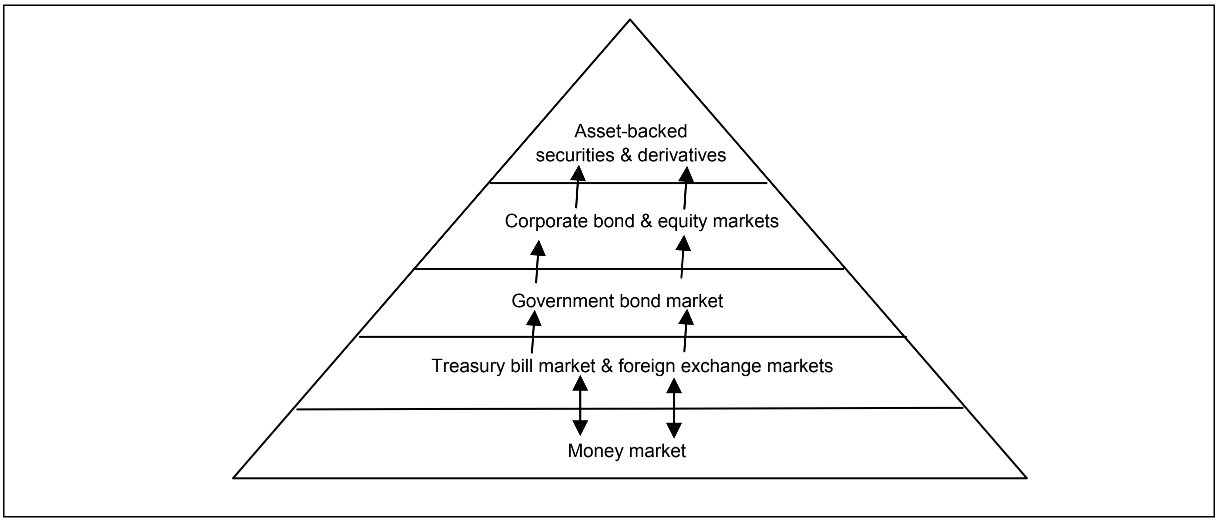
This approach has the advantage of speed, with possibly lower cumulative adjustment costs; another advantage is that full-scale reforms are not undermined by partial reforms.[36] Nevertheless, given the experience of a number of financial crises in which the total adjustment cost was considerably high with the shock approach, a global consensus has been emerging on the use of sequencing in financial liberalisation.

This is confirmed most clearly by the chapter on sequencing in the IMF/World Bank Handbook on the Financial Sector Assessment Program (FSAP). The goal of orderly sequencing is mainly to safeguard monetary and financial stability during financial liberalisation and financial sector development.[37] To comprehend the role of sequencing, we draw upon the paper from which the FSAP's Chapter 12 originated.[38]

Financial markets have a hierarchical order in their development, which is directly linked to the order of financial liberalisation (see Diagram 2). The money market precedes all other markets, with the foreign exchange market following as the point where non-resident capital enters local financial markets. The long-term government bond market is the initial benchmark for corporate and asset-backed securities markets to develop, and markets for more complex risks may follow. The market for short-term government paper should come before the development of the long-term government bond market, although the experience in Japan has been otherwise, perhaps as a result of fiscal and monetary conditions at the time. Derivatives markets require liquidity and efficiency in underlying fixed income or equity markets. Sequencing should assume such a developmental order.

Diagram 2

Hierarchical order of domestic financial markets



Source: Cem Karacadag, V Sundararajan and Jennifer Elliot, "Managing risks in financial market development: the role of sequencing", *IMF Working Papers*, no 03/116, June 2003, p 7.

[36] See Saleh M Nsouli, Mounir Rached and Norbert Funke, "The speed of adjustment and the sequencing of economic reforms: issues and guidelines for policymakers", *IMF Working Papers*, no 02/132, August 2002, p 5.

[37] See IMF and World Bank, *Financial sector assessment program – review, lessons, and issues going forward: a handbook*, 22 February 2005, Chapter 12, p 318.

[38] See, *inter alia*, Cem Karacadag, V Sundararajan and Jennifer Elliot, "Managing risks in financial market development: the role of sequencing", *IMF Working Papers*, no 03/116, June 2003.

Table 2

Financial development: stylised sequencing of reforms

Types of measures	Themes : Hierarchy of market and product development goals				
	Money and exchange market-related central bank reform	**Government bond market and public debt management**	**Banking and financial services to target groups**	**Corporate debt and equity markets**	**Derivatives and asset-backed securities**
Market and product development					
1. Entry, instrument design, primary issuance and access policies					
2. Trading and settlement infrastructure					
Risk mitigation					
3. Prudential super-vision and market conduct oversight					
4. Risk controls in the payment system					
5. Macroprudential surveillance and macro policies to manage volatility and systemic risks					
Financial system infrastructure					
6. Accounting and disclosure standards					
7. Insolvency regime and property rights					
8. Internal information systems, transparency and governance					
Financial institu-tions restructuring and recapitalisation					
Capital account liberalisation					
9. Capital inflows by instruments and sectors					
10. Capital outflows by instrument and sectors					

Source: IMF and World Bank, *Financial sector assessment program – review, lessons, and issues going forward: a handbook*, 22 February 2005, p 319.

Moreover, sequencing needs to be accompanied by an institutional framework, and to be supported by sound financial institutions. Systemic weaknesses need to be addressed by the regulatory authority in close coordination with the central bank (or the monetary authority), and the regulatory authority needs to have appropriate powers to supervise the development of the financial markets. Sound financial institutions contribute through their roles as market intermediaries, providers of backup credit lines, and holders and managers of traded securities portfolios.

Imperative principles of sequencing include (Table 2):[39]

- Capital market development with financial stability hinges on establishing the institutional infrastructure for controlling both macroeconomic and financial risks.
- Market development policies should be comprehensive, and technically and operationally linked measures should be implemented together.
- Capital market development requires a careful sequencing of measures to mitigate risks in parallel with reforms to develop markets.
- Policies to develop markets should be accompanied by prudential and supervisory measures as well as macroprudential surveillance in order to contain risks introduced by new markets and instruments.
- The pace of reforms should take into account the initial financial condition and soundness of financial and non-financial firms, and the time needed to restructure them.
- Institutional development is a critical component of building capital markets and financial risk management capacity.

Recent developments in international financial markets, prompted by rising delinquencies in US mortgage markets, appear to have demonstrated that financial crises are even more contagious today, with the advent of securitisation and proliferation of investment vehicles and hedge funds. Risk contagion has become more rapid and complex, increasing the need to improve prudential measures and strengthen regulatory cooperation. It would be difficult for a country to develop its financial markets and maintain stability without taking into account technological innovations and capital movements. This backdrop of market turbulence reinforces the view that countries need to strengthen the robustness of their financial system with internationally recognised prudential rules and sequential liberalisation.

While the financial institutions of developed countries are generally suffering from sizeable (or, for some institutions, huge) losses from securitized products and/or from shortages of liquidity, the impact on Asian financial institutions appears to be limited. This can possibly be seen as an opportunity for the latter to increase their role and share in international financial markets.

3. Competition law environment in Asia

A. Placing competition law in context

Competition law is the first avenue to be pursued in discussing the existence of competition policy. It also indicates a country's attitude towards competition policy, with enactment of such law implying the relative importance to that country of a fair and balanced competition

[39] See id, p 30.

environment. When considering the competitive environment of a country, however, merely analysing competition law is perhaps insufficient.

Competition law is not the only law that dictates competition in the marketplace, or, more narrowly, regulates unfair transactions. However, competition law is the hallmark of a market economy.

It should be borne in mind that competition law which prohibits anticompetitive actions is meaningless in an environment where there is little or no real competition. Thus, a caveat must be entered: the fact that a competition law is established does not in itself ensure an effective competition policy. The wider system needs to support this philosophy, for example, through civil law and intellectual property laws, or privatisation of state-owned enterprises.

Another factor that should be taken into account is the uniqueness of the financial sector. Traditional public goods, such as a police force and national security, are often characterised by their exclusive provision by the state, and competition does not exist.[40] While competition policy in the financial sector per se is not necessarily within the scope of this paper, it should be noted that, while financial services are not normally considered to be public goods, they have often been excluded from the strict application of the competition law regime due to prudential and other public policy considerations.[41] Thus, when we consider this in the context of financial liberalisation, it is essential to bear in mind that competition law may not necessarily be reflected in the financial sector. The competition law regime may well present a more ambitious market-oriented perspective than is feasible in reality, or its non-existence may not preclude effective competition policy in the marketplace.

Generally speaking, competition law has three components. First, it prohibits anticompetitive practices or agreements (both horizontal and vertical) that restrict free trading and competition between firms.[42] Second, abuse of a dominant market position that is anticompetitive is restricted. Predatory pricing, imposing conditions on the sale of goods and services, controlling prices and refusal to deal are part of such behaviour. Third, large corporate mergers and acquisitions which might threaten competition are subject to decisions by the competition authority to prohibit the deal or to order remedies involving divestment of part of the business.

The rationale for competition law or policy is ultimately and essentially to improve consumer welfare. The objective of competition is to improve efficiency in production and supply and enable the provision of goods and services at lower prices and with wider choice.

When a country decides to enact a competition law, it makes a tacit commitment to adhere to competitive market principles, with a certain degree of government intervention to ensure the running of such markets.[43] If firms are left to compete freely, since they prefer to avoid competition, they will lean towards anticompetitive behaviour. In this case, competition will exist without a competition law or policy, but it will contribute less to economic efficiency.[44]

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[40] In recent years, public goods have not necessarily been provided exclusively by the state; certain services have been outsourced to the private sector. For example, prison services are being run by the private sector in some countries.

[41] See Mamiko Yokoi-Arai and Takeshi Kawana, “Competition policy in the financial sector of Asia”, FSA-FRC discussion paper, December 2007.

[42] Horizontal agreements are agreements between firms in the same industry involving, for example, price fixing, market division and boycotts of third parties. Vertical agreements include agreements between suppliers and buyers of intermediate inputs or final goods, such as exclusive dealing or resale price controls.

[43] See Dennis Swann, *Competition and consumer protection*, Penguin, 1979, p 21.

[44] Id, p 22.

This section will provide an overview of the competition laws of Asian countries with a view to understanding the level of importance that competition law has been given in the region. The objective is not to delve into the detail of the provisions, but to grasp the commitment to a liberalised, market-oriented economy.

B. Competition laws

The enactment of competition law is a prerequisite for developing countries trying to establish a sound economic law infrastructure. However, developing countries may occasionally feel that competition law contradicts their development goals. This fear needs to be overcome and balanced in order for these countries to embrace the comprehensive benefits of well defined competition law and for greater economic growth to be achieved.

Competition law in Asia has often been brought about by external factors, such as membership of the WTO, or FTAs/EPAs that explicitly or implicitly require a competition law regime. Alternatively, countries may deem a competition law necessary as a result of such membership, in order to legitimately control the entry and activities of foreign firms.[45] If a firm with a dominant market position enters the country and behaves anticompetitively or abuses the market, it will become necessary to institute a competition law to manage such activities on the part of the firm. Furthermore, competition law is increasingly becoming a prerequisite for participation in the international economy.

(1) Enactment of competition laws

The landscape of competition laws in Asia is diverse. Since the objective of this paper is more to draw comparisons than to provide a detailed analysis of competition provisions, we draw upon a number of surveys covering the countries that we are investigating in this section in order to comprehend the overall competition policy of the region.

Most countries, with the exception of Korea and Japan, have only recently established their competition laws, or are still in the process of introducing such legislation, and lack substantial experience in the implementation of those laws (Table 3). China adopted its Anti-Monopoly Law in July 2007, to be enforced as from August 2008.[46] Malaysia and the Philippines have draft competition statutes, but their legislative timetables are unclear.

Thailand and India have relatively new competition laws, but they lack guidelines and cases for effective implementation. While a competition law is not necessarily required for a country to apply competition policy to the financial sector, the presence of a competition law generally bodes well for the effective implementation of such a policy.

The group of countries analysed in this section can be generally classified into three groups. The first group includes countries such as Japan and Korea, which have both developed various guidelines and evaluated many cases, and which have a well developed competition regime. The second group includes those countries which have established their competition laws relatively recently and which therefore lack the experience necessary to enhance their competition policy regime. This group covers a wide range of countries, but they have in common the ongoing process of establishing a meaningful competition regime and asserting the authority of the competition authority. India, Indonesia, Singapore and Thailand are the

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[45] See Makoto Kurita, "International rule-making in competition law and the effect on legal systems of developing countries", in Shinya Imaizumi, (ed), *International rule-making and developing countries*, Institute of Developing Economies (JETRO), 2007 (in Japanese), p 132.

[46] The Standing Committee of the National People's Congress adopted the Anti-Monopoly Law in July 2007. It will be enforced as from August 2008.

older members of this group, while China and Vietnam are very new members. The third group comprises those countries that have yet to enact a competition law. Countries such as Malaysia and the Philippines belong to this group; the level of discussion regarding competition law varies among such countries.

Table 3

Enactment of competition laws

State	Name of the law	Authority
Japan	Anti-Monopoly Act, 1947	Fair Trade Commission
China	Anti-Unfair Competition Law, 1993 Anti-Monopoly Law, 2007	National Industrial and Commercial Administrative Bureau Anti-Monopoly Commission
Korea	Monopoly Regulation and Fair Trade Act, 1980	Fair Trade Commission
Indonesia	Anti-Monopoly and Fair Competition Act, 1999	Business Competition Observation Commission
Malaysia	Under discussion	Ministry of Domestic Trade and Consumer Affairs
Philippines	Under discussion	Ministry of Trade and Industry
Singapore	Competition Act, 2004	Competition Commission
Thailand	Trade Competition Act, 1999 (Price Control and Monopoly Prevention Act, 1979)	Trade Competition Commission (Domestic Trade Bureau, Ministry of Commerce)
Vietnam	Competition Act, 2004	Competition Administration Agency Competition Council (Ministry of Commerce)
India	Competition Act, 2002 (Monopolistic and Restrictive Trade Practices Act, 1969)	Competition Commission of India

Source: M Kurita, "Establishment of international competition rules and their influence on enactment of competition law in developing countries", in S Imaizumi (ed), *Establishment of international rules and developing countries – globalised economic statutory reforms*, Institute of Developing Economies (JETRO), 2007 (in Japanese). Updates and revisions made by the authors.

To analyse the provisions of the competition laws, we cite two surveys that we have updated and revised. First, we draw upon the work of Urata,[47] which provides a snapshot of the competition law environment. Urata's index evaluates competition laws on the basis of whether they reflect the seven concepts identified by Bollard and Vautier:[48]

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[47] See Shujiro Urata, "Competition policy and economic development in East Asia", *Washington University Global Law Review*, vol 1, 2002, p 19.

[48] See Alan Bollard and Kerrin Vautier, "The convergence of competition law within APEC and the CER agreement", in Rong-I Wu and Yun-Peng Chu (eds), *Business, markets and government in the Asia-Pacific competition policy, convergence and pluralism*, 1998, pp 126–134.

1. Merger regime
2. Abuse of dominant position
3. Horizontal agreements
4. Vertical restraints
5. Exceptions to jurisdiction
6. Unfair trade practices, and
7. Roles, enforcement and powers.

Table 4 corresponds generally to the stages of competition law in the region, but it defies certain expectations, as some newer legislation has resulted in well defined competition laws. This is illustrated most prominently in the case of China and Singapore, which have recently enacted competition laws and, as a result, have been able to learn from the experiences of other countries in compiling their legislation. The level of enforcement is also clearly demonstrated, as countries with a short record in enforcement have only scored lower on the index, or not at all. Countries which do not have competition laws, but which include relevant clauses in other legislation, are also clearly identified here.

Table 4

Competition law provisions index

	Merger regime	**Dominant position**	**Horizontal agreements**	**Vertical agreements**	**Jurisdiction**	**Unfair practices**	**Enforcement**	**Total**
China	5	10	5	5	5	10	–	40
Hong Kong SAR	10	–	–	–	–	–	–	10
Indonesia	5	5	5	5	0	5	5	30
Japan	10	10	10	5	0	10	10	55
Korea	10	10	5	5	0	10	5	45
Malaysia	–	–	–	–	–	5	–	5
Philippines	–	5	–	–	0	5	0	10
Singapore	10	10	5	10	0	5	5	45
Thailand	10	–	5	5	0	5	5	30
Vietnam	5	5	5	5	5	0	0	25
India	5	5	5	0	0	5	5	25

– A score of 10 indicates that there is an explicit statement concerning anticompetitive behaviour in this area.
– A score of 5 indicates that rules do exist, but they suffer from a lack of clarity.
– A score of 0 indicates that such a rule is not stipulated.

Source: Shujiro Urata, “Competition policy and economic development in East Asia”, *Washington University Global Law Review*, vol 1, 2002, p 21. Revised and updated by the authors.

Table 5 is another antitrust index that corresponds to specific provisions. It is heavily reliant on merger notification and assessment, and the OECD[49] has added countries to the original study.[50] The antitrust index is obtained by adding scores for each criterion included in a list of items that are found in the relevant national laws of the country. The provisions are not examined in detail, but an explicit mention in a provision merits a score. The higher the score, the more specific the provisions of the competition law tend to be.

Considering that the higher-scoring countries have relatively recent legislation, it is to be expected that they would make better provision for the requisite criteria. Countries that have yet to enact competition laws are clearly identified.

As Nicholson admits, there is no guarantee that a competition law is more efficient or stronger simply because it includes a larger set of criteria. The implications of the antitrust law index are greater for the countries that score zero. These are unequivocally apparent in the index score.

Table 5

Antitrust law index

Country	Index
India	20
Vietnam	18
Singapore	14
Korea	14
Chinese Taipei	14
Thailand	13
Indonesia	13
Japan	9
China	6
Philippines	3
Hong Kong, SAR	0
Malaysia	0
United Kingdom	9
United States	21
Ukraine	20

Sources: M W Nicholson, "Quantifying antitrust regimes", *Federal Trade Commission Working Papers*, no 267, February 2004; Sebastien Miroudot, Enrico Pinali and Nicolas Sauter, "The impact of pro-competitive reforms on trade in developing countries", *OECD Trade Policy Working Papers*, no 54, 15 June 2007, pp 64–5. Revised and updated by the authors.

49 See Miroudot, Pinali and Sauter, supra, footnote 9, pp 64–5.

50 See M W Nicholson, "Quantifying antitrust regimes", *Federal Trade Commission Working Papers*, no 267, February 2004.

References for Table 5

List of antitrust law index criteria

Category	Criteria within national law	Score
Scope	Extraterritoriality	1
Remedies	Fines	1
	Prison sentences	1
	Divestitures	1
Private enforcement	Third-party initiation	1
	Remedies available to third party	1
	Third-party rights in proceedings	1
Merger notification	Voluntary	1
	Mandatory	1
	Pre-merger	2
	Post-merger	1
Merger assessment	Dominance	1
	Restriction of competition	1
	Public interest	1
	Other	1
	Efficiency	1
Dominance	Limits on access	1
	Abusive acts	1
	Price setting	1
	Discriminatory pricing	1
	Resale price maintenance	1
	Obstacles to entry	1
	Efficiency defence	1
Restrictive trade practices	Price fixing	1
	Tying	1
	Market division	1
	Output restraint	1
	Market sharing	1
	Eliminating competitors	1
	Collusive tendering/bid rigging	1

What the two surveys indicate is that those countries which do not have competition laws most probably lack the regime necessary for creating and maintaining a competitive environment for the economy in general, including the financial services sector. Some of the countries that have enacted competition laws recently have, in some cases, been able to score well with their carefully formulated legislative acts. It is interesting to refer to the position of developed countries such as the United Kingdom and the United States in the index. The United States has a high score, but only slightly higher than that of India or Ukraine. The United Kingdom scores only nine, while having one of the most comprehensive competition policy regimes. Thus, the antitrust law index is probably only indicative of the strength of the regime, and should not be interpreted as a definitive score of the actual degree of competition for the market in question.

(2) Enforcement of competition laws

It is recognised that the text of the legislation will provide only a foundation for the regime. Enforcement and implementation of the law are significant and crucial for the competition law to be transformed into a competition policy regime. This was demonstrated in abundance during the Asian financial crises. Many of the crisis-affected countries had adequate legislation in terms of the letter of the law. However, it has been argued that the laws were not effectively applied and enforced, and that this may have undermined the spirit of the law, at least in part.[51]

Competition law reflects this recognition, requiring that a competition policy be developed subsequent to, or concurrently with, its enactment. The provisions of the competition law must not only be adequate, but must be supported by a strong and robust enforcement regime. The competition authority needs to be independent and able to provide guidelines to supplement the primary legislation.

As an indicator of enforcement, we use data on the number of investigations and the size of the competition authority (Table 6). For countries that have not enacted a competition law, it is not possible to make an evaluation. Hong Kong SAR, Malaysia and the Philippines fall into this category. For countries where anti-monopoly laws have been enacted recently or have just become effective, enforcement has yet to be carried out. China has just adopted its competition law, and the Anti-Monopoly Commission is yet to be established. Singapore's competition law came into effect in July 2007, and no infringement decisions have been made. However, the Competition Commission of Singapore does not publish the number of cases investigated, so data are unavailable.

At present, Vietnam does not appear to have investigated any cases or imposed any sanctions.[52] Guidelines for industry sectors are being discussed by the relevant ministries, and actual enforcement is about to commence.

India's regulations impose fees of 50,000 rupees (US$ 1,200) to file a complaint with the competition authority. This is very expensive, given the income standard of the country, and may work as a deterrent to filing a complaint. Hence, it may have acted as an impediment to collecting relevant information regarding suspected cartels. The few investigations that have been launched have been either stayed by the high courts or the Supreme Court, or dropped. There is legislation in India, but it may lack the means for effective implementation. At present, about 5,000 cases are said to be pending.[53]

Thailand's competition authority appears to have a management and control issue, with the number of commissioners being excessive, and arguably not all of them having the requisite

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[51] See Joseph Norton, *Emerging markets and financial sector reform,* British Institute of International and Comparative Law, 2000.

[52] See Yuka Kaneko, "Country study: Vietnam", in *Competition policy of the financial sector in Asia*, Financial Services Agency of Japan, 2007, p 349 (in Japanese).

[53] See Pradeep Srivastava, "Enforcement of competition policy and law in India", paper presented at a seminar on "Competition challenges in a globalising economy: issues before India", New Delhi, 4 October 2002.

expertise, thereby weakening the effective implementation of the competition regime. In addition, the authority is said to be affected by lobbyists and politics.[54]

Table 6

Competition law provisions index

	No of investigations			No of cases resulting in sanctions			Competition authority		
	Anti-competitive practices	**M&As**	**Total**	**Anti-competitive practices**	**M&As**	**Total**	**No of employees**	**Total fines imposed**	**Total budget (in USD 000s)**
China	Not enforced	–	–	–	–	–	500	–	–
Hong Kong SAR	No law	–	–	–	–	–	–	–	–
Indonesia (2005)	–	–	21	–	–	11	–	–	–
Japan (2006)	159	74	233	13	0	13	564	84,215	72,252
Korea	–	–	–	304	48	352	416	49,105	49,382
Malaysia	No law	–	–	–	–	–	–	–	–
Philippines	No law	–	–	–	–	88	–	–	–
Singapore (2005)	–	–	–	0	0	0	–	–	3,995
Thailand (2005)	–	–	9	–	–	3			
Vietnam (2006)	0	0	0	0	0	0	–	–	–
India	–	–	–	–	–	–	–	–	390,000–500,000
United Kingdom	11	315	326	0	8	8	170		23,388
United States	100	387	487	66	39	105	1075	442,421	135,486

Note: The dataset uses data from 2000 unless otherwise indicated.

Source: Hiau Looi Kee and Bernard Hoekman, "Imports, entry and competition law as market disciplines", *European Economic Review*, vol 51, 2007, p 835. Revised and updated by the authors.

Despite the relatively recent enactment of its competition law, Indonesia has been quite active in enforcing it. This is obvious in the number of cases that have been investigated by

[54] See Shinya Imaizumi, "Country study: Thailand", in *Competition policy of the financial sector in Asia*, Financial Services Agency of Japan, 2007, p 322 (in Japanese).

the authority. However, cases that have been appealed to the judiciary have often been overturned, which is said to be due to a lack of understanding of competition law concepts by the judges. Procedural inadequacies may have also led to the cases being overruled by the courts.[55]

Korea has been very active in its enforcement of cases and in the fines imposed. While the number of cases investigated is not disclosed, the number of infractions that are sanctioned and the amount of fines are high. This possibly reflects the pressure on the authority to control the dominance of the chaebol industrial groups.

Japan's enforcement record in recent years is outstanding within this group. The Anti-Monopoly Act has been implemented for a long period, but during the last decade, the experience and proceedings of the Fair Trade Commission have become abundant, as its organization as well as its enforcement powers and sanctions have been reinforced. The Fair Trade Commission of Japan has recently announced its intention to revise aspects of the Anti-Monopoly Act that relate to its investigative power and financial penalties, which are considered to be too low.[56] The revision is intended to improve the law's deterrent effect on anticompetitive behaviour.

The enforcement index illustrates well the real nature of competition policy regimes. This is true for the United States and the United Kingdom, which have strong regimes, and is reflected in the cases that have been investigated. It may also indicate that the competition authority can be managed by a relatively small number of employees, as in the United Kingdom.

C. Regional trends in Asia

The discussion in this section demonstrates that, as Asia experienced during the Asian financial crises, the issues surrounding competition law reside in its implementation. In addition, the amount of information available may correspond to the number of cases being investigated. This is probably indicative of the information disclosure policy of the country.

When provisions and enforcement indexes are compared, it is clear that enacting the law is the first crucial step in the implementation of a competition policy regime. Without a strong legal framework, a country will inevitably score low on the indexes. On the other hand, some countries have been able to establish a comprehensive law by learning from the experience of other countries. China and India have relatively high scores in the competition law provisions index and the antitrust law index, respectively, which might be a result of this. Vietnam also has a relatively high index score in this respect.

Once this stage is reached, the enforcement regime becomes critical. Countries such as Singapore, Vietnam and India have had their competition law regimes for some years, but implementation of the law has probably not been strong. Indonesia and Thailand have had some success with their implementation. Japan and Korea stand out in the region in their competition policy enforcement.

While data are limited, in comparing the United Kingdom with the United States, it seems that the competition authority can be managed with a relatively limited number of staff. Nevertheless, the governance structure of the authority and the decision-making bodies needs to be defined to ensure that decisions are made fairly and independently. This is likely

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[55] See Motoaki Tazawa, "Country study: Indonesia", in *Competition policy of the financial sector in Asia*, Financial Services Agency of Japan, 2007, p. 209 (in Japanese).

[56] Fair Trade Commission of Japan, "Basic considerations towards revising the Anti-Monopoly Law", report submitted to the Cabinet Office, 16 October 2007 (in Japanese).

to become a significant issue for countries in Asia, where the independence of competition policy authorities is still in the process of being developed.

4. Schedule of commitments under the GATS and FTAs/EPAs

Financial services commitments are the second most extensive category of commitments made by developing countries in the WTO services negotiations. Seventy-three per cent of developing and least developed countries have commitments in the financial sector.[57] The possibilities that a liberalised financial sector brings to an economy can be vast, as discussed in Section 2. However, due to domestic political considerations and protectionist or nationalist sentiments, engagement in financial liberalisation has not been straightforward for any country. In this respect, the high proportion of commitments made in the financial sector is a significant achievement.

This section seeks to investigate the financial sector commitments made by Asian countries in the GATS and FTA negotiations. Finance is a core element for running an economy, as efficient financial intermediation enables industries to be developed. Foreign capital can play an important role in this process, if countries are able to recognise this and apply financial liberalisation measures appropriately.[58]

A. Overview of the role of the schedule of commitments and its significance in the GATS

General obligations under the GATS[59] are basically non-negotiable, so they are not included in the schedule of commitments. However, specific obligations are subject to negotiation, and are then listed in each member's schedule.

Part III of the GATS[60] requires that specific commitments be made by members in relation to market access and national treatment. Specific commitments are subject to negotiation and then listed in the schedule of commitments, which states the specific conditions of market access and national treatment that members grant for each sector. Parts III and IV of the GATS need to be read together to understand the way in which a schedule of commitments is drafted,[61] its content,[62] and its modification.[63] The schedule of commitments is an important legal document in that it provides the particulars of market liberalisation commitments by each member and is the final product of negotiations between members.

Progressive liberalisation is an objective of the GATS, as set out in Part IV. This is achieved by amending and modifying the schedule to allow greater liberalisation in successive rounds.[64] These clauses prevent members from taking measures that are regressive or that

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[57] See J Marchetti, "Developing countries in the WTO services negotiations", WTO staff working paper, no ERSD-2004-06, 2004.

[58] See supra, Section 2.A.

[59] The general obligations under the GATS are the most favoured nation (MFN) clause and the transparency requirement. See GATS, Arts II and III.

[60] See GATS, Part III (Specific commitments), Arts XVI–XVIII.

[61] See GATS, Art XIX.

[62] See GATS, Art XX.

[63] See GATS, Art XXI.

[64] See GATS, Art XIX, para 1.

seek to maintain the status quo. Members must endeavour to improve commitments from the 1995 financial services agreement; this makes their 1995 schedules a minimum requirement for future negotiations.

The article on market access prevents members from making commitments that are based on an economic needs test.[65] This is a negative list, in that commitments for the service sectors inscribed in the schedule must be made in conformity with the requirements in Article XVI, unless limitations are explicitly entered in the schedule as a result of negotiations with trading partners in the WTO. Commitments that do not come within the ambit of market access and national treatment can also be negotiated and included in the schedule as additional commitments.[66]

The details of what should be specified in the schedule are laid out in Article XX. This sets out the commitments, together with Article XVI. Each schedule should state:[67]

- Terms, limitations and conditions on market access
- Conditions and qualifications on national treatment
- Undertakings relating to additional commitments
- Where appropriate, the time frame for implementation of such commitments, and
- The date of entry into force of such commitments.

These items are expected to be included in the schedule, along with further instructions on the structure of the schedule.[68] It is also noted that the schedule of commitments is an integral part of the GATS.[69]

B. The implications of members' schedules

The structure of members' schedules will be affected by the legal framework of the country. Owing to the US federal structure and its state laws, it became necessary for the United States to list the content of all the state laws that do not conform to the basic agreement negotiated. For example, insurance regulation in the United States is conducted by state insurance regulators, and there is no federal agency responsible for insurance regulation. Thus, in its additional commitments, the United States notes that the National Association of Insurance Commissioners is promoting harmonisation of state insurance regulation.[70] This is a result of negotiations with Japan, but if the United States were to harmonise insurance regulation, it would result in significant liberalisation measures in terms of the GATS. The current structure of insurance regulation in the United States is complex and vertically segregated by state. This does hamper foreign firms from entering the US market.

Part IV of the GATS requires liberalisation to be progressive, and this is to be achieved through agreement in successive rounds. However, the experience with respect to financial services has not been smooth, with the inability to reach an agreement at the end of the

[65] See GATS, Art XVI.

[66] See GATS, Art XVIII.

[67] See GATS, Art XX, para 1.

[68] See GATS, Art XX, para 2.

[69] See GATS, Art XX, para 3.

[70] See United States of America, *Schedule of specific commitments, attachment to the United States schedule, additional commitments*, paper I.

Uruguay Round and the necessity of extending the deadline to enable an agreement in the form of the Fifth Protocol to the GATS.

The progress made to date in the Doha Round that started in November 2001 further indicates the difficulty of depending on negotiation rounds to move forward. In terms of financial services, some countries have yet to ratify the Fifth Protocol because of domestic constraints.[71] While much progress has been made with the accession of new members, there remain barriers to the speed of liberalisation of pre-existing members.[72]

On the other hand, some members have made extensive commitments in their schedule. Indonesia's schedule on financial services includes a commitment to extensive liberalisation by 2020.[73]

The European Union as a regional community also has a unique approach to the GATS. It negotiated as a single entity and listed the divergence of each member state in its schedule. Generally, GATS commitments list horizontal commitments in services, followed by sector-specific commitments. The European Union considers Mode 3, commercial presence, as the mode in which liberalisation must be given priority.[74] However, the European Union claims that limitations applied through horizontal commitments of members are being abused, affecting the financial services sector in particular, by:[75]

- Unspecified authorisation requirements
- Economic needs tests
- Certain limitations on the purchase or rental of real estate
- Restrictions on equity holdings
- Nationality requirements
- Certain tax and subsidy measures
- Etc.

The Uruguay Round resulted in progress on commitments in market access and national treatment in Mode 3 in particular. More specifically, Mode 3 was the mode in which the most advanced and comprehensive commitments to liberalisation were made in financial services.[76] Liberalisation of other modes was given lower priority due to lack of actual business engagement, or was subject to reservations from regulators.[77]

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[71] Brazil, Jamaica and the Philippines have yet to complete ratification of the Fifth Protocol. See WTO, Committee on Trade in Financial Services, "Report of the meeting held on 27 November 2006" (S/FIN/M/53), 30 November 2006.

[72] To mitigate the difficulty of reaching agreement in multilateral negotiations in the WTO, some members have been promoting the use of Economic Partnership Agreements (EPAs) that negotiate liberalisation and economic cooperation on a bilateral basis. Even Japan, which is a latecomer to regional economic agreements, has a stated policy to promote EPAs to complement current negotiations in the WTO. See Ministry of Foreign Affairs, http://www.mofa.go.jp/policy/economy/fta/index.html (last accessed on 8 June 2007).

[73] See infra, Section 4.C, for details of Indonesia's commitments.

[74] See WTO, Council for Trade in Services, special session, "Communication from the European Communities and their member states, *GATS 2000: financial services*" (S/CSS/W/39), 22 December 2000, para 10.

[75] Id, paras 8–10.

[76] Id, para 15.

[77] Financial regulators have expressed concerns over full liberalisation of Mode 1 and, to a lesser degree, Mode 2, since it is considered difficult to supervise or monitor foreign financial service providers and to protect domestic consumers with the currently available prudential supervisory tools.

Mode 3 becomes relevant when suppliers of services establish commercial presence for their businesses in the territory of another country. Commercial presence is defined in the GATS as "any type of business or professional establishment, including … juridical person, or … the creation or maintenance of a branch or a representative office".[78] The Understanding on Commitments in Financial Services (the Understanding) defines commercial presence as "wholly- or partly-owned subsidiaries, joint ventures, partnerships, sole proprietorships, franchising operations, branches, agencies, representative offices or other organizations".[79] The Understanding appears to be more comprehensive in its definition, making it clear that, if adopted by a WTO member, it allows foreign parties to enter a market in more diverse or capital-light forms.

The European Union insists that commercial presence should be permitted in the legal form of the member's choice.[80] Generally, establishment via local incorporation is more costly than branching. Local incorporation frequently requires higher minimum capital, and regulatory monitoring is stricter. Local incorporations need to meet the various regulatory requirements on a single-entity basis rather than on a group basis. In many Asian countries, foreign financial institutions are required to be licensed as local incorporations. Otherwise, their operational scope is limited and not subject to the local safety nets available.[81] The Understanding provides for full liberalisation of Mode 3 in this regard, but, in some cases, prudential regulation calls for certain limitations to be imposed under the so-called "prudential carve-out".[82] Some countries have inscribed this reservation explicitly in the head notes of their schedules of commitments; for example, Japan has listed in its head note that it "shall not be prevented from taking measures such as non-discriminatory limitations on juridical forms of a commercial presence".[83]

It is becoming increasingly difficult to distinguish between Modes 1 and 2 in financial services, as the internet and other forms of electronic trading networks enable cross-border trade to be arguably indistinguishable from consumption abroad. The Committee on Trade in Financial Services has been discussing this issue and will continue to do so.[84] The consumer protection framework may be different for the different modes. In many cases, consumer protection and safety net measures are not provided for cross-border transactions. While some WTO members request that the definition of Modes 1 and 2 be clarified, others consider the difference insignificant as liberalisation has taken place without such classification.[85] Mode 1 may cause greater concern to regulators, as the identification of the service provider is normally more difficult for cross-border trade than for Modes 2 or 3.[86]

The movement of natural persons, Mode 4, is sometimes limited in a member's schedule by listing the proportion/number of board members that need to have the member's nationality.

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78 See GATS, Art XXVIII, para (d).

79 See GATS, Understanding on commitments in financial services, Section D, para 1.

80 See supra, footnote 74, para 16.

81 See Hiroyuki Nakai, "The real objective: protectionism or supervisory requirement?", *Financial Business*, winter 2007, pp 95–7 (in Japanese).

82 See GATS, Annex on financial services, para 2.

83 See Japan, *Schedule of specific commitments*.

84 See WTO, Committee on Trade in Financial Services, "Report of the meeting held on 19 September 2005" (S/FIN/50), 23 September 2005, Section D (Technical issues), paras 65–76.

85 Some argue that the difference between Modes 1 and 2 should be discussed in the horizontal context, covering all service sectors. See WTO, Committee on Trade in Financial Services, "Report of the meeting held on 23 June 2005" (S/FIN/49), 24 August 2005, Section C (Technical issues).

86 Id, para 17.

If the local market lacks officials having the requisite qualifications or expertise in the respective sector, it may act as a de facto restriction to entry, since filling management positions and jobs requiring higher skills will be more difficult under such a limitation.

From the standpoint of facilitating the transfer of knowledge and know-how to developing countries, and to make the commitment acceptable nationally, it has however been necessary sometimes to accept some nationality requirements in the WTO negotiations.

C. GATS schedules of Asian countries

The schedule of commitments is a list of formal undertakings towards financial liberalisation by each WTO member. In order to make a useful comparison, we have compiled a table of commitments made by Asian countries in the Appendix. The table focuses on commitments in the area of banking (deposit-taking and lending) and other financial services (securities dealing, trading and underwriting), and does not include insurance services. Also, for the sake of simplicity, the mode of supply listed is mainly Mode 3. Practically all countries examined have unbound Modes 1, 2 and 4; in other words, they do not permit supply in this mode by a foreign supplier. Market access is where the bulk of commitments are made, and national treatment is either unbound, exclusive to banking, or for securities listed in the same way as banking.

We are aware of some studies that attempt to quantify the schedule of commitments in the GATS to compare financial liberalisation.[87] While these studies provide valuable input into the proliferation of liberalisation in financial services, we feel that the variety of commitments made implies that a qualitative analysis is more insightful than a quantitative investigation for the purposes of our paper.

Modes

The composition of the list makes it clear that Asian countries are reluctant to accept modes other than Mode 3, which the regulatory authority is generally able to monitor closely. Modes 1 and 2 are not permitted in principle in most countries, and for Mode 4, natural persons, commercial presence is required to accompany the supply mode.

Timing of Accession

One of the noticeable differences between the countries that negotiated their commitments during the Uruguay Round and those countries whose accession followed its conclusion (namely China and Vietnam) may be the specificity of their schedule. The relative intensity of the accession negotiations, and more sophisticated scheduling and drafting skills, may explain why China's and Vietnam's schedules are much more progressive in their approach. In those accession schedules, explicit time frames are given for commitments, making the road to liberalisation a much clearer path for foreign counterparties and hence for foreign financial services providers.

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[87] Eg, Ying Qian, "Financial services liberalisation and GATS", in Stijn Claessens and Marion Jansen (eds), *The internationalisation of financial services*, Kluwer, 2000, pp 63–101; Ying Qian, "Financial services liberalisation and GATS – analysis of the commitments under the General Agreement on Trade in Services (GATS) at the World Trade Organization (WTO)", background paper presented at the PECC Trade Policy Forum Meeting "Options for the WTO 2000 negotiations", 8–9 July 2003; Patricio Contreras and Soonhwa Yi, "Internationalisation of financial Services in Asia-Pacific and the western hemisphere", PECC, December 2003; and Piritta Sorsa, "The GATS agreement on financial services – a modest start to multilateral liberalisation", *IMF Working Papers*, no 97/55, May 1997.

The relative intensity of the accession negotiations can be at least partly attributed to the negotiation mechanism in the WTO, whereby countries conduct a series of bilateral and plurilateral negotiations before finally arriving at a multilateral deal. Countries with later accession were subject to concentrated pressure from other member countries, while pressure during the Uruguay Round negotiations was more widely dispersed among countries and more reciprocal. This was due to the strong attraction of the previously closed markets being opened to foreign providers. While China and Vietnam have been gradually liberalising their economies, previously, the possibility of a foreign financial institution taking part in the financial market as a meaningful player had long been a remote notion. At the same time, the closed financial system presented great business opportunities for foreign players since the saving rates of these countries were very high, while before liberalisation, the needs of consumers for diverse financial products had not been realised.

Geographical limitations

Countries such as China and Indonesia have geographical restrictions for foreign entry, with different rationales. China initially allowed entry into Shanghai and Shenzhen, which were already designated as a financial district and a special economic zone, respectively, and therefore already had foreign parties operating in those areas. Special economic zones were gradually enlarged and then phased out. The rationale seems to lie in initially limiting the number of markets that can be accessed, and gradually increasing the presence of foreign parties in order to avoid drastic effects on the domestic suppliers/markets, and to enable a smooth transition to a more competitive market environment.

Indonesia has a more country-specific issue, in that, together with its archipelago geography, rural areas of the country have very limited financial infrastructure that requires government intervention to be sustainable. This seems to be the reason for Indonesia limiting liberalisation only to the more populated areas of the country.

Social interests

Many Asian countries have scheduled the need for social, public and developmental interests to be a consideration or, in some cases, a precondition for a foreign financial institution to be authorised to operate. Malaysia and India have included language issues related to such interests in their horizontal commitments. Malaysia has a unique *Bumiputra* policy which favours Malays' interests in economic activities, and this is inscribed in its schedule of commitments.[88] Malaysia also includes the need for foreign banks to facilitate trade and economic development. The Philippines considers economic conditions and public interest when deciding whether to grant authorisation. Korea requires mandatory lending to small and medium-sized enterprises (SMEs) as part of its limitations on market access by foreign banks.

Numerical restrictions and economic needs tests

Although numerical restrictions, such as the number of suppliers, or market share and economic needs tests, are in principle to be eliminated under the GATS[89] unless specified in their schedule, many countries have in practice opted to schedule various reservations. India limits the number of bank licences to 12 per year for both existing and new banks. Malaysia limits the number of wholly foreign-owned commercial banks to the existing 13. The Philippines requires that 70% of the resources or assets of the banking system be owned by

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[88] See Malaysia, *Schedule of specific commitments*.

[89] See GATS, Art XVI (Market access).

domestic banks, and it has committed to 10 new licences for the period 1995–2000. Singapore does not bind itself to allowing any new full or restricted bank licences, committing to allow only offshore bank branches or representative offices.

On the other hand, China clearly states that an economic needs test will *not* be applied, and that only prudential considerations will enter into the licensing of foreign banks.

Type of legal entity and participation of foreign capital

Many countries restrict the type of legal entity allowed to foreign entrants, and the level of capital participation and investment by foreign banks. Joint ventures with domestic financial services providers are often required (Table 7).

Table 7

Capital participation by foreign financial institutions

	Banking	**Securities business**
China	Subsidiary: assets more than USD 10bn Branch: assets more than USD 20bn Joint bank: assets more than USD 10bn	Foreign investment increased to 49%
Vietnam	Representative office, branch or 50% foreign capital joint venture bank Parent bank has total assets of more than USD 20bn	Foreign participation limited to 49%
India	Only through branches of foreign banks licensed and supervised in home country	Foreign equity limited to 49%
Indonesia	Locally incorporated, joint venture bank only Acquisition of local bank up to 49%	Listed non-bank up to 100% Through establishment of broker/dealer
Japan	–	Investment trust must be juridical person established in Japan
Korea	A person may own up to 4% of bank stock and 15% of provincial bank stock without authorisation Only branches of foreign banks which rank among world's top 500	Only representative office, branches or joint venture permitted. Joint venture foreign participation minimum is 50% Equity participation in existing securities firm is limited to less than 50%
Malaysia	Equity participation limited to 30%	Locally incorporated, joint venture company only, with less than 30% shareholding
Philippines	Not exceeding 30% of voting stock or 40% upon approval by the President of the Philippines	Foreign equity limitation of 51%
Singapore	Single group of foreign shareholders can only hold up to 5% of a local bank's share. A local bank's share held by foreigners is limited to 40% in aggregate	–
Thailand	Maximum foreign equity participation limited to 25% of paid-up registered capital	Maximum foreign equity participation is 49%

The schedules show clearly that many countries continue to limit foreign capital participation at 30% or 49% thresholds, which is often the benchmark for significant shareholdings. Korea and Singapore appear to have strict regimes in their schedules for banks, with a maximum of only 4% and 5% bank shares respectively permitted for a single entity. For Malaysia, the Philippines and Thailand, such limitations vary between 25% and 40%. Vietnam and Indonesia commit to allow 50% and 49% respectively, but Vietnam will be easing this restriction to permit 100% foreign-owned banks in 2008. Japan and India do not specify any such restrictions upon banks in their schedules.

As for securities firms, many countries limit foreign participation to 49–51%, such as China (49%), Vietnam (49%), India (49%), Korea (50%), the Philippines (51%) and Thailand (49%). Malaysia limits this to 30%. In general, one would normally expect that from the standpoint of the authorities, foreign participation would be more permissible for securities firms than for banks, given the relative importance of banks to a country's financial system. However, it is noted that many countries actually restrict foreign ownership in securities businesses, while other, often stricter forms of market access limitations are applied to banks.

As mentioned above, many countries also require financial institutions to be locally incorporated and/or take the form of joint ventures, thereby excluding direct branches of overseas headquarters. Local incorporation is often required to ensure that the bank's local assets are segregated from the assets of the headquarters and operations in other countries. The use of joint ventures may be expected to encourage the transfer of expertise and know-how to the local institutions and markets, as well as to ensure that at least a part of the ownership of domestic businesses remains with local interests.

Apart from limitations on legal form, China requires that the bank maintain a minimum amount of assets, varying according to the legal form assumed by the commercial presence. Vietnam requires a certain level of assets to be held by the parent bank. Indonesia insists on a locally incorporated joint venture for new entrants. Vietnam, India and Korea do not permit local incorporation of foreign banks, committing to allow only representative offices, branches or joint ventures.

Such restrictions are not as prominent or restrictive in securities businesses, although Korea requires that any foreign commercial presence take the form of a representative office, a branch or a joint venture, excluding wholly owned subsidiaries. Malaysia commits to allow only minority-held joint ventures in securities.

Branching restrictions

If foreign banks are considering tapping into the capital accumulated by the high saving rates of Asian countries, they will need to be able to establish branches and ATM networks to provide financial services at the retail level. Branching is often regulated in Asian countries, perhaps not just for prudential reasons but also because of other policy considerations.

Geographical restrictions may have effects similar to branching restrictions on foreign financial services providers, since the size of the market in the region may be limited (Table 8). Singapore appears to have a strict regime, allowing premises at only one location for foreign banks, but its uniqueness as an island nation may mitigate the effect on foreign providers in terms of restricting market access.

Table 8

Branching restrictions and ATM network participation

	Banking	Securities business
China	Geographical restriction on business	–
Indonesia	Geographical limitation	1 sub-branch and 1 auxiliary office
Philippines	Maximum of 6 branches, with 3 at locations of its choice and 3 at designated locations	
Singapore	Operate from only 1 office Cannot establish off-premise ATMs	Operate from only 1 office
Thailand	Existing banks to be permitted 2 further branches Participation in local ATM network is permitted	

Local expertise requirement

Some countries have included requirements to employ local personnel in their schedules (Table 9). Korea and Malaysia have kept themselves unbound in this respect, permitting all types of reservations on market access. Thailand requires a high proportion of locals to be employed as directors in banking and securities. The local employment requirement may be based on a desire to limit the number of foreigners operating in the market, and hence limit their influence, but it can also be viewed as a desire to elevate the level of expertise of local personnel in senior positions.

Table 9

Local expertise requirement

	Banking	Securities business
India	Local advisory board with SME expertise to be established with Indian nationals	
Indonesia	Branch: 1 executive position by expatriate Joint venture: for director positions, in proportion to shareholding	
Korea	Unbound	
Malaysia	Unbound	
Thailand	At least three quarters of directors must be of Thai nationality	At least half of directors must be of Thai nationality

Progressive liberalisation and other entries

On the other hand, some members have made extensive liberalisation commitments in their schedules. Indonesia's schedule on financial services states that "[a]ll Market Access and

National Treatment limitation specified in the banking subsector will be eliminated by the year 2020 subject to similar commitment by other members".[90] This commitment may not have been given great significance in the context of the Uruguay Round negotiations, as the timing given was a far-off date, and the commitment was very general. However, it expresses Indonesia's clear commitment to complete financial liberalisation through future negotiations. This commitment was related to ASEAN's 30th anniversary, when ASEAN Vision 2020[91] was declared. This initiative lays down the marker for ASEAN members to further integrate and achieve developed-nation status in a cooperative manner through economic development. As part of this endeavour, Indonesia has committed itself to possible full liberalisation by 2020. However, this is not an ASEAN-wide commitment, as no other ASEAN member has included this commitment in its schedule.

Some countries have incorporated restrictions on local currency businesses. China had restricted local currency business until five years after accession, so the present situation will have to be assessed to see whether all of its commitments have been honoured in full. Vietnam also limits local currency business. Malaysia limits foreign currency deposits for residents. Korea maintains a unique position on the choice of currencies. Foreign banks with a commercial presence may handle transactions only in Korean won, and assets must be kept within the country. Furthermore, foreign currency loans are restricted. The schedule was agreed in the midst of the financial crisis in 1997, and the intention of restricting disorderly capital movement can be seen from the provisions.

D. Selected RTAs/FTAs

To facilitate the analysis in this section, we consider the following regional trade agreements (RTAs) and FTAs which appear to be important for regional integration in financial services: the ASEAN Framework Agreement on Services (AFAS), the United States-Singapore FTA, and the Japan-Singapore EPA. The FTAs that Singapore has entered into may be particularly interesting in the sense that Singapore has been strategic in its approach to FTAs and liberalisation of its financial sector. The AFAS is an Asian-driven RTA which, if made effective, could signal the active engagement of Asian countries in financial liberalisation. This would mark a positive approach towards regional integration as well.

(1) AFAS

The AFAS is a regional trade agreement in services among ASEAN member states.[92] It was originally concluded in 1995, and has since completed its third round of negotiations, with its Third Package of Commitments having been agreed in April 2005. Negotiations have been held since the Uruguay Round was concluded in 1997, so it is to be expected that further liberalisation commitments have been made beyond those in the GATS.

The AFAS has adopted a positive list approach, similar to the GATS. The commitments made in the latest negotiation rounds for Mode 3 are summarised in Table 10. Commitments in banking are limited mainly to deposit-taking and lending, and those for securities to trading, dealing and underwriting of securities.

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[90] See Indonesia, *Schedule of specific commitments*. In the schedule, Indonesia declares, for both banking and non-banking financial services, that markets will be liberalised if the commitment is mutual.

[91] See ASEAN, "ASEAN Vision 2020", Kuala Lumpur, 15 December 1997, http://www.aseansec.org/1814.htm.

[92] The ASEAN member states are Brunei, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.

The clarity of the drafting seems to have improved compared to the GATS schedules, in which the intentions of the member countries were not always clear. However, whether there has been a significant improvement compared to the GATS in terms of actual commitments is not obvious, and in some cases it appears that, due to the clearer language, the number or content of limitations may have increased.

When compared to the GATS commitments, while there has been some progress in non-banking services, the overall situation does not appear to be very different. Rajan and Sen (2002) have looked into how far the AFAS has achieved GATS "plus", and it was their view that while some progress had been made, it was considered to be "weak".[93]

Table 10

Summary of AFAS commitments

	Banking	**Securities business**
Indonesia	2 sub-branches and 2 auxiliary offices Executive position can be assumed by expatriates only if at least one Indonesian national also holds such position	
Malaysia	Jointly with commercial or merchant banks in Malaysia	Locally incorporated joint venture companies licensed by Securities Commission with aggregate foreign shareholding under 70% will be permitted to offer corporate financial advice
Philippines		Limited to 2 branches. A resident agent needs to be appointed as condition for licence
Singapore	In accordance with GATS	SGX will admit new trading members who will be able to trade directly in local currency securities
Thailand	Removal of quantitative quota on number of foreign personnel permitted	
Vietnam	Foreign bank permitted to carry out specific operation only in accordance with licence issued by the central bank ATMs not permitted outside its branch office	

[93] See, *inter alia*, Ramkishen S Rajan and Rahul Sen, "Liberalisation of financial services in Southeast Asia under the ASEAN Framework Agreement on Services", Centre for International Economic Studies, University of Adelaide, *Discussion Papers*, no 0226, October 2002.

(2) United States-Singapore FTA

The impact that the United States-Singapore FTA has had on the Singapore banking sector is remarkable. According to interviews, opinion leaders in Singapore seem to agree that the FTA signed in May 2003 has had a significant effect on liberalisation of the banking sector.[94] Singapore pursued this FTA with priority over other FTAs, since the United States is one of the largest sources of foreign direct investment for Singapore.[95] As Singapore does not have a large export industry for goods, the main area in which commitments were requested was services.[96] The United States-Singapore FTA goes beyond the bilateral FTAs that Singapore has concluded with New Zealand, Japan, and Australia.

One of the most significant moves by Singapore was the partial opening of its retail banking sector to US banks. Foreign banks were to be given access to Qualifying Full Bank (QFB) licences and Wholesale Bank licences. Foreign banks are granted three types of banking licences: QFB, restricted or offshore. The ban on QFBs was lifted, and branching location restrictions were to be gradually lifted.[97] Furthermore, although foreign banks are not permitted to join the local ATM network, QFBs would be exempt from this limitation.[98]

The United States-Singapore FTA includes a most favoured nation (MFN) clause,[99] which enables MFNs to capitalise on any agreement reached between different counterparties which is more favourable than the United States-Singapore FTA.

(3) Japan-Singapore Economic Partnership Agreement (EPA)

The FTA agreed between Japan and Singapore comprises an FTA and a partnership/cooperation component. It was signed in January 2002, and lists Singapore's Chapter 7 on trade in services, Chapter 13 on financial services cooperation, Annex IVA on financial services, and Annex IVC on Singapore's schedule of specific commitments.

For banking, Japanese banks are allowed only offshore bank branches or representative offices. Merchant banks can establish merchant bank subsidiaries or branches. No new finance companies are permitted. Japanese banks can operate from only one location, and cannot establish off-premise ATMs.

This appears to be very similar to the commitments under the GATS, and significantly less open when compared to the United States-Singapore FTA. As mentioned above, while the United States-Singapore FTA includes an MFN clause, the Japan-Singapore EPA does not require this explicitly.[100] Therefore, while US banks may be able to take advantage of any liberalisation measures, the Japan-Singapore EPA does not automatically grant the same advantage.

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[94] Interviews conducted by the author with Singapore government officials, bankers and banking lawyers in January 2007 for a separate research project.

[95] See Chia Siow Yue, "Provisions and commitments on trade in financial services in trade agreements in East Asia – notes on Singapore's commitments", paper presented at the 2nd Annual Conference of the PECC Finance Forum, 8–9 July, 2003, p 10.

[96] Id.

[97] United States-Singapore FTA, Annex 10B, schedule of Singapore, Section B.

[98] Id.

[99] Id, art 8(4).

[100] The Japan-Singapore EPA, Art 63(4), requires a party to "favourably consider" MFN treatment when either party enters into such an agreement with a third country.

Subsequently, the Japan-Singapore EPA was reviewed and amended in March 2007, and a Japanese bank has been granted a full banking licence accordingly.[101]

5. Actual entry requirements for foreign financial services providers

Given the above examination of the competition law environment, and the GATS and FTA commitments in financial services, we will now proceed to look into the actual entry requirements of selected Asian countries. Analysis will focus on the banking sector.

The objective of this section is to ascertain the effect on actual market liberalisation of commitments made in the GATS and other FTAs. In addition, reference to the level of liberalisation in each country will enable an analysis of the level of convergence of regulatory standards. An effort is also made to confirm whether trade agreements have been implemented through real measures.

Some time has passed since these trade agreements were signed, and some of the FTAs have been revised since. Considering the objective of progressive liberalisation under the GATS and FTAs, the assumption would be that actual entry requirements for foreign banks and securities firms would be more or less the same as or less restrictive than the specific commitments made in the schedules. To make for a meaningful analysis, and due to the limited availability of the requisite information, we have investigated the actual entry requirements for foreign financial institutions in China, Indonesia, Japan, Singapore, and Thailand.[102]

A. Significance of entry requirements for foreign financial institutions

Financial services, especially banks, have been heavily regulated compared to other industrial sectors because of financial stability and other prudential policy concerns. Entry requirements are an important part of this regulatory consideration. Only entities which have fulfilled specific minimum prudential requirements to operate in the financial sector, and which are likely to be able to satisfy the mandate of maintaining a sound and stable financial system, are allowed to enter.[103]

However, entry requirements are not necessarily imposed solely for the purpose of maintaining the soundness and/or stability of the financial system. Some entry requirements have the effect of limiting competition, leading to efficiency losses and underdevelopment of financial markets.[104] This may be the case especially with restrictions on the entry of foreign banks, which may be superior in their financial technology and expertise. While many studies

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[101] Other revisions include the elimination by Singapore of a numerical quota on granting of wholesale banking licences, further liberalisation by Japan of insurance brokerage services and further liberalisation of cross-border securities services by both parties.

[102] *Inter alia,* the data used in this section were collected for a research project sponsored by the Financial Services Agency of Japan, “Competition policy of financial services in Asia”, 2007 (in Japanese).

[103] There are various theories on the rationale for entry requirements, but we consider only the main objective of financial stability. For other theories on entry requirements, see Barth, Caprio and Levine, supra, footnote 8, pp 49–52.

[104] Id, p 50.

have shown that easier foreign bank entry improves bank performance,[105] the inclination of countries to restrict market entry is strong, even taking into account the possibility of sequenced liberalisation. Most countries are not against financial liberalisation per se, particularly when they wish to make use of foreign capital and expertise for economic development and growth. However, the policy that emerges from an overview of their financial roadmaps is to concentrate first on increasing the competitiveness of their financial markets, mainly through consolidation and encouragement of joint ventures, before allowing greater financial liberalisation and introducing foreign competition in full force.[106]

Applications for bank entry in most countries are said to require the submission or fulfilment of the following requirements:[107]

1. Draft by-laws
2. Organisational chart
3. Financial projections for the first three business years
4. Financial information on the main potential shareholders
5. Background/experience of future directors
6. Background/experience of future managers
7. Sources of funds to be used to capitalise the new bank, and
8. Market differentiation intended for the new bank.

When an economic needs test is not applied, and entry is allowed on a purely prudential basis, a bank licence will normally be granted upon the fulfilment of prudential criteria, such as having (1) a sound capital base and adequate financial resources, (2) fit and proper management, and (3) a viable business plan. Nevertheless, three issues may need to be raised when considering the entry of foreign banks. The first is whether entry requirements are effectively non-discriminatory or provide full and effective national treatment to foreign applicants. The second is what juridical forms of entry are permitted for foreign banks. The third is whether foreign share ownership of domestic banks is restricted.

On the one hand, countries may provide preferential treatment to foreign banks. This may be in the form of easing entry requirements, by replacing the entry requirements with those already fulfilled by the home supervisor. This is based on the notion that the home regulator is conducting consolidated supervision, and only limited prudential requirements may be necessary. Needless to say, this will be possible only when the home supervisor's regulatory standards and enforcement are considered sufficient and effective.

On the other hand, foreign banks may be discriminated against, either explicitly or implicitly. Some countries clearly state that only a limited number of licences will be granted to foreign banks. Implicit entry barriers may sometimes take the form of requesting more information upon application, albeit on an informal basis, or slower processing of licence applications.

Some countries will require a foreign bank to enter in a particular juridical form of commercial presence. For example, there is an important distinction between a branch and a subsidiary. A subsidiary is a separate legal entity from the main bank, whereas a branch is not. The

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[105] See Asli Demirgüç-Kunt, Ross Levine and Hong-Ghi Min, "Opening to foreign banks: issues of stability, efficiency and growth", in Seongtae Lee (ed), *The implications of globalization of world financial markets,* Bank of Korea, 1998.

[106] See supra, footnote 41, p 17.

[107] Id, pp 110–11. More than 80% of countries are said to require these eight items, although there are those that require them fully and those that are more flexible or selective.

distinction becomes significant when a foreign bank becomes insolvent. Because a branch is part of the legal entity established in the home country, its assets will be directly subject to claims by the creditors of the entire bank. In contrast, a subsidiary is an independent legal entity, and therefore it will normally be legally shielded from liquidation procedures abroad.

This will also have direct implications for regulatory capital, and it is the primary reason why, as witnessed in the GATS commitments of countries such as Vietnam and Korea, some countries have imposed requirements in regard to the assets of the parent bank when authorising the opening of a branch. Another approach is to require a certain level of branch capital to be set aside for protecting domestic depositors, as in China.

Acquisition of local banks may be limited, narrowing the possible routes for foreign banks to enter the market. Many countries have limits on foreign shareholding of local banks. The level of foreign shareholding permitted varies widely, and majority shareholdings are often authorised only on a restricted basis, or not at all.

B. Country studies[108]

In this section, we will examine three aspects of entry requirements in China, Indonesia, Japan, Singapore and Thailand. The choice of countries in our study has been based on the availability of information and the significance that entry requirements have had for liberalisation.[109] While the main source of information will be the laws and regulations that the regulatory authorities have published, we will also use information obtained through interviews with various experts in each market.

(1) China

Domestic commercial banks are subject to a relatively strict authorisation regime for permitted activities and branches. Each activity requires authorisation from the China Banking Regulatory Commission (CBRC).[110] Interest rates are restricted for deposit rates and lending rates (both ceiling and floor rates), in accordance with the People's Bank of China Law.[111] The fees for services that commercial banks provide are also regulated by the government.[112] Promissory notes, checks, remittances and payment collection services that are settled in the local currency are subject to price controls determined by the CBRC and the Ministry in Charge of National Development and Reform Commission. Branching is restricted to only one branch and three ATMs in any one city.[113]

(a) Distinct rules for foreign financial institutions

China has distinct rules for foreign banks, although they have been eased considerably since December 2006, as a result of GATS commitments to liberalise local currency business.[114] Geographical restrictions on local currency business have been abolished, and foreign

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[108] See, *inter alia*, Michael Gruson and Ralph Reisner, *Regulation of foreign banks: banking laws of major countries and the European Union, vols I, II and III,* Lexis-Nexis, 4th ed, 2005.

[109] In securities, China recently (11 December 2007) announced the lifting of a temporary freeze on new licences and new joint ventures.

[110] See Commercial Banking Law of China, Chapter 3.

[111] See People's Bank of China Law, Art 28.

[112] See Provisional Rules Governing the Pricing of Commercial Bank Services, Arts 6 and 7.

[113] See CBRC, Reform Law on Commercial Bank Permitted Activities, Arts 46 and 52.

[114] See Regulations of the People's Republic of China on Administration of Foreign-funded Banks, November 2006.

financial institutions are able to supply local currency business to firms and individuals upon fulfilment of certain requirements. However, for the purpose of depositor protection, foreign bank branches can only accept local currency deposits from Chinese nationals in the form of time deposits greater than one million renminbi.

Foreign banks are defined as joint capital banks, joint venture banks, and branches and representatives of foreign banks. To apply for local currency business, such banks and branches must have been operating in China for the previous three years, have been profitable for the last two years, and fulfil the prudential requirements of the CBRC.

Detailed capital and asset criteria have been defined. A foreign financial institution is required to hold a minimum of one billion renminbi or equivalent of registered capital, and to allocate a minimum of 100 million renminbi operating capital for each branch opened in China.

There are separate requirements for each type of legal form, as discussed below. Other requirements are as follows: the institution must have been continuously profitable, have experience in international finance, have measures to combat money laundering, be subject to effective regulatory oversight in the home country, and be able to clear other prudential requirements.

The approval process for setting up a foreign bank appears to take considerable time. The preparatory approval is said to take up to nine months. This is followed by a final approval process which can take up to two months. The applicant is also required to obtain a business licence from the local industry and commerce bureau before opening business.

(b) Legal forms

There are separate requirements for each type of legal form that a foreign financial institution takes upon entering the Chinese banking market. While foreign bank branches are limited in their local currency services, such as the acceptance of local currency deposits, other significant obstacles have been removed, resulting in a near national treatment of foreign financial institutions.

Capital investment from a solo foreign financial institution or joint foreign financial institutions

Holders of capital (or shareholders) in a bank must be financial institutions. Majority shareholders must be commercial banks that have had a representative office in China for more than two years. The majority shareholder must also have assets greater than US$ 10 billion and fulfil the capital adequacy requirements of the CBRC.

Joint ventures

Joint ventures are required to be owned by foreign financial institutions and Chinese financial institutions. The majority foreign shareholder must be a commercial bank with an established representative office, have more than US$ 10 billion in assets, and fulfil the capital adequacy requirement of the CBRC.

Branches of foreign financial institutions

To establish a branch, the following additional requirements must be satisfied. The parent bank must have a minimum of US$ 20 billion in assets, fulfil the prudential requirements of the CBRC, and have had a representative office for more than two years. Foreign bank branches are limited in their local currency deposit-taking business to time deposits larger than one million renminbi.

Branching restrictions are not limited to foreign banks, but also apply to domestic banks. Priority in branching is given to areas where banking facilities are inadequate.

(c) Acquisition of local banks

Acquisition of commercial banks needs to be carried out in accordance with the articles of the Company Law and requires the approval of the CBRC. While there are no specific regulations on bank mergers, the CBRC is likely to play a central role in allowing an acquisition. Mergers of domestic banks are subject to a standard applied to companies of all industries, except that the CBRC participates in the process when banks are concerned.

As for foreign financial institutions, they may acquire the equity of a domestic bank directly or indirectly. There is no statutory limitation on the acquisition of listed domestic banks. However, the CBRC does not allow foreign financial institutions to acquire more than a 25% ownership of unlisted domestic banks. As a result, Chinese bank shares have been heavily purchased by foreign financial institutions. By July 2006, 26 foreign financial institutions had purchased equity of 18 domestic banks totalling US$ 17.9 billion.

Foreign banks are now permitted to own 100% of their subsidiary. Ownership of Chinese banks by foreigners is limited to 25%, and approval is needed for foreign banks to own more than 5% of securities. Ownership of securities houses by foreigners is limited to 25% of capital.

(2) Indonesia

Indonesia has relaxed its entry barriers to foreign financial institutions considerably since the Asian financial crisis in 1998.

(a) Distinct rules for foreign financial institutions

The Banking Law of 1998 permitted the establishment of branches by foreign banks. The Banking Law states that non-Indonesian persons or entities cannot establish a commercial bank in Indonesia.[115] However, the regulation on commercial banks permits joint ventures to be established as commercial banks.[116]

The requirements for a foreign bank opening a branch are similar to those for domestic banks, but there are additional requirements for the parent bank.[117] It must:

- Have a minimum "A" rating issued by a leading international rating agency
- Rank among the 200 largest banks in the world
- Have a minimum of 3 trillion rupiah equivalent in paid-up operating funds
- Provide a statement from the banking authorities in the country of origin of the bank's head office, stating no objection to the opening of a branch office in Indonesia.

There are no restrictions on the branching of foreign banks, although a licence needs to be acquired from Bank Indonesia.[118] There is no discrimination against foreign banks when branching in Indonesia.

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[115] See Banking Law of 1998 (Indonesia), Art 22(b).

[116] See Bank Indonesia, Regulation no 2/27/2000 concerning commercial banks, 2000, Art 5(1)b.

[117] See Bank Indonesia, *Indonesian Banking Booklet 2007*, p 77.

[118] See Banking Law, supra, footnote 115, Art 20, and Bank Indonesia regulation, supra, footnote 112, Art 27(1).

(b) Legal forms

A commercial bank is required to be opened as one of the following: a state-owned enterprise of limited liability, a regional government enterprise, a cooperative or a limited liability company.[119] A foreign bank can establish a commercial presence in the form of a branch or a joint venture with a local partner. The legal form of a foreign bank branch must correspond to the legal form of the respective head office.[120]

(c) Acquisition of local banks

Through numerous relaxations of rules, foreign financial institutions can acquire local banks either by purchasing shares in the stock exchange, if they are listed, or through bilateral purchase agreements with the domestic bank itself.[121] While the articles of the banking law seem to suggest that foreign banks can acquire 100% of the shares of domestic banks,[122] they are in fact able to acquire 99%.[123] This is said to be an anomaly resulting from consideration for national sentiment.

Controlling shareholders are defined as entities holding more than 25% of voting shares.[124] This would include holdings within a group structure. Foreigners are permitted to own up to 99% without the participation of an Indonesian entity.[125]

Those intending to become controlling shareholders are subject to evaluation and interviews by the central bank.[126] Controlling shareholders are required to submit a statement of their intention to resolve any capital or liquidity problems that the bank faces.[127]

Foreigners are not permitted to acquire rural banks.[128]

(3) Japan

Japan's regulation regarding the entry of foreign financial institutions is non-discriminatory. There are very few requirements that are specific to foreign banks, other than expecting the home regulator to be competent and able to exchange information.

(a) Distinct rules for foreign financial institutions

A foreign bank is defined as any entity authorised to engage in banking under the legislation of its home country.[129] In other words, the entity making an application must be a bank in its home country. The Banking Law requires foreign banks to obtain a licence from the Prime

[119] See supra, footnote 115, Art 21.

[120] Id, Art 21(3).

[121] Id, Art 26(2).

[122] Id, Art 26(2).

[123] See supra, footnote 116, Art 5(2).

[124] Id, Art 1(13).

[125] Id, Art 5(2).

[126] Id, Art 15.

[127] Id, Art 6(2)a.2.

[128] See supra, footnote 115, Art 23.

[129] See Japan Banking Law (Law no 59), 1981, Art 47(1).

Minister of Japan to establish a branch, which is delegated to the Commissioner of the Financial Services Agency (FSA), except upon initial entry.[130]

Foreign banks must satisfy specific requirements that are also applicable to domestic banks. In addition, it must be ascertained that the legal requirements in the foreign bank's home country are similar to those of the Japan Banking Law.[131]

(b) Legal forms

In Japan, banks are required to establish themselves as limited liability stock companies under the Commercial Code.[132] However, foreign banks are exempted from this requirement and do not have to be incorporated in Japan to establish a branch.[133]

(c) Acquisition of local banks

Any entity may acquire shares in an existing Japanese bank. However, there are requirements imposed on the acquisition of a certain proportion of shares of a local bank. When acquiring more than 5% of a bank or a bank holding company's voting shares, the shareholder must file with the FSA.[134]

A person acquiring more than 20% of a local bank's voting shares becomes a bank major shareholder,[135] for which prior approval from the FSA is required.[136] A bank's major shareholding can also occur as a result of joint holdings by two or more separate entities. Bank primary shareholders are subject to reporting requirements[137] and on-site inspections[138] to ensure the soundness and financial independence of the financial institution.

An entity becomes the controlling shareholder when acquiring 50% of a bank's voting shares.[139] The FSA is given greater authority to intervene in the business of controlling shareholders. The FSA can request the submission of business improvement plans or issue business improvement orders to controlling shareholders.

When the bank's major shareholder is a foreigner or a foreign corporate (including banks), the same requirements apply as to domestic shareholders.

(4) Singapore

The Singapore government has intentionally segregated the domestic and offshore banking sectors, resulting in domestic retail banks being fairly sheltered from international competition.

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[130] See id, Arts 47(1) and 4(1).

[131] Id, Art 4(3).

[132] Id, Art 4(2).

[133] Id, Art 47(3) and Cabinet Order on the Implementation of the Banking Law, Art 10.

[134] Id, Art 52(2).

[135] Id, Arts 2(10) and 2(9).

[136] Id, Art 52(9).

[137] Id, Art 52(11).

[138] Id, Art 52(12).

[139] In the Banking Law, there is no mention of the controlling shareholder. Instead, the bank's primary shareholder with more than 50% of voting shares becomes subject to specific requirements. See id, Art 52(14).

(a) Distinct rules for foreign financial institutions

Banks are licensed as full banks, wholesale banks or offshore banks. Full banks are able to carry out the full range of banking business, while wholesale banks are able to perform all banking activities except Singapore dollar retail banking services. Offshore banks can carry out the full range of banking operations through Asian currency units (ACUs).

Of the full banks in Singapore, five are local banking groups and one is a local incorporation of a foreign bank. Twenty-three are branches of foreign financial institutions.[140] Foreign full banks are restricted in the number of branches, relocation of existing branches and setting up of off-premise ATMs. They cannot share ATMs with other banks, or offer Electronic Funds Transfer at Point-of-Sale (EFTPOS) services.

Singapore created a subcategory of the full bank, ie the qualifying full bank (QFB), in 1999 to grant foreign branches greater privileges as a result of its bank liberalisation package.[141] The Monetary Authority of Singapore (MAS) grants the QFB licences and so far six QFBs have been awarded.[142] QFBs are allowed to open up to 15 sub-branches and/or off-premise ATMs, of which 10 can be sub-branches. QFBs may share ATMs among themselves and relocate their sub-branches freely. Since 2002, QFBs have been allowed to provide debit services through EFTPOS that access social pension investment accounts and other investment accounts.

Since 2005, QFBs have been allowed to establish up to 25 sub-branches, which may be either physical locations or off-site ATMs. The MAS also announced that QFBs will be allowed to negotiate with local banks to let their credit card holders obtain cash advances through the local banks' ATM network.

Foreign bank branches are placed under the same conditions as local banks, but in addition are required to hold paid-up share capital of no less than 200 million Singapore dollars, which is less than the requirement of 1,500 million Singapore dollars for locally incorporated banks. Foreign branches are also required to hold at least 10 million Singapore dollars in a head office fund, of which at least five million Singapore dollars must be held in Singapore, in assets the MAS deems appropriate.

(b) Legal forms

In Singapore, a bank is defined as any company that carries on banking business under a valid licence.[143] The Banking Act does not define a foreign bank, but any bank incorporated outside Singapore and holding a valid banking licence under the Banking Act is considered to be a foreign bank.[144] Subsidiaries of foreign banks and foreign bank branches are treated in the same manner as local banks for regulatory purposes, and as a result, none of the foreign financial institutions operating in Singapore is incorporated in Singapore.

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[140] See MAS website for information on the number of regulated banks: http://www.mas.gov.sg/fin_development/Types_and_Number_of_Institutions.html (accessed on 3 December 2007).

[141] See MAS website for information on the liberalisation package: http://www.mas.gov.sg/news_room/statements/1999/MAS_Statement_on_Measures_to_Liberalise_Commercial_Banking_and_Upgrade_Local_Banks__17_May_1999.html (accessed on 7 December 2007).

[142] MAS website, supra, footnote 140.

[143] See Singapore Banking Act, Chapter 19, 2003 revised edition, paras 7 and 79.

[144] Id, paras 7 and 79.

(c) Acquisition of local banks

Substantial shareholding of a bank requires the prior approval of the MAS.[145] A substantial shareholding is defined as an interest of 5% or more of voting shares.[146] Furthermore, prior approval is required when intending to acquire more than 12% and 20% of voting shares, including indirect control of a bank.[147] The 12% and 20% thresholds may be attained by the aggregate of shares held in a group structure.[148] An indirect controlling person is any person who is able to determine the policy of a financial institution without necessarily holding shares or controlling the voting power of the institution. The approval for substantial shareholding is based on fit and proper criteria of the shareholder and the likely influence the bank might receive in conducting prudent business.[149] Furthermore, the Minister of Finance can object to existing substantial shareholding if it is not in the national interest.[150]

The MAS has discretion under the Banking Act to deny a bank licence if it establishes either that 50% or more of the bank's issued and paid-up capital is owned by a foreign government, or that a majority of persons with control of the bank are appointed by a foreign government.[151]

The acquisition of any foreign or local bank in Singapore requires the prior approval of the MAS, which has indicated that it would not allow a local bank to be acquired by a foreign party.[152]

(5) Thailand

Foreign banks are subject to restrictions that are primarily a result of the reform of the financial sector. Domestic banks are also subject to restrictions as a result of the reform programme, although foreign banks face restrictions on their branching.

(a) Distinct rules for foreign financial institutions

Thais opening a commercial bank and foreign banks establishing a branch both require the permission of the Minister of Finance.[153] Commercial banks are required to be listed stock companies with more than 250 shareholders holding more than 50% of the stock.[154]

As part of the financial system reform, the 2004 Master Plan for the Financial Sector outlines the entry methods for foreign banks. First, no new commercial banking licences are to be issued. However, existing entities can be upgraded to a commercial bank, ie by upgrading from a *crédit foncier* (mortgage bank) that provides mortgage loans, or through local incorporation by a foreign bank branch or a bank with an offshore licence.

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[145] See id, para 15A.

[146] Singapore Companies Act, Chapter 50, 2006 revised edition, para 81.

[147] See supra, footnote 143, para 15B.

[148] Id, para 15B.

[149] Id, para 15C.

[150] Id, para 15E.

[151] Id, para 11.

[152] See supra, footnote 108, vol III, p 765.

[153] See Thailand Commercial Banking Law, B.E. 2505 (1962), Arts 5 and 6.

[154] Id, Art 5(4).

Foreign branches require the permission of the Bank of Thailand for branching, product approval, and promotion activities. These activities do not require authorisation in the case of Thai commercial banks. Foreign branches are permitted to establish ATMs only in their branches. An ATM is counted as one branch, and since only one branch is permitted at a time, the result is that foreign banks have few outlets.

(b) Legal forms

A locally incorporated foreign bank is allowed to conduct the same activities as domestic commercial banks, but may open only a limited number of branches.

Foreign bank branches are also allowed the same range of activities as commercial banks. However, they are unable to open sub-branches. Once local incorporation is permitted, the bank name is expected to be used when acquiring other domestic banks. Locally incorporated foreign banks are expected to merge domestic banks and submit a merger plan to assist in the reform of the financial sector.

(c) Acquisition of local banks

No person is allowed to hold more than 5% of a commercial bank's shares. However, to enable resolution of problem banks, exemptions were made to this restriction for administrative agencies, state-owned enterprises, the Financial Institution Development Fund (the de facto deposit insurance fund at the Bank of Thailand), and cases where the Minister of Finance gives permission to improve the solvency of a commercial bank.[155]

In principle, more than three quarters of the shares of Thai banks must be held by Thai nationals. Further, more than three quarters of the board of directors of commercial banks must be Thai nationals. The Minister of Finance may permit exemptions upon the advice of the Bank of Thailand.

Acquisition of commercial banks requires the permission of the Minister of Finance.

6. Concluding remarks

The investigation into competition law, trade commitments, and entry requirements demonstrates clearly that there still is a gap between the commitments made and the actual environment in which financial institutions operate. It is important to recognise that these differences are not in themselves a hindrance to greater regional financial integration, but a lack of progress can become a significant impediment.

Importance of effectively implementing competition laws

While it is still probably too early to make a definitive assessment of many of the competition regimes in Asia, it is clear that further progress in enforcement and compliance will be a necessary and important element in realising the spirit of the competition laws being implemented in the economies. It is heartening to see that many countries have enacted competition laws in recent years; this reflects a deepening recognition of the importance of having a statutory mechanism to ensure fair competition, eliminate monopolies and suppress anticompetitive practices.

[155] See id, Art 5(2).

Effective enforcement of and compliance with competition law are largely dependent on the dissemination of detailed guidelines, on the competence and independence of the competition authorities, and on strong and timely administrative and judicial actions against serious infractions. It remains to be seen how far the competition regime will be made effective as part of the basic infrastructure of a well functioning market economy.

Indonesia represents the positive effect that the competition policy regime can have on the overall liberalisation path and on trade commitments. Indonesia has been actively enforcing its competition law regime in a relatively high number of cases. It has been taking steps to approach liberalisation in a progressive manner, which reflects its approach to competition law. Thus, it provides an insight into the possibilities that a proactive competition policy might achieve.

Narrowing the gap

While the GATS is seen to have had a great impact on furthering the liberalisation of the financial sector, an analysis of subsequent regional trade agreements and a comparison with actual entry requirements identifies the gap that remains between them (Table 11). Of the countries studied, Indonesia has made marked progress in the liberalisation of its financial sector, going well beyond the commitments made under the GATS. On the other hand, many other countries have maintained the status quo of the Uruguay Round, or have not narrowed significantly the gap between their commitments and the actual requirements currently applied.

Table 11

Competition law, GATS commitments and actual requirements

	Competition law		
	Provisions	**Index**	**Enforcement cases**
	GATS and actual		
	Discriminatory	**Legal form**	**Acquisition**
China			
Competition Law	40	6	None
GATS	Geographical restrictions Local currency business restrictions.	Asset requirement for each legal form.	–
Actual	High capital requirement, continuous profitable operations in China.	Asset requirement for each legal form, as well as interest holder requirement to be commercial bank. Branches only permitted high net-worth time deposits.	Approval of CBRC, social interest for acquisition. Shareholding above 25% not permitted for foreigners.
Indonesia			
Competition Law	30	13	21
GATS	Branching and geographical limitations.	Joint ventures. Local incorporations are considered local banks.	Acquisition of up to 49% of bank shares to be permitted.

Table 11 (cont)

Competition law, GATS commitments and actual requirements

	Competition law		
	Provisions	**Index**	**Enforcement cases**
	GATS and actual		
	Discriminatory	**Legal form**	**Acquisition**
Indonesia (cont)			
Actual	Parent bank's asset requirement, high ranking and capital requirement.	Approval for branch establishment. Otherwise joint venture. No specific differentiation.	Acquisition of controlling shareholding subject to BI approval. Acquisition of bank shares permitted up to 99%.
Japan			
Competition Law	55	9	233
GATS	Understanding	Understanding	–
Actual	Home country regulation is essential.	Do not need to incorporate.	Five per cent shareholding must file. Twenty per cent shareholding requires approval.
Singapore			
Competition Law	45	14	None
GATS	Foreign banks can operate from only one office. Cannot establish off-premise ATMs and new sub-branches.	No new full banks. Foreign banks only as offshore banks.	A foreign shareholder can only hold up to 5% of bank shares. Aggregate foreign shareholding of a bank is limited to 40%.
Actual	Foreign banks limited in their branching, ATMs and subsequent services. Asset requirement for HQ and branch.	No need to incorporate.	Five per cent, 12%, 20% shareholding of banks requires approval. Policy not to permit acquisition of local banks by foreign parties.
Thailand			
Competition Law	30	13	9
GATS	New establishment subject to approval. Branching of existing banks limited to two additional ones.	Branches and incorporate banks permitted different shareholding levels by foreign capital.	Foreign equity participation limited to 25% of paid-up capital for incorporated foreign banks.
Actual	No new banking licences to be issued to foreign banks. Branching requires approval and ATM limited to in-branch.	Incorporation required for commercial banking. Branches are not permitted sub-branches.	No one is allowed to hold more than 5% of bank shares. More than ¾ of shares must be held by Thais.

Since the basic spirit of the GATS is for all members to work continuously for progressive liberalisation, greater progress needs to take place both in the commitments made and in the actual rules imposed, narrowing the gap between the two levels. Progress in competition policy will support the underlying foundation of liberalisation.

It is also noted that regional trade agreements, while increasingly prevalent and preferred by countries seeking reciprocal treatment upon liberalisation, do not appear to have made noticeable headway compared to the GATS, so far as liberalisation of the financial services sector is concerned. One exception may be the United States-Singapore FTA, under which Singapore made much deeper commitments towards the United States than in the GATS or other FTAs, apparently balanced by the business opportunities provided in other sectors under the bilateral agreement. However, even this agreement may be modest in its elimination of market access limitations in financial services in the context of the liberalisation necessary for greater integration. As for the AFAS and Japan-Singapore EPA, the commitments appear to be largely the same as the GATS commitments in financial services.

Making further progress in future negotiations

Prudential considerations call for a cautious approach to commitments in trade agreements for the liberalisation of financial services. The financial crises that inflicted serious damage on the economies of the region seem to justify the caution, even well after the recovery.

An important issue that needs to be addressed is how to facilitate and encourage the willingness to come forward with commitments in financial liberalisation through trade negotiations. Trade negotiations typically involve a certain degree of horse-trading in which liberalisation offers are made across sectors. The GATS was one of the first opportunities for many Asian countries to be involved in financial services trade negotiations, since no regional or bilateral framework for such negotiation existed in the region in the early 1990s. Strong requests from developed countries in the Uruguay Round negotiations resulted in a wide range of financial services liberalisation commitments under the GATS, but these may also have made it difficult for Asian countries to come forward independently with further liberalisation commitments. The mindset of negotiators may have tilted towards making commitments only when and where strong requests were made from their counterparts, not necessarily or always on the basis of economic rationale or according to a carefully considered strategy. It now appears that the Doha Round negotiations are facing serious difficulties as developing countries find it hard to obtain tangible benefits from liberalisation, particularly from the developed member countries.

There is a fundamental need to recognise that the rapidly changing financial market environment requires financial markets to function more efficiently, and effective competition is necessary for the benefit of consumers of financial services and for economic growth. Excessive regulatory control of financial services and markets may succeed in isolating a country's financial sector from global financial crises, but would also inflict heavy efficiency losses and considerable costs on the economy.

Moreover, economic development, particularly for emerging market countries, would be difficult without further liberalisation and effective competition in the financial sector. Instead of making incremental liberalisation commitments which are realised over as long a period as permissible, it would be better for national authorities to develop a properly sequenced liberalisation strategy. This would enable further development of the country's economy based on a clearly defined strategy.

To take an example, Indonesia's entry requirements for foreign banks have gone well beyond the commitments made in trade negotiations. This can be viewed as recognition of the country's need for foreign capital and expertise in developing its financial services sector, and as determination to advance the country's integration into the world economy for further development.

Drawing up an inventory of prudential measures

At a more technical level, the proliferation of prudential measures exempt from commitments under the GATS has made it difficult for countries to move forward to further liberalise their financial services sectors, not just under the GATS, but also in FTAs and other liberalisation processes. While there are genuine prudential concerns and justifiable measures for prudential purposes that should not be eliminated upon liberalising a country's financial services sector, a lack of common understanding and the generally low transparency of the measures taken for this purpose may be behind the slow progress in negotiations. Many regulations applied in the name of prudential measures may have had the effect of inflicting considerable costs and effectively working as barriers to entry into the markets.

To overcome the weaknesses of the GATS and other FTAs in identifying prudential measures and reducing those which may become unnecessary or overly burdensome over time, and to assist in the coherent implementation of prudential regulations across countries, developing country-by-country inventories of prudential regulations could be an effective first step. The difficulty of monitoring developments in member countries after the conclusion of negotiations in the WTO is apparent, as reports to the WTO Financial Services Committee have been largely anecdotal and not made on a regular and consistent basis across countries. The IMF has developed the Special Data Dissemination Standard (SDDS) to encourage countries to develop standard statistics and publish them on their websites. A mechanism like the SDDS could be created to take stock of prudential measures and further promote transparency of the financial system.

The IMF also carries out the Financial Services Assessment Program (FSAP),[156] in which member countries are examined by officials of other countries and by IMF staff, to evaluate the condition of their financial sector, their observation of international standards and their understanding of financial sector regulation. The FSAP has not resulted in an easily accessible and up-to-date inventory of prudential regulation for financial services providers wishing to enter a country's market, as many countries do not agree to the publication of FSAP reports. The FSAP is also analytical in nature and not descriptive of the entire regulatory system, which makes it difficult to use as a database of prudential measures.

Asia would benefit from the compilation of such an inventory, as regional financial integration requires a better understanding of each country's financial sector regulations. With a common format and regular updating, it would also cater for internationally active financial services providers in the region. This would greatly improve the transparency of the region's financial systems, and facilitate the negotiation of future liberalisation agreements.

An inventory would also assist in grasping the level of convergence of regulatory directives in the region. The European experience presents a template which could be referred to in this respect.[157] The European Directives are in themselves a set of comprehensive directories of prudential regulations for each financial services sector or market. A significant level of convergence and minimum levels of harmonisation of prudential regulations may be necessary in laying the groundwork for true financial integration in the region in practical terms. Lack of transparency and of mutual understanding would likely benefit only a handful of countries with strong financial services players. If the inventory were based on international standards, such as the Basel Core Principles or International Organization of

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[156] See *FSAP Handbook*, supra, footnote 37.

[157] The European Union's market integration in financial services is based on principles of essential harmonisation, mutual recognition, home country control of supervision and consolidated supervision. Licensing of banks, securities firms, and collective investment schemes is based on a single passport in which firms need licensing from only one member state. However, this is possible only with effective implementation of the above principles.

Securities Commissions (IOSCO) and International Association of Insurance Supervisors (IAIS) standards, this would not only encourage countries to improve their regulatory standards, but would also achieve greater regulatory convergence in the region and contribute to regional economic development. Through regulatory convergence, the region's supervisory authorities could develop an Asian prudential regulation handbook, not only describing the prudential rules of all countries in the region, but also setting out standard interpretations of the rules and related regulatory principles for the financial services sector. Such a handbook could be useful both for technical training of officials in the region and for enhancing pre-emptive risk management and compliance at financial institutions.

Mutual recognition and regional integration

Mutual recognition of regulatory standards is currently being considered among G7 countries. This would enable relaxation of, or partial exemption from, regulations for financial institutions that have been licensed in a country which has accepted such an agreement. Mutual recognition is based on the general compatibility of the countries' regulatory standards, and can be made effective when countries share common goals in regulatory policy. Thus, licensing of a financial institution in one country would enable it to provide services in another participating country that shares common or similar prudential standards. Mutual recognition is the foundation of financial market integration in the European Union and is made possible by assurances that certain rules are commonly applied in all member states. A prudential regulation inventory would provide an initial step to such progress in Asia as well, by clarifying current regulatory measures.

High convergence of prudential regulation for regional financial integration may be difficult without the conclusion of a formal treaty or agreement among Asian countries. However, sequential liberalisation of the financial markets based on a broad understanding of prudential regulations across countries would facilitate progress towards regulatory convergence in this very diverse Asian region. The compilation of a prudential regulatory inventory of the region may prove to be an initial but significant first step towards true regional financial integration.[158]

Modalities of future negotiations and the development agenda

A useful by-product of compiling a prudential inventory could be the identification of non-prudential or semi-prudential measures that do not belong or do not fit well in a prudential inventory. Those measures are likely to be "genuine" market access and national treatment limitations that should be phased out in stages, in line with the development of the real economy. Although there may be no universal formula for phasing out such measures, future negotiations could focus better on those measures that constitute "genuine" limitations, without possibly entering into a long and difficult debate on what constitutes a prudential measure and which measures must be listed as limitations to market access or national treatment under the GATS or FTAs. Staging the phase-out properly would be essential, and a common understanding on such a strategy could be a useful step towards general regulatory convergence and harmonisation in the region.

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[158] The European Union has been experiencing difficulties in handling emergency situations from a financial supervisory perspective. Further sharing of information and common analysis of financial conditions are considered to be imperative for the region to further integrate its common market. A common rulebook is being proposed by a prominent ex-central banker and current Italian economic and finance minister. See Tommaso Padoa-Schioppa, "Europe needs a single financial rulebook", *Financial Times*, 11 December 2007, p 13.

The difficulties faced by the WTO Doha Round negotiations may be arguably, at least in part, due to the fact that public opinion has not so far fully embraced the liberalisation process in emerging market economies. Suggesting an optimal regulatory framework in competition policy, and prudential regulation in financial services, both of which are conducive to development and coherent with a country's development strategy, could be viewed as a small but important step towards making progress and establishing a development strategy for Asia as a region.

Appendix:
Abridged schedule of commitments in financial services (banking and other financial services) of Asian countries under the GATS

General		Mode 3 market access (banking related)			Mode 3 national treatment (banking)	Mode 3 market access (securities)
		Capital participation/licensing	Local currency	Local clients		Capital participation/licensing
China (accession 2001)	Geographical coverage Foreign exchange, no restrictions	Solely prudential, with no economic needs test Within 5 yrs: any existing non-prudential measures on ownership, operation, and juridical form shall be eliminated Subsidiary: Total assets > USD 10bn Branch: Total assets > USD 20bn Chinese foreign-joint bank: Total assets > USD 10bn	Geographical coverage Upon accession: Shanghai, Shenzhen + 2 cities Within 2 yrs accession: Guangzhou + 4 cities Within 3 yrs: Kunming, Beijing + 1 city Within 4 yrs: Shantou + 3 cities Within 5 yrs: no restrictions Local currency business: 3 yrs business operation in China and 2 yrs profitable business	Foreign exchange business, no restrictions Local currency: Within 2 yrs, to Chinese enterprises Within 5 yrs, to all Chinese clients		Solely prudential, with no economic needs test Upon accession Joint ventures with up to 33% foreign investment to conduct domestic securities investment fund management Within 3 yrs: foreign investment increased to 49% Within 3 yrs: foreign joint ventures (⅓ minority ownership) to engage in underwriting and trading of B and H shares

General		Mode 3 market access (banking related)			Mode 3 national treatment (banking)	Mode 3 market access (securities)
		Capital participation/licensing	Local currency	Local clients		Capital participation/licensing
Vietnam (accession January 2007)	Upon accession: capital contribution limited to 30% One year after accession: foreign equity limitation to be eliminated	Upon accession: representative office, branch of foreign bank, 50% foreign capital commercial joint venture bank April 2007: 100% foreign-owned banks	Five years from accession: limit local currency deposits from Vietnamese with no credit relationship to branch's paid-in capital: 2007: 650% 2008: 800% 2009: 900% 2010: 1000% 2011: full national treatment		Deposit-taking: Parent bank has total assets of more than USD 20bn Lending: parent bank has assets of more than USD 10bn	Upon accession: representative office, joint venture with foreign participation of 49% Five years from accession: 100% foreign capital securities company

General		Mode 3 market access (banking related)			Mode 3 national treatment (banking)	Mode 3 market access (securities)
		Capital participation/licensing	Local currency	Local clients		Capital participation/licensing
India		Only through branch operations of a foreign bank licensed and supervised in home country Not more than five licences a year for both new entrants and existing banks Investments in other financial services companies not to exceed 10% of own funds, or 30% of invested company's funds			Local advisory board with SME expertise to be established with Indian nationals as members, except CEO. Members must be approved by Reserve Bank Public sector enterprises allowed to invest only surplus funds with commercial bank incorporated in India	Branches: allow with Indian bank licence Financial services company: foreign equity not exceeding 51%

General		Mode 3 market access (banking related)			Mode 3 national treatment (banking)	Mode 3 market access (securities)
		Capital participation/licensing	Local currency	Local clients		Capital participation/licensing
Indonesia	All limitations to be eliminated by 2020 subject to similar commitments by other members	Newly established foreign service provider shall be joint venture bank, locally incorporated and a banking institution, which will be unbound Acquisition of locally incorporated banks listed is permitted up to 49% of shares deposit-taking and lending: 1 sub-branch and 1 auxiliary office permitted	Geographical coverage: Foreign bank and joint venture open branches in Jakarta, Surabaya + 7 cities		Foreign bank branch: only 1 executive position can be taken by expatriate Joint venture: only for director position, in proportion to ownership sharing	Foreign ownership bound by laws and regulations. Share of listed non-bank may be 100% foreign owned Through establishment of a securities broker/dealer 1 sub-branch and 1 auxiliary office permitted
Japan	Application of Understanding of Financial Services				Deposit insurance does not cover deposits taken by branches of foreign banks	Commercial presence for investment trust management services must be juridical person established in Japan

General		Mode 3 market access (banking related)			Mode 3 national treatment (banking)	Mode 3 market access (securities)
		Capital participation/licensing	Local currency	Local clients		Capital participation/licensing
Korea	Acquisition of stock of domestic companies by natural persons or juridical persons of another member is restricted. Foreign portfolio investment in Korean stocks is permitted only for listings in Korean Stock Exchange, and individual foreign investors can own up to 6% of each company's total stock Amount of foreign direct investment must be at least KRW 50m	After establishment of commercial presence, financial institutions may only handle transactions denominated and settled in won Assets owned by branches must be kept within territory of Korea. Capital of HQ not recognised as basis for determining the extent of funding and lending Only branches of foreign banks which rank among world's top 500 banks are permitted A person may own up to 4% of bank stock and 15% of provincial bank stock without special authorisation	Foreign currency loans are restricted with respect to ceiling and uses	Mandatory lending to SME companies	Unbound	Only representative office, branches or joint venture companies are permitted Joint venture's foreign equity participation must be at least 50% Equity participation in existing domestic securities is limited to less than 50% in aggregate

General		Mode 3 market access (banking related)			Mode 3 national treatment (banking)	Mode 3 market access (securities)
		Capital participation/licensing	Local currency	Local clients		Capital participation/licensing
Malaysia	Acquisition by a foreign bank of an aggregate of 5% or more of share-holding in Malaysian-owned or -controlled commercial bank must meet following criteria: Foreign bank has ability to facilitate trade and contribute to financial and economic development; Country of foreign bank has significant trade and investment interests in Malaysia; Country of foreign bank does not have a significant presence in Malaysia	Thirteen wholly foreign-owned commercial banks are permitted to remain Entry is limited to equity participation by foreign banks in Malaysian-owned or -controlled commercial bank or a merchant bank not exceeding 30% Commercial bank is not allowed to acquire any share in another commercial bank, but may acquire shares in one merchant bank Merchant bank is not allowed to acquire shares in a commercial bank Other persons are not allowed to own more than 5% shareholding of a commercial bank Deposit-taking only allowed through commercial banks, in Labuan	Foreign commercial banks are permitted to accept foreign currency deposits from residents subject to conditions imposed on designated bank		Unbound	Trading, dealing and underwriting in securities require establishment of a locally incorporated joint venture company and aggregate shareholding must not exceed 30%

General		Mode 3 market access (banking related)			Mode 3 national treatment (banking)	Mode 3 market access (securities)
		Capital participation/licensing	**Local currency**	**Local clients**		**Capital participation/licensing**
Philippines	Appropriate regulatory authority shall determine whether public interest and economic conditions justify authorisation for establishment Demonstrated capacity to contribute to attainment of Philippine development objective required	Monetary Board shall ensure that, at all times, 70% of all resources and assets of the banking system is held by the domestic banks which are at least majority owned by Filipinos Foreign banks must be widely owned, publicly listed. However, this does not preclude secondary investment in the equity of a locally incorporated bank not exceeding 30% of voting stock or 40% upon approval by President of the Philippines Bound for 10 new licences for full banking authority to new and existing foreign bank branches for the period 1995–2000		Each foreign bank shall be allowed to establish a maximum of 6 branches, with the first 3 at locations of its choice and the remaining 3 branches at designated locations		Must be organised as a stock corporation Subject to foreign equity limitation of 51% Majority of members of Board shall be citizens of the Philippines An investment house is not allowed to engage in banking operations

General		Mode 3 market access (banking related)			Mode 3 national treatment (banking)	Mode 3 market access (securities)
		Capital participation/licensing	**Local currency**	**Local clients**		**Capital participation/licensing**
Singapore		No new full and restricted banks. New foreign banks may establish only as offshore bank branches or representative offices A single/related group of foreign shareholders can hold only up to 5% of a local bank's shares. The limit on aggregate foreign ownership of each domestic bank's shares has been increased from 20% to 40%		Banks with the MAS' approval can operate foreign currency savings account only for non-residents	Foreign banks can operate from only 1 office. They cannot establish off-premise ATMs, ATM networking or new sub-branches	Merchant banks can operate from only 1 office

General		Mode 3 market access (banking related)			Mode 3 national treatment (banking)	Mode 3 market access (securities)
		Capital participation/licensing	**Local currency**	**Local clients**		**Capital participation/licensing**
Thailand		Not bound for existing foreign bank branches under present shareholding structure. New establishment is subject to licence approved by the Ministry of Finance with consent of Cabinet Existing foreign banks which already had their first branch prior to July 1995 will each be permitted to open no more than 2 additional branches Locally incorporated banks are limited with respect to acquisition of shares. Maximum foreign equity participation limited to 25% of paid-up registered capital ATM operations permitted by joining ATM pools operated by Thai banks or operation within own premises, or sharing facilities with other commercial banks in Thailand			At least ¾ of directors must be of Thai nationality	Market access is limited to acquisition of shares of existing companies only. Unbound for new licences Maximum foreign equity participation limited to 49% At least half of directors of locally incorporated securities firms must be Thai nationals