Trade in Services: Financial Sector Issues

Yan WANG
Senior Economist, World Bank
ywang2@worldbank.org

Presentation at the MOFCOM-WBI Seminar
Trade in Services: Global Trade and China’s Position
Beijing linking to 8 different cities
October 10-12, 2006
Outline of the session

I. Financial Services matter for development
II. Financial /Banking sector openness: issues
III. Financial Services in WTO/GATS- scope, definitions and major issues
IV. Financial Services and Doha Round
V. China’s pre- and post- WTO reforms in the Banking sector
VI. Summary
I. Financial services matter for development

• Services account for around 50 percent of GDP in developing countries and for over 60 percent of GDP in OECD countries (see charts)

• An efficient and well-regulated financial service sector promotes the efficient transformation of savings to investment.

• Based on the new trade theory, competition/new entry and exit are conducive to productivity growth.

• Liberalization in service may generate sizable gains
  – A) Standard gains from trade and specialization;
  – B) Services as intermediate input—new services will appear and better services for the goods sector;
  – C) Gains from FDI as a means for trade --learning-by-doing.
Financial development matters: impact on economic growth

The theory

Two specific channels
  • Impact on capital accumulation
  • Impact on the rate of technological progress

Functions giving rise to these effects
  • Savings mobilisation
  • Risk management
  • Allocation of resources
  • Monitoring managers
  • Facilitating the exchange of goods & services
Financial development matters: impact on economic growth

The empirical evidence

- A large body of evidence now exists in support of strong linkages between financial sector development and levels of income and long-run growth performance.

- Key policy challenges: not whether but how, where and how fast to promote competition in financial markets.
Developing countries lag behind high-income countries in services liberalization

Modes of Trade: Financial Services

• Cross-border trade (Modes 1 and 2)
  – No presence of the supplier in the host country market (wholesale markets)
  – Consumption abroad (client-initiated)

• Establishment-related trade (Mode 3)
  – Presence in the host country market via representative offices, branches, subsidiaries, joint-ventures
What’s New: E-finance

• E-finance is changing the face of the financial services industry
  – Competition is increasing due to smaller economies of scale, shrinking up-front costs, changing entry barriers, higher network externalities
• The trend is already pervasive in wholesale markets
• But there are still advantages in having a local presence – particularly in retail services
• Still primarily an intra-OECD challenge
II. Why Financial Service is so Special? Key Issues in Financial Services

- Different dimensions of financial liberalization
- Basic principles of regulation
- Regulatory issues in developing countries
- Why open the financial services?
- Gains from opening foreign bank entry: cross country analysis
The different dimensions of liberalization

– Capital account liberalization

– Domestic financial deregulation

– Internationalization of financial services
Regulatory reform matters: Basic principles of financial regulation

- The specialness of finance...
  - Finance is ubiquitous
  - Asymmetric information is prevalent
- ...and its implications for regulation...
  - Protection of consumers (depositors, etc.)
  - Avoidance of systemic macro risks
- A typology of regulation in financial markets
  - Economic regulation (e.g. entry, competition)
  - Prudential regulation
  - Information regulation
Learning from best practices worldwide

• Strengthen the legal, regulatory, accounting environments and the capacity to enforce regulation
• Develop a diversified financial system
• Privatize state-owned institutions, but clean-up non-performing assets first
• Allow entry of foreign institutions
• Intensify competition
• Avoid excessive restrictions on activities and ownership opportunities
• Temper the temptation for haste: big bangs often generate big busts
Regulatory reform matters
Specific challenges in developing countries

- The small size of domestic financial institutions
- Pre-eminence of bank-based systems vs. securities and insurance markets
- Lack of economic infrastructure
- Greater information asymmetries
-Dealing with the transition (appropriate sequencing between *domestic* regulatory reform and *external* liberalization)
Developing country challenges

Challenges raised by the entry of foreign financial institutions

– Licensing policies and coordination with home country supervisors

– Supervision of local establishments of large international institutions

– Likelihood of greater post-liberalization concentration within the financial system (anticompetitive practices, “too-big-to-fail” institutions; need to strengthen and deploy competition policy in finance)
Why Open? International experience

- Financial development contributes significantly to growth, through efficient allocation of resources (King and Levine 1993, and Leving and Zervos 1998)
- Financial markets reduce the information cost of borrowing and lending and help allocate risks
- Financial assets (with attractive returns) encourage saving in financial form
- Financial institutions, banks, mutual/pension funds and others, play important roles in efficient resource allocation
- An efficient banking system requires a contestable system—one that is open to entry and exit
## Who’s Who in Importer/exporters of Financial Services

### Insurance and financial services: Import and Export

<table>
<thead>
<tr>
<th>Country</th>
<th>% Services Import of the country</th>
<th>% Services Export of the country</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>7.13</td>
<td>8.68</td>
</tr>
<tr>
<td>Hong Kong, China</td>
<td>5.47</td>
<td>5.70</td>
</tr>
<tr>
<td>India</td>
<td>10.89</td>
<td>6.44</td>
</tr>
<tr>
<td>Japan</td>
<td>3.34</td>
<td>4.50</td>
</tr>
<tr>
<td>Korea, Rep.</td>
<td>1.01</td>
<td>1.16</td>
</tr>
<tr>
<td>Thailand</td>
<td>5.18</td>
<td>5.59</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>5.29</td>
<td>5.22</td>
</tr>
<tr>
<td>United States</td>
<td>7.16</td>
<td>11.77</td>
</tr>
</tbody>
</table>

Source: IMF Balance of Payments 2006

* 2003 data.
# Financial Openness in Asia

## An Index of Openness in Financial Services, 1997

<table>
<thead>
<tr>
<th></th>
<th>Banking</th>
<th>Securities</th>
<th>Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Commitment</td>
<td>Practice</td>
<td>Commitment</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>4.20</td>
<td>4.75</td>
<td>4.00</td>
</tr>
<tr>
<td>Indonesia</td>
<td>3.15</td>
<td>3.20</td>
<td>3.50</td>
</tr>
<tr>
<td>South Korea</td>
<td>1.10</td>
<td>1.70</td>
<td>1.70</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2.40</td>
<td>2.40</td>
<td>2.50</td>
</tr>
<tr>
<td>Philippines</td>
<td>2.80</td>
<td>3.35</td>
<td>2.40</td>
</tr>
<tr>
<td>Singapore</td>
<td>2.25</td>
<td>2.50</td>
<td>2.70</td>
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<tr>
<td>Thailand</td>
<td>2.95</td>
<td>2.85</td>
<td>2.00</td>
</tr>
<tr>
<td>India</td>
<td>2.70</td>
<td>2.25</td>
<td>2.50</td>
</tr>
<tr>
<td>Average</td>
<td>2.69</td>
<td>2.88</td>
<td>2.66</td>
</tr>
</tbody>
</table>

Note: 1= most closed, 5= most open

Source: Adapted from Claessens, Stijn, and Tom Glaessner. 1998. Internationalization of Financial Services in Asia.
Liberalizing Banking sector

Liberalization Indices based on GATS Commitment
- Core Banking Services

Benefit of banking sector openness:

The presence of foreign banks

- is associated with higher efficiency of banking system, which would improve the allocation of resource and is growth-enhancing.
- It may reduce financial intermediation costs as reflected in domestic banks’ lower net margins, non interest income and lower overhead costs.
- It reduces domestic banks’ pre-tax profitability in high-foreign-entry market
- It helps enhance the capacity of domestic banks by training staff that then move to domestic banks.

Empirical evidence from cross-country analysis

Using data from 30 countries from 1994-2003, we found that

- Foreign banks’ are relatively more efficient as their profitability is higher and their overhead cost lower.

- **Countries with a higher foreign bank share tend to have more competitive domestic banks - cost and profit indicators are lower.**

- Degree of openness to foreign bank entry varies a lot among countries. The asset share of foreign banks ranges from 0.2 percent in China to 61.6 percent in Hong Kong, China.

- Among industrial countries, foreign bank shares also vary significantly, from 34 percent in the United Kingdom- the highest share, to only 1.7 –2 percent in Sweden and Japan. (see Annex table 1)

Regression Results: openness and efficiency

• Banking sector would become more competitive with a higher share of foreign banks. Foreign bank share is a negative related to overhead cost, interest rate margins, and non-interest income, indicating higher efficiency.

• Other economy-wide factors matter as well: Bank performance is positively related to GDP growth rate, and negatively related to the inflation rate, and the real interest rate.
III. The GATS and financial services

- Definitions and scope
- Market access and national treatment limitations in financial services: examples
- Commitments: examples
- Specific provisions in the Annex on financial services
- Does GATS compromise the ability of governments taking measures for prudential reasons? No. Prudential measures allowed
Key Definitions

“A financial service is any service of a financial nature offered by a financial service supplier of a Member”

- Includes all insurance and insurance related services, all banking and other financial services
- “Financial service supplier” means any natural or juridical person wishing to supply or supplying financial services but does not include a public entity
A broad list of activities

- **Insurance**
  - Direct insurance (both life and non-life)
  - Reinsurance and retrocession
  - Insurance intermediation
  - Auxiliary insurance services

- **Banking**
  - Acceptance of bank deposits
  - Lending of all types
  - Financial leasing
  - Payment systems

- **Guarantees and commitments**

- **Securities**
  - Trading, either for one’s account or for others
  - Securities issues
  - Money brokering
  - Asset management
  - Settlement and clearing services
  - Provision and transfer of financial information or data
Trade Barriers: Typical market access limitations (1)

- On the number of service suppliers, e.g. only a fixed number of bank licenses granted per year
- On the value of transactions or assets; e.g. only a fixed aggregate amount of loans can be made to residents by foreign banks
- On the number of operations or on the total quantity of service output: e.g. only a fixed number of bank branches or a fixed total amount of bank lending in local currency allowed
Typical market access limitations (2)

- On the total number of natural persons that may be employed: e.g. only ten foreign personnel allowed for each establishment of a bank
- Specific types of legal entity or joint venture; e.g. only incorporated subsidiaries of insurance companies allowed
- Limitations on the participation of foreign capital; e.g. only 51% foreign ownership allowed in securities firms
Trade Barriers: Typical national treatment limitations

- Nationality or residency requirements on the directors of a bank
- Requirement to invest certain amounts of assets in local currency
- Restrictions on the acquisition of land by foreign financial institutions
- Special subsidy or tax privilege granted to domestic institutions only
- Special operational limits (limitations on the location of branches, prohibition of promotional activities, for example) applying only to branches or operations of foreign institutions
The role of GATS negotiation

• Main limitation to trade/financial reform in developing countries is the lack of policy credibility

• GATS commitments may add credibility to plans for financial liberalization, now or in future

• GATS commitments can help to help lock-in an open trading and regulatory environment, and enhance the investment climate
## Commitment by other countries:

### Example of GATS schedule

*Thailand: life insurance*

<table>
<thead>
<tr>
<th>Description</th>
<th>Limitations on Market Access</th>
<th>Limitations on National Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Cross-border supply</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>(2) Consumption abroad</td>
<td>None</td>
<td>Life insurance premium is tax deductible up to a certain amount for holders of policies issued by local companies</td>
</tr>
<tr>
<td>(3) Commercial presence</td>
<td>(a) Foreign equity participation limited to 25 per cent of registered share capital.</td>
<td>None</td>
</tr>
<tr>
<td></td>
<td>(b) New establishment is subject to license approved by the Minister with the consent of the Cabinet.</td>
<td></td>
</tr>
<tr>
<td>(4) Movement of natural persons</td>
<td>Only senior managerial personnel, specialists and technical assistants with the approval of the Insurance Commissioner</td>
<td>None</td>
</tr>
</tbody>
</table>

Source: Fink, Mattoo, Rathindran (2002)
Comments on China’s commitments in opening its service sector

- China committed to opening in 57% of sectors and modes vs 38% in other large developing countries & 47% in rich countries
  - “The most radical services liberalization ever negotiated in the WTO” (Mattoo 2002)

Aaditya Mattoo (2002) analyzed the pro and cons:

- Initial restrictions could encourage further agglomeration in certain regions which is unlikely to be reversed later
- Restrictions on foreign ownership may dampen the incentives of foreign investors to improve firm performance.
- Improved prudential regulation and measures to deal with NPLs are necessary to deliver the benefits of liberalization in financial services.
Annex on Financial Services

• Content:
  - Definitions
  - Services supplied in the exercise of governmental authority
  - Prudential “carve-out”
  - Recognition of prudential measures
  - Dispute settlement provisions
Scope and Coverage of the GATS in financial services

- All financial services, except services supplied in the exercise of governmental authority
  - Monetary and exchange rate policies
  - Statutory systems of social security or public retirement plans
  - Activities conducted by a public entity for the account or with the guarantee or using the financial resources of the government (e.g. export credits)
- All measures, including by sub-national authorities (important in federal countries)
Prudential Measures Allowed

• The Annex on FS allows Members to take measures for prudential reasons, *including*:
  - for the protection of investors, depositors, policy holders; or
  - to ensure the integrity and stability of the financial system

• The measures shall not be used as a means of avoiding commitments or obligations under the GATS
  - Prudential measures do not need to be scheduled, but …
  - …they can be challenged under WTO dispute settlement procedures
Typical Prudential Measures

• Capital adequacy ratios and solvency margin requirements
• Liquidity ratios
• Requirements for preserving asset quality (provisioning or classification requirements)
• Fit and proper tests for members of the board of directors of financial institutions
• Disclosure and reporting requirements
Recognition of prudential measures

• Members may recognize the prudential measures of any other country
• Such recognition may be based on a bilateral agreement or may be accorded autonomously
• Adequate opportunity shall be afforded to other interested Members to join such agreements, as per GATS Article VII (Recognition)
• No need to notify to the WTO when entering into recognition talks
Dispute Settlement

- Panels for disputes on prudential issues and other financial matters shall have the necessary expertise relevant to the specific financial service under dispute

- Unique to financial services (bureaucratic “turf” at play)
IV. Financial Services and the Doha Development Agenda

• Doha and GATS: What are the offers
• Deadlines repeatedly missed. But there are now 71 “initial” offers (EC/25 = 1) and 31 “revised” offers.
• Further revised offers were due on 31 July. With the suspension of the negotiations no additional submissions made.
• Very few current offers provide significant liberalization. There are many criticisms both to the quantity/coverage and quality of offers.
• Many are reserving concessions. But some progress in revised offers has happened (e.g., Brazil has improved its offer, but explicitly conditioned it on further reforms in agriculture).
Sectoral Pattern of Offers
(Number of offers with commitments per sector)
Financial Sector: Negotiating Context

• FSA is still new: January 1999 entry into force
• Greater awareness of the infrastructural role of financial services
• Continued liberalization of financial markets, much of it unilateral, some induced by World Bank-IMF lending
• Growing wedge between *actual* degree of financial market openness and *bound* WTO commitments in FSA
FSA: Currents negotiations

• Proposals have been submitted by 11 Members: Australia, Canada, Colombia, Cuba, the European Communities, Japan, Kenya, Korea, Norway, Switzerland, and United States

• Objectives:
  – Advocate further expansion of MA, NT and additional commitments for all modes of supply
  – Reaffirm the right to regulate for prudential reasons, taking into account the special nature of the sector
Barriers identified in the proposals (1)

- Restrictions on the form of commercial presence (preference for branching)
- Restrictions on foreign equity participation
- Discrimination between national and foreign providers
- Mandatory cession requirements
- Quantitative limitations on the number of suppliers
Barriers identified in the proposals (2)

- Restrictions on geographical expansion
- Restrictions on movement of key personnel
- Greater use of the Understanding on an à la carte basis
- Restrictions on the supply of certain financial services on a cross-border basis
- Lifting of restrictions on MAT insurance, reinsurance and financial information services (limited requests for cross-border market opening)
- North-North vs. North-South negotiating issues: e-finance (N-N) vs. a traditional contestability agenda (N-S)
Towards greater transparency in financial services: US proposal

- Transparency in developing regulations
- Transparency in applying regulations
- Other principles (e.g. independence of regulator)
Summing Up

• The FSA provides a solid foundation, but much remains to be done on the market access front
  – e-finance in OECD markets, with proper prudential/regulatory underpinnings
  – traditional contestability agenda in developing countries, with strengthened regimes of prudential supervision and pro-competitive regulation
  – challenge of reducing the wedge between current openness and bound liberalization
  – Limited export interests of developing countries in financial services lessens the scope for inter-sectoral bargaining
  – This in turn heightens the need for a broader negotiating agenda, so as allow market access-enhancing trade-offs to be made in sectors of export interest to developing countries
  – Progress in regulatory convergence and strengthening of prudential supervision (e.g. BIS) forms a strong complement to WTO negotiations
V. China: internationalization and domestic restructuring
China’s commitment is strong in opening its banking sector

China has committed to open its banking sector to foreign banks after joining WTO:

• Immediately open foreign currency business to foreign banks without limit;

• In the 2nd year, open RMB business to firms, and open four cities each year; and

• In the 5th year (2006), open RMB business to all residents in all regions with no geographic limit.

• Geographical restrictions: open 14 coastal cities first, and 4 more cities each year until 2006.

See Annex 9 of China’s WTO agreement.
Pre-WTO: Cost of not open Monopoly and Inefficiency

- Pre-WTO, market access in banking was not allowed to the domestic private sector. The sector has been dominated by four State-owned banks (the big four), and a dozen shareholding banks.
- “The Big Four” have extensive branch networks and employ 1.3 million people [in 2004]
- But they were actually bankrupt in 2002. The total amount of Non-performing loans were estimated at 25.4% (Dai, 2002) to 40% of their total assets in 2002.
- Four AMCs were established to restructure the NPLs. Fiscal revenues were injected to recapitalize the banks.
Challenges to China’s inefficient banking sector

<table>
<thead>
<tr>
<th>Banks</th>
<th>Tier-1 capital $mn</th>
<th>Returns on assets %</th>
<th>Profit/ employee ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Citi-Group</td>
<td>74,415</td>
<td>1.63</td>
<td>84,260</td>
</tr>
<tr>
<td>HSBC</td>
<td>67,259</td>
<td>1.38</td>
<td>72,360</td>
</tr>
<tr>
<td>ICBC</td>
<td>20,170</td>
<td>0.05</td>
<td>940</td>
</tr>
<tr>
<td>AgriBC</td>
<td>16,670</td>
<td>0.19</td>
<td>1600</td>
</tr>
<tr>
<td>Bank of China</td>
<td>27,602</td>
<td>0.81</td>
<td>22,970</td>
</tr>
<tr>
<td>ChinaConB</td>
<td>23,530</td>
<td>1.29</td>
<td>19,550</td>
</tr>
</tbody>
</table>

Post-WTO Implementation

1. Banking sector

• Opening further to foreign bank entry.
  – Dec ’03, ceiling on foreign ownership in local banks raised from 15% to 20% for a single bank and 25% overall
  – RMB business has been opened in 25 cities by the end of 2005, and geographic restrictions will be eliminated by the end of 2006

• By the end of 2005, 25 foreign banks have invested in 20 China’s domestic banks, accounting for 15% of these banks’ capital.

• 71 foreign banks from 20 countries have set up 238 operational entities in 23 cities in China. 138 of them are allowed to engage in RMB business. Though they still account for a small 2%($84.5bil) of total banking asset. (see table)

• Strengthening supervision and regulation—legal reform, CBRC.
Openness and restructuring reinforcing each other: “one stone, two birds”

• Banking sector openness can help the re-structuring process, improve governance and efficiency.
  – Goldman Sachs and others bought 9.9% stake in ICBC
  – Bank of America holds 9% of China Construction Bank [$3 billion]
  – A consortium led by Royal Bank of Scotland invests in Bank of China (22%)
  – Swiss bank UBS invests $500mn in Bank of China
  – Bank of Communications’ IPO raised $1.9bn in HongKong and
  – HSBC took 20% share in Bank of Communications for $1.75bn.

• Ideally, these will help the ownership restructuring and transform State Owned banks into shareholding ones; and promote growth. But it also depends on corporate governance issues....
## Foreign Ownership in China’s Local Banks:

<table>
<thead>
<tr>
<th>Local Banks</th>
<th>Investing Foreign Banks</th>
<th>% of Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial and Commercial Bank of China</td>
<td>Goldman Sachs, Allianz and American Express</td>
<td>9.9</td>
</tr>
<tr>
<td>Bank of China</td>
<td>Royal Bank of Scotland- Li Ka-shing - Merrill Lynch/ Temasek Holding/UBS/ ADB</td>
<td>10*/10*/1.68*/0.2*</td>
</tr>
<tr>
<td>China Construction Bank</td>
<td>Bank of America/ Temasek Holding</td>
<td>9.1**/5.1**</td>
</tr>
<tr>
<td>Bohai Bank (Pivate- Tianjin)</td>
<td>Standard Chartered Bank</td>
<td>19.9**</td>
</tr>
<tr>
<td>Jinan City Commercial Bank</td>
<td>Commonwealth Bank of Australia</td>
<td>11**</td>
</tr>
<tr>
<td>Bank of Communications</td>
<td>HSBC (Shanghai)</td>
<td>19.9**</td>
</tr>
<tr>
<td>Shenzhen Development Bank</td>
<td>New Bridge Capital</td>
<td>17.89</td>
</tr>
<tr>
<td>Shanghai Pudong Development Bank</td>
<td>Citi Bank</td>
<td>4.6</td>
</tr>
<tr>
<td>China Minsheng Banking Corp.</td>
<td>Temasek Holding*/IFC</td>
<td>5** / 1.6</td>
</tr>
<tr>
<td>Industrial Bank Co.(Fujian)</td>
<td>Hang-Seng Bank/ Tetrad Ventures/IFC</td>
<td>16 / 5 / 4</td>
</tr>
<tr>
<td>China Everbright Bank</td>
<td>China Everbright Group (Hong Kong) / ADB</td>
<td>20.1 / 3</td>
</tr>
<tr>
<td>Bank of Shanghai</td>
<td>HSBC/IFC/Shanghai Commercial Bank</td>
<td>8 / 7 / 3</td>
</tr>
<tr>
<td>Nanjing City Commercial Bank</td>
<td>IFC</td>
<td>15</td>
</tr>
<tr>
<td>Fujian Asia Bank(a joint venture bank)</td>
<td>HSBC/Ping An Insurance Group</td>
<td>50 / 50</td>
</tr>
<tr>
<td>Xi’An City Commercial Bank</td>
<td>IFC/ Scotia Bank</td>
<td>12.5 / 12.4</td>
</tr>
<tr>
<td>Dalian City Commercial Bank</td>
<td>SHK Financial Group</td>
<td>10</td>
</tr>
</tbody>
</table>

Domestic Restructuring:

- State-owned Banks are being restructured and commercialized – publicly listed.
  - $60 billion capital injection to re-capitalise 3 of 4 big state banks in the past two years;
  - Set up Asset Management Companies to dispose over $170 billion bad assets received from the State Banks.
  - Eased interest rate restriction, banks were allowed into new business (e.g. fund management companies, etc.)
  - “Big four” are engaging in restructuring, and preparing for public listing.
    - China Construction Bank launched its IPO in Hong Kong on Oct 27, 2005, raised $9.2 billion – the world's largest IPO in the last four years.
    - Bank of China, ICBC are being restructured to share-holding companies.
- Asset quality improved slightly (see table), although more than 100 other commercial banks and credit cooperatives still have problems of NPLs and under-capitalization.
- State Banks consolidation -- cutting branches in rural areas represents a new problem — Poor people’s access to credit is a big concern
## Non-performing loans and capital adequacy of banks

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Non-performing loans ratio (NPL)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State owned commercial banks</td>
<td>15.6</td>
<td>20.4</td>
<td>26.1</td>
<td>31.0</td>
</tr>
<tr>
<td>Joint stock banks</td>
<td>4.9</td>
<td>7.9</td>
<td>11.9</td>
<td>..</td>
</tr>
<tr>
<td>City commercial banks</td>
<td>14.1</td>
<td>15.0</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td><strong>Capital adequacy ratio</strong></td>
<td>6.8</td>
<td>6.7</td>
<td>5.2</td>
<td>5.4</td>
</tr>
<tr>
<td>State owned commercial banks</td>
<td>6.8</td>
<td>6.7</td>
<td>5.2</td>
<td>5.4</td>
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<tr>
<td>Joint stock banks</td>
<td>7.6</td>
<td>7.4</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>City commercial banks</td>
<td>..</td>
<td>6.1</td>
<td>..</td>
<td>..</td>
</tr>
</tbody>
</table>

### Memorandum:

- 1. End-June.
- 2. End-September.
2. Securities Market

• Significant steps to open its stock market: Qualified Foreign Institutional Investors (QFII) implemented in 2003 to allow market access by high quality firms. By April 2006, 34 QFIIs have entered China’s securities market.

• Joint-venture securities companies emerged. (e.g. China-Euro Securities Limited, and Changjiang BNP Paribas Peregrine Securities both have 33% foreign shares.) By April 2006, there are 6 Joint Venture Securities Companies, and 18 joint venture Fund Management Companies in China.

• The ceiling on foreign investment was raised several times.
3. Insurance

• Implementing WTO commitment: By the end of 2004, China’s Insurance regulator CIRC announced further easing of restrictions on foreign participation in the insurance sector, including:
  – Cancellation of geographical restrictions on foreign insurers, who were previously confined to 15 cities,
  – Opening up of health insurance, group insurance and annuity sectors (foreign insurers had been limited to selling individual life policies)
  – Abolition of compulsory reinsurance requirements; and
  – Raising the cap on foreign insurance brokers’ ownership share from 50% to 51%.
3b. Insurance

- **Strong growth of the insurance market**
- By the end of 2004, more than 100 foreign insurers established offices in China, of which 32 have business licenses. Of these, 19 are life-insurance joint ventures and 13 have licenses that apply to property and casual insurance.

- According to CIRC, by the end of 2005, 40 foreign insurers have got business license in China. Foreign Insurers have a 6.92% (RMB34.12 billion) market share of the total premium in China, increased considerably compared to around 2% in 2004.
Summary

- Trade in financial services brings large gains from competition, new and better service provision, lower prices, innovation and learning by doing.

- Banking sector would become more competitive with a higher share of foreign banks. Foreign bank share is a negative related to overhead cost, interest rate margins, and non-interest income, indicating higher efficiency.

- Liberalize under MFN principle /making commitment in WTO negotiations is a good way to lock-in reforms.

- Openness and domestic reforms may reinforce each other. See the case of China.

- There is an unfinished agenda of ensuring the poor’s access to credit, in China and elsewhere.

- Many issues in Doha FSA negotiations remain
<table>
<thead>
<tr>
<th>Country</th>
<th>Total number of banks</th>
<th>Total number of foreign banks</th>
<th>Asset share of foreign banks (in % of total assets)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>156</td>
<td>41</td>
<td>0.2</td>
</tr>
<tr>
<td>Brazil</td>
<td>213</td>
<td>39</td>
<td>1.7</td>
</tr>
<tr>
<td>Canada</td>
<td>81</td>
<td>22</td>
<td>2.1</td>
</tr>
<tr>
<td>Chile</td>
<td>39</td>
<td>8</td>
<td>4.6</td>
</tr>
<tr>
<td>China</td>
<td>61</td>
<td>5</td>
<td>5.1</td>
</tr>
<tr>
<td>Colombia</td>
<td>64</td>
<td>8</td>
<td>5.3</td>
</tr>
<tr>
<td>Denmark</td>
<td>125</td>
<td>12</td>
<td>5.4</td>
</tr>
<tr>
<td>Finland</td>
<td>23</td>
<td>3</td>
<td>6.1</td>
</tr>
<tr>
<td>France</td>
<td>372</td>
<td>69</td>
<td>6.8</td>
</tr>
<tr>
<td>Germany</td>
<td>447</td>
<td>33</td>
<td>6.9</td>
</tr>
<tr>
<td>Hong Kong, China</td>
<td>155</td>
<td>59</td>
<td>8.5</td>
</tr>
<tr>
<td>Indonesia</td>
<td>111</td>
<td>26</td>
<td>10.0</td>
</tr>
<tr>
<td>Ireland</td>
<td>79</td>
<td>48</td>
<td>13.2</td>
</tr>
<tr>
<td>Italy</td>
<td>429</td>
<td>27</td>
<td>13.9</td>
</tr>
<tr>
<td>Japan</td>
<td>322</td>
<td>5</td>
<td>14.9</td>
</tr>
<tr>
<td>Korea, Rep.</td>
<td>66</td>
<td>3</td>
<td>17.9</td>
</tr>
<tr>
<td>Malaysia</td>
<td>95</td>
<td>14</td>
<td>18.5</td>
</tr>
<tr>
<td>Mexico</td>
<td>68</td>
<td>14</td>
<td>18.6</td>
</tr>
<tr>
<td>Norway</td>
<td>65</td>
<td>9</td>
<td>19.0</td>
</tr>
<tr>
<td>Peru</td>
<td>29</td>
<td>9</td>
<td>20.7</td>
</tr>
<tr>
<td>Philippines</td>
<td>51</td>
<td>12</td>
<td>20.7</td>
</tr>
<tr>
<td>Portugal</td>
<td>61</td>
<td>17</td>
<td>23.9</td>
</tr>
<tr>
<td>Spain</td>
<td>192</td>
<td>25</td>
<td>28.0</td>
</tr>
<tr>
<td>Sweden</td>
<td>50</td>
<td>5</td>
<td>29.8</td>
</tr>
<tr>
<td>Taiwan, China</td>
<td>66</td>
<td>2</td>
<td>30.7</td>
</tr>
<tr>
<td>Thailand</td>
<td>49</td>
<td>9</td>
<td>30.9</td>
</tr>
<tr>
<td>Turkey</td>
<td>75</td>
<td>11</td>
<td>33.9</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>357</td>
<td>143</td>
<td>53.1</td>
</tr>
<tr>
<td>United States</td>
<td>451</td>
<td>54</td>
<td>54.2</td>
</tr>
<tr>
<td>Venezuela</td>
<td>85</td>
<td>8</td>
<td>61.6</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations using data from BANKSCOPE.
Table 7: Summary Table - Foreign Bank Share as a Determinant of Performance Indicators
(Weighted Least Squares estimation with country and year dummies, heteroskedasticity corrected standard errors)
(domestic banks)

<table>
<thead>
<tr>
<th></th>
<th>Foreign bank asset share</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Change in net margin/ta</td>
<td>Change in Non-interest income/ta</td>
<td>Change in before tax profits/ta</td>
<td>Change in overhead/ta</td>
<td>Change in loan loss provision/ta</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>-0.002***</td>
<td>-0.009***</td>
<td>-0.007***</td>
<td>-0.003***</td>
<td>0.001</td>
</tr>
<tr>
<td></td>
<td>(-2.793)</td>
<td>(-4.963)</td>
<td>(-2.711)</td>
<td>(-3.951)</td>
<td>(0.885)</td>
</tr>
<tr>
<td><strong>Stock market liberalized first</strong></td>
<td>0.000</td>
<td>-0.001</td>
<td>-0.004***</td>
<td>-0.002***</td>
<td>0.001***</td>
</tr>
<tr>
<td></td>
<td>(-1.092)</td>
<td>(-1.502)</td>
<td>(-4.580)</td>
<td>(-5.281)</td>
<td>(3.962)</td>
</tr>
<tr>
<td><strong>Domestic financial markets liberalized first</strong></td>
<td>0.015***</td>
<td>0.016***</td>
<td>0.001</td>
<td>0.021***</td>
<td>0.013***</td>
</tr>
<tr>
<td></td>
<td>(2.820)</td>
<td>(3.767)</td>
<td>(0.141)</td>
<td>(6.646)</td>
<td>(3.526)</td>
</tr>
<tr>
<td><strong>Capital account liberalized first</strong></td>
<td>0.002</td>
<td>-0.002</td>
<td>-0.008**</td>
<td>-0.001</td>
<td>-0.005***</td>
</tr>
<tr>
<td></td>
<td>(1.284)</td>
<td>(-0.853)</td>
<td>(-2.347)</td>
<td>(-0.318)</td>
<td>(-2.642)</td>
</tr>
</tbody>
</table>

Source: The first two lines of the estimated coefficients of the foreign bank share are taken from Tables 5 and 6. The estimated coefficients of the foreign bank share in the last two lines are obtained by running an exact set of regression equations as in Table 5 and 6 but including only countries which liberalized their domestic financial first in the first set and then including countries which liberalized their capital account first in the second set.

Note: t-statistics are reported below estimated coefficient values. *, **, and *** indicate 10 percent, 5 percent, and 1 percent significance levels successively.


