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Financial Opening under the WTO Agreement in Selected Asian Countries: Progress and Issues

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Draft

FINANCIAL OPENING UNDER THE WTO AGREEMENT IN SELECTED ASIAN COUNTRIES: PROGRESS AND ISSUES

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* The views expressed in this paper are those of the author and do not necessarily reflect the policies and views of the Asian Development Bank.

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I. INTRODUCTION

The General Agreement on Trade in Services (GATS) provides an international regulatory framework for administering global liberalization of trade in services,[1] and the trade in financial services is its major component. The increasing importance of services trade led to the establishment of the GATS as one of the new areas at the Uruguay Round negotiations, although developing countries, in general, initially had reservations. The reservations were based on the perception that services, unlike goods, are exported more from developed economies to developing economies,[2] and that domestic service industries remained at an underdeveloped stage requiring further protection and regulation.

Against this backdrop, the GATS allows remarkable flexibility within which the WTO member governments determine the level of obligations they will assume. Four main elements of flexibility are underlying the GATS (WTO 2002): (i) Member governments choose those service sectors or subsectors in which they will make commitments guaranteeing the right of foreign suppliers to provide the service. Each member must have a schedule of commitments, but there is *no minimum required* coverage – members may cover only a small part of one sector; (ii) For those services that are committed, the governments may set *limitations* specifying the level of market access and the degree of national treatment they are prepared to guarantee; (iii) The governments are able to *limit commitments* to one or more of the four recognized "modes of supply"[3] through which services are traded and they may also *withdraw and*

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[1] Generally, the GATS rules over all services with two exceptions, namely the services provided in the exercise of governmental authority and, in the air transport sector, air traffic rights and all services directly related to the exercise of traffic rights.

[2] Appendix Table 1 provides some information on the services flows, compared to merchandise flows, from and to individual countries.

[3] GATS identifies four different modes of trade in services. Mode 1 (cross-border) means that the service is delivered to consumers in the trade partner country across borders; in Mode 2 (consumption abroad), consumers come to the service provider; in Mode 3 (commercial presence), the providers establish a branch or subsidiary; and in Mode 4 (movement of natural persons), individuals are traveling from their own country to supply services in another. In case of the first two, the provider of services stays in the home country, whereas the provider comes to the country of the consumers in Mode 3. Mode 3 is presently the dominant mode of financial service trade. (WTO 2002)

renegotiate commitments; and (iv) In order to provide more favorable treatment to certain partners, the governments may take *exemptions*, in principle limited to 10 years, from the most-favored-nation (MFN) principle,[4] which is otherwise applicable to all services, whether scheduled or not. This flexibility in the scheduling of commitments contributed to the early resolution of the north-south controversy over the services trade.

The Fourth WTO Ministerial Conference declaration in November 2001 in Doha, Qatar provides the mandate for negotiations on a wide range of subjects and sector issues. Of primary importance is the declaration that sets 1 January 2005 as the date for completing all but two of the negotiations (i.e., the Dispute Settlement Understanding and a multilateral register of geographic indications for wines and spirits by 2003). It is therefore during the period 2002 – 2004 that a new round of negotiations on financial services should be held and concluded. Services negotiations have been ongoing as mandated since January 2002. WTO countries should submit initial requests for specific commitments by 30 June 2002, and initial offers by 31 March 2003; All services negotiations should concluded by the end of 2004.

Opening of financial services has enormous policy implications for a member country. As demonstrated by the Asian crisis, which erupted in 1997, mismanagement of financial opening may lead to disastrous economic consequences. Only prudent financial policies, including implementation of GATS commitments, can result in macroeconomic stability, sustained output growth and financial sector development. This paper examines six selected countries, i.e., the People’s Republic of China (PRC), Indonesia, Korea, Malaysia, Singapore and Thailand. To the PRC, as a new member, successful liberalization of financial service trade is of great importance while there arises the need to review ongoing financial liberalization policies and look into future directions in the five other countries, all crisis-affected.

[4] The MFN principle applies also to newly acceding countries. The MFN principle, the non-discrimination principle, means treating one’s trading partners equally. It guarantees equal opportunities for suppliers from all WTO members. However, it does not require any degree of market openness. (WTO 2002).

The first four sections will examine the following*:* (i) relations between financial services liberalization and capital account liberalization; (ii) GATS and/or multilateral commitments made by these countries; (iii) progress in compliance of the commitments and its impact; and (iv) implications and issues of financial opening *with focus on the banking sector*. The last section presents concluding remarks.

II. RELATIONS BETWEEN FINANACIAL SERVICES LIBERALIZATION AND CAPITAL ACOUNT LIBERALIZATION

It is desirable to clarify both the difference and linkage between opening of financial services within the context of the GATS and capital account liberalization before the paper proceeds with its main subject, namely opening of financial services. Confusion arises frequently in that people do not always distinguish between cross-border capital flows and transactions of financial services. Strictly speaking, the latter does not necessarily always entail the first (for example, provision of financial information only by foreign financial organizations), although most of financial transactions involve cross-border capital flows (e.g., foreign currency lending by a foreign (resident) bank with the money imported from abroad). If a domestic bank imports foreign currency funds from overseas markets/institutions, it is not opening of financial services but simply international capital movements related to capital account liberalization. Table 1 provides an example on differences between domestic financial deregulation, capital account liberalization and financial services liberalization.

The GATS requires **only** the liberalization of capital flows that is crucial for the financial services provided by foreign financial institutions. Commitments to cross-border trade liberalization (Mode 1) require the liberalization of inflows and outflows of capital which are an *essential* part of the concerned services, while commitments to commercial presence (Mode 3) require the liberalization of capital *inflows that are related to* the supply of the services[5] (Kono and Schuknecht 2000), which might include the capital for foreign financial institutions to establish branches or companies and to

[5] Refer to GATS Article XVI, Footnote 8.

facilitate their operations. Capital outflows related to the supply of services under Mode 3 do not have to be liberalized. The GATS does *not* oblige the WTO members to fully liberalize capital flows related to the activities of such local establishments. This means that opening of financial services is consistent with the existence of certain capital account restrictions. This is particularly important to most of developing countries where domestic financial markets remain underdeveloped and small and balance of payments positions are weak.

Table 1: Example - Comparisons of Domestic Deregulation, Capital Account Liberalization, and Financial Services Liberalization

	Domestic Funds (I)	International Funds (II)
Credit provided by domestic supplier (A)	*Domestic deregulation* – neither financial services trade nor international capital flow	*Capital account liberalization* – international capital flow only
Credit provided by overseas supplier (B)	*Financial services liberalization*	*Capital account liberalization, and Financial services liberalization*
Credit provided by foreign resident supplier (C)	*Domestic deregulation and Financial services liberalization*	*Capital account liberalization and Financial services liberalization*

It should be noted, however, that there is a coherent linkage between the opening of financial services and liberalization of capital account. For example, a high level of capital control will discourage the entry of foreign financial institutions into the country, because of the poor prospects of local currency convertibility and withdrawals/remittances of the concerned capital. It is why opening of financial services can be implemented successfully only when a prudent, sound policy on capital account liberalization is in place. An orderly and well-designed sequencing of capital account liberalization is therefore critical to reap the benefits of opening of financial services in developing countries.

III. OVERVIEW OF FINANCIAL OPENING UNDER GENERAL AGREEMENT ON TRADE IN SERVICES IN SELECTED ASIAN COUNTRIES

A. Definition of Financial Services

According to definitions provided in the Annex on Financial Services (the Annex) of the GATS, "a financial service is any service of a financial nature offered by a financial service supplier of a Member." The term "financial service supplier" does not include a public entity that provides services in the exercise of government authority. Financial services include the following activities:

(a) *Insurance and Insurance-related Services* covering (i) direct insurance (including co-insurance), both life and non-life; (ii) reinsurance and retrocession; (iii) insurance intermediation, such as brokerage and agency; and (iv) services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

(b) *Banking and Other Financial Services (excluding insurance)* covering deposit taking, lending, leasing, payment and monetary transmission, guarantees and commitments, financial trading (money market instruments, foreign exchange, derivative products, swaps, forward rate agreements, transferable securities and other negotiable instruments), money brokering, asset management, settlement and clearing services, provision of financial information, and advisory services.

B. Commitments of Individual Countries

The six countries under examination have generally made commitments to all financial areas but differences between countries exist. Individual country commitments are composed of the *horizontal* commitments and *sector* commitments; the first deals with the across-the-board agreements while the latter with the sector-specific ones.

In addition to the GATS, the ASEAN Framework Agreement on Services (AFAS)[6] was born out of the ASEAN Bangkok Summit in 1995 which provides a basis for ASEAN countries to launch negotiations on seven areas of services, i.e., banking, tourism, air transportation, maritime transportation, telecommunications, construction and professional services. Commitments were made only in primary sectors such as finance and telecommunications in September 1998. The GATS framework provided the basis for the AFAS negotiations and a positive list approach was opted in liberalizing service sectors. Slow progress in the AFAS is attributed to the weak political will, legal restrictions and institutional limitations. The PRC joined the WTO as a new member on 11 December 2001 after the WTO approved the accession protocol in November 2001.

1. People's Republic of China

PRC has made substantial commitments in the banking sector during WTO entry negotiations. Its financial markets will be opened on a step-by-step basis. Two years after PRC's entry into WTO, foreign banks will be allowed to undertake some local currency business with all their customers. Five years after PRC's entry, foreign banks will be able to fully engage in local currency services and receive national treatment of banking service without restrictions in terms of geography, branching, and scope.

As of the end of 2000, there are 178 foreign banking institutions in PRC with total assets of $34.6 billion, including $18.8 billion of foreign currency loans accounting for 22.7 percent of total foreign currency loans in PRC. However, because of various restrictions, foreign banks account for only 2 percent of total banking business in PRC, a much lower level than in most of the other developing and transition economies.

<u>Major horizontal commitments</u>:

[6] The commitments under AFAS are slightly more liberalized than those under the GATS.

(i) On Commercial Presence Foreign investment[7] in an equity joint venture should be no less than 25 percent of the registered capital; and the establishment of branches by foreign enterprises are boundless unless otherwise indicated in specific sectors.
(ii) On Presence of Natural persons Senior employees (managers, executives and specialists) of a corporation are permitted for an initial term of three years.

Commitments on specific financial services:

(i) Insurance and insurance-related services

Foreign equity participation Foreign non-life insurers will be permitted to establish a branch or a joint venture with 51% foreign ownership, and within two years after accession, 100 percent; life-insurers 50% foreign ownership in a joint venture upon accession; Brokerage of insurance/reinsurance no more than 50% foreign ownership upon accession, 51% within three years upon accession, and 100% within five years upon accession.
Geographic coverage Upon accession, foreign life and non-life insurers and insurance brokers will be permitted to provide services in Shanghai, Guangzhou, Dalian, Shenzen, and Foshan. Within three years after accession, no restrictions will be imposed.

(ii) Banking and other financial services

Geographic coverage For foreign currency business, there will be no geographic restriction upon accession. Local currency business is possible only in Shanghai, Shenzen, Tianjin, and Dialin upon accession; within one year after accession — Guangzhou, Zhuhai, Qingdao, Najing and Wuha; within two years — Jiha, Fuzhou, Chengdu and Chongqing; within three years — Kunming, Beijing, and Xiamen; within four years — Shantou, Ningbo, Shenyang, and Xian; no more restrictions thereafter.

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7 According to the Schedule of Specific Commitments of PRC, "foreign invested enterprises" include (i) foreign capital enterprises (also referred to as wholly foreign-owned enterprises) and (ii) joint ventures which are either equity joint ventures or contractual ventures.

Licensing Foreign financial institutions that meet the following conditions can establish a subsidiary of a foreign bank or a foreign finance company: total assets of at least $10 billion at the end of the year prior to filing of application. Conditions for establishment of a branch of a foreign bank: total assets at least $20 billion. Conditions for establishment of a joint bank or a joint finance company: total assets of at least $10 billion.

2. Indonesia

Indonesia's commitments to the AFAS (September 1998) and GATS (February 1998) on the banking sector (horizontal and general conditions) are summarized as follows: (i) All market access and national treatment limitations specified will be eliminated by the year 2010 (2020 for the GATS) subject to a similar commitment by other members; (ii) Foreign bank(s) and foreign legal entity(ies) are, in cooperation with Indonesian national(s) and/or Indonesian legal entity(ies), allowed to establish or acquire locally incorporated banks with existing regulations (a new license not allowed for GATS); (iii) Branch office of foreign banks and joint venture banks may open their offices in the cities of Jakarta, Surabaya, Semarang, Bandung, Medan, Denpasar, Batam Island, Padang, Mandado, Ambon, and for all other capitals of the provinces subject to economic need test (only one sub-branch and one auxiliary office per foreign bank's branch office); (iv) Acquisition of local existing banks through purchase of shares in the stock exchange is allowed up to 49 percent (51 *percent* for the AFAS) of the listed shares; and (v) With respect to the presence of natural persons, a non-Indonesian employed as manager or technical expert is required to have at least two Indonesian nationals as understudies during his/her term.

The commitment is generally conservative but in reality it is much more liberal. For example, ownership of a domestic bank by foreign investors is limited to a maximum of 49 percent in the GATS (51 percent in the AFAS) but the country is in fact allowing up to 99 percent upon approval by the Government. With regard to the entry of foreign banks, the issue on hand is finding means to attract more funds from these banks, rather than restricting their business scope, given the large net outflows of foreign capital from Indonesia in recent years. Presence of natural persons is generally prohibited except for a non-Indonesian manager or technical expert. Temporary entry may be granted to technical experts/advisors of foreign bank branches for joint venture banks for a maximum of three months per person for any given year.

Indonesia imposes several specific restrictions on non-banking finance: market access and national treatment for cross-border supply of non-life insurance/life insurance /factoring services/securities business/investment advisory services is not allowed. These will be eliminated by the year 2020 subject to similar commitment by other WTO members. To conduct securities business, foreign brokers/companies need to establish a broker/securities company. On the others, the following horizontal restrictions should be complied with. First, the share of ownership of a foreign services supplier is bound by the prevailing laws and regulations. Second, the share of non-bank financial companies listed in the stock exchange may be 100% owned by foreign investors. Third, in relation to the presence of natural persons, expatriates may assume the positions of directors, managers, and experts/advisors with a maximum term of 3 years that can be extended.

3. Korea

The policies on financial opening in Korea have exhibited sharp contrast before and after the Asian crisis. Opening of the financial sector after the crisis progressed in a more rapid pace than in the precrisis period though there had been significant opening efforts immediately before the crisis to prepare for Korea's accession to the OECD. The rapid postcrisis progress was attributed to a combination of these factors: (i) the urgent and impending need for foreign funds to fill the financial gap created after the crisis; (ii) the new shift in the government's attitude into one that is highly favorable of foreign investments, and (iii) international pressures by the OECD and international financial agencies to deregulate and open the financial sector as a member of the OECD.

In the early part of 1998 a spectrum of major policy actions were taken to increase the **commercial presence** of foreign financial institutions in Korea. In April 1998 foreign banks and securities firms were allowed to establish subsidiaries; 100 percent foreign ownership of Korean financial institutions was made possible. In May 1998 Korean banks were able to recruit foreign nationals as directors. As seen in Table 2, commercial presence of all financial institutions (establishment of branches, subsidiaries and joint ventures) became possible by 2000. Foreign ownership of a Korean bank up to 100 percent was permitted in April 1999.[8] In summary, any foreign bank can enter Korean markets in principle, enjoying virtually the same national treatment.

Table 2: Commercial Presence of Foreign Financial Institutions in Korea (2000)

	Bank	Security	Investment Trust company	Investment Advisory	Life Insurance	Non-Life Insurance
Branch	Open	Open	Open	Open	Open	Open
Subsidiary	Open	Open	Open	Open	Open	Open
Joint Venture	Open	Open	Open	Open	Not Open	Not Open
Cross-Border Trade	Partially Open	Not Open	Partially Open	Open	Open	Aviation, Hull (open)

Source: Korea Institute of Finance (2000), “Main Issues in International Financial Market”.

Toward the end of 1997, Korea opened its domestic *bond market* and accelerated the opening of stock and money markets to attract foreign funds in the wake of the crisis.[9] By May 1998, ceilings on *stock investment* by foreigners in non-state owned companies were completely removed. In the case of state owned companies, the ceiling was raised to 30 percent from 18 percent set a year ago. Ceilings on stock investments in private companies had been drastically reduced: to 23 percent in May 1997, 26 percent in November 1997, 55 percent in December 1997 and 100 percent in May 1998. Foreign investment in private companies’ equities was fully liberalized only six months after the crisis.

[8] Prior limit was 4 percent for a nationwide bank, 8 percent for a bank converted from other financial institutions, and 15 percent for a regional bank.

[9] This section on Korea is based on S.I. Hwang and I.S. Shin (Dec 2000).

In bond markets, investments in and trading of both corporate and government bonds, which had not been allowed to foreigners till the end of November 1997, were fully opened by the end-of 1997. Other important opening measures include:

- Markets for CP and trade bills were opened in February 1998.
- All money market instruments including CDs and RPs were opened in May 1998.
- Trading of listed bonds over-the-counter markets was permitted in May 1998
- Trading of non-listed bonds was allowed in July 1998.

Further, the government took various actions to liberalize *foreign exchange markets*. In July 1998, medium term foreign loans were permitted in order to facilitate business sector's borrowing of foreign funds. In April 1999 the Foreign Exchange Management Act that had long provided the legal basis for foreign exchange control in the country, was replaced by the Foreign Exchange Transactions Act (FETA) to support financial liberalization. Offshore issuance of securities and foreign borrowing by Korean firms and financial institutions became much easier. Since 2001, many restrictions on foreign exchange transactions by foreign and Korean individuals have been removed.

Korean laws largely prohibit cross-border financial services trade, which is increasingly important within the context of GATS negotiations. Although cross-border banking is not allowed in principle, a limited number of cross-border transactions are possible under the FETA (partially open). Table 1 shows the liberalization status of cross-border trade as well as commercial presence by type of financial services. With respect to cross-border trade, banking and mutual fund investment are partially open; securities transactions are not open, while life insurance and investment advisory are fully open. As of March 2002, there are 61 foreign bank branches and 26 foreign representative offices.

4. Malaysia

Malaysia has kept a financial liberalization schedule within the context of the GATS (Feb 1998) and AFAS (Sep 1998). The 10-year Financial Sector Master Plan also provides the country's financial sector with a roadmap on financial reform, opening of domestic market, and development direction.

Market access and national treatment for cross-border supply, consumption abroad and presence of natural persons of *offshore* banks, offshore investment banks and offshore insurance companies are generally not allowed. Concerning market access, commercial presence of these offshore financial institutions is allowed only in Labuan and entry is limited to establishment of a branch or a subsidiary incorporated in Malaysia. There is no restriction on national treatment.

Market access and national treatment for cross-border supply and consumption abroad of *commercial* banks and *merchant* banks are not generally allowed. The 13 wholly foreign-owned foreign banks are permitted to remain 100% foreign owned; new licenses are not allowed. Natural persons are not allowed to hold office on a temporary basis except for senior managers and specialists. Entry of these banks is limited to equity participation by foreign banks in Malaysian-owned or controlled commercial banks and merchant banks. Aggregate foreign shareholding in a commercial or merchant bank shall not exceed *30 percent*. Shareholding by a single person individually or jointly is limited to a maximum of 20 percent.

Market access and national treatment for cross-border supply and consumption abroad of *direct insurance companies* are not allowed in general. On commercial presence, branches of foreign insurance companies are required to be locally incorporated by 30 June 1998 and new licenses are not allowed. Acquisition by a foreign insurance company of more than 5 percent aggregate shareholding in a locally incorporated insurance company is possible with the approval of the Government provided certain conditions are met.

The basic principles behind Market access and national treatment for cross-border supply and consumption abroad of securities business are summarized as follows:

Offshore financial institutions – only for non-resident customers.

Issues and placements as agents – merchant banks and a locally incorporated joint venture company.

Underwriting company – commercial presence and authorization required.

Asset management company - commercial presence and authorization required.

Securities broking company – equity participation in an existing stockholding company or establishment of a locally incorporated joint-venture company with a Malaysian stock broking company.

Aggregate foreign shareholding in the company – not to exceed 30 percent.

To cope with challenges in this age of globalization, Malaysia considers a banking consolidation program within which banks will be merged into three to four large banks to provide a full range of banking services, with another three to four medium-sized banks consolidated to perform specialized services. The consolidated banks will be better capitalized to meet international standards as well as undertake a wider scope of business. The operational business integration process and rationalization exercise have been the major components of the recent consolidation efforts to reduce duplication of resources and/or functions and to attain higher levels of economies of scale and efficiency in banking institutions. There are currently 14 foreign banks operating in Malaysia out of a total of 47 banking institutions (composed of commercial banks, finance companies and merchant banks). Foreign bank branches totaled 145 out of 2,557 branches in the entire banking system.

5. Singapore

Cross-border supply and consumption abroad of all financial services are generally prohibited. Presence of natural persons is also limited.

The schedule of specific commitments within the context of the GATS (Feb 1998) and AFAS (Sep 1998) deals with insurance and insurance-related services, banking, and securities, and other financial services. The presence of natural persons is unbound, except for intra-corporate transfers of managers, executives, and specialists and the entry of these intra-corporate transfers is limited to three years that may be extended for up to two additional years (horizontal restrictions). Specific commitments under GATS are summarized as follows:

Life insurance and non-life insurance – consumption abroad is allowed; foreign parties can acquire aggregate equity stakes of up to 49 percent in locally-owned insurance companies provided the acquisition does not result in any foreign party being the largest shareholder.

Acceptance of deposits and other payable funds from the public (banks) – market access for only institutions approved as banks, merchant banks and finance companies; foreign banks can operate only one office and cannot establish off-premise ATMs and ATM networking and new sub-branches.

Lending (banks) – Mode 2 (consumption abroad) is allowed; each offshore bank's lending in Singapore dollars to residents shall not exceed $200 million in aggregate; no limit on the establishment of off-premise cash dispensing machines for credit and charge cards.

Financial leasing, guarantees, and money and foreign exchange market transactions – generally no restrictions.

Participation in issues of securities including underwriting and placement as agent – foreign stockbrokerage companies, as non-members of the Stock Exchange of Singapore (SES), can become Approved Foreign Brokers to trade directly in non-Singapore dollar denominated securities quoted on SES.

Advisory and other auxiliary financial services – commercial presence is required; and establishment of branches, subsidiaries or representatives is allowed.

While the schedule generally keeps a conservative stance toward the trade in these financial services, the Singapore financial authorities have, since 1998, taken many important steps to expedite internationalization and liberalization of Singapore's financial markets and the Singaporean dollar. According to the Monetary Authority of Singapore (MAS), Singapore has, since the crisis, reviewed the East Asian growth model that emphasizes high savings, reliance on foreign investment and outward orientation. Some economists have argued that East Asian economies should lower savings and stimulate domestic demand, develop indigenous enterprises and insulate themselves from volatile external conditions.[10] However the review has reached a conclusion that, in particular, for small economies like Singapore to rely on small domestic markets and traditional-type indigenous enterprises to stimulate its growth and investment seems inherently implausible and that Singapore's economic regime should remain externally oriented.

Against this backdrop, Singapore has shifted from the previously conservative and risk-averse regulatory approach to an internationalized and liberalized approach supported by prudential supervision while at the same time accepting calculated risks in order to promote competition and efficiency of the financial industry. The core of this liberalization policy comprises two key elements: (i) progressive internationalization of the Singaporean dollar; and (ii) fostering capital markets, particularly bond markets with a goal to diversify Singapore's financial markets and develop Singapore as a global financial hub. On the first element, through two amendments in banking laws and regulations, most of policy restrictions propping up the long-standing non-internationalization policy have been phased out over the past four years. Singapore is retaining only two basic restrictions to prevent currency speculation: (i)financial institutions may not extend Singapore dollar credit facilities exceeding S$5 million to non-resident financial entities, where they have reason to believe that proceeds may be

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[10] Special Keynote Address delivered by Lee Hsien Loong, Deputy Prime Minister and Chairman of the Monetary Authority of Singapore, at the Euromoney Asia-Pacific Issuers and Investors Forum, 19 March 2002.

used for speculation against the Singapore dollar exchange rate; and (ii) when a non-resident entity wishes to obtain a Singapore dollar loan, or tap Singapore equity or bond markets to fund overseas activities, it must swap or convert the proceeds in Singapore dollars into foreign currency as and when it uses the proceeds offshore.

Concerning the second point, the country's efforts have yielded encouraging results. The outstanding volume of Singapore Government Securities (SGS) since 1998 has doubled to S$ 54 billion in 2001, and average daily turnover increased about three times to S$ 1.9 billion in 2001. New corporate debt issuance has also continued to grow rapidly, with S$ and non-S$ corporate bond issuance totaling a record amount of S$72 billion in 2001, almost an 8-fold growth over issuance volumes in 1998. The tenors of corporate issues range evenly across a spectrum of maturity of up to 15 years exhibiting a greater diversity of corporate bonds.

The functions of local bankers on the entry of foreign financial institutions into Singapore is highly favorable and generally support the aforementioned liberalization measures which will create more efficient and vibrant markets. A reservation is possible overcompetition in local retail banking and insurance markets, taking away the business ground of smaller-sized local banks and insurance companies by international financial institutions. In line with this, the MAS has licensed only six Qualifying Full Banks (QFBs) till now, which are allowed to establish additional local branches off-premise ATMs and ATM sharing to undertake retail banking. Further, a deposit insurance scheme is under consideration to protect small savers. The entry of insurers and independent intermediaries is allowed based on strict MAS criteria, despite the general liberalization stance in place since early 2000. Securities business is virtually fully open.

About 200 foreign banks are operating in Singapore, with their share in total public loans (i.e., loans to non-bank clients) and total deposits being about 50 percent and 35 percent, respectively. It is a significantly high share, noting a liberalized business environment in Singapore. Major clients of foreign banks, except for the six QFBs, are home country enterprises.

6. Thailand

The following is a summary of major commitments under GATS:

Horizontal conditions (i) commercial presence is permitted in principle only through a limited liability company registered in Thailand in which foreign equity participation must not exceed 49 percent of the registered capital[11] and the number of foreign shareholders must be less than half of the total number of shareholders of the company concerned; (ii) national treatment for this mode has no limit in principle; (iii) temporary movement of natural persons is limitless except for a corporate transfer of the managerial or executive level or a specialist for a one year period (altogether for not more than three years); and (iv) foreigners are not allowed to purchase or own land.[12]

Specific commitments

(i) "Cross-border supply" and "consumption abroad" are generally not allowed for banking, securities services and non-life insurance.

(ii) Ceiling of foreign share holding in different financial institutions under the GATS/AFAS commitments is: life and non-life insurance 25 percent of registered share capital; services auxiliary (excluding pension funds) 49 percent; representative office of commercial banks none; local incorporated banks 25 percent (each limited to 5 percent); securities companies and credit foncier companies 25 percent (each limited to 10 percent); securities companies 49 percent; asset management companies 25 percent for the first five years followed by

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[11] In reality, the Stock Exchange of Thailand allows any shares exceeding 49% to be held in a special Fund. The exceeding portion is not entitled to vote.

[12] Some changes have recently been made to allow foreigners to purchase land to construct manufacturing facilities.

49 percent after five years; and financial leasing, factoring services, credit cards, charge and debit cards 49 percent.[13]

(iii) Presence of natural citizens – For *life and non-life insurance*, only senior managerial personnel, specialists, and technical assistants are allowable, subject to the approval of the Insurance Commissioner.

(iv) Banking - Consumption abroad and cross border supply without limit except for financial advisory and financial data processing; commercial presence generally no restrictions for existing foreign bank branches.

(v) Securities companies (brokerage, dealing, underwriting, and investment advisory services) – market access and national treatment for consumption abroad is fine; national treatment for cross border supply is allowed; limitation on market access for commercial presence none for representative office, share acquisition of existing companies allowed up to 100 percent of paid-up capital; national treatment allowed.

Percentage of foreign share holding in Thai banks has, since the Asian crisis, increased significantly due to the Government's policy encouraging foreign participation under multi- purposes such as recapitalization of domestic troubled banks and attraction of advanced banking techniques. In June 1997, before the outbreak of the crisis, foreign share in the financial sector was zero but rose to six percent as at December 2000 (all in commercial banks).[14] The number of foreign bank branches decreased slightly from 21 in 1997 to 18 in March 2002 in the wake of the general consolidation of banking institutions in the country since the crisis. The perception of local clients of foreign banks is generally positive noting that these banks can contribute to mobilizing foreign funds for

13 The commitment schedule under the AFAS (Sep 1998) is different from the GATS (Feb 1998) in that three more commitments have been added, which are: foreigners' share holding of securities companies; increase in number of expatriates of a securities company from two to three; and pension fund consulting services.

14 Foreign share (%) as of March 2002 : 48.77 Bangkok Bank; 46.82 SCB; 48.98 Thai Farmer; 2.97 Thai Military; 50.27 DBS Thai Danu; 75 ABN Amro Asia; 75.02 Standard Charted Nakornthon; 75.02 UOB Radanasin; and minimal in Ayudhaya, Krung Thai, Bank Thai, Siam City Bank, and Metropolitan Bank.

the country and that the major cause of the crisis was not simply the capital inflows but more importantly the lack of prudential supervision of financial activities.

IV. IMPLICATIONS OF BANKING SECTOR OPENING – CASES OF THE PEOPLE'S REPUBLIC OF CHINA, INDONESIA, KOREA AND MALAYSIA

1. People's Republic of China[15]

a. Implications and Issues

PRC has made far-reaching commitments in WTO negotiations in opening up its financial sector. During the phase-out period of five years, PRC will gradually remove the geographic and regulatory restrictions for foreign financial institutions and liberalize scope of businesses. The final commitments will open the sector to foreign access while maintaining some limitation on cross-border supply and foreign equity participation.

Given the rapid development of the PRC financial sector and its integration into the global financial sector, the People's Bank of China faces a daunting task of improving the legal and regulatory system to address existing weaknesses and prepare for future challenges. Substantial development of the legal and regulatory framework for the financial sector greatly accelerated the reform and growth of both banking and non-banking sectors. One noticeable example is the recent enactment of the Trust Law which provides underlying principles for fiduciary duties and governing rules on the Board of Trustees. The law lays down the foundation for development of legal trusts in the PRC. The future laws and regulations governing various trusts will comprise two general tiers: one is the basic law such as the Trust Law; and the other laws pertain to detailed rules on the specific trusts, such as pension funds and investment funds.

However, there are a number of weaknesses in the legal and regulatory system, which may hamper financial sector development. There are still gaps or gray areas where

15 This section is heavily indebted to an internal paper prepared by Min Tang, ADB People's Republic of China Resident Mission (2002).

no suitable law or subordinate legislation can apply. For example, there is no legal code for handling bankruptcy of financial institutions, nor are there regulations governing electronic transactions, anti-money laundering, and non-bank financial companies, such as trust and investment companies, and finance and leasing companies, etc, as they are regulated by various regulations and decree. There is also a lack of consistent and effective approach in enacting and amending laws as well as transparent procedures to bring in stakeholders' participation in the legislation process.

Enforcement laws and regulations are inadequate and on many occasions, financial sector supervisors would have to rely on the interpretation of the supreme court when implementing the law. Foreign participation in PRC financial sector has been governed mostly by separate sets of temporary regulations and provisions. However, PRC's entry into the WTO requires a complete overhaul of these temporary regulations and makes them consistent with PRC's WTO commitment regarding opening up the financial industry.

The segregated regulatory system has over-emphasized the regulation of market behaviors compared with the prudential regulation of financial institutions. Prudential supervision proves to be more difficult in a segregated system where financial institutions are engaged in cross-sector activities. There is no mechanism in the People's Bank of China to address solvency issues within a financial conglomerate such as double or multiple gearing, risks incurred by unregulated entities, erection of firewalls between subsidiaries and between subsidiaries and parent companies.

International experience shows that in the long run, increased foreign participation in the banking sector has a generally positive effect on countries. The banking sector will also benefit in many ways from involvement in the process of global financial integration.

First, involvement in global integration and competition will act as a catalyst for banks to reform and improve efficiency, thus accelerating the process of economic development. Second, internationalization can help in the process of building more robust and efficient financial systems by introducing international best practices and standards, by improving the quality, efficiency of financial services, and by attracting more stable sources of funds. Third, domestic banks surviving the competition will learn to establish more sophisticated services and systems that meet international standards and thereby increase their productivity. Fourth, it will facilitate PRC's access to international markets and for PRC banks to open up overseas operations. Finally, a liberalized and efficient financial sector will make a significant contribution to the overall development of the economy. Better and more efficient banking services will stimulate the development of the industrial, agricultural and service sectors.

In the short-term there will be costs associated with WTO accession. Once the current protective measures are removed, PRC's state owned commercial banks would be placed in a rather unfavorable competitive position.

One of the important drawbacks will be a fall in the market share of domestic banks. Estimates suggest that five years after PRC’s entry to the WTO, the market share of foreign banks in the total banking business would increase from the current 2 percent to about 15 percent. Ten years later, the market share of foreign banks will rise to one third of the total banking business. This increase in the foreign banks’ share indicates a corresponding decrease in domestic banks’ share.

Another drawback is the decline in the profitability of local banks. Some high quality clients with good creditworthiness, particularly those located in the coastal areas, may shift to foreign banks leaving the less creditworthy clients and some policy-based business with the domestic banks. This probable shift is a major threat to the domestic banks.

Increased competition with international banks may adversely affect the liquidity of domestic banks as some of the funds available for domestic banks may gradually shift to foreign banks. Given the high proportion of bad assets among domestic banks, especially the state-owned commercial banks, the loss of liquidity will worsen the precarious situation of these banks and threaten their survival.

Given the strength of their flexible management mechanisms and better remuneration packages, international companies would likely attract skilled personnel from domestic banks, leading to a “brain drain” of PRC’s financial firms. This will post a threat to their operation and management and force domestic salary scales to increase. In fact, competition for personnel has already started. Initial estimates show that about one third of the managers or higher positions employed by foreign banks in Beijing and Shanghai came from domestic banks.

Domestic banks are given five years to assess these challenges and take necessary measures. The reform of the financial sector must be accelerated to face the challenges arising from international banks.

b. Addressing NPLs

The key challenge for the Government is to strengthen domestic banks by addressing the problem of non-performing loans (NPLs). The official figure of the NPLs of the four state-owned commercial banks is about 25 percent of their total loan portfolio. This excludes the 10 percent equivalent of total portfolio of the NPLs transferred to the four Asset Management Companies established in 1999. However, if a more strict, international NPL classification were adopted, NPLs may be close to half of the loan portfolio of the big four state-owned banks. The NPLs of other commercial banks are lower due to their shorter operational history and less exposure to the state owned enterprises. Further, the NPLs in the Rural and Urban Credit Cooperatives could be as high as, or even higher than that in the four big banks.

Table 3: Non-performing Loan (NPL) Rates in Selected Asian Countries, 2001
(percent in total loans)

	People's Republic of China	Indonesia	Korea	Malaysia	Philippines	Thailand
NPLs	25	18	5.4	9.4	16.7	17
NPLs (broad)*	35	57	16	16	NA	27

* includes NPLs transferred to asset management companies.
Source: Min Tang, ibid

A comparison of the level of NPLs in other countries suggests the severity of the NPL problem in PRC. Table 3 shows the NPLs in some Asian countries. With the exception of Indonesia, the ratio of NPLs in PRC is higher than many of the countries that were badly hit by the Asian financial crisis. However, a simple comparison of the NPLs in PRC with that of the other countries may be somewhat misleading. A large proportion of NPLs in PRC is part of the transition cost from a centrally planned economy to a market economy, particularly related to the state owned enterprises reforms. The NPL situation in PRC has to be addressed as part of the ongoing transition and structural changes of the economy, a long-term process involving many steps.

c. Commercialization of State-owned Banks

Accelerating the pace of commercialization of state-owned banks is another important task if domestic banks are to enhance their international competitiveness. As the first step, domestic banks should establish an effective corporate governance structure. The Governor of the Central Bank has recently announced that a number of state-owned banks will be listed in the stock exchange in the next few years. To do so, the banks must operate under market rules and improve disclosure and transparency.

To improve the competitiveness of the domestic banks, expeditious development of private-owned banks is strongly suggested. For a long period of time, banking regulations have restricted private sector participation. The significance of developing a private-owned banking system has great merits in two areas. It facilitates competition by ending the monopoly of major state-owned banks. Creating a competitive environment will improve efficiency, innovation and the development of new services. Second, development of private banks will help address the distortion in credit allocation in which the state sector benefits at the expense of the non-state sector, particularly small and medium enterprises. State-owned industrial enterprises product is less than 30 percent of total industrial output. However, they receive more than 70 percent of the credit allocated by the banking sector. If a non-state sector banking system is developed, SMEs, private enterprises and consumers will have better access to bank credits.

d. Human Resource Development

Domestic banks must develop better human resource management systems, compensation systems and incentive packages. There is an acute shortage of high-quality and senior personnel familiar with modern commercial bank management. The Central Bank is considering employing an officer from Hong Kong as its Deputy Governor. The Government also plans to modify its policy by allowing domestic banks and brokerages to hire overseas Chinese professionals as departmental heads, in an effort to accelerate their development as commercial entities. This shows the Government’s willingness to upgrade professional skills to better respond to the changing environment.

2. Korea

Table 3 indicates the market share of foreign banks’ assets as a percentage to the total assets of all deposit banks (including foreign banks) in Korea. The market share of foreign banks remained at 6-7 percent except for 8.0 percent in 1997 when the crisis started. The share is low, exhibiting that the role of foreign banks in Korea is far from significant and Korea’s financial opening has not led to any major change in the foreign banks’ share in the Korean market. However, it is noted that their share has steadily increased since 1998. It is not clear, though, whether this is a long-term trend or a temporary occurrence.

Hwang and Shin (2000) examined cyclical characters of foreign and domestic currency loans by foreign banks in Korea for the period 1981-1999. They ran regressions to find out the relationship between growth rates of foreign and domestic currency loans and nominal GDP growth rates and interest rate differentials between Korea and the U.S. The first finding is that domestic banks provided more stable lending service in domestic currency while foreign banks did so in *foreign currency*. Looking into the relationship between loan growth and nominal GDP growth, this study concludes that domestic currency loans by foreign banks are pro-cyclical, whereas no significant relationship was found in the case of domestic banks. However, highly contrasting results were achieved in the case of foreign currency loans. GDP growth did not have any significant explanatory power in foreign currency loans by the foreign banks but it had significant positive relationship with domestic banks' foreign currency loans. Given this result, they concluded that foreign banks played a stabilizing role in economic fluctuations. Similarly Goldberg et al (2000) found that foreign banks in Argentina and Mexico had lower volatility in lending, contributing to financial stability in times of financial crisis and economic depression.

In relation to the Asian financial crisis, foreign banks had not contributed to the eruption of the crisis given that foreign banks' assets (both in size and share) including loans did not show any sharp increase immediately before the crisis (Table 4). Their market share in the pre-crisis period was even much lower than that in the post crisis period.

On the contrary, since 1998 foreign banks have been increasingly relying on domestic sources in mobilizing their operating funds (Table 5). This trend is attributed to the country's active liberalization policy under the new Government since the crisis, which provides more favorable operational environment to foreign banks. This signifies localization of foreign banks. Till 1997, the share of domestic liabilities of foreign banks remained at about 20 percent of total liabilities but it sharply rose to 37.4 percent in 1998, followed by 62.3 percent in 2000 and 68 percent by the end-November 2001. Now the major source of liabilities is deposits received from domestic customers in both Korean won and foreign currencies.

Table 4: Market Share of Foreign Banks in Korea, End of Period

	Assets: Foreign Banks (Tril. won) (A)	Assets: All banks (Tril. won) (B)	Market share (A/B) (%)
1995	19.4	379.5	5.1
1996	24.7	451.2	5.5
1997	45.8	573.7	8.0
1998	33.8	576.9	5.9
1999	34.7	640.0	5.4
2000	46.9	737.8	6.4
Nov 2001	49.3	762.1	6.5

Source: The Bank of Korea, *Monthly Bulletin (Jan 2002)*, Seoul, Korea

Table 5: Source of Operating Funds of Foreign Banks in Korea, End of Period
(trillion won)

	Domestic	Foreign	Total Liabilities
1995	3.1 (23.5)	10.1 (76.5)	13.2 (100.0)
1996	3.2 (18.6)	14.0 (81.4)	17.2 (100.0)
1997	7.1 (21.1)	26.5 (78.9)	33.6 (100.0)
1998	9.2 (37.4)	15.4 (62.6)	24.6 (100.0)
1999	12.5 (45.6)	14.9 (54.4)	27.4 (100.0)
2000	24.3 (62.3)	14.7 (37.7)	39.0 (100.0)
Nov 2001	30.2 (68.0)	14.2 (32.0)	44.4 (100.0)

Figures in parentheses represent percent in total.
Source: The Bank of Korea, *Monthly Bulletin (Jan 2002)*, Seoul, Korea

It has been argued that opening of domestic banking markets involves both costs and benefits. Possible costs include dominance in local markets; increased influence of foreign capital in economic activities; and intervention in corporate management. Benefits include increased competition; induction of advanced banking and risk management techniques; diversification in resource mobilization of the country; and facilitation of foreign trade and investment. In the case of Korea, while benefits appear to be dominant and costs non-existent or minimal, this observation has not been tested by a field survey. Foreign banks contributed to higher competition and introduction of new banking and financial techniques and helped Korean companies expand foreign trade with new clients.

3. Indonesia and Malaysia

The share of foreign banks' loans in total loans has been checked to examine whether foreign banks in Indonesia were pro-cyclical or counter-cyclical after the crisis. Table 6 shows the share of foreign and joint banks in the period 1996- 2001. The share, which remained at 9.4 percent in 1996, has risen every year till 2000 when it reached 27.7 percent. Growth rate of foreign and joint banks loans have been higher than that of domestic banks in this time when Indonesian economy was severely depressed, foreign capital flows reversed, and enormous financial and corporate restructuring efforts were made. This pattern notes that foreign banks' lending was more counter-cyclical and stable than domestic banks', contributing to financial and economic recovery and private sector investment. Sector lending performance indicates that the share of foreign banks' loans to manufacturing has steadily increased in the post crisis period but services and trade sectors suffered a sharp decline in the same period. It should have also contributed to manufacturing of goods for exports and employment opportunities.

In Malaysia, the share of foreign banks' lending in total lending has been stable at 23-24 percent but increased steadily year by year since the crisis (Table 9). The rate of increase of foreign banks' lending appears to be slightly higher than that of domestic banks' since the crisis. Foreign banks in Malaysia did not cut down their lending level after the crisis, rather showing a counter-cyclical lending pattern which must have contributed to the country's economic recovery, employment creation and financial stabilization in this period.

Table 6: Credits of Foreign and Joint Banks, Indonesia
(trillion Rp)

	1996	1997	1998	1999	2000	Nov 2001
Foreign & Joint Banks (A)	27.6	48.6	66.7	50.0	74.4	74.9
All Banks (B)	292.9	378.1	487.4	225.1	269.0	303.0
Share (A/B, %)	9.4	12.8	13.7	22.2	27.7	24.7

Source: Bank Indonesia, *Indonesian Financial Statistics*, December 2001

Table 7: Growth of GDP and Bank Credits, Indonesia
(%)

	1997	1998	1999	2000	2001 (est)
GDP (current) (real)	17.8 4.7	57.6 -13.1	13.0 0.9	15.3 4.8	13.0 3.3
Credits (Foreign and Joint Banks)	76.1	37.2	-25.0	48.8	0.7
Local Banks	24.1	27.6	-58.4	11.1	17.2

Source: Asian Development Bank, Statistical Data Base System (SDBS) and Bank Indonesia, *Indonesian Financial Statistics*, December 2001

Table 8: Credits of Foreign and Joint Banks to Economic Sectors, Indonesia
(%)

	1996	1997	1998	1999	2000	Nov 2001
Agriculture	1.4	2.7	2.5	3.4	3.8	3.2
Mining	1.4	1.9	2.2	3.8	4.3	1.2
Manufacturing	55.4	59.3	61.9	62.4	65.5	65.6
Trade	17.4	15.6	16.5	14.4	6.5	6.5
Service Industry	18.5	16.5	14.2	12.4	12.4	15.0
Others	5.8	4.1	2.7	3.6	7.5	8.5
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank Indonesia, *Indonesian Financial Statistics*, December 2001

Table 9: Credits of Foreign Banks, Malaysia
(billion ringgit; end-of-period)

	1996	1997	1999	20001	2001 (Nov)
Foreign Banks					
Assets	80.1 (22.2)	87.5 (22.5)	109.1 (22.6)	124.0 (24.2)	130.0 (24.9)
Loans	50.3 (23.1)	55.6 (23.6)	68.0 (23.8)	72.1 (23.8)	80.3 (24.6)
Domestic Banks					
Assets	280.0 (77.8)	300.8 (77.5)	373.6 (77.4)	388.7 (75.8)	392.6 (75.1)
Loans	167.6 (76.9)	179.9 (76.4)	216.6 (76.2)	231.2 (76.2)	245.8 (75.4)
Country Total					
Assets	360.1 (100.0)	388.3 (100.0)	482.7 (100.0)	512.7 (100.0)	522.6 (100.0)
Loans	217.9 (100.0)	235.5 (100.0)	285.2 (100.0)	303.3 (100.0)	326.1 (100.0)

Source: Bank Negara Malaysia, *Monthly Statistical Bulletin*, December 2001, Kuala Lumpur.

Table 10: Growth of GDP and Bank Credits, Malaysia
(%)

	1997	1998	1999	2000	2001 (est)
GDP (current) (real)	11.1 7.3	0.5 -7.4	6.0 6.1	13.5 8.3	6 0.4
Loans :Foreign Banks	10.5	11.1(est)	11.1(est)	6.0	13.1
Local Banks	7.3	10.2(est)	10.2(est)	6.7	7.9

Source: Bank Negara Malaysia, *Monthly Statistical Bulletin*, December 2001, Kuala Lumpur.

V. COMPARATIVE ASSESSMENT OF FINANCIAL OPENING POLICIES

Many studies indicate that the opening of financial services involves both advantages and risks. Advantages include reduction in unit costs by facilitating economies of scale, increasing competition, reducing price markups, and increasing managerial efficiency (Cecchini 1988). Local consumers can benefit from increased competition and access to foreign expertise in several ways: a wider choice of financial products; better credit assessment procedures and information services; faster access to advanced services; and increased availability in credit. However, there are also reservations to market opening, of which the most noteworthy would be the following argument: the opening is often accompanied by capital account liberalization, and banking and financial crises in most cases are associated with capital account liberalization or wrong sequences of liberalization measures.

The debate on the source of the Asian financial crisis has uncovered several causes of the crisis, but the root cause would be the serious mismanagement of huge overseas borrowing by *domestic* (not *foreign*) banks and finance companies and business corporations. International hedge funds, the size of which was much smaller than bank borrowing, also played a significant role, though it is not the primary factor. All these are associated with the capital account liberalization of the crisis-hit countries, which had been actively pursued since the late 1980s in these countries. By contrast, the size of foreign banks' lending and assets remained too small to be a major contributor to the crisis.

Table 11: Comparisons of Domestic and Overseas Interest Rates before the Crisis[1/]
(Percent p.a., period average)

	1993	1994	1995	1996	1997	1998	Oct 1999
Indonesia	20.6	17.8	18.9	19.2	21.8	32.2	22.8
Korea, Republic of	8.6	8.5	9.0	8.8	11.9	15.3	9.0
Malaysia	9.1	7.6	7.6	8.9	9.5	10.6	6.8
Thailand	11.2	10.9	13.3	13.4	13.7	14.4	8.3
LIBOR[2/] (US$)	3.64	5.59	6.24	5.78	6.08	5.53	5.7(Jul)

[1/] *Commercial bank lending rates, unless otherwise stated.*
[2/] *For one year*
Source: Kim (2000)

Table 12: Purchasing Power Parity of Crisis Economies' Currencies before the Crisis
(1990 = 100)

	1990	1991	1992	1993	1994	1995	1996
Indonesia							
Relative price (I)	100	104.9	109.6	119.7	128.0	135.7	140.6
Exchange rate(II)	100	105.8	110.2	113.3	117.3	122.0	127.1
PPP(II/I)	100	100.9	100.5	94.6	91.6	89.9	90.4
Korea							
Relative price (I)	100	104.9	108.1	110.0	113.9	115.8	118.1
Exchange rate(II)	100	103.6	110.3	113.4	113.5	109.0	113.7
PPP (II/I)	100	98.8	102.0	103.1	99.6	94.1	96.3
Malaysia							
Relative price (I)	100	100.2	101.8	102.4	103.5	106.0	106.7
Exchange rate(II)	100	101.7	94.2	95.2	97.0	92.6	93.0
PPP(II/I)	100	101.5	92.5	93.0	93.7	87.4	87.2
Thailand							
Relative price (I)	100	101.4	102.4	102.8	105.4	108.4	111.5
Exchange rate(II)	100	101.4	101.8	101.0	99.6	100.1	101.5
PPP(II/I)	100	100	99.4	98.2	94.5	92.3	91.0

* Overvalued if the PPP number is less than 100; undervalued if it is over 100.
Source: Kim (2000)

Immediately before the crisis from the early 1990s to the second quarter of 1997, *domestic* commercial banks, finance companies and large corporations continued to borrow enormous short-term funds from international banking markets. The borrowing was spurred by a big difference between domestic and foreign interest rates and a rigid foreign exchange policy in the crisis-hit countries which resulted in significantly cheaper financing through overseas bank borrowing.[16] The misalignment of interest and foreign exchange rates is shown in Table 11 and 12.

Among the countries reviewed by the paper, namely, PRC, Indonesia, Korea, Malaysia, Singapore and Thailand, Korea's financial markets are most liberalized, followed by Singapore and other ASEAN countries (a summary in Table 13). Foreign equity holding in Korea is allowed up to 100 percent for any kind of financial institutions, while other countries restrict it to below 50 percent in general. Commercial presence of *all* kinds of foreign financial institutions is possible in Korea. Participation in capital markets is much easier in Korea than in the four ASEAN countries. Both corporate and government bond markets have been fully opened to foreigners since December 1997, while in May 1998 ceilings of stock investments by foreigners in non-state-owned enterprises were removed. This action has promoted a large amount of foreign portfolio investment in Korea since 1998. Foreigners' share in stock market in Korea in 2001 was as high as 36.6 percent compared to Japan 12.4 percent, Singapore 9.6 percent and Taipei,China 9.4 percent.

An interesting feature of Korea's liberalization is that the country has opened its domestic markets more actively in the post crisis period than in the pre crisis period.[17] Singapore has taken a similar policy, while other ASEAN countries have not taken new major measures since the crisis but generally kept the commitments originally made in 1998. This difference and its implications deserve a careful study. A comparative study on the Korean and the ASEAN pattern will be able to draw some interesting and useful

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16 For details, see Kim (2000).

17 Foreign investment in Korea: (i) Foreign direct invesment $52 billion for 1998-2001 ($24.6 billion for 1962-1997); Foreign portfolio investment $29.1 billion for 1998-201 ($17.8 billion for 1962- 1997); Foreigners' share in stock market as of 2001 – Korea 36.6%, Japan 12.4%, Taipei,China 9.4, and Singapore 9.6%.

lessons. In terms of economic growth and financial restructuring since the crisis, Korea has performed better than the other crisis-hit countries. The question is whether such better performance has encouraged the Korean government to expedite opening of domestic markets or the active opening policy has rather contributed to the fast growth and restructuring. Given that most of liberalization measures were taken not long after the eruption of the crisis in Korea, the latter appears to be more convincing. It implies that financial opening has had significant positive impact on the domestic economy and financial markets in Korea. Also it should be noted that foreign banks' lending has been more counter-cyclical than domestic banks' in Korea (Section IV).

Relationship between Financial Opening and Economic Growth

Foreign banks in these countries are generally concentrating their business on expatriate home-country enterprises. There are two views on the role of foreign banks in developing countries (Clark et al. 2000). The first referred to as the traditional view (Aliber 1984) is that foreign banks follow their domestic clients to finance their trade and service their needs in other countries. The second view envisions a more active role by foreign banks in the development of the host country's banking sector. Drawing on the theory of comparative advantage, the second view posits that foreign banks can use management technology and banking expertise developed for their home use at a very low marginal cost abroad. In the ASEAN countries in general (except for the Singapore offshore market), the role of foreign banks is basically consistent with the first view. In Korea, however, some foreign banks such as the Citibank are rapidly penetrating into local clients, with having more positive and deep impacts on the local banking sector. Foreign banks are generally enjoying more advanced banking techniques than local banks, and thus contribute to induction of new techniques into local markets. Foreign banks hold comparative advantages particularly in risk analysis and management, loan project assessment, credit analysis, portfolio management and computerization.

Table 13: Highlights of Individual Countries' Opening of Financial Services within GATS

Country	Banking	Equity Holding (financial institutions)	Presence of natural persons	Other Restrictions
Indonesia	Branch offices only 10 cities in principle. Foreign-Indonesian joint ownership allowed with existing banks, but a new license not allowed for GATS.	Local existing bank: 49 % of the listed shares. Non-bank finance company listed in the stock exchange: 100% Others: 49%	Expatriate directors, managers, experts, advisors can be assumed for 3 years and can be extended. Manager or technical expert requires two Indonesian understudies at minimum.	Cross-border supply and consumption abroad generally prohibited. Securities brokers must establish a local company to run the business.
Korea	No restriction in general. In 1998 after the crisis, most restrictions were removed to increase the commercial presence.	100% for any kind of financial institution. Stock investments in private companies 100% (May 1998). Bond markets fully open.	Allowed. Korean banks can recruit foreign nationals as directors (May 1998).	Cross-border and consumption abroad partially allowed for banking and investment advisory
Malaysia	The 13 wholly foreign-owned foreign banks are permitted to remain wholly foreign owned. New licenses are not allowed.	Entry of foreign banks is limited to equity participation in local commercial banks and merchant banks. Aggregate foreign shareholding in a bank shall not exceed *30 %*. Securities company (a locally incorporated joint-venture): not exceed 30 percent	Not allowed except for temporary presence of senior managers and specialists in relation to the commercial presence.	Regarding the cross-border and consumption abroad, similar to Indonesia above. Offshore institutions allowed in Labuan.
Singapore	One office only and cannot establish off-premise ATMs and new sub-branches. Money and foreign exchange market transactions generally unrestricted.	Banks: 40% Insurance: 49% of locally owned insurance companies. Securities companies: unbound	Unbound, except for intra-corporate transfers of managers, executives, and specialists. Limited to a three year period that may be extended for up to two additional years	Regarding the cross-border and consumption abroad, similar to Indonesia above, but insurance allowed.
Thailand	Commercial presence generally no restrictions for existing foreign bank branches. (Foreign bank share: zero in 1997, six percent at December 2000)	Foreign equity participation up to 49 % in principle. But the following only 25%: life and non-life insurance, local incorporated banks, securities companies.	Unbound except a corporate transfer of the managerial or executive level or a specialist for a one year period (altogether for not more than three years)	Regarding the cross-border and consumption abroad, similar to Indonesia above. Foreigners are not allowed to purchase or own land.

VI. CONCLUDING REMARKS

The four ASEAN countries studied in this paper have been retaining their original commitments since 1998, while Korea has revised the original significantly in 1999 and PRC has just become a member of WTO. Given this, the ASEAN countries may have to consider substantial revisions, particularly in response to the Doha agreement. In opening of financial services, however, it is advisable to take these three guiding principles into account: (i) **resource mobilization** for economic recovery and sustained development, (ii) **financial stability**, and (iii) **market competition**. Some policy suggestions within this context are presented below.

First, ASEAN countries may have to consider more active liberalization of financial services in light of their extensive economic exposure to foreign trade and global economy as well as the immense need for foreign capital and financial services. Although economic circumstances in these countries are different from those in Korea, they may draw valuable lessons from the Korean experience after the crisis in order to figure out the best liberalization strategy. The ASEAN countries are committed to not only the GATS but also to the ASEAN Framework Agreement on Services (AFAS) born out of the ASEAN Bangkok Summit in 1995 which provides a basis for liberalization of seven areas of services, i.e., banking, tourism, air transportation, maritime transportation, telecommunications, construction and professional services. However, the scope of commitments either in the GATS or in the AFAS is not broad enough and the speed of progress in liberalization is slow.

Second, sequencing of liberalization is of prime importance. From this viewpoint, the priority should be placed on banking markets first in the next round of financial opening. Foreign banks bring foreign capital, facilitate foreign investment through their support for foreign investors' trade and production activities in the host country, increase market competition in the banking sector. This paper found that foreign banks' lending attitude is more counter-cyclical than domestic banks. In the case of Singapore, it would be important to develop its offshore financial market in a more vigorous manner within the context of its goal to transform it to an international financial center.

Third, Indonesia, Malaysia and Thailand should consider further opening of other non-bank financial markets in such a manner to minimize inflows of short-term speculative money and at the same time promote foreigners' long-term direct investment in local infrastructures and productive sectors. Opening of leasing, guarantees, local bond markets, underwriting of international bonds issued by domestic enterprises, and foreign direct investments in local banks/securities companies are consistent with this objective. In any case, each country needs to carefully envision its long-term financial sector objectives through undertaking a thorough research study, and then formulate short- and medium-term negotiation strategies to maximize benefits of financial opening.

Fourth, issues on“ commercial presence” of foreign suppliers should be first addressed, followed by those on "cross-border" supplies given that the latter involves free movements of services, capital and information (e.g., international hedge funds) without sufficient supervisory mechanisms in place.

Fifth, it is crucial to implement sound capital account policies in parallel with financial opening, given that opening of financial services is closely associated with capital account liberalization, as stated in Section II. A great lesson drawn from the Asian crisis is that it is not advisable for developing countries to fully liberalize their capital accounts until effective regulatory and supervisory regimes for their financial systems are operational and appropriate macroeconomic policies, including a well-aligned exchange rate regime, are in place.

Lastly, domestic equity markets need to be opened in a phased manner taking into account capital market development, corporate sector capacity, and the urgency for foreign currency savings. It is also important to establish regulations to prevent sudden and large capital flights, while financial authorities monitor capital flows so that they may take relevant policy actions if necessary. Equity investment flows into and out of a country are determined by many factors, both external and domestic. Domestic factors include economic reforms, capital control, explicit and implicit government guarantees, and transparency and disclosure of information (Islam 2000). External factors include changes in interest rates in the U.S., terms of trade shocks, and increases in international risk premia. Some suggest that external factors are more important (e.g., Calvo et al 1993), while others argue domestic factors are equally or more important (e.g., Chuan et al 1998 and Islam 2000). It is essential that each country understand which factors are more relevant to it.

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