“WTO accession and financial liberalization in developing countries: assessing the evidence”

working paper

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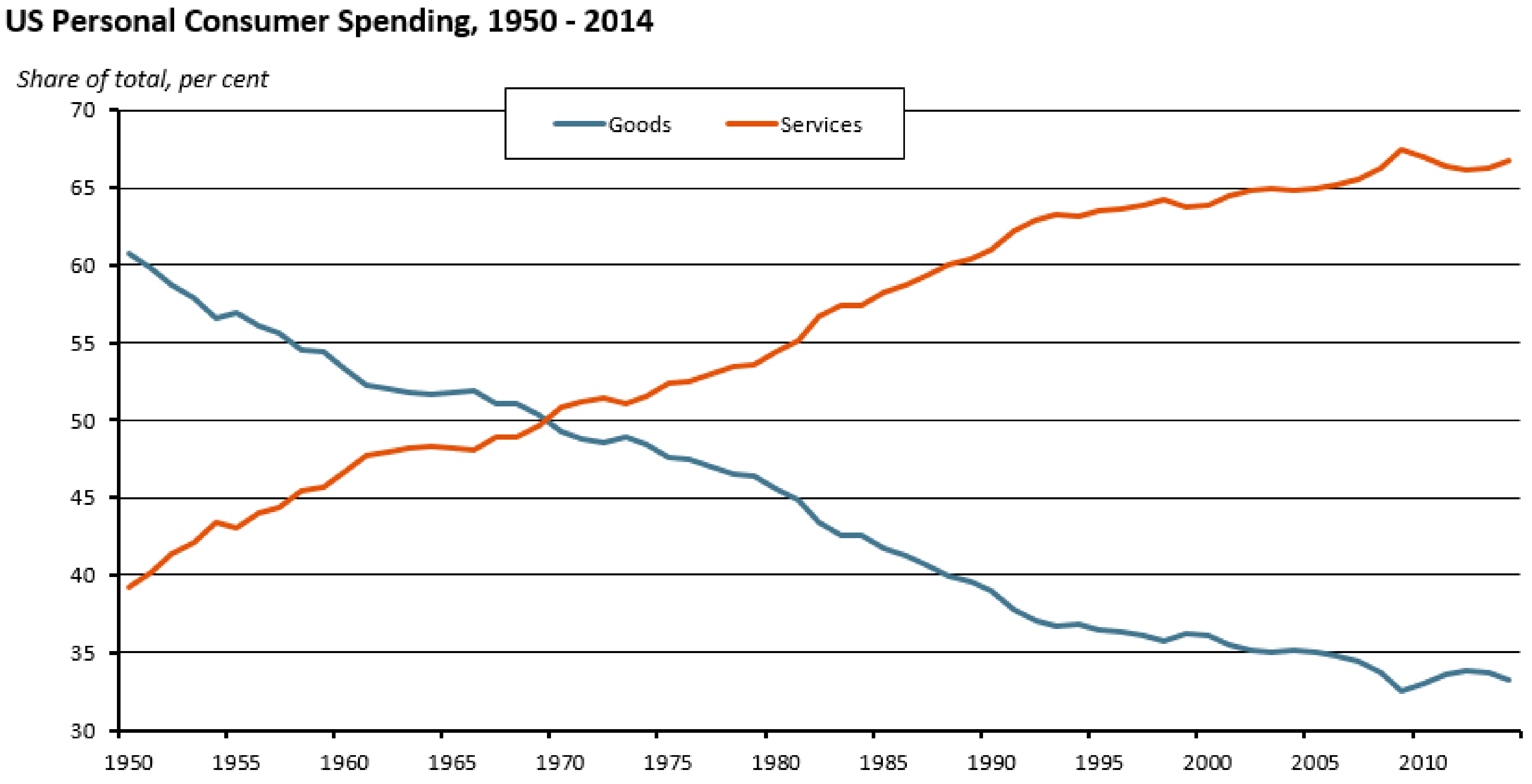
Introduction

- Why financial services trade important?
- How WTO regulates financial services?
- Does liberalization lead to financial development?
- What is evidence from developing countries?
- What are implications for Uzbekistan?

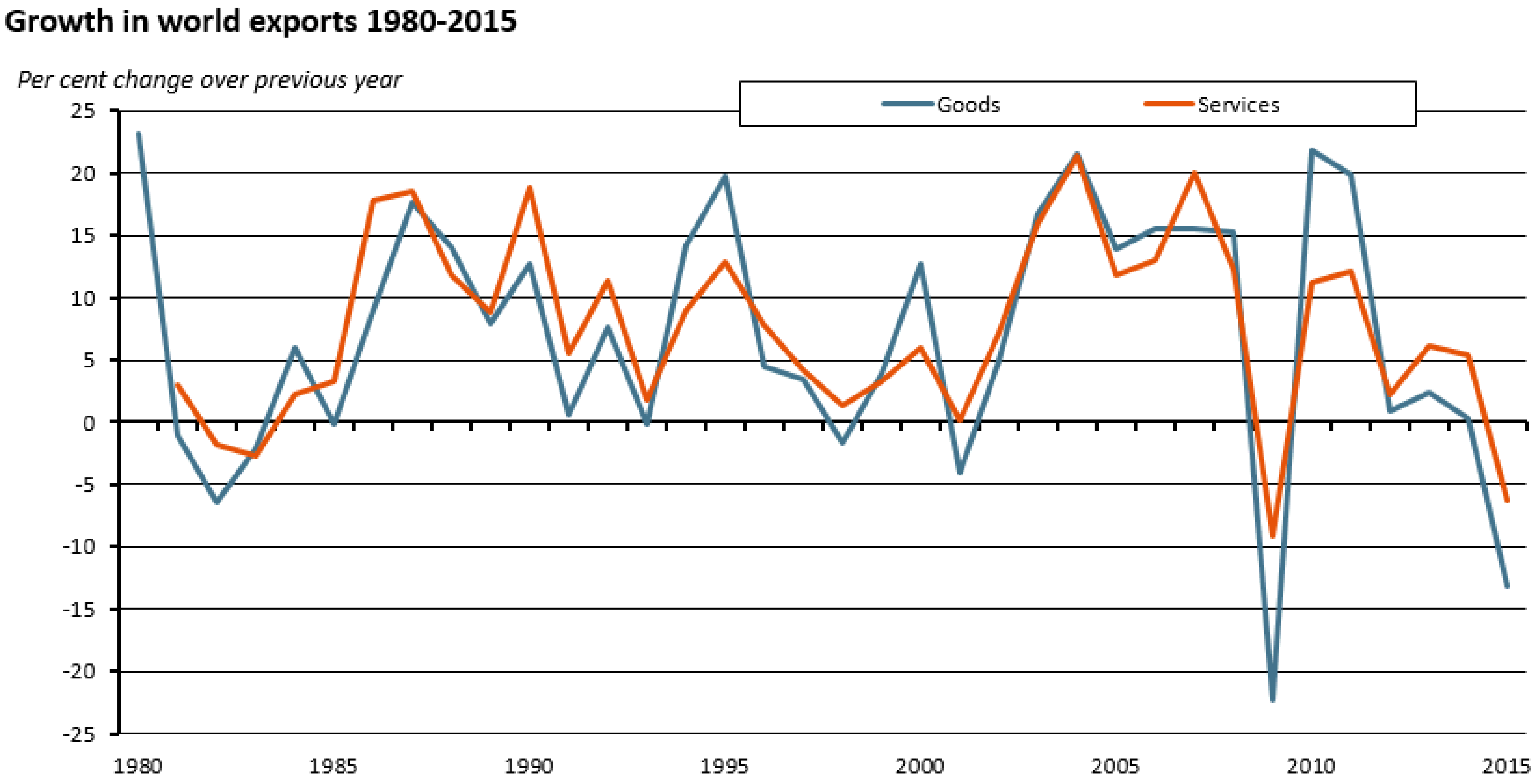
World export volumes: Goods vs Services

The dematerialisation of consumption: ‘peak stuff’



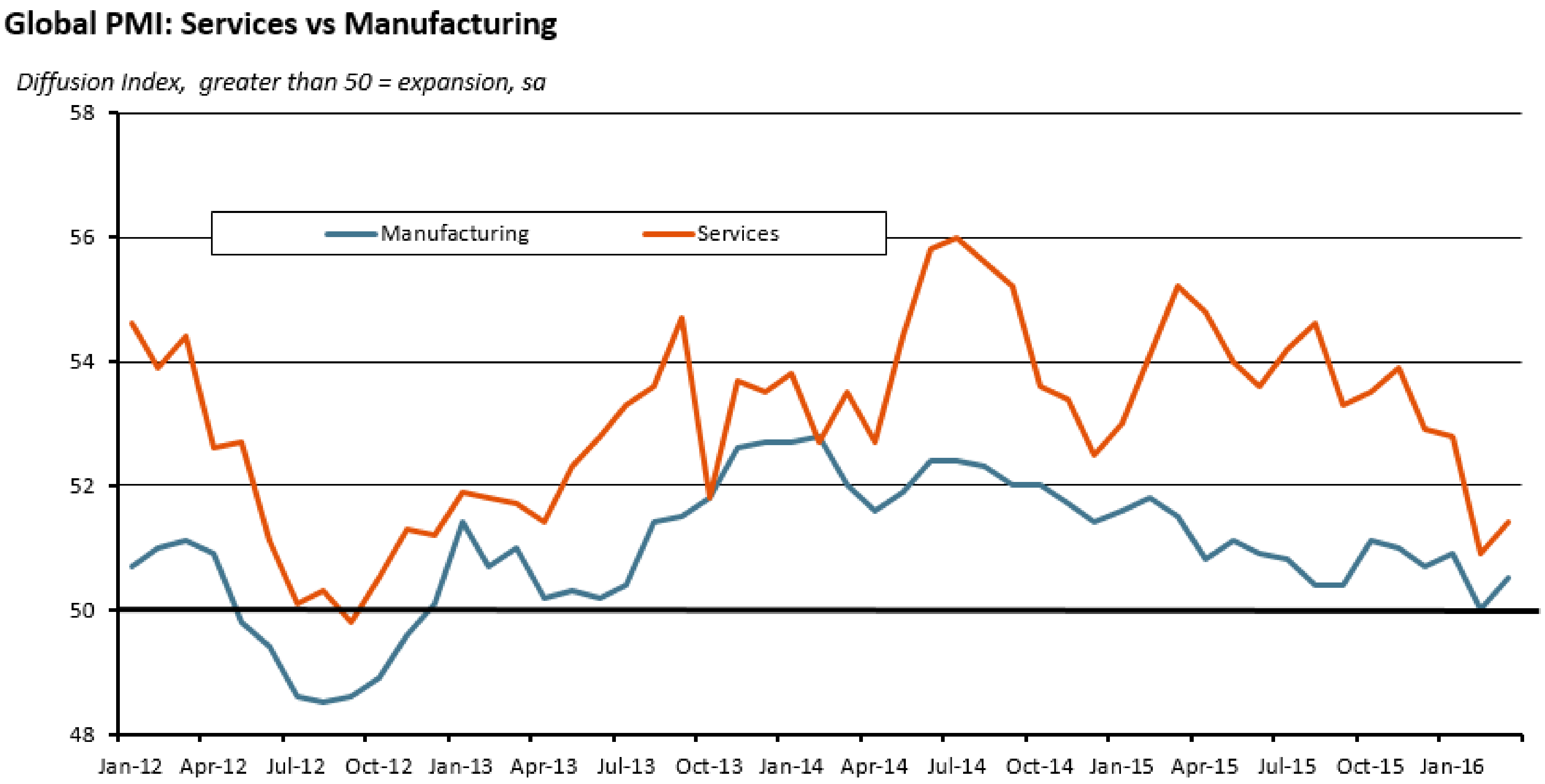
Source: US Bureau of Economic Analysis.

World export values: Goods vs Services



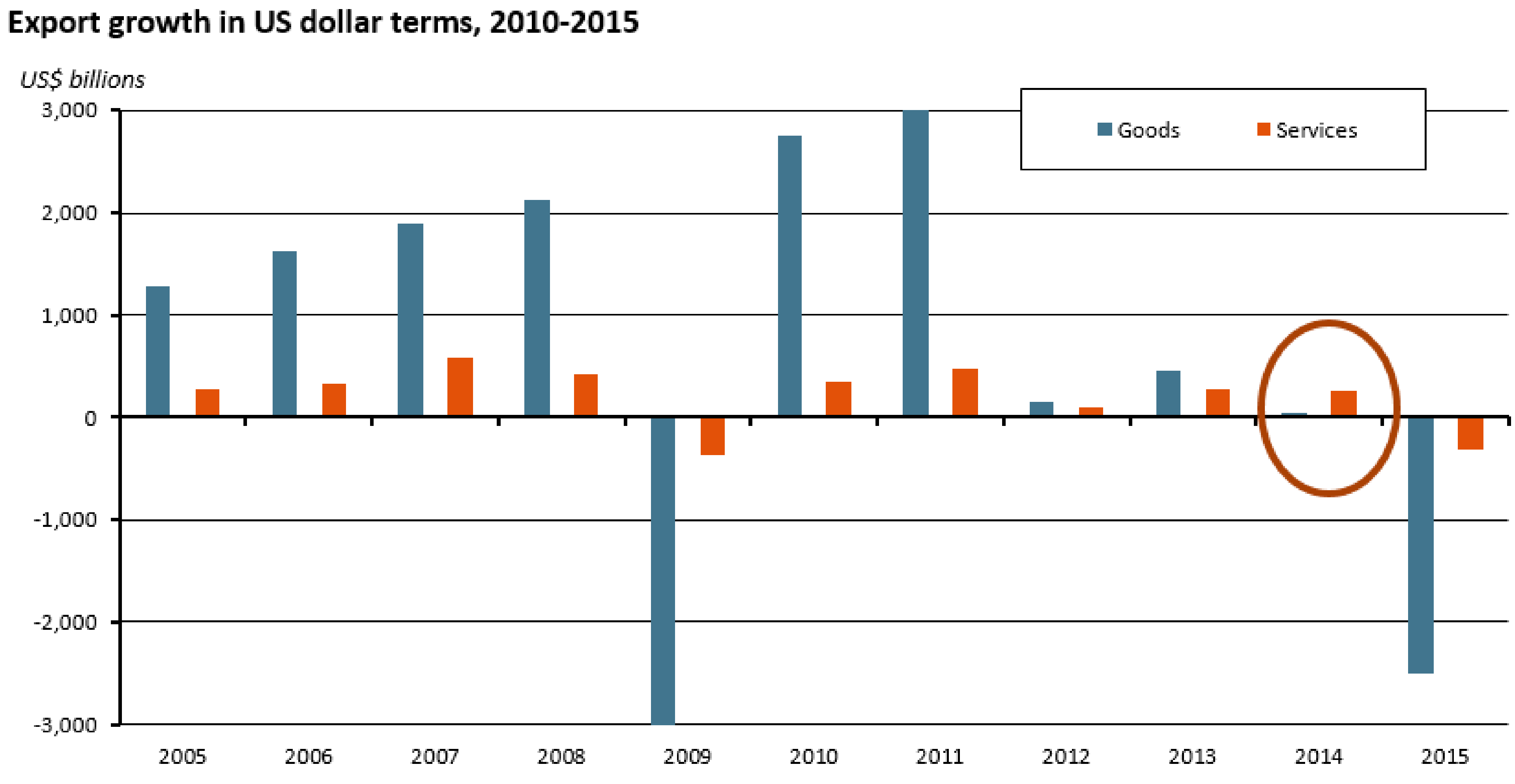
Source: UNCTAD database. Note series break for services in 2010.

Services have (had?) outperformed



Source: JP Morgan and Markit

2014 was an historic year for services trade . . .



Source: UNCTAD press release April 2016 and UNCTAD database

Part I.
Regulatory framework: WTO agreements on Financial services

GATS

Agreements identifies four modes in which services can be provided internationally:

- Mode (1) Cross-border-supply
  - eg. taking loan from a bank located in another country
- Mode (2) Consumption abroad
  - Purchasing financial services while traveling abroad
- Mode (3) Commercial presence
  - Foreign bank presence
- Mode (4) Presence of persons
  - Financial consultants traveling abroad

GATS: principles on financial services trade

- Transparency
  - Openness and clarity of rules on trade financial services
- most-favourate-nation (MFN)
  - Equal treatment of financial services providers from all WTO countries, but
  - Qualified: may be limited to specified sectors
- National treatment
  - Equal treatment of foreign and domestic services provider, but
  - May be limited

GATS: market access limitations

a) number of suppliers;
b) value of service transactions;
c) total number of service operations;
d) total number of natural persons that may be employed;
e) types of legal entity or joint venture;
f) participation of foreign capital

Annex on financial services: prudential carve-out

Paragraph 2(a): Prudential carve-out

"*Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system.*"

- Allows countries to protect domestic financial market against financial instability
- Establish strict criteria for prudential measures, so that they are not to lessen country's commitments on Market Access

5^{th} Protocol to gats

also known as 'Understanding on Commitments in Financial Services'

- Endorsed by 61 countries (mostly developed, and by new WTO entrants)
- Specifies Market Access commitments for which GATS, GATS Annex of Financial Services apply

5 th protocol and domestic financial system reform

- Bind the status quo, achieved after liberalization
- Binding below the Status Quo
- Making commitments for future liberalization

Discussion: Merits and limitations of wto rules on Financial services

- Merits:
  - Legal framework for supply of internal financial services;
  - Multilateral platform for increasing Market access for financial services trade;

- Limitations:
  - not universal coverage (pluralateral agreement);
  - qualified Market access:
    - Limited progress in mode 1 and mode 3;
    - Existence of barriers on Market access;

Discussion: selected issues on market access

- Economic needs’ test
- Limits on foreign investments in domestic institutions
- Limits on permissible activities of foreign banks
- Transparency deficit and Tax disadvantages

DISCUSSION: reforms of wto financial services regulation

- Slow progress in multilateral liberalization of financial services;
  - Due to global financial crises that shook off countries' plans for further liberalization;
  - Regional, bilateral negotiations.

- Different interests of developing and developed nations
  - EU and OECD offers;
    - EU wants more developing countries to join the 5^{th} Protocol
    - Rationale – more benefit for developing countries in form of investments (under mode 3)

  - Developing and emerging economies
    - "watching and waiting" position,
    - using FS commitments for bargaining in negotiations with developed nations to get Market access e.g. in Agriculture

FSA: risks for developing economies

- Big gap in development levels of financial sector between advanced and developing economies.

- Foreign banks are likely to operate in most profitable sectors on expense of local companies

- Local deposits in foreign banks might be invested abroad (flight of capital)

FSA reform calls

- Financial crises in 2008 made developing economies to reconsider their liberalization commitments
    - Stiglitz commission (2011) recommended change of FSA with regard to rules on capital account transations

- have not worked yet, since Developing economies, in case of re-regulation, risk:
    - 1) WTO sanctions
    - 2) compensation for trading partners for damage from worsening trading terms

WTO and financial sector development: empirical evidence

- Existing research mostly focuses on relationship between Financial openness and financial development/economic growth, but
- Research on impact of WTO on financial sector is limited;
- Most important research IMF working paper “WTO Financial Services Commitments: Determinants and Impact on Financial Stability” (2002);

IMF paper highlights:

- Study compares financial commitments of WTO members for the period of 1995-99 with pre WTO establishment period 1990-94;
- Study divides countries to low- and high- commitment countries;
- Tests correlations between commitments and actual policies (using Heritage Foundation policy restrictiveness indicators);
- Addresses the question of what systemic factors influenced commitments of WTO members applying the ordered-choice model;
- Concludes liability position relative to IMF, growh, trade openness, population growth, policy restrictiveness indicators explain fin. commitments (with R2 between 0.25 – 0.60, good for cross-country regressions).

IMF paper highlights (continued):

- Countries with liabilities position against IMF had higher commitments;
- Countries with increased trade openness had less commitment in financial services;
- Countries with higher financial development indicators adopted more commitments;

- Limitations: study focused mostly on developed economies and did not include new accessions.

New accessions to WTO and financial commitments

- All new accessions to WTO made it compulsory for a new member to commit to FSA;
- New members had no choice but to join to fifth protocol of GATS, as it was a condition for joining the WTO;
- Number of countries had transition periods to keep markets protected, but usually limited for 5 years;
- See: schedule of commitment example

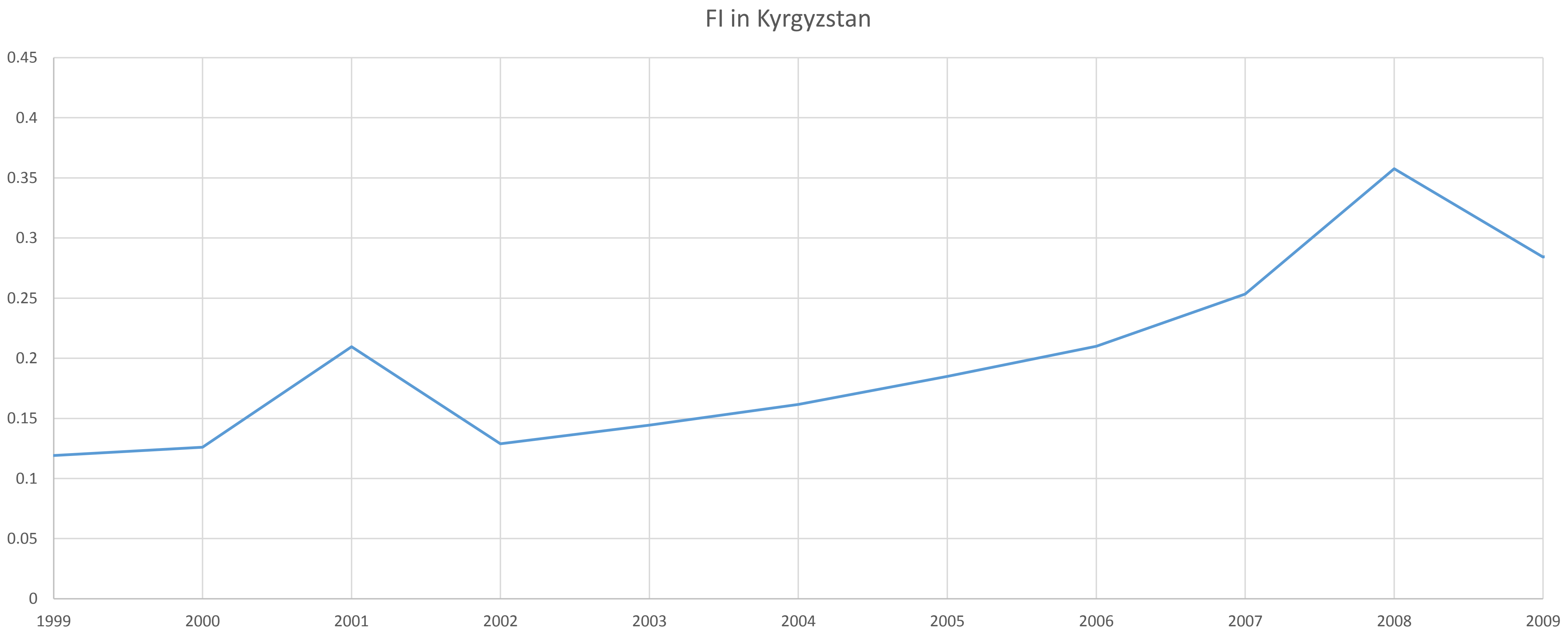
WTO accession and Financial Development

- Case of new accessions shows some impact of WTO accession to Financial development;
- IMF's new broad-based Index of Financial development measures FD based on Financial Institutions development and Development of Financial markets;
- Impact of WTO accession is evident in Financial Institutions (FI) index, but negligible in Financial Markets (FM) index;

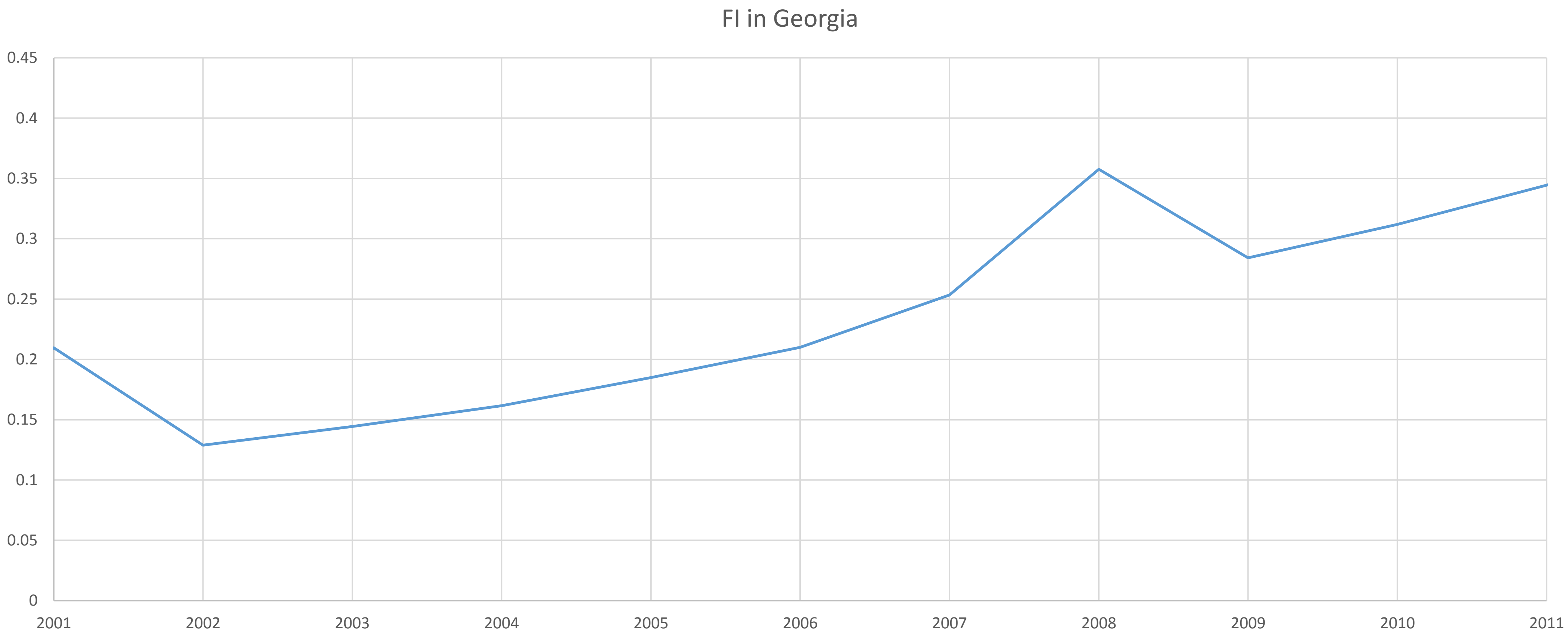
- Financial institutions index:

  Aggregated index measuring depth (private-sector credit to GDP), access (ability of individuals and companies to access financial services), and efficiency (ability of institutions to provide financial services at low cost and with sustainable revenues).

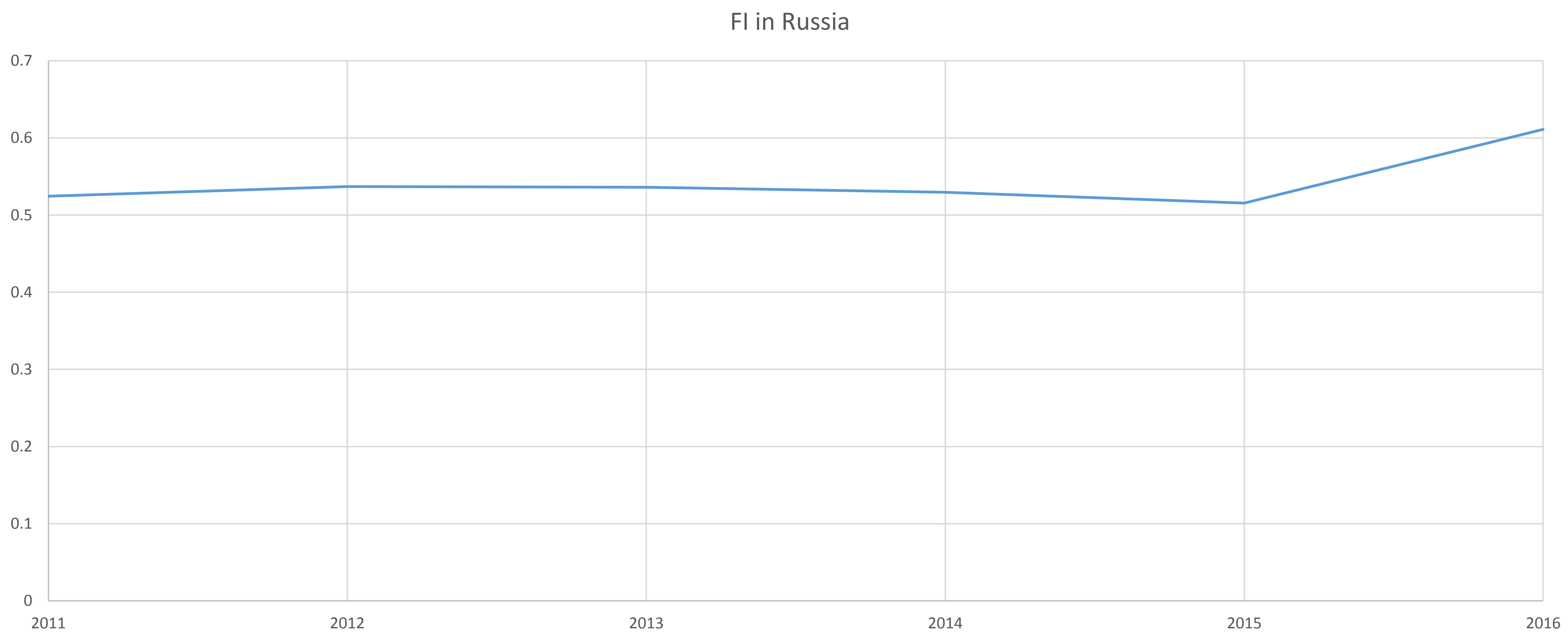
Kyrgyzstan (WTO member since 1998)



Georgia (WTO member since 2001)



Russia (WTO member since Jan 2012)



Uzbekistan’s accession to WTO: possible implications for financial sector

WTO accession: key areas of negotiations

Acceding country has to liberalize trade in:

- Goods;
- Services;
- and enforce Intellectual property rights.

- Financial services – sensitive area of negotiations, since it is important for the development of the whole economy

Financial sector of Uzbekistan I

Uzbek financial sector characteristics:

- 80% of assets of banks owned by the state
  - National bank of Uzbekistan – ab 50% of total assets and total capital of banking system;
  - State maintains stakes in biggest banks and effectively controls decision making;
- Insurance bank dominated by state
  - Single state run company Uzbekinvest controls 70% of market

Financial sector of Uzbekistan II

- Financial sector of Uzbekistan – relatively small in international comparison
  - Broad money (M3) to GDP is below 20% of GDP
  - Insurance companies assets less than 1% of GDP
  - Securities/equity markets are at rudimentary state
- Financial sector reforms – limited and focus on supervision and financial institutions stability
  - Private banks allowed, but under stringent licensing requirements
  - Foreign ownership of banks and financial institutions limited
    - 50% of stocks of banks need to be controlled by state
    - Only foreign insurance company INGO – with 25% stock ownership by the state

WTO accession negotiations

- Acceding country has to accept WTO rules, which are two types: mandatory and negotiable
  - Mandatory rules: non-discrimination, transparency and commitment for progressive liberalization
  - Negotiable rules: conditions on Market access (how far to open markets)

- Financial sector: negotiations focus on commercial presence of financial institutions
  - New members have higher commitments on Market access
  - China, Russia, Kazakhstan had commitments higher than commitments of some developed economies
  - Uzbekistan is likely to enter with high commitments in Financial sector

WTO accession: possible implications for Uzbek financial sector

- WTO accession will help transition to market economy
- Increased competition
- Risk of default of local banks

- WTO accession will create winners and losers
- Winners
  - Domestic consumers of financial services – greater choice and higher quality of services;
- Losers
  - Local banks

Summary

- WTO accession will allow foreign entry to financial sector of Uzbekistan
- Bank regulation is like to improve in line with international standards
- Competition will increase and quality of services will improve
- Relocation of customer base and savings from local to foreign banks
- Local banks will have to improve or leave the market
- Overall, economy is likely to benefit from more efficient and stable financial system in Uzbekistan

THANK YOU FOR ATTENTION!