



Independent Evaluation Office  
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# BACKGROUND PAPER



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## **Trade in Financial Services—Has the IMF Been Involved Constructively?**

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Independent Evaluation Office  
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**Abstract**

This paper considers the key policy issues related to liberalization of trade in financial services that the IMF should be concerned with, and the role the IMF has played in advising on policies related to trade in financial services in its bilateral and multilateral surveillance and conditionality attached to lending programs. IMF staff were generally aware of the literature and country experiences showing the benefits of financial liberalization. But Fund advice in support of liberalization can be best interpreted to be in support of country unilateral policy actions and the dynamics of the WTO accession process.

The views expressed in this Background Paper are those of the author(s) and do not necessarily represent those of the IEO, the IMF or IMF policy. Background Papers report analyses related to the work of the IEO and are published to elicit comments and to further debate.

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## I. INTRODUCTION

1. Attention has focused especially in the past few years on the importance of issues concerning trade in services in light of the macroeconomic interests of the IMF. IMF (2005b) pointed to the critical role of services issues for competitiveness, the difficulties posed by limitations on the availability of data covering restrictions on services trade, and the indications that protection of service sectors is relatively high especially compared to that of manufactures.

2. In this context, this paper will describe/assess the following three broad issues:

- (i) What key policy issues related to liberalization of trade in services should the IMF be concerned with, and on what existing standards of evidence should the IMF base its approach(es) to these issues?
- (ii) What role has the IMF played in advising on policies related to trade in services in its bilateral and multilateral surveillance and in conditionality attached to lending programs?
- (iii) What is the overall assessment of the IMF's involvement in trade in services liberalization?

3. In considering services, an obvious starting point is to note the characteristics of services, which are that they are intangible, invisible, and perishable, requiring simultaneous production and consumption. Goods, in contrast, are tangible, visible, and storable, and hence do not require direct interaction between producers and consumers. An indication of the scope of services is provided in Box 1, which is based on the framework of the General Agreement on Trade in Services (GATS)—a component of the World Trade Organization (WTO).

4. It should be evident from the GATS categorization of services that, except for financial services, which will be the focus of this paper, most services do not come under the direct purview of the IMF and instead are subject to the rules and operational responsibilities of the WTO and the World Bank. This is not to say that nonfinancial services do not affect a country's macroeconomic conditions and policies. Rather, the point is that such effects may be primarily indirect in character and better left to the other international institutions.

### Box 1. Scope of Services Covered in the GATS

1. Business services
2. Communication services
3. Construction services
4. Distribution services
5. Educational services
6. Environmental services
7. Financial services
8. Health-related and social services
9. Tourism and travel-related services
10. Recreational, cultural, and sporting services
11. Transport services
12. Other services not elsewhere included

5. The modes of delivery of international service transactions can be categorized as follows:
- *Cross-border trade (Mode 1)*: services that are traded internationally across borders. An example is financial services provided by a bank in one country through mail or electronic means to a bank or consumers in another country.
  - *Consumption abroad (Mode 2)*: services that require the consumer to be in the location of the producer. Examples are when consumers from one country travel to another country to consume tourism or education services.
  - *Commercial presence (Mode 3)*: services that require commercial presence in the form of foreign direct investment. An example is a bank or insurance company owned by citizens of one country establishing a branch in another country.
  - *Presence of natural persons (Mode 4)*: services that require the temporary cross-border movement of workers. An example is the foreign employees of a foreign bank providing services on a temporary basis in a country.
6. A country's financial services sector consists of users and providers of financial services and the government agencies that regulate them. Financial services are defined in the GATS Annex on Financial Services to include two broad categories of services: (i) insurance and insurance-related services and (ii) banking and other financial services, such as financial trading, asset management, brokerages, settlement and clearing services, provision of financial information, and advisory services.<sup>1</sup>

## II. LIBERALIZATION OF TRADE IN SERVICES: WHAT ARE THE ISSUES?<sup>2</sup>

### A. Measuring Restrictiveness

7. Barriers to trade interfere with the ability of firms from one country to compete with firms from another. This is true of trade in goods, where a tariff or nontariff barrier typically drives a wedge between the price of the good on the world market and its domestic price. This wedge, or tariff-equivalent, provides a convenient and often observable measure of the size of the impediment. In the case of services, however, such a simple measure is often not observable. Nonetheless, the concept of a tariff-equivalent is a useful way of quantifying a barrier to services trade even though it may be much harder to observe.

8. Since direct price comparisons of domestic and world prices of services are generally not observable, other means of inferring the presence and size of service barriers must be used. Some

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<sup>1</sup> [http://www.wto.org/english/tratop\\_e/serv\\_e/10-anfin\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/10-anfin_e.htm).

<sup>2</sup> This section is adapted in part from Deardorff and Stern (2008), and draws on Gootiiz and Mattoo (2008).

of these methods are direct, in asking governments or participants in services markets what barriers they impose or face. Though the answers they yield are usually only qualitative, indicating the presence or absence of a particular barrier but not its quantitative size or effect, such qualitative information takes on a quantitative dimension when tabulated by sector, perhaps with subjective weights to indicate severity. The result is a set of frequency measures of barriers to trade, recording what the barriers are and where.

9. An example of the foregoing type of measure is provided in Gootiiz and Mattoo (2008), who surveyed actual or applied trade policies in services for the World Bank in 2007 covering 32 developing countries and 24 OECD countries and the four modes of supplying financial services (banking and insurance), telecommunications, retail distribution, transport, and professional services.<sup>3</sup> For each sector and mode of supply, the openness of policy towards foreign suppliers was mapped on a 5-point scale, ranging from no restrictions to highly restricted. The sector results were aggregated across modes of supply, based on weights reflecting judgments of the relative importance of the different modes. Sector restrictiveness indices were then aggregated using sector GDP shares, and country income-group indices were aggregated using GDP weights for the component countries.

10. The 2007 World Bank survey contained a number of specific questions on the different services and modes.<sup>4</sup> For example, with regard to financial (banking) services, mode 3 (establishing commercial presence), the survey asked (i) for greenfield investments, whether foreign banks were permitted to enter as a branch or as a locally incorporated subsidiary; (ii) for entry through acquisition or joint ventures, whether foreign banks could enter the market by acquiring part or all of a local private bank, state-owned bank, or joint venture; the maximum ownership permitted to a single foreign bank; the maximum aggregate foreign investment permitted; and whether a foreign bank could acquire the controlling stake; (iii) if a license was required to establish commercial presence; whether the criteria to obtain a license were publicly available; whether fulfillment of the criteria would ensure that a license was granted; whether the licensing criteria differed between foreign and domestic banks; if the number of licenses was fixed, whether this restriction applied only to foreign banks, and on what basis the licenses would be allocated. Other survey questions that related to banking services addressed regulation, treatment of foreign banks that have a commercial presence, and cross-border trade. A similar set of questions covered the various forms of insurance services.

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<sup>3</sup> The sectors were further disaggregated into banking (retail and merchant), insurance (life, nonlife, and reinsurance), road transport, railway shipping, maritime shipping and auxiliary services, air transport (freight and passengers), accounting, auditing, and legal services.

<sup>4</sup> The questionnaires are available on the World Bank's website: <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTPROGRAMS/EXTTRADERES/0,,contentMDK:20540747~menuPK:791346~pagePK:64168182~piPK:64168060~theSitePK:544849~isCURL:Y,00.html>.

11. As of March 2009, the detailed country results were not yet available. But from the aggregated results reported in Gootiiz and Mattoo (2008) it seems that, on the whole, trade in financial services was relatively restricted, particularly in non-OECD countries. Thus, the liberalization of trade in financial services may be disproportionately a developing country/emerging market issue.

12. Deardorff and Stern (2008) provide illustrations of the specific restrictions applied to banking services and the calculation of restrictiveness indexes for several developing and industrial countries, based on the work of McGuire and Schuele (2000). They also review studies of this type for a number of other sectors and provide a conceptual discussion and illustrations of price-impact and quantity-impact measurements and econometric specifications and estimation, estimates of services barriers based on gravity models, and financial-based measurements. In addition, they discuss how tariff-equivalent and price-impact estimates of services barriers can be incorporated into computational general equilibrium models in order to analyze the economy-wide effects of these barriers. Finally, they set forth a number of principles and recommended empirical procedures for measuring services barriers and for assessing the consequences of their liberalization (Box 2).

13. The survey work being conducted by the World Bank together with the presentation and illustrations of methodologies for the measurement of services barriers (Deardorff and Stern, 2008) suggest that it would be feasible for Fund staff to undertake the measurement of financial services barriers and/or to carry out econometric analysis of the economic effects of these barriers and the benefits from liberalization for a number of IMF members. Because it would be necessary to construct measures of existing financial services barriers for individual countries, such analysis would be best suited for inclusion in the Selected Issues Papers (SIPs) for Article IV consultations.

## **B. Liberalization of Financial Services and the Capital Account**

14. Liberalizing financial services essentially involves deregulating domestic policies and institutions. There are several dimensions to the regulatory process, including: the withdrawal of government intervention through, for example, privatizing state-owned banks, freeing key prices like interest rates to be market-determined, and removing restrictions on the activities that banks can offer. A further dimension is the strengthening of domestic financial institutions and markets, so as to increase the efficiency with which funds are channeled from depositors and investors to borrowers and issuers.

15. More particularly, the liberalization of financial services refers to the removal of quantitative or qualitative regulations that limit (domestic or foreign) market entry or foreign commercial presence or that involve relatively high costs of doing business and as a result effectively make foreign entry unprofitable. Changes in host-country regulations that liberalize domestic financial markets can facilitate greater cross-border trade in financial services and the entry of foreign financial services providers under modes 1-4 as applied to financial services.



**Box 2. Principles and Recommended Procedures for Measuring Services Barriers and for Assessing the Consequences of their Liberalization<sup>1</sup>**

***Principles:***

1. Most barriers to trade and investment in services take the form of domestic regulations, rather than measures at the border.
2. No single methodology is sufficient for documenting and measuring barriers to trade in services. Instead, investigators need to draw upon all available information, including both direct observation of particular barriers and indirect inference of barriers using data on prices and quantities.
3. Because of the special role of incumbent firms in many service industries, regulations do not need to be explicitly discriminatory against foreign firms in order to have discriminatory effects.

***Procedures:***

1. Collect the details of domestic regulations and related policies affecting services firms in the countries, including the manner in which they apply to foreign versus domestic firms, plus quantitative details of their application, such as any percentage or dollar limits that they impose. (Ideally, this information should be collected by systematic surveys of governments and/or firms. However, it may also be possible to infer it less directly from documents prepared for other purposes, such as the commitments that governments made to the GATS in the Uruguay Round and subsequent negotiations.)
2. For each type of regulation or policy, define degrees of restrictiveness and assign scores to each, ranging from zero for least restrictive to one for most restrictive.
3. Construct a measure of restrictiveness by weighting the scores from step 2 based on judgments of the relative importance of each policy using a statistical methodology such as factor analysis to identify the weights or by designing proxy measures, such as dummy variables, to represent particular restrictions. The resulting measures can then be used for reporting the presence and importance of barriers across industries and countries, as well as for providing an input to subsequent analysis.
4. Convert the measures of restrictiveness from step 3 into a set of tariff-equivalents by one or more of the following methods:
  - (a) Assign judgmental tariff-equivalent values to each of the component measures, representing the percentage taxes on foreign suppliers to which each component is thought to correspond at their most restrictive levels.
  - (b) Use data on prices and their determinants as the basis for a regression model that includes an index or other measures of restrictiveness and that estimates the effect on prices.
  - (c) Use data on quantities produced or traded as the basis for a regression model that includes an index or other measures of restrictiveness and that estimates the effect on quantities. This estimate can then be converted to tariff-equivalents using an assumed or estimated price elasticity of demand.
5. Use an index or other measures of restrictiveness or the tariff equivalents constructed above as inputs into a model of production and trade in order to ascertain the effects of changes in the barriers to which they correspond. The appropriate model for this purpose depends on whether sectoral or economy-wide policy changes are to be analyzed. For economy-wide policy changes, the model should be a general equilibrium one, incorporating the full effects of barriers across sectors and countries.

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<sup>1</sup>Source: Deardorff and Stern (2008).

16. Trade in financial services also entails certain GATS obligations with regard to ensuring transparency of regulatory measures, adhering to nondiscrimination according to the most favored nation principle; and making commitments to provide for market access and national treatment for foreign services providers. GATS commitments are not intended to compromise the ability of governments to pursue sound regulatory and macroeconomic policies. In particular, GATS commitments allow considerable freedom to achieve such domestic economic objectives as prudential regulation and macroeconomic policy.

17. Once a country has made formal commitments with regard to liberalizing trade in financial services, the IMF is constrained to avoid advising the country authorities to liberalize slower or less (except for prudential reasons) though the IMF can advise the authorities to liberalize faster or more. Country commitments under the GATS may constrain IMF options for advising member countries on liberalization of trade in financial services. Such constraints will depend on the extent to which individual countries may have limited the opening of their financial sectors in the context of the liberalization that was to be undertaken in the Uruguay Round. Also, countries engaged in the process of WTO accession are often requested by other WTO members to implement liberalization covering various aspects of their financial services at different intervals of time. The WTO accession process may therefore constrain the advice on financial liberalization that the IMF may offer to member countries.

18. Policy reforms that free up the cross-border supply of financial services and market entry for foreign financial services providers are likely eventually to require loosening of restrictions on at least some forms of capital flows. This interrelationship often raises fears about the impact of increased competition, loss of autonomy, and the potential increased volatility of capital flows.<sup>5</sup> The interaction between capital controls and opening the market to foreign financial services providers arises when domestic financial services transactions involve international capital account transactions. While it is possible for some international transactions in financial services to take place without cross-border capital flows, the presence of capital controls may substantially reduce the freedom of firms and households to buy financial services more cheaply from more diversified sources of funds. This may in turn discourage foreign services providers from entering an economy. Opening the capital account, therefore, although a distinct issue from that of financial services policy reform, will sooner or later become an issue to be faced.

19. In principle, domestic regulatory reform and services liberalization can be seen as precursors of capital account liberalization. A sound and diverse financial system will better intermediate volatile international capital flows. But there may not be a one-size-fits-all approach to sequencing financial services liberalization and capital account liberalization.<sup>6</sup> It is important in any event to note that GATS commitments may not oblige a country to allow international capital mobility, and the Fund may wish to exercise caution in pressing for open capital accounts in view of the potential volatility of capital flows.

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<sup>5</sup> See Ocampo and Stiglitz (2008) and the IMF publications and working papers in Annex Tables A1.3 and A3.1 for discussions of the liberalization experiences of a number of emerging market economies.

<sup>6</sup> If a country fully liberalizes its capital account in an atmosphere of macroeconomic instability and/or poor banking regulation and supervision, it may be more vulnerable to crises. Conversely, if a country uses capital controls to achieve prudential regulation, its financial system may remain weak. Argentina and Thailand are examples of countries that fully liberalized their financial systems, including their capital accounts, in an atmosphere of macroeconomic instability (Argentina) and poor bank regulation and supervision (Thailand). In contrast, India has demonstrated a cautious, phased approach to capital account liberalization.

### C. Benefits and Costs of Financial Liberalization

20. While the current international financial turmoil strongly suggests some serious problems in the functioning and efficacy of financial institutions in many countries, it is important not to lose sight of the potential benefits that may be realized from financial services liberalization. These costs and benefits have been identified in a growing literature, a representative sample of which is provided in Annex 3, Table A3.2. The remainder of this section summarizes salient conclusions for IMF work.

21. Some of the benefits of liberalization of trade in financial services involve macroeconomic outcomes and overall financial sector issues that fall within the purview of the IMF:<sup>7</sup>

- The prospect of financial liberalization may provide a catalyst for domestic reform by creating a constituency for improved regulation and supervision, better disclosure rules, and an improved legal and regulatory framework that can be put into place before foreign institutions are permitted to operate in the country.
- The prospect of financial liberalization may also provide a catalyst for greater regulatory transparency and strong prudential supervision by making information about laws, regulations, and administrative guidelines more readily available to all current and prospective market participants, including both domestic and foreign financial institutions.
- The robustness of the domestic financial system to shocks may be enhanced by foreign banks that can draw on their parent organizations if additional funding and capital are needed.
- Access to international capital may be facilitated and the amount of saving available for productive investment augmented.

22. Other potential benefits appear to fit more into the mandate of the World Bank:

- Increased domestic competition may improve the quality of services and widen the range of choice, in the form of access to new services channels, faster access to services, better credit assessment procedures and information gathering techniques, wider choice of products and vendors, and easier and more effective diversification of risk.

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<sup>7</sup> Several IMF publications pick up on many of these issues, including IMF (2000a) especially Chapter VI (“The Role of Foreign Banks in Emerging Markets”); IMF (2007a) especially Chapter III (“The Globalization of Financial Institutions and Its Implications for Financial Stability”); and IMF (2007b) especially Chapter 3 (“Sustaining Financial Development in Emerging Europe”). Also see Annexes 1 and 3 below.

- New skills, products, and technologies may be diffused into the domestic financial system, assisting its modernization.
23. By the same token, financial-services liberalization may entail certain economic risks and uncertainties:<sup>8</sup>
- Liberalization may not yield a more stable source of credit for domestic borrowers. If foreign bank entry is accompanied by reduced barriers to capital outflows, banks may use funds raised in the domestic market to undertake external lending so that domestic borrowers may not have the same degree of access to domestic savings as before liberalization. Another risk is that foreign banks might shift funds abruptly from one market to another as they perceive changes in risk-adjusted returns. In particular, internet banking may be a source of instability as financial turmoil in one country may have significant spillover effects in other countries.
  - Especially in the early stages of liberalization, foreign banks may “cherry-pick” the most desirable markets and customers, leaving the domestic banks with higher-risk assets and customers. Foreign banks may only service profitable market segments, leaving aside retail banking in rural areas
  - Foreign banks are perhaps more likely to “cut and run” during financial crises.
  - Depending on the banking structure, foreign banks may encourage the development of oligopolistic, rather than competitive, banking structures.
  - Foreign banks may not guarantee safety and soundness, especially if they have questionable ownership links with other international banks and are not subject to close monitoring in the host country.
  - Establishing clarity in how foreign banks or banking service providers are supervised is highly complex owing to differing supervision practices for foreign-owned subsidiaries, branches of foreign banks, and banking services provided by foreign banks. These differences create scope for regulatory arbitrage, regulatory overlap, and imprecise boundaries between the domestic and foreign accounts and activities of banks.

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<sup>8</sup> In addition to considering the potential economic benefits and costs of foreign banking, it is important to consider their social impact. Foreign banks may not give priority to issues of poverty alleviation and the access of low-income and rural-based savers and borrowers to financial services.

#### **D. Fund Guidance and Advising for Financial Liberalization**

24. The foregoing discussion suggests that the IMF needs to consider a number of key issues when countries are planning to reduce or remove barriers to trade in financial services or when financial services markets may already be open to varying degrees:

- The adequacy and transparency of existing and prospective regulation of the financial sector.
- The stability of sources of credit to host-country financial institutions and residents, including in times of crisis.
- Effects of financial liberalization on the structure, stability, and efficiency of banking or the financial sector more generally.
- The risks that foreign institutions may cherry-pick the most desirable markets and customers.
- The adequacy and clarity of supervision of financial institutions operating across national borders.

25. There are further considerations that the IMF should take into account in its advisory capacity to member countries:

- The need for adequate data on restrictions on trade in financial services, taking into account difficulties in collecting and interpreting such data.
- The development and implementation of partial and general equilibrium models that take account of the country's major sectoral characteristics. This would require the construction of comprehensive databases; estimation of the pertinent parameters that reflect the responses of economic agents to the reduction and/or elimination of financial services barriers in a global context; and assessment of changes in economic welfare resulting from liberalization of trade in financial services.
- For IMF members that are parties to preferential trade agreements (PTAs) that cover their financial services sectors, modeling efforts should be adapted to reflect the potential impacts of the preferential existence or removal of financial services barriers, including the effects on financial services trade and associated changes in the economic welfare of PTA members and nonmembers.<sup>9</sup>

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<sup>9</sup> In this connection, see Roy, Marchetti, and Lim (2007); and Hoekman (2008).

### **III. IMF INVOLVEMENT IN LIBERALIZATION OF FINANCIAL SERVICES TRADE ISSUES**

26. This section addresses the role that the IMF has played in advising on policies related to the liberalization of financial services trade in its bilateral and multilateral surveillance and in conditionality attached to lending programs. The analysis is based on official reports, background papers, and other source materials provided by the IEO evaluation team for a selected set of economies chosen by the IEO. The focus is on the way that IMF missions may have helped countries prepare for liberalization and how good or appropriate the IMF's advice was on the scope and pace of liberalization per se. The country studies are therefore intended to illustrate when the IMF played an appropriate and useful role, and when it fell short of the role it could or should have played. Conclusions will be drawn as to whether the IMF approach to financial services trade liberalization during the evaluation period, 1996 to 2007, seems to have been well thought out and broadly consistent with best practice.

#### **A. Evolution of Article IV Surveillance of Trade in Financial Services**

27. Before turning to the country studies, it is useful to provide a broad overview of the record of the IMF's advice across its entire membership through bilateral surveillance and program conditionality on financial services trade liberalization. Annex 1 analyzes systematically the IMF's advice in the area of trade in financial services, based on a review of Article IV staff reports for three years: 1996, 2000, and 2006. The results (Annex Table A1.1) are intended to serve as proxy to represent the whole evaluation period, 1996 to 2007.

28. Although Executive Board guidance in 2002 encouraged greater surveillance of trade in services, in view of its increasing significance and the impact of services trade negotiations on the role and mission of the Fund (IMF, 2002a), trade in financial services did not receive a great deal of advisory attention from IMF staff during the evaluation period (Annex Table A1.1). Thus, more than four-fifths of the staff reports for the three discrete years 1996, 2000, and 2006 were either silent on issues on trade in financial services or simply provided a factual description without any accompanying staff advice or recommendations. Nonetheless, there is evidence of gradual improvement: though in 1996 almost 90 percent of the staff reports in 1996 contained no reference to issues of trade in financial services, by 2006 this proportion had fallen closer to 80 percent.

29. The comparative dearth of advice on trade in services in the Article IV surveillance reports may reflect the lack of guidance on the framework for assessing the appropriate pace and scope of financial services trade liberalization and coordination with financial liberalization in general. This contrasts with the rather clear advice and recommendations with regard to the reform of merchandise trade policies. Fund advice on financial services liberalization issued through the Article IV reports mostly related to the encouragement of market competition by means of greater participation of foreign financial institutions but was rarely accompanied by systematic analysis and supporting data.

## B. Country Case Studies

30. Four country cases are examined: China, India, Italy, and Tajikistan.<sup>10</sup> These countries were chosen because they undertook a significant liberalization of trade in financial services during the evaluation period. This section examines the role the IMF played in providing advice on their liberalization. The sources provided by the IEO for the country studies consisted primarily of staff reports and SIPs for Article IV consultations; Financial System Stability Assessment (FSSA) reports of Financial Sector Assessment Program (FSAP) missions; staff reports and other documents related to IMF-supported programs; IMF Executive Board minutes; WTO trade policy reviews; and media reports from Factiva.

### China

31. The staff reports, SIPs, and Board minutes for China's Article IV consultations during 1996–2007 concentrated primarily on macroeconomic and related issues, though some attention was also given to issues of trade in financial services. Perhaps the most prominent of these were the terms related to trade in financial services of China's 2001 WTO accession. Reports also considered policies indirectly related to trade in financial services—banking and capital market reforms designed to strengthen supervision, improve the efficiency of banking intermediation, and financial restructuring especially of the large state-owned commercial banks.

32. During the earlier part of the evaluation period, a recurring theme in IMF advice to China on financial sector reforms was the need to enhance competition in the banking sector, including by opening the sector to foreigners. IMF missions suggested gradually increasing access to renminbi business for foreign banks (IMF, 1997b), allowing new entry of foreign and domestic banks (subject to appropriate safeguards), and allowing outside (including foreign) investors to purchase shares in state-owned commercial banks (IMF, 1998b; 1999b). The Chinese authorities responded that an extension of the role of foreign banks was under consideration in the WTO accession negotiations (IMF, 1999b). They considered—and IMF staff concurred—that the WTO agreement would provide an impetus to domestic commercial banks to accelerate their restructuring efforts and enhance competition in the banking system (IMF, 2000c).<sup>11</sup> A 2000 SIP (Robinson, Dorsey, and Zebregs, 2000) on the potential sectoral impact of China's WTO accession noted that for the financial sector, the reforms represented “potentially enormous changes”: foreign financial institutions would be permitted to provide services without client restrictions for foreign currency business upon accession, local currency services to Chinese

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<sup>10</sup> Country case studies for Algeria, Thailand, Ukraine, and Vietnam are available on request.

<sup>11</sup> Outside the Fund staff, Langlois (2001), and Crosby (2008) review China's banking reforms and WTO accession commitments on financial services. While both authors view China's WTO commitments in a positive and promising light in permitting greater foreign bank entry, they note that there may be significant impediments to foreign entry, depending on how the Chinese authorities view their WTO commitments and the manner in which disagreements and disputes about entry are addressed by China and other WTO members.

companies within two years, and services to all Chinese clients within five years. The paper noted that the main risk to domestic banks was that their best borrowers would migrate to foreign banks but that on the other hand—based on the experience of transition economies in Eastern Europe—liberalization had the potential to give foreign banks access to domestic currency and Chinese banks access to foreign bank know-how and additional capital.

33. After China acceded to the WTO in 2001, the Chinese authorities and the IMF missions turned their attention to banking reforms for ensuring future financial stability and creating sound domestic banks that would be able to adequately compete after 2006 when the banking sector was to be fully open to foreign participation. IMF staff welcomed the authorities' increased attention to bank supervision, recommended additional steps to improve the internal operations of (domestic) banks such as improving risk management and controls and upgrading accounting systems (IMF, 2003b), and reiterated the point that “[d]iversifying bank ownership, for example by allowing qualified foreign financial institutions to take strategic stakes... could bring much needed technical expertise and better governance” (IMF, 2005c; and IMF, 2004a; 2006c).<sup>12</sup>

34. In the years leading up to the 2006 liberalization, IMF staff noted that the state-owned commercial banks continued to be the major part of the banking system, while the share of foreign-funded banks was comparatively small, with foreign ownership shares being limited and foreign management control practically nonexistent (Podpiera, 2005). China's financial sector operations thus contrasted with those of several other former centrally planned economies that had carried out major financial sector reforms involving sharply reduced state control over banks during the mid- to late-1990s, selling majority stakes to foreign private owners (Aitken, 2005).

35. A 2006 SIP (Leigh and Podpiera, 2006) addressed the contribution of foreign investors to improving banking services in China. While foreign banks' direct participation in China (through their own branches and subsidiaries) was relatively small, their indirect participation as minority shareholders had grown rapidly, to the point that almost all major Chinese banks now had a foreign strategic investor. The paper concluded that the overall contribution of foreign investors in improving the core operations of China's banks had been limited as foreign investors lacked sufficient incentives and opportunities—their ownership shares were relatively small and their management involvement minimal.<sup>13</sup> As this form of foreign investor entry into the banking

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<sup>12</sup> A 2004 SIP (Baldwin and Barnett, 2004) reviewed the international experience of bank restructuring with reference especially to reform of China's state-owned commercial banks and drew four main lessons: “(i) time-bound restructuring plans are essential for ensuring successful bank reforms; (ii) banks should have a strong commercial orientation, sound corporate governance framework, and freedom from political interference; (iii) reform should be guided by a comprehensive bank restructuring strategy that, among other things, identifies which agency will lead the reform program; and (iv) the market environment should be conducive to sound banking practices, which may require complementary legal, tax, and corporate sector reforms.” No reference was made to the potential role of foreign bank entry in the process of reform.

<sup>13</sup> Foreign investors had: (i) increased bank capital, even though some of the investment went to the State Administration of Foreign Exchange as foreign investors partly bought existing shares; (ii) provided credibility

(continued...)



sector (with foreign banks taking only a minority stake in domestic banks rather than taking a controlling stake or entering as fully-owned subsidiaries) was “fairly unique” to China, the paper noted that it was difficult to extrapolate from international experience what effects foreign investors may eventually have on the performance of Chinese banks.<sup>14</sup>

36. In summary, the evolution of the opening of China’s financial sector to the entry of foreign banks was largely predetermined by China’s WTO accession commitments, while the IMF documents reviewed focused primarily on macroeconomic and related issues, including financial sector reforms more broadly. The IMF did point out the potential benefits to China of foreign bank entry, but this recognition was mainly qualitative, drawing in general terms on the experiences of other former centrally planned and emerging market economies. None of the issues mentioned in Section II above that might have guided the Fund’s advice on financial liberalization was addressed systematically, no studies identified and measured the specific barriers to China’s financial liberalization were prepared, and no assessment was presented of the potential economic benefits to be derived from the reduction or removal of existing financial sector barriers. Potentially much could have been gained if Fund staff had carried out explicit analysis of the terms and potential economic effects of China’s WTO accession agreements.

## **India**

37. Following India’s unilateral policy reforms in 1991–92, the process of allowing private domestic and foreign banks to enter or expand operations in the state-bank-dominated Indian market was slow. It was official Indian government policy to give Indian public banks more breathing room vis-à-vis foreign banks until 2009 when full national treatment for wholly owned foreign banks would take effect.

38. IMF surveillance missions quite consistently pointed to the potential benefits of privatization and foreign entry into India’s financial sector, stressing that “increasing the private sector’s role in bank management offered the best prospects for achieving a fundamental improvement in the banks’ operating efficiency” (IMF, 1997c) and that a “much greater private sector opening” was urgently needed “to avoid further burdening the public debt outlook, as well as to improving bank governance and market discipline” (IMF, 1998c). The Indian authorities were hesitant, noting that “obtaining private capital—including foreign equity—will require far-reaching changes in management and public control” (IMF, 1998c). However, they agreed to continue licensing new domestic private banks and foreign banks, and to consider allowing foreign banks to compete on a level playing field with domestic banks (IMF, 1998c). A 1998 SIP

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needed to launch relatively large initial public offerings; (iii) induced improvements in corporate governance and management, with some board seats and management positions going to the foreign investors; and (iv) provided limited technical assistance (Leigh and Podpiera, 2006).

<sup>14</sup> The paper included a summary of the literature on the impact of foreign bank entry and a brief survey of selected country experience with foreign investment in domestic banks (Malaysia, Korea, Central and Eastern Europe, and Latin America).

(Callen, 1998) noted that some private and foreign banks had entered the sector between 1993 and 1998 and cited evidence that these banks were more profitable and less concentrated than India's public sector banks.

39. Incremental steps toward financial services liberalization were taken in 2001. In January of that year, the Indian authorities released a long-delayed comprehensive program of “second-generation” reforms prepared by the Prime Minister’s Economic Advisory Council. The Council’s report covered a broad range of recommendations, including financial sector reforms such as opening the insurance sector to private sector entrants—subject to minimum capital requirements and a 26 percent cap on foreign ownership—and introducing legislation to reduce the minimum government shareholding in public sector banks from 51 percent to 33 percent. In the latter regard, according to Towe (2001), the report cautioned that the Indian government’s desire to retain the “public sector character of public sector banks” could undermine the benefits that would accrue from increasing competition in the banking sector. The same argument was also made in the IMF’s 2000 Article IV consultation report (IMF, 2000b) and in the joint IMF-World Bank FSSA report (IMF, 2001a).<sup>15</sup>

40. Subsequent IMF Article IV missions tracked India’s progress in opening its financial sector and reducing the government’s ownership and control of public sector banks. A 2002 SIP (Koeva, 2002) presented evidence that the entry of new foreign and domestic banks had led to a reduction in banking industry concentration between 1990/91 and 2000/01 and with it, a significant decline in bank intermediation costs and profitability.<sup>16</sup> IMF staff consistently pressed the Indian authorities to do more to relinquish effective control of public sector banks to private shareholders. Besides reducing the government’s share in public sector banks, IMF staff urged the Indian authorities to raise the foreign direct investment limit in private banks and to lift the 10 percent limit on voting rights in a bank (IMF, 2003a; 2004b; 2005d).

41. In early 2005, the Indian authorities announced a few more incremental reforms—foreign banks would be allowed to establish wholly-owned subsidiaries and legislation would be amended to eliminate the 10 percent cap on the voting rights of foreign banks—but stated that they would defer further liberalization considerations to 2009. The 2005 IMF Article IV staff

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<sup>15</sup> In the staff report for the 2000 Article IV consultation with India, the IMF mission urged the authorities to reduce the minimum government shareholding in public sector banks because it would “facilitate needed improvements in governance and efficiency in the banking sector” and cautioned that “these objectives as well as private sector interest in equity participation, could be undermined by the government’s statement that the public sector characteristic of banks and their employees would be protected” (IMF, 2000b). The FSSA report noted: “Introducing private capital participation, while seeking to maintain ‘the public sector character’ of banks, is a source of concern” (IMF, 2001a).

<sup>16</sup> An econometric study by staff of the Office of the IMF Executive Director for India concluded that during 1996–2004, the Indian banking industry operated under competitive conditions and earned revenues as if under monopolistic competition and hence that “the competitive nature of the Indian banking system [was] not significantly different from the banking system in other countries” (Prasad and Ghosh, 2005).

report called for bringing forward the 2009 target date for some liberalization measures. The report noted that foreign presence in the Indian banking system (as captured by balance sheet data) was lower than in some other emerging Asian countries, and significantly lower than in Latin America and Eastern Europe, and cited empirical studies (e.g., IMF, 2000a) on the benefits to be derived from competition by foreign banks (IMF, 2005d). But subsequent IMF missions did not press the issue.

42. In 2009, as planned, the Indian authorities released a major and comprehensive report on financial sector reform (Government of India, Planning Commission, 2009). This report set out a series of proposals recommending the sale of underperforming public-sector banks, allowing takeovers and mergers between public and private Indian banks and foreign banks, permitting domestic and foreign banks to set up branches and automated teller machines anywhere in the country, and adopting other measures that would bring about competition and improve service and prices of financial services for Indian firms and consumers.

43. Overall, during most of the evaluation period, the IMF advised in favor of increased financial liberalization in India, including both privatization and the entry of foreign banks. At the same time, the Indian authorities have instituted policy reforms since 1991/92 that resulted in (a slow process of) privatization and entry of foreign banks. The Fund's recommendations for India's financial liberalization were mainly qualitative and with no supporting studies of how the process of liberalization might be best designed and implemented. While it is not clear how much of a role the Fund's advice played in the authorities' 2009 blueprint for the continuing reform measures, the broad thrust of the proposed reforms seems to be in line with the IMF's advice.

## Italy

44. The IMF paid very little attention to trade in financial services issues in Italy in the earlier part of the evaluation period. Article IV staff reports during 1997–99 called for further privatization and increased labor market flexibility to improve performance in the banking sector in the face of intensified competition under the European Monetary Union (IMF, 1997a; 1998a; 1999a), but did not suggest enhancing competition through greater participation in the financial sector by foreign banks.

45. The IMF's attention to trade in financial services issues in Italy stepped up beginning in 2003. In that year, the staff report put forth the view that the consolidation, privatization, and improvements in risk management in recent years had helped to strengthen the financial position of banks and insurance firms and that "[s]ecuring additional efficiency gains while maintaining competitive pressures [was] likely to require further consolidation and eventually greater cross-border penetration by financial institutions (in Italy, as elsewhere in Europe)" (IMF, 2003c). A subsequent process of banking consolidation was actively encouraged by the Bank of Italy to establish the basis for greater competition at the EU level. The 2004 staff report noted that this consolidation had indeed significantly changed the characteristics of the banking system: it was

now essentially private and the number of banks had fallen by one-third since 1990, though the number of branches had increased by some 80 percent (IMF, 2005a).

46. The 2004 Article IV mission observed that “competition could be further enhanced through increased involvement of foreign banks, but that—as elsewhere in continental Europe—cross-border mergers and acquisitions had been limited, a fact many analysts attributed to the opposition of the domestic supervisory authorities” (IMF, 2005a). IMF staff also reported that an amendment had been proposed to the draft savings law that would transfer responsibility for banking system competition from the Bank of Italy to the antitrust authority, but that its timing and final content were uncertain (IMF, 2005a).

47. During 2004-05, a number of media reports observed that Antonio Fazio, the Bank of Italy governor, had “firmly resisted foreign interest in Italian banks, even though there [was] more foreign capital invested in minority stakes in Italian banks than any other European banking system.”<sup>17</sup> Italy’s fragmented banking system led the European Commission to call on Italy’s central bank to declare publicly its commitment to an open and competitive banking sector that did not freeze out foreign players. This underscored growing concerns of the Brussels regulator and some European banks that Italy’s financial sector was not sufficiently open to takeovers and investments from non-Italian banks.<sup>18</sup>

48. An IMF FSAP mission in 2005 also noted that the presence of foreign banks was very limited in retail banking and that foreign takeovers had proven difficult to carry out. It recommended that “[g]reater foreign ownership in the Italian retail banking sector would help strengthen efficiency” (IMF, 2006b).<sup>19</sup> A SIP for the 2005 Article IV consultation (Drummond, Maechler, and Marcelino, 2006) addressed competition in Italy’s banking system and provided evidence that Italy’s banking system remained fragmented, was relatively small, and was less efficient than banking systems of other EU countries.<sup>20</sup> However, the Bank of Italy “expressed skepticism about the need for an increased foreign presence in the banking system, noting that

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<sup>17</sup> “Italian banking arrives at brink of a wave.” *Financial Times*, January 27, 2004.

<sup>18</sup> “Commission puts pressure on Italian banks,” *Financial Times*, February 8, 2005; “Italian bank governor denies protectionism,” *Financial Times*, February 18, 2005; “Italy: The kiss of death?” *Economist Intelligence Unit*, August 1, 2005; “Brussels accuses Fazio of violating ‘spirit’ of rules,” *Financial Times*, September 17, 2005; “EU challenges Italy on bank deals,” *The Wall Street Journal*, December 14, 2005.

<sup>19</sup> A FSAP was completed for Italy in July 2005 and the findings were discussed with the Italian authorities during the Article IV consultation in November of that year. The FSSA report concluded that Italy’s financial system was generally sound, that potential conflicts of interest arising from the Bank of Italy’s governance structure had been addressed by a new savings law, and that measures had been taken to help reorient the Italian financial system away from a predominantly relationship-based system that tended to favor incumbents over new entrants (IMF, 2006b).

<sup>20</sup> The paper did not find a link between foreign ownership and banks’ efficiency in its six-country sample (France, Germany, Italy, Spain, the United Kingdom, and the United States), suggesting that “foreign penetration in these countries remains too low to significantly modify the dynamics in the respective banking sectors” (Drummond, Maechler, and Marcelino, 2006).

the share of the system owned by foreign entities was already comparatively high (albeit consisting only of minority positions)” (IMF, 2006a).

49. Noting that recent controversies over the conduct of the Bank of Italy in responding to two cross-border bank takeover bids were negatively affecting perceptions of the contestability of the Italian banking system and eroding confidence in Italian institutional arrangements, IMF staff urged the central bank to shift responsibility for competition to another authority (IMF, 2006a). There was some resistance to this suggestion—Bank of Italy representatives argued that other central banks were also jointly entrusted with responsibility for competition and stability—but in mid-December 2005, the Italian government amended the savings law to give the Bank of Italy and the antitrust authority joint responsibility for bank mergers and acquisitions and to transfer responsibility for other anticompetitive behavior fully to the antitrust authority (IMF, 2006a). Governor Fazio resigned as central bank governor shortly thereafter.

50. The 2006 Article IV mission noted that appreciable progress had been made in implementing the recommendations of the FSAP, particularly in banking-market contestability but that further progress was needed in reducing bank costs. It also noted that the new leadership of the Bank of Italy supported banking sector consolidation, with tangible results, and that the new joint oversight of merger activity by the Bank of Italy and the antitrust authority was proceeding smoothly (IMF, 2007c).

51. Improvements in the business environment, the increasing efficiency of the banking system, and the encouraging attitude of the Bank of Italy may have been a factor in the greater number of mergers in 2006 than in the previous five years. While some of the changes noted may have been in response to Fund advice and recommendations, the pressures from the European Commission and the Italian government were most likely the decisive influences in promoting financial liberalization.

52. In sum, the IMF’s attention to trade in financial services issues in Italy emerged gradually after 2003. Fund surveillance then pointed to the limited pace of cross-border consolidation in the banking system, though it did not give the issue a great deal of prominence. After the change of leadership of the Bank of Italy in 2005, the Fund’s activity stepped up with the completion of an FSAP. Some of the subsequent changes in the structure of the banking system may have been in response to Fund advice and recommendations, but it appears that pressures from the EU Commission and Italian Government officials to remove Governor Fazio from the Bank of Italy may have been the decisive influences on the measures undertaken to promote financial liberalization.

## **Tajikistan**

53. Throughout the evaluation period, Tajikistan’s banking system was small and vulnerable, with levels of intermediation and private-sector credit that were low relative to GDP even by regional standards; high interest-rate spreads; and low confidence in the system. By the end of the period, nonperforming loans were relatively high by international standards, and provisioning

looked insufficient. Despite amendments to the banking law introduced in 2005 to ease restrictions on foreign bank participation, foreign competition in the banking system remained limited. Tajikistan ranked rather low on the various international indicators of governance, transparency, and doing business.

54. Banking sector reform was always high on the reform agenda advocated by the IMF. The first IMF-supported program under the Enhanced Structural Adjustment Facility (ESAF)/Poverty Reduction and Growth Facility (PRGF) (1998–2001) included a number of measures and benchmarks to lay the foundations for the development of an efficient and solvent banking sector. Initial measures focused on strengthening the capital base of the banks to allow them to meet prudential requirements, and included the development of a comprehensive bank restructuring program (IMF, 1998d). Subsequent reform measures *inter alia* focused on the gradual withdrawal of the central bank from the retail banking business and strengthening of the central bank's banking supervision department (IMF, 1999c; 2000d). In the first review of the third-year ESAF/PRGF program, as a structural benchmark for end-June 2001, the Tajik authorities agreed to amend legislation to allow average foreign equity ownership of the banking system as a whole to increase to a maximum of 40 percent in 2001 and 50 percent in 2002 (IMF, 2001b).<sup>21</sup> However, the program went off-track after the second review in June 2001.

55. The new three-year PRGF-supported program agreed between the IMF and the government of Tajikistan in November 2002 included further banking sector reforms. During the third program review in July 2004, the Tajik authorities indicated their openness to the entry of foreign banks with established expertise, and the central bank requested Fund technical assistance to review the legal framework for impediments (such as limits on foreign ownership) to the entry of more established foreign banks and to address other deficiencies that limited lending opportunities (IMF, 2004c).

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<sup>21</sup> Tajikistan is one of the few countries whose IMF-supported program(s) contained conditionality related to trade in financial services. For other examples, see Annex 2.

56. During the fourth program review in March 2005, the Tajik authorities committed to relax the remaining restrictions on the entry of foreign banks, in particular by eliminating the ceiling on foreign capital participation and the requirement that Tajik nationals head banks operating in the country (structural benchmark for June 2005) (IMF, 2005e); the benchmark was met. A SIP (Fischer, 2005) prepared for the 2004 Article IV consultation (which coincided with the fourth program review) analyzed Tajikistan's banking sector and recommended a number of reforms to deepen the sector, including opening the banking system to entry by major international banks to obtain access to banking expertise, capital, and increased credibility. The paper cited "substantial cross-country evidence" from La Porta, Lopez-de-Silanes, and Shleifer (2002) associating state ownership of banks with slower subsequent financial development, lower growth of per capita income, and lower growth of productivity in the non-financial sector.<sup>22</sup>

57. During the fifth and sixth reviews of the PRGF-supported program, IMF staff reported that "there was growing interest among foreign banks to operate in Tajikistan" (IMF, 2005f) and opined that the approval of the amendments aimed at eliminating restrictions on foreign competition would help to strengthen the banking system and improve the quality of financial services (IMF, 2006d). But the 2006 Article IV mission found that while the Tajik banking sector was stronger, it remained "small and vulnerable" with limited foreign competition despite the legal changes introduced late in 2005 (IMF, 2007d). A joint IMF-World Bank FSAP mission in 2007 noted that trade in financial services was still at a rudimentary stage—no Tajik banks were established outside the country, and only one foreign bank (from Kazakhstan) operated in Tajikistan, with a specialized role serving two embassies. However, the FSSA report predicted that there would be more foreign bank entry and greater competitive pressure in the coming years and advised the central bank to develop the necessary regime to deal with such a scenario, including the ability to effectively supervise foreign banks established in Tajikistan (IMF, 2008).

58. It seems reasonable to conclude that Fund advice and conditionality in Tajikistan with regard to liberalization of trade in financial services were grounded analytically and empirically in cross-country studies that had been designed to investigate the benefits of financial liberalization and that could be brought to bear on the circumstances and limitations pertinent to the Tajik financial sector. However, there was no direct evidence in the Fund documents on the specific barriers that constrained the entry of foreign banks and the impact that reduction and/or removal of these barriers would have on the structure and efficiency of the Tajik financial sector and the country's economic welfare.

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<sup>22</sup> An earlier IMF working paper by De Nicolo, Geadah, and Rozhkov (2003) comparing the level of financial development between the Commonwealth of Independent States countries (including Tajikistan) and the more advanced transition economies in Central and Eastern Europe and Baltic states also cited the work of La Porta, Lopez-de-Silanes, and Shleifer (2002). The paper observed that the liberalized entry of "fit-and-proper" financial firms in the latter group of countries had speeded up rationalization in the provision of financial services and increased overall transparency and competition.

#### IV. CONCLUSIONS

59. Based on the broad review of the Fund's Article IV surveillance activities and the four country studies summarized above, it seems reasonable to conclude that the Fund staff were generally aware of the benefits of financial liberalization, based on their apparent knowledge of the literature and the findings of some of the SIPs on financial liberalization carried out in the context of Article IV consultations for individual countries. However, it is doubtful whether the Fund's advice and recommendations on financial liberalization have had much influence. Rather, it appears especially in the case studies that the pace and effects of financial liberalization have been determined to a large extent by unilateral policy initiatives and by the terms and timing of the negotiations for WTO accession. What can be said therefore is that Fund advice in support of liberalization can be best interpreted to be in support of country unilateral policy actions and the dynamics of the WTO accession process.

60. Barriers to trade in financial services are akin to nontariff barriers as applied to trade in goods. Measurement of the size and economic effects of these barriers therefore poses considerable problems. Since the available international data sources on financial service barriers are limited, the Fund could play a useful role, in the course of its surveillance, by encouraging its members to identify existing financial services barriers and by providing the modeling expertise needed to construct measures of the price and quantity effects of the reducing or removing these barriers. The basis for this role may lie in the collaboration by Fund staff with the survey work on services barriers now being done by Gootiiz and Mattoo at the World Bank and on the methodologies for measuring services barriers that have been developed by Deardorff and Stern (2008). The data and measures of existing barriers can be embedded in partial or general equilibrium modeling frameworks that can be used to provide a quantitative assessment of the economic effects that may be expected if certain liberalization measures were to be adopted. In this way, Fund advice would become more precise in character as compared to its usually more qualitative and general nature.



## ANNEX 1. COVERAGE OF TRADE IN FINANCIAL SERVICES IN IMF SURVEILLANCE

### A. Article IV Staff Reports

1. Annex Table A1.1 summarizes the coverage of trade in financial services issues in all Article IV consultations in three sample periods corresponding to 1996, 2000, and 2006. Each sample included all Article IV staff reports for that year plus reports for the closest earlier year for countries that did not have an Article IV consultation in that particular year. For example, the 1996 sample included staff reports for all 143 countries that had 1996 consultations, plus—for countries that did not have 1996 consultations—35 staff reports from 1995 consultations and 1 staff report from a 1994 consultation.

2. Coverage of trade in financial services issues was classified as: absent (i.e., no mention of issues related to trade in financial services in the staff report); factual reporting only (e.g., “Trade in services, notably financial services, will be further liberalized under the EU single passport regime....”); and advice (i.e., staff expressed a view and/or provided a recommendation on one or more issues related to trade in financial services). The review considered only coverage related to *trade* in financial services; coverage of broader financial sector reforms was not included unless there was an obvious international aspect to the issue. Advice was divided into two categories, depending on whether or not staff’s recommendation was supported by underlying analysis found in a SIP or other background work. When such support was present, the advice is classified as “deep.”

3. Coverage of trade in financial services issues in the staff reports sampled was extremely limited. Fewer than 15 percent of the 554 staff reports sampled contained some mention of issues related to trade in financial services, with coverage limited to factual reporting of the authorities’ actual/intended policies in approximately one-fourth of the cases. When given, staff’s advice was mainly to promote competition in the banking/financial sector, including, in several cases, by privatizing public banks (with the involvement of strategic foreign investors). The staff’s advice on liberalization of trade in financial services was rarely backed up by detailed analytical work such as SIPs.

4. The breakdown by time period in Annex Table A1.1 shows a slight increase in coverage over time, and a shift from factual description toward some form of advice in the later periods.

5. The breakdown by area departments indicates that the Asia-Pacific Department (APD), the European Department (EUR), and the Middle East and Central Asia Department (MCD) gave the most advice (or most often expressed a view) on trade in financial services issues. These views mostly fell into two groups:

- supporting the authorities’ initiatives to liberalize trade and level the playing field for domestic and foreign providers of financial services (e.g., in Hong Kong, India, Malaysia, Nepal, and Singapore in APD; in Albania, Belarus, Germany, Luxembourg,

Moldova, Norway, San Marino, and the Slovak Republic in EUR; and in Algeria, Azerbaijan, Bahrain, Georgia, Iran, Oman, and Tunisia in MCD)

- urging the authorities to liberalize further (e.g., in Laos, Myanmar, Sri Lanka, Thailand, and Vietnam in APD; in Austria, the Euro Area, Israel, Italy, Poland, and Turkey in EUR; and in Armenia, Kuwait, Libya, and Syria in MCD).
6. In a number of countries (e.g., Botswana, Brunei, Namibia, and Saint Lucia), staff strongly cautioned the authorities against developing offshore financial centers, at least until the country's supervisory and regulatory capabilities were sufficiently strengthened.

### **B. Article IV Background Papers**

7. Annex Table A1.2 provides a list of selected background papers focusing on trade in financial services issues that were prepared for Article IV consultations over the period 1996–2008. The papers are listed in chronological order. The criterion for inclusion in the table is that the paper focuses primarily on, and contains some analysis (either quantitative or qualitative) beyond a factual description of, an issue related to *trade* in financial services. Papers on broader financial sector issues (such as the degree of competition in the banking system, recent reforms in the financial sector, or bank restructuring following a financial crisis) were not included unless there was an obvious international aspect to the issue. This rough criterion yielded twenty SIPs along with one background paper for the Baltic countries.

8. The papers listed in Annex Table A1.2 analyzed the ex ante and ex post effects of (liberalizing) trade in financial services on the structure and performance of the financial sector and financial supervision. Half of the papers studied the implications of a country's recent or impending liberalization of trade in financial services (e.g., Decressin (1998) for Portugal; Schipke and others (2003) for the Baltic countries; Leigh and Podpiera (2006) for China); the other half looked at the effects of trade in financial services on a country's financial sector (e.g., Koeva (2002) for India; Lukonga (2006) for South Africa) and macroeconomy (e.g., Muhleisen (2003) for Germany, and Klyuev (2007) for Canada).

9. More than half of the papers were from the most recent part of the evaluation period—2005 or later. Only three were written before 2000.

10. More than half of the papers came from EUR where financial integration was an especially significant topic during the evaluation period; there were three papers each for the Euro Area and Austria. There were also a number of papers from APD (on China, India, Japan, and Singapore) though none of the analysis seems to have been reflected in staff views/advice on trade in financial services in the Article IV reports for those countries sampled in Annex Table A1.1.

Annex Table A1.1. Coverage of Trade in Financial Services Issues in Article IV Consultations<sup>1</sup>

	Aggregate			Africa (AFR)			Asia-Pacific (APD)			Europe (EUR)			Middle East and Central Asia (MCD)			Western Hemisphere (WHD)		
	1996	2000	2006	1996	2000	2006	1996	2000	2006	1996	2000	2006	1996	2000	2006	1996	2000	2006
Number of staff reports	180	184	190	43	44	46	32	33	34	43	44	45	28	28	30	34	35	35
Number of staff reports containing:																		
No mention of trade in financial services	161	160	160	40	40	41	26	25	30	40	38	35	24	26	21	31	31	33
Factual reporting of trade in financial services	10	2	5	3	1	0	3	0	2	1	1	1	1	0	1	2	0	1
Views/advice on trade in financial services	9	19	24	0	3	5	3	8	2	2	5	9	3	2	8	1	4	1
<i>Of which: "Deep" views/advice<sup>2</sup></i>	1	3	1	0	0	1	0	0	0	0	2	0	0	0	0	1	1	0
Percent of staff reports containing:																		
No mention of trade in financial services	89.4	87.0	84.2	93.0	90.9	89.1	81.3	75.8	88.2	93.0	86.4	77.8	85.7	92.9	70.0	91.2	88.6	94.3
Factual reporting of trade in financial services	5.6	1.1	2.6	7.0	2.3	0.0	9.4	0.0	5.9	2.3	2.3	2.2	3.6	0.0	3.3	5.9	0.0	2.9
Views/advice on trade in financial services	5.0	10.3	12.6	0.0	6.8	10.9	9.4	24.2	5.9	4.7	11.4	20.0	10.7	7.1	26.7	2.9	11.4	2.9
<i>Of which: "Deep" views/advice</i>	0.6	1.6	0.5	0.0	0.0	2.2	0.0	0.0	0.0	0.0	4.5	0.0	0.0	0.0	0.0	2.9	2.9	0.0

<sup>1</sup> Includes Article IV staff reports for three territories (Aruba, Hong Kong, and Netherlands Antilles) and four currency unions (CEMAC, ECCU, Euro Area, and WAEMU).

<sup>2</sup> "Deep" views/advice denote views/advice in Article IV staff reports that were supported by analysis in a current or recent SIP or other background work.

Source: IEO.

Annex Table A1.2. Selected SIPs and Background Papers on Trade in Financial Services Issues

	Country	Ex ante implications	Ex post effects
Decressin, Jorg, 1998, "The Portuguese Banking System: Feeling its Pulse on the Eve of EMU," in Portugal—Selected Issues and Statistical Appendix, SM/98/243	Portugal	X	
Drees, Burkhard, 1998, "European and Global Integration: the Challenges for Austria's Financial Sector" Chapter IV in Austria—Selected Issues and Statistical Appendix, SM/98/126	Austria	X	
Hviding, Ketil, 1999, "Swiss Banking at the Start of the Twenty-First Century: Challenges and Opportunities," Chapter I in Switzerland—Selected Issues and Statistical Appendix, SM/99/31	Switzerland	X	
Ubide, Angel, 2000, "Supervising a Largely Foreign-Owned Financial Sector: A Sketch of Luxembourg's Approach and Alternative Arrangements," Chapter IV in Luxembourg—Selected Issues and Statistical Appendix, SM/97/136	Luxembourg		X
Hviding, Ketil, 2000, "Challenges of European Financial Integration: The Case of Austria," Chapter I in Austria—Selected Issues and Statistical Appendix, SM/00/179	Austria	X	
Drees, Burkhard, 2002, "Singapore's Role as a Financial Center in a Changing Global Financial System," Chapter I in Singapore— Selected Issues and Statistical Appendix, SM/02/358	Singapore	X	
Koeva, Petya, 2002, "The Performance of Indian Banks During Financial Liberalization," Chapter V in India—Selected Issues and Statistical Appendix, SM/02/181	India		X
Schipke, Alfred, and others, 2003, Capital Markets and Financial Intermediation in the Baltic States, SM/03/122	Baltic countries	X	
Muhleisen, Martin, 2003, "Germany's Financial System— International Linkages and the Transmission of Financial Shocks," Chapter III in Germany—Selected Issues, SM/03/354	Germany		X
Dell'Araccia, Giovanni, 2005, "Outward Expansion of Singapore Banks," Chapter II in Singapore—Selected Issues, SM/05/22	Singapore		X
Haas, Francois, 2005, "The Integration of European Financial Markets," Chapter IV in Euro Area Policies—Selected Issues, SM/05/259	Euro Area	X	
Decressin, Jörg, and Beata Kudela, 2005, "Banks and Markets in Europe and the United States," Chapter VI in Euro Area Policies—Selected Issues, SM/05/259	Euro Area		X
Nakagawa, Shinobu, 2006, "The Re-emergence of Japanese Banks in Asia," Chapter VI in Japan—Selected Issues, SM/06/231	Japan		X
Lukonga, Inutu, 2006, "Integration of South African Banks in Sub-Saharan Africa—Regulatory and Stability Implications," Chapter V in South Africa—Selected Issues, SM/06/244	South Africa		X
Leigh, Lamin, and Richard Podpiera, 2006, "The Rise of Foreign Investment in China's Banking System," Chapter VI in People's Republic of China—Selected Issues, SM/06/249	China	X	
Tieman, Alexander, 2007, "Cross-Border Banking Issues for the Austrian Banks and Their Supervisors," Chapter III in Austria—Selected Economic Issues, SM/07/114	Austria		X
Bems, Rudolfs, 2007, "Efficiency of Slovene Banking Sector in the EU Context," Chapter II in Republic of Slovenia—Selected Issues, SM/07/145	Slovenia	X	
Andritzky, Jochen, 2007, "Bank Risks from Cross-Border Lending and Borrowing in Slovenia," Chapter III in Republic of Slovenia—Selected Issues, SM/07/145	Slovenia		X
Haas, François, 2007, "The Market in Financial Instruments Directive and the Transformation of Europe's Capital Markets," Chapter I in Euro Area Policies—Selected Issues, SM/07/241	Euro Area	X	
Klyuev, Vladimir, 2007, "Real Implications of Financial Linkages Between Canada and the United States," Chapter II in Canada—Selected Issues, SM/08/19	Canada		X

### C. Multilateral Surveillance Reports

11. Coverage of trade in financial services in multilateral surveillance—the World Economic Outlook (WEO), the International Capital Markets Report (ICMR) and its successor, the Global Financial Stability Report (GFSR)—was scant during the evaluation period (Annex Table A1.3). Region-specific coverage was limited to Europe, with the exception of a box on trade finance in Sub-Saharan Africa in the April 2009 GFSR.

Annex Table A1.3. Trade in Financial Services Topics in the WEO, ICMR, and GFSR

EMU: Systemic Implications and Challenges	Chapter III	<i>International Capital Markets: Developments, Prospects, and Key Policy Issues</i> , November 1997
European Monetary Union: Institutional Framework for Financial Policies and Structural Implications	Annex IV	<i>International Capital Markets: Developments, Prospects, and Key Policy Issues</i> , November 1997
Globalization of Finance and Financial Risks	Annex V	<i>International Capital Markets: Developments, Prospects, and Key Policy Issues</i> , September 1998
Progress with European Monetary Integration	Annex I	<i>International Capital Markets: Developments, Prospects, and Key Policy Issues</i> , September 1999
The Role of Foreign Banks in Emerging Markets	Chapter VI	<i>International Capital Markets: Developments, Prospects, and Key Policy Issues</i> , September 2000
Extension of Emerging Market Household Credit by Foreign-Owned Banks	Box 2.1	<i>Global Financial Stability Report: Market Developments and Issues</i> , September 2006
The Globalization of Financial Institutions and Its Implication for Financial Stability	Chapter III	<i>Global Financial Stability Report: Market Developments and Issues</i> , April 2007
Cross-Border Exposures and Financial Interlinkages within Europe	Box 1.2	<i>Global Financial Stability Report: Market Developments and Issues</i> , April 2009
Effects of the Global Financial Crisis on Trade Finance: The Case of Sub-Saharan Africa	Box 1.3	<i>Global Financial Stability Report: Market Developments and Issues</i> , April 2009
Impact of Foreign Bank Ownership during Home-Grown Crises	Box 4.1	<i>World Economic Outlook: Crisis and Recovery</i> , April 2009

## ANNEX 2. IMF CONDITIONALITY ON TRADE IN FINANCIAL SERVICES

1. Annex Table A2.1 lists conditions on trade in financial services found in IMF-supported programs that began during 1996–2007. As before, the criterion for inclusion in the table was that the condition had to be related to *trade* in financial services; conditions involving measures to generally reform or liberalize the financial sector or to privatize state banks were not included unless they contained an obvious international aspect. Only conditions specified as prior actions, structural performance criteria, or structural benchmarks were included; other policy measures mentioned in the Memorandum of Economic and Financial Policies (MEFP) for the program were not included. This rough criterion yielded 18 conditions in eleven programs in ten countries. The IMF-supported programs with trade conditionality on financial services included Stand-By Arrangements (SBAs) (3) as well as programs supported by the Extended Fund Facility (EFF) (1) and the Poverty Reduction and Growth Facility (PRGF) and its predecessor, the Enhanced Structural Adjustment Facility (ESAF) (7).
2. Almost all the conditions listed in Annex Table A2.1 were introduced in the context of reforming the banking/financial system to foster competition and improve efficiency. Exceptions were the condition to allow foreign banks and brokerage houses to establish subsidiaries in Korea's 1997 SBA, which was part of a package of capital account liberalization measures, and the conditions relating to the licensing of new banks in Mongolia's 2001 PRGF-supported program, which were introduced to improve the governance of the banking system. Only one condition related to the liberalization of insurance services (in Armenia's 2006 PRGF-supported program).
3. More than half of the conditions were found in IMF-supported programs from the earlier part of the evaluation period (before 2000). More than half of the conditions were found in PRGF- or ESAF-supported programs, presumably because these programs are more likely to contain structural reforms. And except for Egypt and Korea, all the conditions were found in IMF-supported programs in transition countries (in Asia, Central Asia, and Europe).

Annex Table A2.1. IMF Conditionality on Trade in Financial Services

Country and IMF-supported program	Date condition was included	Condition(s)	Reference
<b>ASIA-PACIFIC</b>			
Korea SBA (1997–2000)	February 1998	<ul style="list-style-type: none"> <li>• Allow foreign banks and brokerage houses to establish subsidiaries (Structural performance criterion).</li> </ul>	IMF, 1998, <i>Republic of Korea—First Quarterly Review Under the Stand-By Arrangement</i> (EBS/98/20, Supplement 1)
Mongolia PRGF (2001–05)	September 2001	<ul style="list-style-type: none"> <li>• Finalize the Bank of Mongolia's decision regarding the disposition of recent or prospective bank license applications by foreign institutions consistent with the MEFP's stipulation that applicants be limited only to the largest and most reputable institutions from countries with proven records of effective consolidated supervision (Prior action).</li> <li>• Adhere to best international standards for the licensing of new banks, including by limiting prospective applicants only to the largest and most reputable institutions from countries with proven records of effective consolidated supervision, and consult with IMF staff about the appropriate interpretation of these standards when considering applications for new bank licenses (Structural benchmark).</li> </ul>	IMF, 2001, <i>Mongolia—Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility</i> (EBS/01/166)
Lao P.D.R. PRGF (2001–05)	August 2003	<ul style="list-style-type: none"> <li>• Submit to the Standing Committee of the National Assembly amendments to the Decree Law on Commercial Banks that equalize the capital requirements for banks with domestic and foreign shareholders (with state commercial banks' capital requirements linked to their restructuring progress) and permit foreign bank branches to operate on a nationwide basis (Structural benchmark).</li> </ul>	IMF, 2003, <i>Lao People's Democratic Republic—Third Review Under the Poverty Reduction and Growth Facility and Requests for Waiver of Performance Criterion and Extension of the Arrangement</i> (EBS/03/127)
<b>EUROPE</b>			
Ukraine SBA (1997–98)	August 1997	<ul style="list-style-type: none"> <li>• Eliminate licensing requirements for foreign borrowing by individuals and enterprises (Prior action).</li> <li>• Allow foreigners to buy seats at the commodity exchanges (Prior action).</li> </ul>	IMF, 1997, <i>Ukraine—Staff Report for the 1997 Article IV Consultation and Request for Stand-By Arrangement</i> (EBS/97/144)
Albania ESAF (1998–2001)	April 1998	<ul style="list-style-type: none"> <li>• Savings Bank to agree on governance contract allowing participation with foreign bank in management (Prior action).</li> <li>• Appoint foreign CEO for National Commercial Bank (Prior action).</li> </ul>	IMF, 1998, <i>Albania—Staff Report for the 1998 Article IV Consultation and Request for Arrangements Under the Enhanced Structural Adjustment Facility</i> (EBS/98/17)
Albania PRGF/EFF (2006–09)	June 2007	<ul style="list-style-type: none"> <li>• Allow nonbank foreign and domestic institutional investors full access to primary auctions—on a competitive basis—for all government securities (Structural benchmark).</li> </ul>	IMF, 2006, <i>Albania—Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under Extended Arrangement, and Financing Assurances Review</i> (EBS/07/70)

Annex Table A2.1. IMF Conditionality on Trade in Financial Services (concluded)

Country and IMF-supported program	Date condition was included	Condition(s)	Reference
<b>MIDDLE EAST AND CENTRAL ASIA</b>			
Egypt SBA (1996–98)	September 1996	<ul style="list-style-type: none"> <li>Eliminate the 49 percent limit to foreign ownership of joint venture banks (Prior action).</li> </ul>	IMF, 1996, <i>Arab Republic of Egypt—Staff Report for the 1996 Article IV Consultation and Request for Stand-By Arrangement</i> (EBS/96/149)
Azerbaijan ESAF/EFF (1996–2000)	December 1997	<ul style="list-style-type: none"> <li>Issue an Azerbaijan National Bank (ANB) regulation allowing foreign banks and non-residents, in addition to all residents, to participate directly in the primary and secondary treasury bill markets, as well as interbank money market (the latter applies to foreign banks only) (Prior action for second review).</li> <li>Allow foreign banks to participate in ANB credit auctions (Structural benchmark).</li> </ul>	IMF, 1997, <i>Azerbaijan Republic—Request for the Second Annual Arrangement Under the Enhanced Structural Adjustment Facility, and Second Review Under the Extended Arrangement</i> (EBS/97/229)
	January 1999	<ul style="list-style-type: none"> <li>Complete bank restructuring measures, including participation of a foreign strategic investor in the International Bank and implementation of the Prominvestbank twinning arrangement (Prior action for third-year ESAF/EFF program).</li> <li>Invite foreign banks to raise up to 30 percent of banking system capital (Structural benchmark).</li> </ul>	IMF, 1999, <i>Azerbaijan Republic—Request for the Third Annual Arrangement Under the Enhanced Structural Adjustment Facility, Fourth Review under the Extended Arrangement, and Use of Fund Resources—Request for Purchase Under the Compensatory and Contingency Financing Facility</i> (EBS/99/1)
Kazakhstan EFF (1996–99)	June 1998	<ul style="list-style-type: none"> <li>Adopt by mid-June 1998, and undertake to submit to parliament no later than September 1998, an amendment to the banking law which will increase the limit on foreign-owned banks' share in aggregate capital of the commercial banking sector from 25 percent to 50 percent by end-1998 (Prior action for fourth review).</li> <li>Adoption by parliament of amendment to the banking law which increases the limit on foreign-owned banks' share in aggregate capital of the commercial banking sector from 25 percent to 50 percent from end-1998 (Structural benchmark).</li> </ul>	IMF, 1998, <i>Republic of Kazakhstan—Staff Report for the 1998 Article IV Consultation, Fourth Review Under the Extended Arrangement, and Request for Waiver of Performance Criterion</i> (EBS/98/92)
Tajikistan ESAF (1998–2001)	March 2001	<ul style="list-style-type: none"> <li>Amend legislation to allow average foreign equity ownership of the banking system as a whole to increase to a maximum of 40 percent in 2001 and 50 percent in 2002. (Structural benchmark).</li> </ul>	IMF, 2001, <i>Republic of Tajikistan—Staff Report for the 2001 Article IV Consultation, First Review Under the Third Annual Arrangement Under the Poverty Reduction and Growth Facility, and Request for Waiver and Modification of Performance Criteria</i> (EBS/01/46)
Tajikistan PRGF (2002–06)	February 2005	<ul style="list-style-type: none"> <li>Remove the regulatory limits on foreign capital in the banking system and the requirement for a Tajik citizen to head commercial banks in the Banking Law (Structural benchmark).</li> </ul>	IMF, 2005, <i>Republic of Tajikistan—Staff Report for the 2004 Article IV Consultation and Fourth Review Under the Poverty Reduction and Growth Facility</i> (EBS/05/38)
Armenia PRGF (2005–08)	April 2006	<ul style="list-style-type: none"> <li>Submit to Parliament an amendment to the Law on Insurance that eliminates the limitations on the range of services that insurance companies with substantial foreign ownership (above 49 percent of capital) can provide in Armenia (Structural performance criterion).</li> </ul>	IMF, 2005, <i>Republic of Armenia—Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion</i> (EBS/06/65)



### ANNEX 3. IMF WORKING PAPERS AND EXTERNAL RESEARCH ON TRADE IN FINANCIAL SERVICES

1. Annex Table A3.1 lists 18 IMF working papers from 1996–2008 with a focus on trade in financial services. The inclusion criterion is whether the main focus of the paper was on some aspect of trade in financial services, narrowly defined as in the earlier annexes; both empirical and theoretical papers are included. Working papers that are closely based on SIPs listed in Annex Table A1.2 are not included in this table to avoid double-counting.
2. The papers—the majority of which were written before 2000—fall into three broad categories:
  - Three early (1997–2003) papers sought to clarify the main issues in trade in financial services and their implications for IMF work.
  - Four papers analyzed—mainly qualitatively—prospects for (further) liberalization of trade in financial services in Central Africa, Central America, the Maghreb countries, and West Africa.
  - The rest of the papers focused on the effects of liberalizing trade in financial services, from both an ex ante and ex post perspective.
3. Working papers in the third group were mostly empirical studies based on cross-country data or individual country cases (e.g., Barajas, Steiner, and Salazar (1999) on Colombia; Detragiache and Gupta (2004) on Malaysia). The papers analyzed the effects of foreign banks on bank behavior (e.g., Barajas, Steiner, and Salazar, 1999; Cihak and Podpiera, 2005; and Detragiache, Tressel, and Gupta, 2006); financial sector stability (e.g., Kireyev, 2002b; Valckx, 2002; and Arena, Reinhard, and Vazquez, 2006); capital flows (Tamirisa, 1999); credit growth (Aydin, 2008); and financial supervision (e.g., Song, 2004; and Hardy and Nieto, 2008).
4. The amount of IMF research on trade in financial services issues, as proxied by the number of IMF working papers on this topic, is surprisingly small given the centrality of financial sector issues in the IMF's operational work. The quality of the empirical work is, for the most part, reasonably high, with a number of the papers having been subsequently published in refereed journals. Of particular note are Barajas, Steiner, and Salazar (1999) and Detragiache, Tressel, and Gupta (2006) which were published in the *Journal of Development Economics* and the *Journal of Finance* respectively, and whose findings have been widely cited.<sup>23</sup>

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<sup>23</sup> Annex Table A3.2 provides a list of selected external publications and working papers on topics related to trade in financial services, broadly defined to include general financial sector liberalization.

Annex Table A3.1. Selected Working Papers on Trade in Financial Services Issues

	Country/ Region	Methodology	Main Conclusions
<b>Understanding trade in financial services and its implications for the IMF</b>			
Sorsa, Piritta, 1997, "The GATS Agreement on Financial Services: A Modest Start to Multilateral Liberalization," WP/97/55 (May)		Qualitative analysis	In many countries, multilaterally liberalized financial sector policies are more restrictive than the actual state of openness or development of financial sectors. Many emerging markets liberalized little under the GATS despite often well-developed financial markets, while the opposite was true in some less developed developing countries.
Tamirisa, Natalia, and others, 2000, "Trade Policy in Financial Services," WP/00/31 (February)		Qualitative analysis	Trade liberalization could complement other financial reforms by enhancing the efficiency, quality, and variety of financial services and by encouraging improvement of financial regulations and practices. However, it raises sectoral, strategic, and cultural concerns. The design of trade policy should therefore emphasize the nexus with the macroeconomic framework and other financial sector policies, especially prudential and capital account regulations. It should also differentiate between types of trade.
Lehmann, Alexander, Natalia Tamirisa, and Jaroslaw Wieczorek, 2003, "International Trade in Services: Implications for the Fund," PDP/03/6 (December)		Qualitative analysis	Further liberalization of services trade in developing countries, as currently envisaged in the context of the WTO Doha Development Agenda, holds a number of potential benefits, such as underpinning the liberalization of goods trade, but it is also being resisted due to its potential adjustment costs. Two implications for IMF activities are examined: coherence among the three principal international economic institutions and sequencing with macroeconomic stabilization and regulatory reforms.
<b>Assessing prospects for liberalization of trade in financial services</b>			
Canales Krijlenko, Jorge Iván, Padamja Khandelwal, and Alexander Lehmann, 2003, "Financial Integration in Central America: Prospects and Adjustment Needs," PDP/03/3 (October)	Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua	Qualitative analysis	Even though there are few formal barriers to trade in financial services in the six Central American Free Trade Area (CAFTA) countries, deficiencies in regulatory and competition standards and in the judicial systems still restrict the participation of foreign institutions in the financial systems in the region. A greater presence of such institutions could support other objectives of trade and investment liberalization, though it would require several adjustments in prudential supervision at national levels and greater cooperation between members of the CAFTA.
Sy, Amadou N.R., 2006, "Financial Integration in the West African Economic and Monetary Union," WP/06/214 (September)	West African Economic and Monetary Union (WAEMU)	Qualitative analysis	The structure of the financial sector and its institutional arrangements indicate that financial integration is well advanced in some aspects. Common and foreign ownership of banks is very high and cross-border transactions are frequent in the government securities markets; common institutions help achieve a high degree of similarity of rules. There is nonetheless scope for further financial integration as indicated by persistent deviations from the law of one price, limited cross-border bank transactions, and differences in treatment.
Saab, Samer Y., and Jérôme Vacher, 2007, "Banking Sector Integration and Competition in CEMAC," WP/07/3 (January)	Central African Economic and Monetary Community	Qualitative analysis, econometric analysis	There is some evidence of price convergence in average interest rate spreads. However, this observation is not supported by an increase in cross-border flows in retail loans and deposits, and price convergence may merely reflect excess liquidity in the region. Other data also indicate that bank competition within the CEMAC as a region is limited, complementing the findings on integration. Addressing shortfalls in legal and regulatory frameworks, infrastructure, and markets would facilitate integration.
Tahari, Amor, and others, 2007, "Financial Sector Reforms and Prospects for Financial Integration in Maghreb Countries," WP/07/125 (May)	Algeria, Libya, Mauritania, Morocco, Tunisia	Qualitative analysis	So far, only limited actions and progress have been made toward financial integration within the Maghreb region. Useful lessons can be garnered from the experiences of the European Union and Gulf Cooperation Council countries, including: (a) adopting a gradual approach; (b) consolidating macroeconomic stability in all the countries; (c) strengthening financial markets; (d) harmonizing rules and regulations; (e) improving regional coordination; and (f) lifting restrictions on cross border flows of goods and services.

Annex Table A3.1. Selected Working Papers on Trade in Financial Services Issues (continued)

	Country/ Region	Methodology	Main Conclusions
<b>Effects and implications of liberalizing trade in financial services</b>			
Tamirisa, Natalia, 1999, "Trade in Financial Services and Capital Movements," WP/99/89 (July)	OECD countries	Econometric analysis	Capital inflows tend to fall (rise) with the liberalization of commercial presence in banking and securities (insurance) services, possibly reflecting an increase (decrease) in saving. When cross-border trade is liberalized, capital flows change insignificantly.
Barajas, Adolfo, Roberto Steiner, and Natalia Salazar, 1999, "Foreign Investment in Colombia's Financial Sector," WP/99/150 (November)	Colombia	Econometric analysis	Financial liberalization in general had a beneficial impact on bank behavior in Colombia. Although the positive contribution of foreign entry may be overstated in recent studies by not controlling for other liberalization factors, foreign (and domestic) entry beginning in 1990 did improve bank behavior by enhancing operative efficiency and competition. However, this came at the expense of deterioration in the loan quality of domestic banks.
Kireyev, Alexei, 2002a, "Liberalization of Trade in Financial Services and Financial Sector Stability (Analytical Approach)," WP/02/138 (August)		Qualitative analysis	Liberalization of trade in financial services undertaken by countries under the WTO has generally been conducive to the stability of their financial systems because of the mutually reinforcing nature of existing international rules and practices.
Kireyev, Alexei, 2002b, "Liberalization of Trade in Financial Services and Financial Sector Stability (Empirical Approach)," WP/02/139 (August)	92 countries	Econometric analysis	Econometric testing of indicators intended to proxy financial sector stability—subdivided into exchange rate and banking sector stability—suggests that opening of the financial sector is an efficient policy instrument for achieving a variety of macroeconomic goals. While liberalization is found to be broadly conducive to stability, the outcome of liberalization on exchange rate stability is less predictable than on banking sector stability.
Valckx, Nico, 2002, "WTO Financial Services Commitments: Determinants and Impact on Financial Stability," WP/02/214 (December)	92 countries	Econometric analysis	The most important factors that have influenced WTO members to take on their chosen level of liberalization commitments in the framework of liberalization of trade in financial services are economic growth, current account, trends in banking sector development, policy restrictiveness, and peer group effects. More liberal commitments may be associated with greater vulnerability to currency and banking crises—most likely a short-term effect, which should be mitigated with time through increased market efficiency and better resource allocation.
Song, Inwon, 2004, "Foreign Bank Supervision and Challenges to Emerging Market Supervisors," WP/04/82 (May)		Qualitative analysis, case studies	As the presence of foreign-owned banks grows, the challenges for emerging market supervisors include: (i) choosing a licensing policy for foreign banks; (ii) monitoring the local establishments of large international banks; (iii) upgrading their supervisory capacity to oversee complicated financial products of foreign banks; (iv) dealing with the issue of the parent bank support in case of difficulties or crises; (v) handling consolidated supervision if the market is heavily dependent on foreign banks; (vi) dealing with bank holding companies or other complex financial institutions; (vii) dealing with increased concentration in the banking system; and (viii) improving the governance structure of complex international banking groups.
Detragiache, Enrica, and Poonam Gupta, 2004, "Foreign Banks in Emerging Market Crises: Evidence from Malaysia," WP/04/129 (July)	Malaysia	Econometric analysis	Foreign banks not specialized in Asia performed better than banks mainly active in Asia (including all domestic and some foreign banks) during the crisis, maintaining higher profitability thanks to higher interest margins and lower nonperforming loans. Foreign banks did not abandon the local market during the crisis and received less government support than domestic institutions.
Cihák, Martin, and Richard Podpiera, 2005, "Bank Behavior in Developing Countries: Evidence from East Africa," WP/05/129 (June)	Kenya, Tanzania, Uganda	Qualitative analysis, econometric analysis	International banks are generally more efficient and more active in lending than domestic banks. Hence, there is no support for the argument that the presence of large international banks would have an adverse effect on the effectiveness and efficiency of banking sectors in developing countries. However, as suggested by the Kenyan experience, the presence of international banks may not lead to increased competition and provision of banking services if weak institutions are allowed to remain in the system.

Annex Table A3.1. Selected Working Papers on Trade in Financial Services Issues (concluded)

	Country/ Region	Methodology	Main Conclusions
Detragiache, Enrica, Thierry Tressel, and Poonam Gupta, 2006, "Foreign Banks in Poor Countries: Theory and Evidence," WP/06/18 (January)	89 countries	Theoretical model, Econometric analysis	The theoretical model shows that when foreign banks are better at monitoring high-end customers than domestic banks, their entry benefits those customers but may hurt other customers and worsen welfare. The model also predicts that credit to the private sector should be lower in countries with more foreign bank penetration. In both cross-sectional and panel tests, a stronger foreign bank presence is robustly associated with less credit to the private sector in poor countries. In countries with more foreign bank penetration, credit growth is slower and there is less access to credit. There are no adverse effects of foreign bank presence in more advanced countries.
Arena, Marco, Carmen Reinhart, and Francisco Vázquez, 2006, "The Lending Channel in Emerging Economies: Are Foreign Banks Different?" WP/07/48 (March)	20 emerging market countries	Econometric analysis	There is weak evidence that foreign banks have a lower sensitivity of credit to monetary conditions relative to their domestic competitors, with the differences driven by banks with lower asset liquidity and/or capitalization. The lending and deposit rates of foreign banks tend to be smoother during periods of financial distress. However, the differences across domestic and foreign banks do not appear to be strong. These results provide weak support to the existence of supply-side effects in credit markets and suggest that foreign bank entry in emerging countries may have contributed somewhat to stability in credit markets.
De Nicoló, Gianni, and Elena Loukoianova, Elena, 2007, "Bank Ownership, Market Structure and Risk," WP/07/215 (September)	133 developing countries	Theoretical model, econometric analysis	The positive and significant relationship between bank concentration and bank risk of failure is stronger when bank ownership is taken into account, and it is strongest when state-owned banks have sizeable market shares. Conditional on country and firm specific characteristics, the risk profiles of foreign (state-owned) banks are significantly higher than (not significantly different from) those of private domestic banks. Private domestic banks do take on more risk as a result of larger market shares of both state-owned and foreign banks. The model rationalizes this evidence if both state-owned and foreign banks have either larger screening and/or lower bankruptcy costs than private domestic banks, banks' differences in market shares, screening or bankruptcy costs are not too large, and loan markets are sufficiently segmented across banks of different ownership.
Cihák, Martin, and Li Lian Ong, 2007, "Estimating Spillover Risk Among Large EU Banks," WP/07/267 (November)	European Union	Econometric analysis	Spillovers within domestic banking systems generally remain more likely than cross-border spillovers among major EU banks. But the number of significant cross-border links is already larger than the number of significant links among domestic banks, adding a piece of empirical evidence supporting the need for strong cross-border supervisory cooperation within the EU.
Aydın, Burcu, 2008, "Banking Structure and Credit Growth in Central and Eastern European Countries," WP/08/215 (September)	Central and Eastern European (CEE) countries	Econometric analysis	CEE countries depend on foreign banks, and these foreign banks depend on interbank funding. Lending by foreign banks seems driven by economic growth and interest rate margins. This lending appears independent of economic but not financial conditions in the foreign bank's home country.
Hardy, Daniel, and Maria Nieto, 2008, "Cross-Border Coordination Of Prudential Supervision And Deposit Guarantees," WP/08/283 (December)	European Union	Qualitative analysis, theoretical model	The first best approach is to simultaneously strengthen prudential supervision and limit depositor protection. However, each country has an incentive to "free ride" on the strengthened supervision of others, so an enforcement mechanism such as mutual evaluations is needed. Strengthening coordinated prudential regulation and supervision is valuable even if deposit guarantee schemes are not well coordinated. Consideration should be given to establishing not only a minimum level of deposit guarantee coverage, but also a maximum level.

Annex Table A3.2. An Annotated Bibliography of the Economic Determinants and Effects of Financial Services Liberalization

	Main Conclusions
<p>Barajas, Adolfo, Roberto Steiner, and Natalia Salazar, 2000, "The Impact of Liberalization and Foreign Investment in Colombia's Financial Sector," <i>Journal of Development Economics</i>, Vol. 63 (1), pp. 157–196.</p>	<p>This study analyzes financial liberalization measures undertaken in 1990, of which an opening to foreign investment was a major component. After a brief description of the major changes in legislation on foreign investment, the performance of foreign-owned vs. domestic banks is compared, first using a descriptive approach, then in a more systematic manner using econometric analysis. Panel data estimations reveal that financial liberalization in general had a beneficial impact on bank behavior in Colombia, by increasing competition, lowering intermediation costs and improving loan quality. Although the positive contribution of foreign entry may be overstated in recent studies by not controlling for other liberalization factors, foreign and domestic entry beginning in 1990 did improve bank behavior by enhancing operative efficiency and competition. However, the greater competition may have resulted in increased risk and a subsequent deterioration in loan quality, particularly among domestic banks.</p>
<p>Beck, Thorsten, Asli Demirguc-Kunt, and Maria Soledad Martinez Peria, 2008, "Banking Services for Everyone? Barriers to Bank Access and Use around the World," <i>The World Bank Economic Review</i>, Vol. 22 (3), pp. 397–430.</p>	<p>Using information from 193 banks in 58 countries, the authors develop and analyze indicators of physical access, affordability and eligibility barriers to deposit, loan and payment services. They find substantial cross-country variation in barriers to banking and show that in many countries these barriers can potentially exclude a significant share of the population from using banking services. Correlations with bank- and country-level variables show that bank size and the availability of physical infrastructure are the most robust predictors of barriers. Further, they find evidence that in more competitive, open, and transparent economies, and in countries with better contractual and informational frameworks, banks impose lower barriers. Finally, though foreign banks themselves seem to charge higher fees than other banks, in foreign-dominated banking systems, fees are lower, and it is easier to open bank accounts and to apply for loans. On the other hand, in systems that are predominantly government-owned, customers pay lower fees but also face greater restrictions in terms of where to apply for loans and how long it takes to have applications processed. These findings have important implications for policy reforms to broaden access.</p>
<p>Bonaccorsi di Patti, Emilia, and Daniel C. Hardy, 2005, "Financial Sector Liberalization, Bank Privatization, and Efficiency: Evidence from Pakistan," <i>Journal of Banking and Finance</i>, Vol. 29 (8-9), pp. 2381–2406.</p>	<p>The Pakistani banking system has been transformed over the past 15 years through liberalization, the entry of private banks, the privatization of public-sector banks, and the tightening of prudential regulations. The effects of these changes on bank productivity and relative efficiency are investigated using various techniques. Bank productivity in terms of profits has increased, and new entrants have been efficient, but the dispersion of efficiency remains wide. The privatized banks improved their profit efficiency in the period immediately following their privatization, but in the subsequent years only one significantly improved its efficiency, whereas the other did not differentiate itself in terms of efficiency from the remaining state-owned banks. The new private domestic banks generally proved to be among the most efficient, and sometimes out-performed the foreign banks.</p>
<p>Bonin, John P., Iftekhar Hasan, and Paul Wachtel, 2005, "Privatization Matters: Bank Efficiency in Transition Countries," <i>Journal of Banking and Finance</i>, Vol. 29 (8-9), pp. 2155–78.</p>	<p>To investigate the impact of bank privatization in transition countries, the authors take the largest banks in six relatively advanced countries, namely, Bulgaria, the Czech Republic, Croatia, Hungary, Poland, and Romania. Income and balance sheet characteristics and efficiency measures computed from stochastic frontiers are compared across four bank ownership types. The empirical results support the hypotheses that foreign-owned banks are most efficient and government-owned banks are least efficient. In addition, the importance of attracting a strategic foreign owner in the privatization process is confirmed. However, counter to the conjecture that foreign banks cherry pick the most profitable opportunities, the authors find that domestic banks have a local advantage in pursuing fee-for-service business. Finally, they show that both the method and the timing of privatization matter to performance; specifically, voucher privatization does not lead to increased efficiency and early-privatized banks are more efficient than later-privatized banks, even though there is no evidence of a selection effect.</p>
<p>Boubakri, Narjess, Jean-Claude Cosset, and Klaus Fischer, 2005, "Privatization and Bank Performance in Developing Countries," <i>Journal of Banking and Finance</i>, Vol. 29 (8-9), pp. 2015–41.</p>	<p>The authors examine the post-privatization performance of 81 banks from 22 developing countries. The results suggest that: (i) On average, banks chosen for privatization have lower economic efficiency, and lower solvency than banks kept under government ownership. (ii) In the post-privatization period, profitability increases but, depending on the type of owner, efficiency, risk exposure and capitalization may worsen or improve. However, (iii) over time, privatization yields significant improvements in economic efficiency and credit risk exposure. (iv) Newly privatized banks that are controlled by local industrial groups become more exposed to credit risk and interest rate risk after privatization.</p>
<p>Claessens, Stijn, Asli Demirguc-Kunt, and Harry Huizinga, 2001, "How Does Foreign Entry Affect Domestic Banking Markets?" <i>Journal of Banking and Finance</i>, Vol. 25 (5), pp. 891–911.</p>	<p>Using 7900 bank observations from 80 countries for the 1988–95 period, this paper examines the extent and effect of foreign presence in domestic banking markets. The authors investigate how net interest margins, overhead, taxes paid, and profitability differ between foreign and domestic banks. They find that foreign banks have higher profits than domestic banks in developing countries, but the opposite is the case for developed countries. Estimated results suggest that an increased presence of foreign banks is associated with a reduction in profitability and margins for domestic banks.</p>

Annex Table A3.2. An Annotated Bibliography of the Economic Determinants and Effects of Financial Services Liberalization (continued)

	<b>Main Conclusions</b>
Claessens, Stijn, and Jong-Kun Lee, 2002, "Foreign Banks in Low-Income Countries: Recent Developments and Impacts," Background paper commissioned for the Global Development Finance (Washington: The World Bank).	As in many other countries, foreign participation in low-income countries' banking systems has increased in the last decade, although from a low level. The authors show that the increased foreign bank participation combined with a commitment to open markets has improved the efficiency and competitiveness of these countries' financial systems. Foreign banks have also introduced improved risk management practices and "imported" supervision from parent country regulators, thereby helping to strengthen banking systems. At the same time, increased competition may lower franchise value of incumbent banks and can lead to financial instability. While adequate regulation and supervision would be the natural policy response, many low-income countries have had great difficulty in establishing good legal and institutional frameworks. The answer might be to harness more the benefits of foreign entry, while focusing institutional efforts on a few key aspects.
Clarke, George R.G., Robert Cull, and Mary M. Shirley, 2005, "Bank Privatization in Developing Countries: A Summary of Lessons and Findings," <i>Journal of Banking and Finance</i> , Vol. 29 (8-9), pp. 1905–1930.	Although a large and growing literature shows that privatization can improve the performance of non-financial enterprises, there is less evidence on how it affects the performance of the banking sector. This paper summarizes the results from the papers in the special issue of the <i>Journal of Banking and Finance</i> on bank privatization. It concludes that although bank privatization usually improves bank efficiency, gains are greater when the government fully relinquishes control, when banks are privatized to strategic investors, when foreign banks are allowed to participate in the privatization process, and when the government does not restrict competition.
Crystal, Jennifer S., B.Gerard Dages, and Linda S. Goldberg, 2001, "Does Foreign Ownership Contribute to Sounder Banks? The Latin American Experience," in <i>Open Doors: Foreign Participation in Financial Systems in Developing Countries</i> , ed. by Robert E. Litan, Paul Masson, and Michael Pomerleano (Washington: The Brookings Institution).	The study concluded that the entry of foreign banks had positive effects on the overall soundness of local banking systems partly because foreign banks screened and treated problem loans more aggressively.
Demirgüç-Kunt, Asli, Ross Levine, and H.G. Min, 1998, "Opening to foreign banks: Issues of stability, efficiency, and growth," in <i>The Implications of Globalization of World Financial Markets</i> , ed. by S. Lee (Seoul: Bank of Korea).	This study investigated the effects of foreign bank presence in 80 countries between 1988 and 1995. They found that liberalizing restrictions on foreign bank entry accelerated the efficiency of the domestic banking sector, and thereby contributed to long-run economic growth.
Francois, Joseph F., and Felix Eschenbach, 2002, "Financial Sector Competition, Services Trade, and Growth," <i>Working Paper TI 2002-089/2</i> (Rotterdam: Tinbergen Institute).	The authors explore dynamic linkages between financial/banking sector openness, financial sector competition, and growth. They first develop an analytical model, highlighting links between long-run economic performance and services trade, through scale economies and market and cost structures in the financial services sector. This is followed by an econometric exercise based on data for 130 countries for the 1990s. The results point to a strong positive relationship between financial sector competition/performance and financial sector openness (meaning foreign bank access to domestic markets), and between growth and financial sector competition/performance. They also point to the presence of scale economies in the sector.
Kiyota, Kozo, Barbara Peitsch, and Robert M. Stern, 2009, "The Benefits of Financial Sector Liberalisation for Developing Countries: A Case Study of Ethiopia," <i>OECD Journal of Investment Policy</i> , forthcoming.	This paper focuses on issues of financial sector liberalization in Ethiopia, with reference in particular to the Ethiopian banking sector. The results of the micro-data analysis of the Ethiopian banking system suggested that the costs of public banks were 1.6 percent higher than those of private banks, and that the public banks appeared to be less efficient than private banks. Also, the interest-rate spread was 1.5 percentage points smaller for public banks than private banks. These results suggest that, if foreign banks were permitted to enter into the Ethiopian economy, there would likely be a narrowing of the efficiency gap and interest-rate spread between the public and private banks and a consequent improvement in Ethiopia's national economic welfare.
La Porta, Rafael, Florencio Lopez-de-Silanes, and Andrei Shleifer, 2002. "Government Ownership of Banks," <i>Journal of Finance</i> , Vol. 57 (1), pp. 265–301.	The authors assemble data on government ownership of banks around the world. The data show that such ownership is large and pervasive, and higher in countries with low levels of per capita income, backward financial system, interventionist and inefficient governments, and poor protection of property rights. Higher government ownership of banks in 1970 is associated with slower subsequent financial development and lower growth of per capita income and productivity. This evidence supports "political" theories of government ownership of firms.

Annex Table A3.2. An Annotated Bibliography of the Economic Determinants and Effects of Financial Services Liberalization

	<b>Main Conclusions</b>
Levine, Ross, Norman Loayza, and Thorsten Beck, 2000, "Financial Intermediation and Growth: Causality and Causes," <i>Journal of Monetary Economics</i> , Vol. 46 (1), pp. 31–77.	This paper evaluates: (1) whether the exogenous component of financial intermediary development influences economic growth, and (2) whether cross-country differences in legal and accounting systems (e.g., creditor rights, contract enforcement, and accounting standards) explain differences in the level of financial development. Using traditional cross-section, instrumental variable procedures and recent dynamic panel techniques, the authors find that the exogenous components of financial intermediary development are positively associated with economic growth. Also, the data show that cross-country differences in legal and accounting systems help account for differences in financial development. Together, these findings suggest that legal and accounting reforms that strengthen creditor rights, contract enforcement, and accounting practices can boost financial development and accelerate economic growth.
Lewis, Peter, and Howard Stein, 1997. "Shifting Fortunes: The political Economy of Financial Liberalization in Nigeria," <i>World Development</i> , Vol. 25 (1), pp. 5–22.	On the recommendation of the World Bank, Nigeria began to liberalize its financial sector in 1986. Contrary to the prediction of financial repression theory, savings and investment declined in the wake of banking deregulation. By 1995, the Nigerian financial system was in a state of collapse. The paper locates the main failure of Nigeria's financial deregulation in the political and institutional setting of reform. The institutional mechanisms needed to supervise and regulate banking under the new system were absent while private sector banking capacities were weak. Moreover, financial liberalization was quickly captured by a clientelist state as a means of reallocating rents to strategic constituents. An additional precipitating factor was macroeconomic instability. The paper points to the importance of incorporating political and institutional variables into any model of financial reform or transformation.
Mattoo, Aaditya, Randeep Rathindran, and Arvind Subramanian, 2006, "Measuring Services Trade Liberalization and Its Impact on Economic Growth: An Illustration," <i>Journal of Economic Integration</i> , Vol. 21 (1), pp. 64–98.	The authors explain how the output growth effect from liberalizing the service sectors differs from the effect from liberalizing trade in goods. They also suggest using a policy-based rather than outcome-based measure of the openness of a country's services regime. They construct such openness for two key service sectors: basic telecommunications and financial services. They provide some econometric evidence relatively strong for the financial sector and less strong, but nevertheless statistically significant, for the telecommunications sector that openness in services influences long-run growth performance. Their estimated measures suggest that growth rates in countries with fully open telecommunications and financial services sectors are up to 1.5 percentage points higher than those in other countries.
Mohieldin, Mahmoud, and Sahar Nasr, 2007, "On Bank Privatization: The Case of Egypt," <i>The Quarterly Review of Economics and Finance</i> , Vol. 46 (5), pp. 707–725.	This paper discusses the controversy regarding the privatization of the banking sector in Egypt. It provides an overview of the structure and evolution of the banking system, in the context of the series of reform measures undertaken by the Egyptian authorities over the past decades. The paper assesses the performance of the state-owned banks versus private banks over the period 1995–2005. Micro-prudential indicators, such as capital adequacy, asset quality, earnings, and profitability, reveal that state-owned banks lag behind in terms of efficiency and performance, compared to their private counterparts. Results also suggest that retaining government ownership can adversely affect bank performance. The paper explores the factors hindering the smooth implementation of bank privatization. The authors indicate that the financial sector reform currently adopted is comprehensive; however it is confronted with various political, social, and economic risks, which raise concerns regarding its sustainability. The paper then draws on the existing literature to provide guidance to policy makers, regarding effective and successful implementation of bank privatization.
Nannyonjo, Justine, 2001, "Financial Sector Reforms in Uganda (1990-2000): Interest Rate Spreads, Market Structure, Bank Performance and Monetary Policy" (Göteborg: Göteborg University).	This paper outlines the process of and experience with financial sector reforms in Uganda during the period, 1990–2000. It indicates that although reform measures led to encouraging results in terms of increasing monetization and achieving a steady real GDP growth in a stable macroeconomic environment, performance of the financial system fell short of expectations in other respects. This was evidenced by a number of developments: wide spreads between lending and deposit rates, low profitability and poor asset portfolios of commercial banks, excess reserves, incidents of liquidity/solvency problems and bank closures. Competition within the financial system does not appear to have improved as expected either while concentration of the market persisted. Consequently, the implementation of monetary policy remained constrained due to weaknesses in the financial sector.
Obadan, Mike I., 2006, "Globalization of Finance and the Challenge of National Financial Sector Development," <i>Journal of Asian Economics</i> , Vol. 17 (2), pp. 316–32.	Against the background of the significant acceleration of the pace of financial globalization, this paper examines the features of the phenomenon and the challenges they pose for national financial sector development. Although financial globalization confers notable benefits, it also entails huge costs including financial crisis. The factors of weak banking system and poor regulation helped to exacerbate the financial crises of the 1990s. The paper, therefore, stresses the need for sound macroeconomic policies, orderly liberalization of capital accounts, adequate preparation of national financial systems and meeting other preconditions for countries to reap the benefits of financial globalization at minimum costs.

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