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I. Introduction

This article draws from an earlier paper[1] that analyzed a wider group of Asian countries, and further investigates the state of financial liberalization in three of the largest economic powers in Asia (China, India, and Japan). It further attempts to address the impact that financial liberalization in these states will have on the wider region.

It is widely recognized that economic growth in China and India has supported the global economy.[2] As a result, the two countries have a strong influence on the political economy of Asia and have been increasingly engaged diplomatically to leverage their economic power.[3]

> It has been over a decade since serious and positive deliberation of Asia's regional integration has taken place, especially from the financial and monetary perspectives. With various domestic economic and financial issues, the progress of regional integration in the domain of financial services has been slow. But with improved macroeconomic conditions, especially in China and India, Asia is at an ideal juncture

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1. Masamichi Kono & Mamiko Yokoi-Arai, *Dissecting Regional Integration in Financial Services from the Competition Policy and Trade Policy Perspectives* (BIS Papers No. 42, Regional Financial Integration in Asia: Present and Future, October 2008), *available at* http://www.bis.org/publ/bppdf/bispap42.pdf?noframes=1.

2. Press Release, International Monetary Fund, World Economic Outlook Update, Global Economic Slump Challenges Policies (Jan. 28, 2009), *available at* http://www.imf.org/external/pubs/ft/weo/2009/update/01/. The only countries that continue to have a strong growth prospect are China and India, but even China and India are not "decoupled" from the global economy and are susceptible to macroeconomic weakening.

3. One indicator has been Wen Jiabao, the Chinese Premier's lecture at the World Economic Conference at Davos, which has urged China to play a bigger role in the world economy. Andrew Edgecliff-Johnson & Gillian Tett, *Wen and Putin Lecture Western Leaders*, FIN. TIMES, Jan. 28, 2009, *available at* http://www.ft.com/cms/s/0/d0fac984-ed6e-11dd-bd60-0000779fd2ac.html?nclick_check=1.

to revisit the subject and propose pragmatic avenues to follow if regional integration in financial services is to take place.[4]

The global financial difficulties may actually prove to be a boon to improve prudential concerns in Asia.

The region has changed dramatically in the past decade. Structural reform has increased in the countries that were hit by the financial crises of 1997-1998, with emerging economies becoming more entrenched in the global economy and playing a larger role. The economic development of China and India has been especially prominent, leading to the need for them to participate and contribute heavily in regional fora.[5] China and India present the region with a reason to revisit regional integration. Previously, regional integration in Asia was considered in blocs. China would belong to the East Asian bloc, while India would belong to the South Asian bloc. It is not often that China and India would be considered in the same context of Asian integration. Nevertheless, if we assume that the two had a strong interest to integrate in the same bloc, this would have a significant impact on Asia's future. The financial crises since 2008 have had a significant global impact, and the real economies have been strongly affected.[6] But the strong growth prospects in Asia, especially China and India, have significantly limited the economic downturn, not only regionally, but also globally. The importance of China and India has also been highlighted through their participation in G20, which is becoming one of the main global summits.[7]

As a precursor, this article will analyze the level of financial liberalization that Asia has generally achieved and specifically, in the three countries subject to this study: China, India, and Japan. The premise of this study is that mutual recognition of regulatory standards is likely to be the initial avenue for financial integration to progress.[8] Grasping the level of harmonization of regulatory standards will be necessary in this respect.

In order to comprehend financial liberalization, one must understand the competition policy regime because it is an important indicator of general market openness. Given the generic nature of this aspect, competition policy is not analyzed here.[9] Liberalization of the financial sector is carried out by two approaches. Trade commitments signify the

4. Kono, *supra* note 1. We are aware that liberalization of financial services is closely linked to, or in some cases, cannot be discussed separately from liberalization of capital flows. But to the extent that liberalization of capital flows, and eventually monetary integration, cannot reasonably be attained until trade liberalization succeeds in creating a single market in goods and services trade, and because there is still a long way to go before this happens in Asia, we focus in this paper on the liberalization of financial services trade.

5. Chandan Sinha & Narayan Chandra Pradhan, *India's Financial Openness and Integration with Southeast Asian Countries: An Analytical Perspective* 182 (BIS Papers No. 42, Regional Financial Integration in Asia: Present and Future, October 2008), *available at* http://www.bis.org/publ/bppdf/bispap42.pdf?noframes=1.

6. *Id.*

7. G20 is a forum of finance ministers and central bank governors of important economies that include Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, UK, and U.S. In the past year, it has also held a summit meeting and is upstaging G8 meetings in some instances. The exclusion of many of the large emerging economies, including China and India, from the G8 has significantly lessened the importance of the G8. *See* G-20, About the G-20, http://www.g20.org/about_index.aspx (last visited Sept. 5, 2009).

8. Kono, *supra* note 1, at 109.

9. *See* Shujiro Urata, *Competition Policy and Economic Development in East Asia*, 1 WASH. U. GLOB. STUD. L. REV. 15 (2002) (providing a detailed examination of competition policy regimes in Asia).

commitment that a country makes to allow foreign participation in the domestic market.[10] Entry requirements for financial institutions then provide the conditions for allowing both domestic and foreign institutions in its markets.[11]

Trade commitments are analyzed through the country's schedule of commitments under the General Agreement on Trade in Services (GATS).[12] While there are certain exceptions, the commitments made under such trade agreements represent a minimum level of liberalization that a country is willing to make towards a foreign counterparty.[13] The next dimension is the actual entry requirements imposed on foreign counterparties, including procedural and enforcement mechanisms.[14]

After a brief analysis of the level of harmonization in Asian countries within each of the dimensions cited above, it is argued that further progress and harmonization efforts are necessary in Asia within all dimensions; otherwise regional market integration will be surpassed by global market integration. To put it differently, global financial markets may become dominated by those countries that succeed in enhancing effective competition and innovation, perhaps even leading to disintegration of regional financial markets.

The following section will examine various conceptual issues relating to financial liberalization. The next section will look into the various commitments made in relation to GATS. The third section will scrutinize the actual entrance requirements of foreign counterparties and compare it with the commitments made in regional agreements. From this, the final section will analyze the extent to which trade agreements are being actively applied in the region, and what effect this may have on the progress of regional integration.

> This article attempts to demonstrate that financial services liberalization and proactive competition policy implementation are key ingredients for regional integration in the financial services markets. Progress in this area needs to be carried out in stages, with overall implementation sequential, but comprehensive. This represents a bottom-up approach to regional integration, with all three dimensions possessing similar importance and need for advance.[15]

The commitment of the three large economies of Asia to financial liberalization is essential for Asian regional integration to take place. Without viable and meaningful liberalization commitments and pro-active implementation, Asia will not be able to move progressively forward toward regional integration, which has a positive impact on the real economy. It is imperative to mention the credit crises that have gripped the financial markets in 2008, and continue to affect the outlook of economies. These crises have prompted some policymakers to question the safety of the market economy. But no policymaker would consider abolishing the market system. Rather, they would seek to modify it to ensure better regulation and safety as a result. This attitude is evident from the responses being made despite criticism towards financial institutions. Thus, it is unlikely that market liberalization will reverse, although the speed might slow. Fundamental and

10. *Id.* at 87.
11. *Id.* at 63.
12. *Id.*
13. *Id.*
14. *Id.*
15. *Id.* at 64.

progressive market liberalization is necessary for financial markets to thrive. In addition, better comprehension of financial regulation and liberalization is essential to ensure the stability of the global financial system.

II. Conceptual Issues and the Benefits of Financial Liberalization

> [The extent to which] foreign firms can operate in a certain sector affects the speed at which the financial sector develops. For both emerging and developing countries, opening their financial markets to foreign financial services providers raises the possibility of domestic financial institutions being taken over by foreign firms. This may lead to the financial sector being eventually monopolized by foreign interests. Hence, most countries do not agree to the complete opening of their financial markets, and usually place certain reservations on their liberalization.[16]

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

Taking a step back, the rationale for a country to repress the financial system would be primarily twofold: developmental reasons and rent seeking. Rent seeking often comes in the form of favorable interest rates and specialized financial institutions.[17] It may also come with the high price of lax credit policies and mounting non-performing loans. Many developing countries also establish "strategic" industries to channel resources.[18] Often it is taken for granted that the regulator will act in the best interest of the public.[19] But regulators may lack appropriate and sufficient authority to enforce rules effectively.[20]

Such diverging views make it imperative that a lively discussion take place within the country to understand the rationale of financial liberalization, its possible impact, and in what form the country would like to achieve a liberalized market. Developed countries tend to demand the opening of markets based on mutual commitments. This is advantageous to countries that already have a developed and liberalized market. Negotiations in financial services have reflected this tendency, with countries with developed financial markets making demands for liberalization on emerging market countries, and emerging market countries compromising to reach an agreement. This compromise is usually the result of horse-trading, with developing countries and developed countries compromising in different markets to reach an overall agreement.

16. *Id.*
17. *Id.* at 64-68.
18. Sourafel Girma & Anja Shortland, *The Political Economy of Financial Development*, 60 OXFORD ECON. PAPERS 567 (2008).
19. JAMES R. BARTH ET AL., RETHINKING BANK REGULATION: TILL ANGELS GOVERN 34-35 (2006).
20. Sebastian Miroudot et al., *The Impact of Pro-Competitive Reforms on Trade in Developing Countries* 52 (Organization for Economic Co-operation and Development Trade Policy Working Paper No. 54, 2007), *available at* http://www.olis.oecd.org/olis/2006doc.nsf/LinkTo/NT000092E2/$FILE/JT03229130.PDF. But such a requirement is part of the Basel Core Principles, Principle 1. Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* 2 (Bank for International Settlements, 2006), *available at* http://www.bis.org/publ/bcbs129.htm.

It is essential to understand the benefits of trade liberalization in financial services to comprehend the influence of competition policy and GATS negotiations. No member is being forced to make specific commitments, but commitments are made for the overall welfare that could be achieved through the World Trade Organization (WTO).[21] Competition policies will enable a regime for competition to be established, minimizing the negative effects of competitive markets, and laying down the rules for fair competition.

A. Economic benefits

In general economic theory, the participation of foreign firms in the financial market has multiple beneficial effects and some negative ones. There are a number of barriers and restrictions when a financial institution enters a foreign financial market. Management theory predicts that because foreign firms are not familiar with the customs, information, and knowledge of the local market, there will be added information and transaction costs to overcome. This is disadvantageous to foreign firms and is called the "liability of foreignness."[22] Thus, local firms initially have a natural advantage.

Despite the difficulties that foreign firms might have in entering a local market, there are potentially great merits from permitting their entrance. This limitation has been widely appreciated for goods,[23] but not so well for services.

Liberalization of financial services would allow foreign financial institutions to participate in the market, improving competition and efficiency of the market. Efficiency gains in financial services would be in terms of economies of scale and scope. Economies of scale can be gained by focusing on a specific area. Fixed costs would become lower per unit, and specialization would become possible. Economies of scope can be gained when one institution provides cross-sectoral services, taking advantage of their network and resources. Such an institution would be able to respond better to the needs of consumers. Competition from foreign financial institutions that are managed more cost-consciously would prompt local institutions to review their management and cost structure. This would result in lower prices and better services for consumers.[24]

Research suggests a correlation between market liberalization and economic growth.[25] The improved efficiency of local financial institutions as a result of competition from foreign financial institutions would contribute to the development of the markets through better and cheaper financial intermediation. This would in turn enhance the profitability of local financial institutions and add to economic growth.

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21. This follows David Ricardo's theory of comparative advantage. Library of Economics and Liberty, *The Concise Encyclopedia of Economics: David Ricardo*, http://www.econlib.org/library/Enc/bios/Ricardo.html (last visited Sept. 6, 2009).

22. Lilach Nachum, *Liability of Foreignness in Global Competition? Financial Services MNEs in the City of London* 1 (ESRC Centre for Business Research, Working Paper No. 229, 2002), *available at* http://www.cbr.cam.ac.uk/pdf/WP229.pdf.

23. Jeffrey D. Sachs et al., *Economic Reform and the Process of Global Integration*, *in* Brookings Papers on Economic Activity 1 (1995).

24. Nihal Bayraktar & Yan Wang, *Banking Sector Openness and Economic Growth* 3 (World Bank Policy Research, Working Paper 4019, 2006), *available at* http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2006/09/29/000016406_20060929142324/Rendered/PDF/wps4019.pdf/.

25. Roberto Chang et al., *Openness Can Be Good for Growth: The Role of Policy Complementarities* 1 (World Bank Policy Research Working Paper 3763, 2005), *available at* http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2005/10/31/000016406_20051031155510/Rendered/PDF/wps3763.pdf.

Further, efficiency enables the lending cost of financial institutions to be lowered, leading to possible growth.[26] Often when foreign firms enter the market, it induces foreign capital inflow as well. This adds foreign investment that is a prerequisite for economic growth in a country short of domestic savings.

There also are said to be real economic benefits, although the data is not always clear-cut. The OECD has estimated that gains in potential GDP per capita from pro-competitive reforms may be substantial for developing countries. As Table 1 indicates, pro-competitive trade reforms have the potential to bring substantial economic benefits on an individual basis. The World Bank estimates that more globalized developing countries generate growth averaging five percent a year, against minus one percent for less globalized countries.[27]

Table 1: Gains in Potential GDP Per Capita From Pro-Competitive Reforms

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

Source: Sébastin Miroudot, Enrico Pinali & Nicolas Sauter, "The Impact of Pro-Competitive Reforms on Trade in Developing Countries" *OECD Trade Policy Working Paper No 54* (15 June 2007), p. 26.

B. Managerial Expertise

Some of the greatest advantages from market liberalization in services, however, come from transfer of soft elements, such as information, know-how, and technology. In addition, the entrance of foreign financial institutions brings potential improvements in general management, accounting, database processing, and corporate governance.[28] These would all be beneficial to the consumer.

The transfer of technology, know-how, and personnel would take place, contributing to the formation of a basic market infrastructure. This enables (or forces) local firms to

26. Bayraktar, *supra* note 24, at 21.

27. News Conference, The World Bank, Report on Study Regarding Globalization, Growth, and Poverty (Dec. 5, 2001), *available at* http://go.worldbank.org/X103WD8FW0.

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

innovate processes and services to cater for the local market and become competitive in their own right.

C. Regulatory Implications

Permitting foreign firms to enter the market often is accompanied by the lowering of entrance requirements and clarification of their contents, or vice versa. This is to ensure that all parties are on an equal footing and will be judged on the same criteria. It also corresponds to the specific commitment of GATS regarding national treatment.[29] This assists in ruling out arbitrary decisions and in encouraging regulatory rules to be better drafted, disclosed, and scrutinized.

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

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

The threat from foreign firms, however, needs to be viewed in the long-run and placed within a larger picture. It can be argued that countries with smaller economies will benefit from open markets, as external forces will absorb any major disruption, limiting systemic risk to domestic markets.[30] When the host-country economy is either stagnant or in a crisis situation, a foreign financial institution, which often has a more diversified portfolio, can provide stability to the financial system.[31]

This can be countered by arguing that when the market is opened and foreign personnel enter the market, the host-country may become susceptible to economic difficulties of the home country or the wider international financial market.[32] Rapid opening of the financial market may have certain repercussions, and therefore, appropriate measures need to be considered, particularly through prudential regulation, to limit negative effects.

29. *See infra* section III.B.

30. Morris Goldstein & Philip Turner, *Banking Crises in Emerging Economies: Origins and Policy Options* 9-10 (Bank for International Settlements, Economic Papers No. 46, 1996), *available at* http://www.bis.org/publ/econ46.pdf?noframes=1. Some of the experiences in countries such as Canada and Australia during the credit crises in 2008 point towards such evidence as well.

31. George Clarke et al., *Foreign Bank Entry: Experience, Implications for Developing Economies, and Agenda for Further Research*, 18 The World Bank Research Observer 25, 43 (2003).

32. Joe Peek & Eric S Rosengren, *Collateral Damage: Effects of the Japanese Bank Crisis on Real Activity in the United States*, 90 Am. Econ. Rev. 30, 43 (2000).

There are also types of financial services liberalization that are more conducive to financial stability than others.[33]

Society-wide discussion needs to take place to understand the possible negative and positive effects that liberalization may have on the domestic economy. This is an imperative prerequisite because the initial economic outcome may be positive or seem negative. Opening of the market also needs to be carried out in a sequenced manner, so the economy can adjust to changes and form a consensus on the progress taking place. A country that, for whatever reason, is reluctant to liberalize all financial services trade and capital flows immediately should still consider the liberalization of those types of trade which promote stability and efficiency in the financial system. Such liberalization of the financial services trade: (1) promotes trade in a broad array of financial instruments; (2) allows the commercial presence or local establishment of foreign financial institutions (Mode 3 trade in GATS terms); (3) does not unduly restrict the business operations of similar local establishments; (4) strengthens institutional capacity (such as transparency, regulation and supervision, etc.); and (5) improves financial sector efficiency.[34] Liberalization of this nature is also likely to promote less distorted and volatile capital flows, both directly through the types of financial flows it encourages and indirectly through its effect on institutional capacity.[35]

Often, the possible impact of liberalization of a financial market is not well-perceived by the domestic economy. Protectionism can be rife, and so-called "vultures" from abroad have been criticized for abusing and even destroying the local economy and reaping excessive profits.[36] But financial services liberalization is not a simple question of whether to open or not. Liberalization is inevitable for any economy that has either an excess or a shortage of domestic savings. Further, when economies are increasingly globalized, remaining oblivious to financial services trade liberalization is not possible. In the case of trade in goods, it is difficult to remain isolated from trade with other countries when all countries depend on trade with others for economic development. This holds equally for financial market liberalization because financial services are a necessary component of a growing economy through their intermediation in the flow of savings to productive investment.[37]

If that is the case, what is required is preparation and planning for a well-coordinated and appropriately sequenced liberalization. This would enable countries to reap the maximum benefits from liberalization of financial services. If diplomatic negotiations lead to liberalization of financial services under the pressure of market forces, a country should

33. For further discussion of this topic, *see* Masamichi Kono & Ludger Schuknecht, *Financial Services Trade, Capital Flows, and Financial Stability* 1 (World Trade Organization, Staff Working Paper ERAD-98-12, 1998), *available at* http://www.wto.org/english/tratop_e/serv_e/finance_e/finance_e.htm.

34. *Id.* at 1-2.

35. *Id.*

36. Dustin G. Hall, *The Elephant in the Room: Dangers of Hedge Funds in our Financial Markets*, 60 FLA. L. REV. 183, 184 (2008). One case in point is the attack on the sterling pound in 1992 by the fund led by George Soros, which resulted in the UK having to leave the European Exchange Rate Mechanism.

37. *Cf.* In Conversation with Alan Greenspan, The LSE Hay Lecture Series, Podcast (Oct. 1, 2007), *available at* http://archive.hayfestival.com/. For countries with limited domestic financial intermediaries, liberalizing their financial services may be the only means in which to gain access to financial sources. For example, countries like Estonia, which became independent in 1991 and whose financial system is dominated by foreign service providers, growing domestic institutions has little basis and appeal.

maximize the benefits by developing well-coordinated policies and implementing them in a strategic manner. Global financial services liberalization is an opportunity to be seized, not a disaster with the only option being the insulation of domestic markets.

III. Schedule of Commitments of GATS

Financial services commitments are the second most extensive made commitments by developing countries. Seventy-three percent of developing and least-developed countries have commitments in the financial sector.[38] As discussed in section II, the possibilities that a liberalized financial sector brings to an economy can be vast. But due to domestic political considerations and protectionist or nationalist sentiments, engagement in financial liberalization has not been straightforward for any country. In this respect, the high proportion of commitments made in the financial sector is a significant achievement.

This section seeks to investigate the financial sector commitments in the GATS and free trade agreement (FTA) negotiations. Finance is a core element of running an economy, as efficient financial intermediation enables industries to be developed. Foreign capital can play an important role in this process if countries are able to recognize this and apply financial liberalization measures appropriately.[39]

A. Overview of the Role of Schedule of Commitments and Its Significance in GATS

General obligations of GATS[40] are basically non-negotiable, so they are not included in the schedule of commitments. But specific obligations are subject to negotiation and listed in the schedule of each member.

Part III of GATS[41] requires that members make specific commitments to market access and national treatment. Specific commitments are subject to negotiation and then listed in the schedule of commitments, which states the specific conditions of market access and national treatment that members grant for each sector. Parts III and IV of GATS need to be read together to understand the way in which a schedule of commitments is drafted,[42] its contents,[43] and its modification.[44] The schedule of commitments is an important legal document in that it provides the particulars of market liberalization commitments by each member and is the final product of negotiations between members.

Progressive liberalization is an objective of GATS, as set out in Part IV. This is achieved by amending and modifying the schedule to allow greater liberalization in successive rounds.[45] These clauses prevent members from taking measures that are regressive

38. Juan A. Marchetti, *Developing Countries in the WTO Services Negotiations* 12 (WTO Staff Working Paper ERSD-2004-06 2004).

39. *See* Nachum, *supra* note 22.

40. *See* General Agreement on Trade in Services, arts. II and III, Apr. 15 1994, 1869 U.N.T.S. 183 (1994) [hereinafter GATS] (noting the general obligations in GATS are the most favored nation (MFN) clause and the transparency requirement).

41. GATS Part III Specific Commitments, *supra* note 40, arts. XVI - XVIII.

42. GATS, *supra* note 40, art. XIX.

43. *Id.* art. XX.

44. *Id.* art. XXI.

45. *Id.* art. XIX ¶ 1.

or trying to maintain the status quo. Members must endeavor to improve commitments from the 1995 financial services agreement, making their 1995 schedules a minimum requirement for future negotiations.

The article on market access prevents members from making commitments that are based on an economic needs test.[46] This is a negative list, in that commitments for the service sectors inscribed in the schedule must be made in conformity with the requirements in Article XVI, unless limitations are explicitly entered in the schedule as a result of negotiations with trading partners at the WTO. Commitments that do not come under the ambit of market access and national treatment can also be negotiated and included in the schedule as additional commitments.[47]

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

(a) terms, limitations and conditions on market access;

(b) conditions and qualifications on national treatment;

(c) undertakings relating to additional commitments;

(d) where appropriate, the time-frame for implementation of such commitments; and

(e) the date of entry into force of such commitments.[48]

It is envisioned that these items will be included in the schedule with further instructions on the structure of the schedule.[49] It is also noted that the schedule of commitments is an integral part of GATS.[50]

B. The Implications of Members' Schedules

The structure of members' schedules will be affected by the legal framework of the country. Due to its federal structure and state laws, it became necessary for the United States to list the content of all the state laws that do not conform to the basic agreement negotiated. Insurance regulation in the United States is conducted by state insurance regulators, and there is no federal agency responsible for insurance regulation. Thus, in its Additional Commitments, the United States notes that the National Association of Insurance Commissioners is promoting harmonization of state insurance regulation.[51] This is a result of negotiations with Japan, but if the United States were to harmonize insurance regulation, it would result in significant liberalization measures in terms of GATS. The current structure of insurance regulation in the United States is complex and vertically segregated by state. This does hamper foreign firms from entering the U.S. market.

Part IV of GATS requires liberalization to be progressive, and this is to be achieved through successive rounds agreeing on progressive liberalization. But the experience in financial services has not been smooth, with the inability to reach an agreement at the end of the Uruguay Round and the necessity of extending the deadline to enable an agreement in the form of the Fifth Protocol to the GATS.

46. *Id.* art. XVI.
47. *Id.* art. XVIII.
48. *Id.* art. XX ¶ 1.
49. *Id.* art. XX ¶ 2.
50. *Id.* art. XX ¶ 3.
51. United States of America, Schedule of Specific Commitments, Attachment to the United States Schedule, Additional Commitments Paper I(a) 27 (1998).

The progress to date that has been made in the Doha Round that started in November 2001 further indicates the difficulty of depending on negotiation rounds to move forward. In terms of financial services, some countries have yet to ratify the Fifth Protocol due to domestic constraints.[52] While much progress has been made with the accession of new members, there remain barriers to the speed of liberalization of pre-existing members.[53]

The European Union as a regional community also has a unique approach to GATS. It negotiated as a single entity and listed the divergence of each member state in its schedule. Generally, GATS commitments list horizontal commitments in services, followed by sector-specific commitments. The European Union considers Mode 3 (commercial presence) as the mode in which liberalization must be given priority.[54] The European Union, however, claims that limitations applied through horizontal commitments of members are being abused, affecting the financial services sector in particular, by the following:

"-Unspecified authorization [sic] requirements;

-Economic needs tests;

-Certain limitations on the purchase or rental of real estate;

-Restrictions on equity holdings;

-Nationality requirements;

-Certain tax and subsidy measures;

-etc."[55]

The Uruguay Round resulted in progress on commitments in market access and national treatment in Mode 3, in particular. More specifically, Mode 3 was the mode in which the most advanced and comprehensive commitments to liberalization were made in financial services.[56] Liberalization of other modes was given lower priority due to lack of actual business engagement or reservations from regulators.[57]

Mode 3 becomes relevant when suppliers of services establish commercial presence for their businesses in the territory of another country. Commercial presence is defined under GATS as "any type of business or professional establishment, including . . . juridical person, or . . . the creation or maintenance of a branch or a representative office."[58] The Understanding on Commitments in Financial Services (the Understanding) defines commercial presence as "wholly- or partly-owned subsidiaries, joint ventures, partnerships,

52. Report of the Meeting Held on 27 November 2006 (S/FIN/M/53), WTO Committee on Trade in Financial Services (noting that Brazil, Jamaica, and the Philippines have yet to complete ratification of the Fifth Protocol).

53. To mitigate the difficulty of agreeing in multilateral negotiations in the WTO, some members have been promoting the use of Economic Partnership Agreements (EPA) that negotiate liberalization and economic cooperation on a bilateral basis. For example, even Japan, which is a latecomer to regional economic agreement, has a stated policy to promote EPAs to complement current negotiations of the WTO. *See, e.g.*, Ministry of Foreign Affairs, Free Trade Agreement and Economic Partnership Agreement, http://www.mofa.go.jp/policy/economy/fta/index.html (last visited June 8, 2007).

54. Council for Trade in Services, Special Session, *Communication from the European Communities and Their Member States GATS 2000: Financial Services*, (S/CSS/W/39, Dec. 22, 2000), ¶ 15.

55. *Id.* ¶¶ 8-10.

56. *Id.* ¶ 15.

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

58. GATS, *supra* note 40, art. XXVIII ¶ d.

sole proprietorships, franchising operations, branches, agencies, representative offices[,] or other organizations."[59] The Understanding appears to be more comprehensive in its definition, making clear that, if adopted by a WTO member, it allows foreign parties to enter a market in more diverse or capital-light forms.

The European Union insists that commercial presence should be permitted in the legal form of the member's choice.[60] Generally, establishment via local incorporation is more costly than branching. Local incorporation frequently requires higher minimum capital, and regulatory monitoring is stricter. Local incorporations need to meet the various regulatory requirements on a single-entity basis rather than on a group basis. In many Asian countries, foreign financial institutions are required to be licensed as local incorporations. Otherwise, their operational scope is limited and not subject to the local safety nets available.[61] The Understanding provides for full liberalization of Mode 3 in this regard, but in some cases, prudential regulation calls for certain limitations to be imposed under the so-called "prudential carve-out."[62] Some countries have inscribed this reservation explicitly in the head notes of their schedules of commitments; for example, Japan has listed in its head note that it "shall not be prevented from taking measures such as non-discriminatory limitations on juridical forms of a commercial presence."[63]

It is becoming increasingly difficult to distinguish between Modes 1 and 2 in financial services, as the Internet and other forms of electronic trading network enable cross-border trade to be arguably indistinguishable from consumption abroad. The Committee on Trade in Financial Services has been discussing this issue and will continue to do so.[64] The framework for protection of consumers may be different for the different modes. In many cases, consumer protection and safety net measures are not provided for cross-border transactions. While some WTO members request that the definition of Modes 1 and 2 be clarified, others consider the difference insignificant as liberalization has taken place without such classification.[65] Mode 1 may cause greater concern to regulators, as the identification of the service provider is normally more difficult for cross-border trade than for Modes 2 or 3.[66]

The movement of natural persons, Mode 4, is sometimes limited in a member's schedule by listing the proportion/number of board members that need to have the member's nationality. If the local market lacks officials having the required qualifications or expertise in the respective sector, it may act as a de facto restriction to entry because filling management positions and jobs requiring higher skills will be more difficult under such a limitation.

59. World Trade Organization, *Services: Agreement Understanding on Commitments in Financial Services*, http://www.wto.org/english/tratop_e/serv_e/21-fin_e.htm (last visited Sept. 5, 2009).

60. *See* Council for Trade in Services, *supra* note 54, ¶ 16.

61. Hiroyuki Nakai, *The Real Objective: Protectionism or Supervisory Requirement?*, FIN. BUS., Winter 2007 at 95-97 (in Japanese).

62. GATS Annex on Financial Services, *supra* note 40, ¶ 2.

63. Japan-Singapore Economic Partnership Agreement, Japan-Sing., Japan's Schedule of Specific Commitments, Annex IV(C), http://www.mofa.go.jp/region/asia-paci/singapore/jsepa-5-3.pdf.

64. WTO Secretariat, *Report of the Meeting Held on 19 September 2005*, Part D, S/FIN/50 (Sept. 23, 2005).

65. Some argue that the difference between Modes 1 and 2 should be discussed in the horizontal context, covering all service sectors. WTO Secretariat, *Report of the Meeting Held on 23 June 2005*, Part C, S/FIN/49 (Aug. 24, 2005).

66. *Id.* ¶ 17.

Facilitating the transfer of knowledge and know-how to developing countries and making the commitment nationally acceptable has, at times, made it necessary to accept some nationality requirements in the WTO negotiations.

C. GATS Commitments of China, India, and Japan

The schedule of commitments is a list of formal undertakings towards financial liberalization by each member of WTO. This section, while mainly interested in the three countries discussed above, also includes information on other Asian countries to make the study relevant in Asia. Table 2 compiles the specific commitments made by China, India, and Japan. The table focuses on commitments in the area of banking (deposit taking and lending) and other financial services (securities dealing, trading, and underwriting) but does not include insurance services. Also, for the sake of simplicity, the mode of supply listed is mainly Mode 3. Practically all countries examined have unbound Modes 1, 2, and 4; in other words, they do not permit supply in this mode by a foreign supplier. Market access is where the bulk of commitments are made, and national treatment is either unbound, exclusive to banking, or for securities listed the same as banking.

Some studies attempt to quantify the schedule of commitments in GATS to compare financial liberalization.[67]

1. *Modes*

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

2. *Timing of Accession*

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

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67. *See, e.g.*, Ying Qian, *Financial Services Liberalisation and GATS*, *in* The Internationalisation of Financial Services (Stijn Claessens & Marion Jansen eds., 2000); Ying Qian, *Financial Services Liberalisation and GATS-Analysis of the Commitments Under the General Agreement on Trade in Services (GATS) at the World Trade Organization (WTO)*, paper presented at PECC Trade Policy Forum Meeting Options for the WTO 2000 Negotiations July 8-9, 2003, http://www.pecc.org/finance/forum2003/Session6-Ying(ref).pdf; Patricio Contreras & Soonhwa Yi, *Internationalization of Financial Services in Asia-Pacific and the Western Hemisphere*, Dec. 2003, *available at* http://www.pecc.org/finance/default.htm; Piritta Sorsa, The GATS Agreement on Financial Services—A Modest Start to Multilateral Liberalisation, International Monetary Fund, Working Paper No. 97/55) *available at* http://www.imf.org/external/pubs/ft/wp/wp9755.pdf.

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

3. *Geographical Limitations*

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

4. *Social Interests*

Many Asian countries have scheduled the need for social, public, and developmental interests to be a consideration or, in some cases, a precondition for a foreign financial institution to be authorized to operate. Malaysia and India have included language-related issues to such interests in their horizontal commitments.

5. *Numerical Restrictions and Economic Needs Tests*

Although numerical restrictions such as the number of suppliers or market-share and economic-needs tests are in principle to be eliminated under GATS[68] unless specified in their schedule, many countries have in practice opted to schedule various reservations. India limits the number of bank licenses to twelve licenses per year for both existing and new banks.

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

6. *Type of Legal Entity and Participation of Foreign Capital*

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

68. GATS, *supra* note 40, art. XVI.

Table 2: Capital Participation by Foreign Financial Institutions

	Banking	Securities business
China	Subsidiary: assets more than USD10 bln Branch: assets more than USD20 bln Joint bank: assets more than USD10 bln	Foreign investment increased to 49%
Vietnam	Rep office, branch or 50% foreign capital joint venture bank. Parent bank has total assets of more than USD20 bln.	Foreign participation to 49%
India	Only through branches of foreign banks licensed and supervised in home country.	Foreign equity limited to 49%
Indonesia	Locally incorporated, joint venture bank only. Acquisition of local bank up to 49%	Listed non-bank up to 100%. Through establishment of broker/dealer.
Japan	—	Investment trust must be juridical person established in Japan.
Korea	A person may own up to 4% of bank stock and 15% of provincial bank stock without authorisation. Only branches of foreign bank which rank among world's top 500.	Only rep office, branches or joint venture permitted. Joint venture foreign participation minimum is 50%. Equity participation in existing securities firm is limited to less than 50%.
Malaysia	Equity participation limited to 30%.	Locally incorporated, joint venture company only, with less than 30% shareholding.
Philippines	Not exceeding 30% of voting stock or 40% upon approval by the President.	Foreign equity limitation of 51%.
Singapore	Single group of foreign shareholder can only hold up to 5% of a local bank's share. A local bank's share held by foreigners is in aggregate limited to 40%.	—
Thailand	Maximum foreign equity participation limited to 25% of paid up registered capital.	Maximum foreign equity participation 49%.

The schedules clearly show that many countries continue to limit foreign capital participation at thirty or forty-nine percent thresholds, which is often the benchmark for significant shareholdings. Japan and India do not specify any such restrictions upon banks in their schedules.

As for securities firms, many countries limit foreign participation to a level somewhere between forty-nine to fifty-one percent, such as China (forty-nine percent), Vietnam (forty-nine percent), India (forty-nine percent), Korea (fifty percent), the Philippines (fifty-one percent), and Thailand (forty-nine percent). Malaysia limits this to thirty percent. In general, one would expect that foreign participation might be more permissible from the viewpoint of the authorities for securities firms compared to banks, due to the relative importance banks have in a country's financial system. But it is noted that many countries actually restrict foreign ownership in securities businesses, while other often stricter forms of market access limitations are applied to banks.

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

Apart from limitations on legal form, China requires that the commercial presence maintain a minimum amount of assets, varying according to the type of legal form, with regard to banking. Vietnam, India, and Korea do not permit local incorporation of foreign banks, committing to allow only representative offices, branches, or joint ventures.

7. *Branching Restrictions*

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

Table 3: Branching Restrictions and ATM Network Participation

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

Geographic restrictions may have similar effects on foreign financial service providers as branching restrictions because business is limited geographically, and the size of the market in the region may be limited (Table 3). Singapore appears to have a strict regime, allowing premises at only one location for foreign banks, but its uniqueness as an island nation may mitigate the effect on foreign providers in restricting market access.

8. *Local Expertise Requirement*

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

D. FTAs of the Three Countries

Most of the FTAs that have been signed globally are bilateral trade agreements. China has FTAs with Chile, Pakistan, and the Association of South East Asian Nations (ASEAN). India has so far signed an agreement with Bhutan, Chile, Singapore, and Sri Lanka. Japan does not have so-called FTAs, but does have economic partnership agreements (EPAs) with many countries and is in FTA negotiations with India. EPAs are similar to FTAs, but are more comprehensive in that they include economic cooperation clauses as well. While GATS has been a launching pad for liberalization means, bilateral trade agreements further liberalization and benefit other countries a result of most favorite nation clauses that are often included.

For some countries, FTAs bring about significant liberalization and/or market economy concepts. In the case of Singapore, the FTA with Australia required that Singapore apply competition law to the financial sector as well.[69]

The FTAs that have been agreed have not presented the financial sector with greater significance than the GATS. This is perhaps because for FTAs to have an impact on the financial sector, the counterparty would need to be a country with more advanced financial services sector wanting to enter the market. China and India have yet to agree to FTAs with such a country, but because they are in negotiation with countries like Australia, Japan, and Korea, this may produce financial liberalization greater than GATS.

One of the important developments in terms of the WTO has been the accession of Russia. Russia has become one of the most important emerging economies, together with China and India, especially given its large natural reserves. Russia's negotiation to accede the WTO has been ongoing since 1993. Russia has recently indicated its intention to renegotiate its accession as a custom union with Belarus and Kazakhstan. This would mean that Russian negotiations would have to be re-opened, and accession will be equal for Belarus and Kazakhstan as well. Russia is in a unique position in terms of WTO accession, as its accession will have an important impact on trade liberalization worldwide, given its rising economic strength and large resources. It also demonstrates the importance that such large emerging economies potentially have in world affairs and their impact on trade liberalization.

69. In interviews with Singaporean lawyers in February 2007.

Table 4: Schedule of Commitments of GATS in Financial Services (Banking and Other Financial Services) of China, India and Japan

General		Mode 3 market access (Banking related)			Mode 3 national treatment (Banking)	Mode 3 market access (securities)
		Capital participation/ Licensing	**Local currency**	**Local clients**		**Capital participation /Licensing**
China (Accession 2001)	Geographic coverage Foreign exchange no restrictions.	Solely prudential and no economic needs test. **Within 5 yrs**: any existing non-prudential measures on ownership, operation, and juridical form shall be eliminated. Subsidiary Total assets >USD10 bln. Branch Total assets >USD20 bln Chinese foreign joint bank Total assets >USD10 bln	Geographic coverage **Upon accession**: Shanghai, Shenzhen +2 cities. **Within 2 yrs** accession: Guangzhou, +4 cities. **Within 3yrs**: Kunming, Beijing +1 cities. **Within 4yrs**: Shantou +3 cities. **Within 5 yrs**: no restrictions Local currency business 3 yrs business operation in China and 2yrs profitable business	Foreign exchange business, no restriction. Local currency: **within 2 yrs**, to Chinese enterprises, **within 5 yrs**, to all Chinese clients		Solely prudential with no economic needs test. **Upon accession** Joint ventures with up to 33% foreign investment to conduct domestic securities investment fund management. **Within 3yrs**: foreign investment increased to 49% Within 3yrs: foreign joint ventures (1/3 minority ownership) to engage in underwriting and trading of B and H shares.
India		Only through branch operations of a foreign bank licensed and supervised in home country. Not more than five licences a year for both new entrants and existing banks. Investments in other financial services companies not to exceed 10% of own funds, or 30% of invested company's funds			Local advisory board with SME expertise to be established with Indian nationals members except CEO. Members must be approved by Reserve Bank. Public sector enterprises only allowed to invest surplus funds with commercial bank incorporated in India.	Branches: allow with Indian bank license Financial services company: foreign equity not exceeding 51%
Japan	Application of Understanding of Financial Services.				Deposit insurance does not cover deposits taken by branches of foreign banks.	Commercial presence for investment trust management services must be juridical person established in Japan.

IV. Actual Entrance Requirements for Foreign Financial Services Providers

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

The objective of this section is an attempt to ascertain the effect on actual market liberalization of commitments made in GATS. In addition, reference to the level of liberalization in each country will enable an analysis of the level of convergence of regulatory standards. There is also an element of confirming the implementation of trade agreements into real measures.

Some time has passed since GATS was signed. Considering the objective of progressive liberalization under GATS, the assumption would be that actual entry requirements for foreign banks and securities firms would be more or less the same level or less restrictive than the specific commitments made in the schedules of commitments. To make for a meaningful analysis, and due to limited availability of required information, the actual entry requirements for foreign financial institutions in China, India, and Japan have been investigated.[70]

A. Significance of Entry Requirements for Foreign Financial Institutions

Financial services, especially banks, have been heavily regulated compared to other industrial sectors because of financial stability and other prudential policy concerns. Entry requirements are an important part of this regulatory consideration because they restrict operation in the financial sector to entities that have fulfilled specific minimum prudential requirements and that are likely to be able to satisfy the mandate of maintaining a sound and stable financial system.[71]

Entry requirements, however, are not necessarily imposed solely for the purpose of maintaining the soundness and/or stability of the financial system. Some entry requirements have the effect of limiting competition, leading to efficiency losses and underdevelopment of financial markets.[72] This especially could be the case with restrictions on the entry of foreign banks, which may be superior in their financial technology and expertise. While many studies have shown that easier foreign bank entry improves bank performance,[73] the inclination of countries to restrict market entry is strong even taking into account the possibility of sequenced liberalization. Most countries are not against financial liberalization per se, particularly when they wish to make use of foreign capital and expertise for economic development and growth. But the policy that appears from an overview of their financial roadmaps is one that first concentrates on increasing the competitiveness of their financial markets, mainly through consolidation and encouragement

70. Data used in this section was collected for a research project sponsored by the Financial Services Agency of Japan. Mamiko Yokoi-Arai & Takeshi Kawana, Competition Policy in the Banking Sector of Asia (2007), *available at* http://www.fsa.go.jp/frtc/seika/discussion/2007/20071204-1.pdf.

71. There are various theories for the rationale of entry requirements, but we only consider the main objective of financial stability. *See also* Barth, *supra* note19, at 49-52 (providing other theories on entry requirements).

72. *Id.* at 50.

73. Asli Demirgüç-Kunt et al., *Opening to Foreign Banks: Issues of Stability, Efficiency, and Growth*, *in* The Implications of Globalization of World Financial Markets (Seongtae Lee ed., 1998).

of joint ventures, before allowing greater financial liberalization to take place and introducing foreign competition in full force.[74]

Applications for bank entry in most countries are said to require the submission or fulfillment of the following:

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

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

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

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

Some countries will require a foreign bank to enter in a particular juridical form of commercial presence. For example, there is an important distinction between a branch and a subsidiary. A subsidiary is a separate legal entity from the main bank, whereas a branch is not. The distinction becomes significant when a foreign bank becomes insolvent. Because a branch is part of the legal entity established in the home country, its assets will be directly subject to claims by the creditors of the entire bank. In contrast, a subsidiary is an independent legal entity, and therefore it normally will be legally shielded from liquidation procedures abroad.

This will also have direct implications on regulatory capital and is the primary reason why, as witnessed in the GATS commitments of countries such as Vietnam and Korea, some countries have imposed requirements in regard to the assets of the parent bank when

74. Yokoi-Arai & Kawana, *supra* note 70.

authorizing the opening of a branch. Another approach is to require a certain level of branch capital to be set aside for protecting domestic depositors, such as in China.

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

B. Country Studies[75]

The study has been based on information available in August 2008. While the main source of information will be the laws and regulations that the regulatory authorities have published, we will also use information provided by experts in each market obtained through various interviews.

1. *China*

Domestic commercial banks are subject to a relatively strict authorization regime for permitted activities and branches. Each activity requires authorization from the China Banking Regulatory Commission (CBRC).[76] Interest rates are restricted for deposit rates and lending rates (both ceiling and floor rates) in accordance with the People's Bank of China Law.[77] The government also regulates the fees for services that commercial banks provide.[78] Promissory notes, checks, remittances, and payment collection services that are settled in the local currency are subject to price controls determined by the CBRC and the Ministry in Charge of National Development and Reform Commission. Branching was restricted to only one branch and three ATMs in any one city,[79] but has since been liberalized allowing approval to the application of the branching of the commercial banks.[80] Further, CBRC now allows state-owned commercial banks and joint-stock commercial banks to establish bank card centers, instruments centers, capital operating centers as well.[81]

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75. *See, e.g.*, Michael Gruson & Ralph Reisner, *Regulation of Foreign Banks: Banking Laws of Major Countries and the European Union*, Vol. I, II & III (4th ed., Lexis Nexis 2005).

76. Commercial Banking Law of China (promulgated by the Standing Comm. Nat'l People's Cong., May 10, 1995, effective July 1, 1995), art. 3, *translated at* http://www.asianlii.org/cn/legis/cen/laws/cblotproc396/ (last visited Sept. 5, 2009).

77. People's Bank of China Law (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 18, 1995, amended Dec. 27, 2003), art. 28, *available at* http://www.pbc.gov.cn/english//detail.asp?col=6800&ID=22 (last visited Sept. 5, 2009).

78. Provisional Rules Governing the Pricing of Commercial Bank Services, art 6-7, *available at* http://www.cbrc.gov.cn/english/home/jsp/docView.jsp?docID=282 (last visited Sept. 5, 2009).

79. China Banking Regulatory Commission, Decree of China Banking Regulatory Commission Decision on Amendments to Bank Licensing Policies and Procedures No. 1, 2003, (July 1, 2003), http://www.cbrc.gov.cn/english/home/jsp/docView.jsp?docID=278.

80. Measures for the Administration of Interbank Lending (promulgated by .the People's Bank of China, June 8, 2007, effective July 3, 2007) *translated at* http://www.for68.com/new/2008/5/wa800617552112258002 21660-0.htm (P.R.C.).

81. Regulations Governing the Establishment of the Intra-city Business Offices by the Commercial Banks (promulgated by the People's Bank of China, Feb. 21, 2002, effective Apr. 23, 2003) *translated at* http://www.pbc.gov.cn/english//detail.asp?col=6400&ID=57&keyword=ATM (P.R.C.)

a. Distinct Rules for Foreign Financial Institutions

China has distinct rules for foreign banks, although they have been eased considerably since December 2006 because of GATS commitments to liberalize local currency business.[82] Geographical restrictions on local currency businesses have been abolished, and foreign financial institutions are able to supply local currency business to firms and individuals upon fulfillment of certain requirements. But for the purpose of depositor protection, foreign bank branches can only accept local currency deposits from Chinese nationals in the form of time deposits greater than one million renminbi.[83]

Foreign banks are defined as joint capital banks, joint venture banks, and branches and representatives of foreign banks.[84] To apply for local currency business, such banks and branches must have been operating in China for the previous three years, have been profitable for the last two years, and fulfill the prudential requirements of the CBRC.[85]

Detailed capital and asset criteria have been defined. A foreign financial institution is required to hold a minimum of one billion renminbi or equivalent of registered capital, and to allocate a minimum of 100 million renminbi operating capital for each branch opened in China.[86]

There are separate requirements for each type of legal form, as discussed below. Other requirements are as follows: the institution must have been continuously profitable, have experience in international finance, have measures to combat money laundering, must be subject to effective regulatory oversight in the home country, and must be able to clear other prudential requirements.[87]

The approval process for setting up a foreign bank appears to take a considerable amount of time. The preparatory approval is said to take up to nine months, which is followed by a final approval process, which can take up to two months. The applicant is also required to obtain a business license from the local industry and commerce bureau before opening business.[88]

b. Legal Forms

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

82. *See generally* Regulations of the People's Republic of China on Administration of Foreign-Funded Banks (promulgated by the Standing Comm. Nat'l People's Cong., Nov. 8, 2006, effective Dec. 11, 2006), *translated at* http://www.cbrc.gov.cn/english/home/jsp/docView.jsp?docID=2871 [hereinafter Regulations Foreign Funded].

83. *See id.* ch. III, art. 31.

84. *Id.* ch. I, art. 2.

85. *Id.* ch. III, art. 34.

86. *Id.* ch. II, art. 8.

87. *Id.* ch. III, art. 34.

88. *Id.* ch. II, art. 19.

i. Capital Investment From a Solo Foreign Financial Institution or Joint Foreign Financial Institutions

Holders of capital (or shareholders) in a bank must be financial institutions. Majority shareholders must be commercial banks that have had a representative office in China for more than two years.[89] The majority shareholder must also have assets greater than $10 billion, and must fulfill the capital adequacy requirements of the CBRC.[90]

ii. Joint Ventures

Joint ventures are required to be owned by foreign financial institutions and Chinese financial institutions. The majority foreign shareholder must be a commercial bank, with an established representative office and more than $10 billion in assets, and must fulfill the capital adequacy requirement of the CBRC.[91]

iii. Branches of Roreign Financial Institutions

To establish a branch, the following must be satisfied in addition to the above requirements. The parent bank must have a minimum of $20 billion in assets, must fulfill the prudential requirements of the CBRC, and must have had a representative office for more than two years.[92] Foreign bank branches are limited in their deposit-taking business in local currency acceptance to time deposits that are larger than one million renminbi.[93]

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

c. Acquisition of Local Banks

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

As for foreign financial institutions, they may directly or indirectly acquire the equity of a domestic bank. There is no statutory limitation on the acquisition of listed domestic banks. But the CBRC does not allow foreign financial institutions to acquire more than a twenty-five percent ownership of unlisted domestic banks. As a result, Chinese bank shares have been heavily purchased by foreign financial institutions. By July 2006, twenty-six foreign financial institutions purchased equity of eighteen domestic banks totaling $17.9 billion.

89. *Id.* ch. II, art. 10.

90. *Id.*

91. *Id.* ch. II, art. 11.

92. *Id.* ch. II, art. 12; Hearing Before the H. Fin. Servs. Comm., at 9 (June, 6 2007) (statement of the Honorable Donald L. Evans, Chief Executive Officer, The Financial Services Forum), *available at* http://financialservices.house.gov/hearing110/htevans060607.pdf.

93. Regulations Foreign Funded, ch. III, art. 31.

Foreign banks are not permitted to own 100% of their subsidiary. Ownership of Chinese banks by foreigners is limited to twenty-five percent, and approval is needed for foreign banks to own more than five percent of securities. Ownership of securities houses by foreigners is limited to twenty-five percent of capital.

In 2007, CBRC announced plans to introduce regulations on controlling shareholders of banks.[94] Consultation is ongoing, and it is likely that changes will be made to the acquisition of controlling shareholding by foreign investors.

2. *India*

Foreign banks that are considering entering India must comply with the general entry requirements and the additional foreign bank entry requirements. The Indian government has a policy of limiting the number of banks through consolidation, and it is unlikely that new licenses will be made based on an economic needs test. Nonetheless, there has been an increase in the number of foreign banks in recent years, which could indicate an easing of restrictions on foreign bank entries.

a. Distinct Rules for Foreign Financial Institutions

Discretion on the granting of banking licenses resides with the Reserve Bank of India (RBI), which also determines the condition for entry. Without specific authority, even a court order cannot overturn a decision made by RBI.[95]

Private banks have only been permitted in India since 1993. Twelve domestic banks and fifteen foreign banks with bank licenses were granted before 1998. Until relatively recently, bank license were rarely issued. Further, as a result of the decision of the Narasimham Committee on Financial Sector Reforms in 1998, efforts were made to create a limited number of robust banks. But in recent years, the number of both domestic and foreign banks has grown distinctly in India. The interest in the Indian economy is perhaps in the backdrop of this increase, but the easing of restrictions on the number of bank licenses in also evident from the changing structure of the banking industry.

From the initial number of twelve domestic banks and fifteen foreign banks, by June 2009, India has fifty-three commercial banks,[96] and there are now thirty-two foreign banks operating in India with 293 branches. Another forty-three foreign banks were also operating in India through representative offices.[97]

While there is no distinct rule for the licensing of foreign banks, only five banking licenses are admitted annually to foreign banks. Foreign banks must establish a local advisory board, and the chairman must be approved by the RBI. In addition, the Banking Law states that foreign banks must comply with the following conditions:

94. CRBC, *Public Notice of the CBRC to Solicit Public Comments on the Rules Governing Bank Controlling Shareholders*, Draft, http://www.cbrc.gov.cn/english/home/jsp/docView.jsp?docID=200806116E1306BB533CB019FFE661541E8F0900.

95. Shivabhai v. Ahmedabad, Gujarat High Court (AIR 1986 Guj. 19).

96. This includes twenty nationalized banks, eight banks that are associated with the State Bank of India, and twenty-five other commercial banks. RBI, A PROFILE OF BANKS: 2007-08, at 87 (2008), *available at* http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/87122.pdf.

97. RBI, ANNUAL REPORT: 2008-09, at 247 (2009), *available at* http://rbidocs.rbi.org.in/rdocs/AnnualReport/PDFs/IRAR200809_Full.pdf.

i. management of the bank is in the public interest of India,
ii. it does not result in discrimination towards Indian banks, and
iii. it complies with Indian law.[98]

India requires that $25 million in capital be brought in for the opening of the first branch of a foreign bank. Branch expansion is considered on an annual basis.[99]

b. Legal Forms

Foreign banks are only allowed entry via branches or joint venture banks with foreign capital below fifty-one percent.

c. Acquisition of Local Banks

Acquisition of more than five percent of shares of private banks requires the approval of the RBI.[100] To obtain ten to twenty percent of shares, the acquirer is assessed on its fitness and properness, experience, internal controls, and compliance record.[101] In 2004, all banks were prohibited from acquiring more than five percent of another banks's shares.[102]

Foreign banks are not allowed to invest in local foreign institutions beyond ten percent of their own capital, or more than thirty percent of the institution receiving investment's capital.

3. *Japan*

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

a. Distinct Rules for Foreign Financial Institutions

A foreign bank is defined as any entity authorized to engage in banking under the legislation of its home country.[103] In other words, the entity making an application must be a bank in their home country. The Banking Law requires foreign banks to obtain a license from the Prime Minister of Japan to establish a branch, which is delegated to the Commissioner of the Financial Services Agency (FSA), except upon initial entry.[104]

Foreign banks must satisfy specific requirements that are also applicable to domestic banks. In addition, it must be ascertained that the legal requirements in the home country of the foreign bank are similar in content to the Japanese Banking Law.[105]

98. RBI, TECHNICAL PAPER ON DIFFERENTIATED BANK LICENSES (2007), http://www.rbi.org.in/scripts/PublicationsView.aspx?id=9795.
99. *Id.*
100. *See* RBI, MASTER CIRCULAR-LOANS AND ADVANCES - STATUTORY AND OTHER RESTRICTIONS, § 3.9.2(c)(iv)(ix) (2004), *available at* http://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=1820#38.
101. *Id.*
102. *Id.*
103. Japan Banking Act, Law No. 59 of 1981, art 47(1), *translation at* http://www.fsa.go.jp/common/law/bank02.pdf.
104. *Id.* art. 4(1).
105. *Id.* art. 4(3).

b. Legal Forms

In Japan, banks are required to establish themselves as limited liability stock companies under the Commercial Code,[106] although foreign banks are given an exemption from this requirement and do not have to be incorporated in Japan to establish a branch.[107]

c. Acquisition of Local Banks

Any entity may acquire shares in an existing Japanese bank, but there are requirements imposed on the acquisition of a certain proportion of shares of a local bank. When acquiring more than five percent of a bank or a bank holding company's voting shares, the shareholder must file with the FSA.[108]

A person acquiring more than twenty percent of a local bank's voting shares becomes a bank major shareholder,[109] which requires prior approval from the FSA.[110] A bank's major shareholding can also occur as a result of joint holdings by two or more separate entities. Bank primary shareholders are subject to reporting requirements[111] and on-site inspections[112] to ensure the soundness and financial independence of the financial institution.

An entity becomes the controlling shareholder when it acquires fifty percent of a bank's voting shares.[113] The FSA is given greater authority to intervene in the business of controlling shareholders. The FSA can request the submission of business improvement plans or issue business improvement orders to controlling shareholders.

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

V. Issues at Stake and Concluding Remarks

The investigation into competition law, trade commitments, and entry requirements demonstrates clearly that there remains a gap between the commitments made and the actual environment in which financial institutions operate. It is important to recognize that these differences are not in themselves a hindrance toward greater regional financial integration, but a lack of progress can become a significant impediment. Also, it is important to recognize issues that are unique to China, India, and Japan in order to comprehend their role in regional integration.

A. Narrowing the Gap

While GATS is seen to have had a great impact on furthering the liberalization of the financial sector, an analysis of subsequent regional trade agreements and a comparison

106. *Id.* art. 4-2.
107. *Id.* art. 47(3) and Cabinet Order on the Implementation of the Banking Law, art 10.
108. *Id.* art. 52-2.
109. *Id.* arts. 2(10) and 2(9).
110. *Id.* art. 52-9.
111. *Id.* art. 52-11.
112. *Id.* art. 52-12.
113. In the Banking Law, there is no mention of controlling shareholder. Instead, the bank primary shareholder with more than fifty percent of voting shares becomes subject to specific requirements. *Id.* art 52-14.

with actual entry requirements identifies the gap that remains between them. Many countries have maintained the status quo of the Uruguay Round, or have not narrowed significantly the gap between their commitments and actual requirements currently applied.

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

Table 5: Competition Law, GATS' Commitments and Actual Requirements

	Competition Law		
	Provisions	Index	Enforcement cases
	GATS and Actual		
	Discriminatory	Legal form	Acquisition
China			
Competition Law	40	6	None
GATS	Geographic restrictions Local currency business restrictions.	Asset requirement for each legal form.	—
Actual	High capital requirement, continuous profitable operations in China.	Asset requirement for each legal form, as well as interest holder requirement to be commercial bank. Branches only permitted high net-worth time deposits.	Approval of CBRC, social interest for acquisition. Shareholding above 25% not permitted for foreigners.
India			
Competition Law	30	13	21
GATS	No more than five licenses a year.	Only through branch operations.	Limitation on investment in other financial services companies
Actual	Paid in capital required for each branch. RBI has strong discretion in decision of licensing.	Only through joint ventures of branches.	Same as above.
Japan			
Competition Law	55	9	233
GATS	Understanding	Understanding	—
Actual	Home country regulation is essential.	Do not need to incorporate.	5% shareholding must file. 20% shareholding requires approval.

It is interesting to note that while China is a relatively new arrival in terms of market liberalization, the attention that it has attracted has resulted in significantly greater progress in liberalization. India has been mired by political difficulties arising from its democratic political structure. It is also interesting to note that China has perhaps achieved greater real liberalization as a result. China's political structure, on the other hand, has allowed it to make decisive decisions.

Additionally, regional trade agreements and bilateral agreements, while becoming prevalent and preferred by countries seeking reciprocal treatment upon liberalization, do not appear to have made noticeable headway as compared to GATS regarding liberalization of the financial services sector.

It is important to take note that the number of foreign establishments in both China and India have increased in the past few years. This is an indication of the strong interest held in the real economy of China and India, despite some remaining restrictions. Thus, if further liberalization were to take place, greater entrance of foreign entities is likely to take place. Significantly, many of the foreign banks in India are of Asian origin. Greater liberalization may bring about regional integration through offering of business opportunities within the region.

B. Making Further Progress in Future Negotiations

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

An important issue that needs to be addressed is how to facilitate and encourage the willingness to come forward with commitments in financial liberalization through trade negotiations. Trade negotiations typically involve a certain degree of horse dealing, where liberalization offers are made across sectors. GATS was one of the first opportunities for many Asian countries to be involved in financial services trade negotiations because no regional or bilateral framework for such negotiation existed in the region in the early 1990s. Strong requests from developed countries in the Uruguay Round negotiations resulted in a wide range of liberalization commitments under the GATS in financial services, but it also may have made it difficult for Asian countries to come forward independently with further liberalization commitments. The mindset of negotiators may have tilted towards making commitments only when and where strong requests were made from their counterparts; not necessarily or always based on economic rationale or according to a carefully considered strategy. This is especially the case for China.

It now appears that the Doha Round negotiations are facing serious difficulties because developing countries find it hard to obtain tangible benefits from liberalization, particularly from the developed member countries. There is a fundamental need to recognize that the rapidly changing financial market environment requires financial markets to function more efficiently, and effective competition is necessary for the benefit of the consumers of financial services and for economic growth. Excessive regulatory control of financial services and markets may succeed in isolating a country's financial sector from global financial crises, but it may also inflict heavy efficiency and cost losses on the economy.

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

C. Drawing up an Inventory of Prudential Measures

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

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

The IMF carries out the Financial Sector Assessment Program (FSAP)[114] in which member countries are examined by officials of other countries and IMF staff to evaluate the condition of their financial sector, their observation of international standards, and their understanding of financial sector regulation. The FSAP has not resulted in an easily-accessible and up-to-date inventory of prudential regulation for financial services providers wishing to enter a country's market, as many countries do not agree to the publication of FSAP reports. The FSAP is also analytical in nature and not descriptive of the entire regulatory system, which makes it difficult to use as a database of prudential measures.

Asia would benefit from the compilation of such an inventory, as regional financial integration requires a better understanding of each country's financial sector regulations. With a common format and regular updating, it would also cater for internationally active financial services providers in the region. This would greatly improve the transparency of the region's financial systems, and facilitate the negotiation of future liberalization agreements. When researching on financial regulations in China, India, and Japan, information is not always readily available in English, which poses an inhibition towards foreigners.

An inventory would also assist in grasping the level of convergence of regulatory directives in the region. The European experience presents a template that could be referred

114. *See generally* International Monetary Fund and World Bank, Financial Sector Assessment Program—Review, Lessons, and Issues Going Forward (Feb. 22, 2005), *available at* http://www.imf.org/external/np/fsap/2005/022205.pdf.

to in this respect.[115] The European Directives are in and of themselves a set of comprehensive directories of prudential regulations for each financial services sector or market. A significant level of convergence and minimum levels of harmonization of prudential regulations may be necessary in laying the groundwork for true financial integration in the region to take place in practical terms. Lack of transparency and mutual understanding would likely benefit only a handful of countries with strong financial services players. If the inventory were to be based on international standards such as the Basel Core Principles, IOSCO, and IAIS standards, this would not only encourage countries to improve their regulatory standards, but it would also achieve greater regulatory convergence in the region by contributing to regional economic development. Through regulatory convergence, the supervisory authorities of the region could develop an Asian Prudential Regulation Handbook in which not only the prudential rules of all countries in the region are described, but also standard interpretations of the rules and related regulatory principles for the financial services sector. Such a Handbook could be useful both for technical training of relevant officials in the region and for enhancing pre-emptive risk management and compliance at financial institutions.

D. Mutual Recognition and Regional Integration

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

High convergence of prudential regulation for regional financial integration may be difficult without the conclusion of a formal treaty or agreement among Asian countries. But sequential liberalization of financial markets based on a broad understanding of prudential regulations across countries would assist progress towards regulatory convergence in this very diverse Asian region. The compilation of a prudential regulatory inventory of the region may prove to be an initial but significant first step towards true regional financial integration.[116]

115. The EU's market integration in financial services is based on principles of essential harmonization, mutual recognition, home country control of supervision, and consolidated supervision. Licensing of banks, securities firms, and collective investment schemes is based on a single passport in which firms only need licensing from one member state, but this is possible only with the above principles being effectively implemented.

116. The EU has been experiencing difficulties in handling emergency situations from a financial supervisory perspective. Further sharing of information and common analysis of financial conditions is considered to be imperative for the region to further integrate their common market. A common rulebook is being proposed by a prominent ex-central banker and current Italian economic and finance minister. *See generally* Tommaso Padoa-Schioppa, *Europe Needs a Single Financial Rulebook*, Fin. Times, Dec. 2007, at 13.

Mutual recognition would also supplement any attempts to liberalize cross-border transactions. As mentioned above,[117] cross-border transactions have hitherto not been widely negotiated in the framework of GATS. This is due to the difficulty of monitoring financial institutions without a presence in the host country. Mutual recognition would provide a standardized approach to regulation and facilitate information exchange that would supplement the lack of direct supervision.

E. Modalities of Future Negotiations and the Development Agenda

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

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

F. Leading Regional Integration: China, India, and Japan

The schedule of commitments and entry requirements highlight an interesting aspect of financial regulation in China and India. In its schedule of commitments, China initially limited liberalization but was gradually liberalized. While China does not have restrictions on branches, it requires branches to have a certain amount of capital to safeguard its soundness. India has branching restrictions by way of limiting the number of branches that can be opened annually. As a result, both countries have de facto branching restriction, although China's approach is more subtle. Despite this restriction, the number of foreign banks has steadily risen in both countries, and interest in the market is increasing.

Another aspect is the acquisition of local banks. India only permits ten percent of local banks' shares to be acquired by foreign banks. This limits the form of entry by foreign banks to de novo entry. China has provided a window of opportunity to foreign banks to acquire a twenty-five percent of shares. Furthermore, foreign banks cannot wholly own their subsidiaries, but must establish them as joint ventures with local players. India requires that banks must have a local advisory board with Indian nationals who have small-

117. *See supra* Part III.B.

and medium-enterprise expertise. The two countries demonstrate that they would allow foreign banks to enter and would like to benefit from the experience and know-how of them. China's requirement for joint ventures and India's requirement for local advisory boards suggests that both countries like expertise to be transferred and at the same time ensure that foreign banks operate to benefit the local economy as well.

Despite some banks having a colonial history, India in essence has only recently opened its financial markets to even its domestic private sector. Until 1993, India did not have private banks. India has clearer trade policies in that the relatively limited liberalization that exists is clarified in its schedule of commitments and entry requirements. China's liberalization policy is positively progressive, but there have been instances where clarity of process has been lacking.

China has approached financial liberalization by carving out business that it would like to have developed being liberalized and the central banking operation for renminbi only permitted to local banks. In terms of competition policy, business lines are segregated, which limits the options of operation and competition. India has a restricted competition policy as well with the number of bank licenses limited annually. Entry into banking cannot be achieved by acquisition of local banks but is essentially restricted to establishment of branch operations.

Competition policy in the financial sector is limited, and greater freedom of business will need to be realized if China and India are to lead the financial markets in the region. Japan has an open financial market and has benefited from foreign banks bringing various advanced financial technology to its markets.

When this is considered in the context of regional integration, it provides a sense of what policies need to be followed and what method needs to be applied. Japan has the most open economy and liberalized financial markets, but occasionally protectionist policies have influenced decision-making. The maturity of the market, while providing well tuned financial expertise, is less attractive for foreign banks. China, while embarking on financial liberalization, has been proceeding carefully to protect its national interests. India has been gradually liberalizing its economy, but the political process has been hindering great progress and liberalization may lack a strategic outlook.

Nevertheless, the planned FTAs provide great hope from these three big economies and for the future of financial liberalization. FTAs encourage greater integration as they permit economies to invest in each other progressively. China has planned FTAs with Australia, while India has them with Japan, Korea, and the EU. The fact that each country has FTAs planned suggests that some progress will be made in financial liberalization or regional integration.

By better understanding prudential regulations, the three countries may benefit greatly from mutual liberalization. An inventory of prudential regulation would lead to the three countries defining their regulatory policies and as a result clarifying the role that foreign entities can play in their markets. If this is integrated with the negotiations of FTAs, greater financial liberalization and clarity of financial regulation can be achieved.

Geographic proximity would provide ample benefits in terms of mutual investment opportunities, and the different strengths of each country would bring advantages industrially. Foreign banks would benefit from new business opportunities and local markets from expertise being brought in. The scale of China and India itself would encourage all Asian countries to form economic alliances. The region does not need to be considered in

terms of an East Asian bloc and a South Asian bloc; it should rather try to cooperate where benefits would be brought to citizens the most. The big economies have a responsibility to lead the region to gain better welfare as well.

Unless China, India, and Japan grant greater financial liberalization, regional integration in the true sense is unlikely to be achieved. They are the three leading economies, and their actions matter too much for the region to be left to chance. The crisis is leading many countries to take on protectionist overtones, but now is not the time to restrict trade. Greater trade flows will enhance commerce and economic activity. The three countries need to become committed to greater financial liberalization in a better-regulated context to ensure that they are able to contribute globally to macroeconomic development. This, in a sense, may be the opportunity to demonstrate their willingness and ability to become leaders in the Asian region.