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## **LIBERALIZING FINANCIAL SERVICES HELPS ECONOMIES WITHOUT COMPROMISING THEIR RIGHT TO REGULATE**

A new study by economists from the WTO Secretariat discusses the benefits and challenges related to the liberalization of financial services trade in both developing and developed countries. The study highlights the importance of international competition in banking, securities and insurance markets while acknowledging the critical need for preserving prudential policies to safeguard financial systems for the benefit of investors and consumers.

The study, "Open Markets in Financial Services and the Role of the GATS"<sup>1</sup> explains that trade liberalization in this sector will:

- enhance competition and improve sectoral efficiency, leading to lower costs, better quality, and more choice of financial services;
- improve financial intermediation and investment opportunities through better resource allocation across sectors, countries and time, and through better means of managing risks and absorbing shocks; and
- induce governments to improve macroeconomic management, domestic policy interventions in credit markets, and financial sector regulation and supervision.

Liberalization of financial services can have strong positive effects on income and growth. Developed and developing countries with open financial sectors have typically grown faster than those with closed regimes. The economic success of Hong Kong (China) and Singapore has been greatly facilitated by internationally-oriented financial service sectors. Many developing countries such as Argentina, Brazil, Ghana, Hungary, Indonesia, and Pakistan have become increasingly integrated in the world's financial markets.

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<sup>1</sup> The study, the first in a series of studies on topical issues, is available in English, French and Spanish and may be purchased for CHF 30.- from the WTO's Publications Division.



The financial services sector has expanded rapidly in recent years. The study notes that employment increased by 25 to 50 per cent in a number of industrialized countries since 1970 and now represents 3 to 5 per cent of total employment. Value-added in the financial service sector has also grown considerably over the past 25 years and now reaches between 7 and 13 per cent of GDP in Hong Kong (China), Singapore, Switzerland, and the United States.

Financial service sector growth reflects the rise in international financial market activities. Lending and securities trading, and derivative markets have experienced rapid growth in the past 10 years, with many developing and transition economies also benefitting from improved international market access. Foreign ownership of banking assets, an indicator of commercial presence in this sector approaches 20 per cent in the United States, Argentina and Chile. Consequently, the study says, cross-border trade in financial services more than tripled between 1985 and 1995 and now exceeds US\$50 billion for the most important trading countries. Data for the United States suggests that trade via commercial presence in foreign markets is even more important than cross-border trade.

The study identifies a number of challenges which must be met if countries are to reap the full benefits from trade liberalization in the financial services sector. It states that "macroeconomic stability, structural policies which minimize distortionary interventions in the financial sector and prudential regulation and supervision" must underpin the benefits of liberalization. The study notes that there is no universally applicable liberalization strategy and that the specific circumstances of each country should be taken into consideration.

The study stresses that maintaining the stability and security of the financial services system is of paramount importance. The authors point out that the General Agreement on Trade in Services (GATS) allows WTO Members to take prudential measures to protect investors and to ensure the integrity and stability of their domestic financial systems. It also permits the use of temporary non-discriminatory restrictions on balance-of-payments and transfers in the event of serious balance-of-payments and external financial difficulties. Moreover, the management of monetary and exchange rate policy falls outside the scope of the GATS.

In its overall assessment concerning the benefits of trade liberalization and the challenges for Member governments, the study states: "The benefits from participating in the multilateral negotiating process under the GATS, through market access and national treatment commitments, can accrue to countries without in any way compromising their ability to pursue sound macroeconomic and regulatory policies." Indeed, notes the study, "there are circumstances where forward commitment to liberalization may help to support the development of better macroeconomic and regulatory policies."

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