

PRESS RELEASE

PRESS/208
19 February 2001
(01-0828)

RISKS AND BENEFITS FOR DEVELOPING COUNTRY BANKING SYSTEMS FROM THE INTERNATIONALIZATION OF FINANCIAL SERVICES EXAMINED IN NEW BOOK BY THE WTO AND THE WORLD BANK

A new book by the WTO and the World Bank "*The Internationalization of Financial Services: Issues and Lessons for Developing Countries*" offers a comprehensive review of the benefits and risks of internationalization of financial services. Based on wide-ranging cross-country analysis and a number of detailed case studies, internationally recognized researchers analyze the effects on banking systems from opening up—how stability and efficiency improved, the relationship between capital account liberalization and internationalization of financial services, and the importance of the supporting framework for reaping the gains and minimizing the costs of opening up. The book will be useful for policymakers considering further liberalizing their country's financial sector in the context of the new round of multilateral negotiations on services, launched by the WTO's Services Council in February 2000, and for policy makers interested in strengthening financial systems around the world.

The internationalization of financial services is an important issue for the strengthening and liberalizing of financial systems in developing countries. The elimination of discriminatory treatment between foreign and domestic financial services providers and the removal of barriers to the cross-border provision of financial services opens the door to the entry of foreign suppliers. There has been considerable support for the view that this favors the building of financial systems that are more stable and efficient by introducing international standards and practices. At the same time, there have been concerns about the risks that internationalization may carry for some countries, particularly in the absence of adequate regulatory structures. This book examines various factors affecting the relative costs and benefits of internationalization and provides an insight into the diversity and significance of the effects of internationalization on domestic financial systems.

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The main findings are:

- Internationalization of financial services can help countries build more robust and efficient financial systems by introducing international practices and standards; by improving the quality, efficiency and breadth of financial services; and by allowing more stable sources of funds. Given the present state of institutional development of many developing countries' financial systems, these benefits could be substantial.
- Empirical evidence shows that increased competitiveness enhanced through financial sector openness spurs economic growth. Evidence also suggests that it is the number of foreign entrants in the market rather than their market share that has a positive effect on the functioning of national banking markets. Increased competition may imply a reduction in domestic bank profits, but banking customers gain through reduced net interest margins, lower costs of fee-based services and the availability of a greater variety of services.
- Foreign and domestic financial institutions differ in their performance, interest and operational focus. Analysis suggests that reasons for foreign entry, as well as the competitive and regulatory conditions found abroad, differ significantly between developed and developing countries.
- The extent of the benefits of internationalization depends largely on how it is phased in with other types of financial reform, particularly domestic financial deregulation and capital account liberalization. The experience of the European Union, in particular, shows that internationalization and domestic deregulation can be mutually reinforcing.
- The degree of capital account liberalization can determine the potential gains and benefits of internationalization. Internationalization does not, however, require moving to a fully open capital account. Analysis suggests that internationalization of financial services results in less distorted and less volatile capital flows while also promoting financial sector stability.
- Experience shows that it is vital to strengthen the supporting institutional framework in parallel with domestic deregulation and internationalization: this is particularly true of the regulatory and supervisory functions of the state but it also applies to the use of the market in disciplining financial institutions. Both factors can play a crucial role in minimizing the potential risks of opening up, particularly when it comes to dealing with large non-performing loans.
- Multilateral agreements like GATS allow countries to add credibility to their plans for financial system liberalization. In particular, agreements can help with the sequencing of reform. Authorities may liberalize domestically today and, through agreements, commit to future internationalization after allowing a period of time to strengthen financial regulation and supervision.

The papers collected in this volume arose from a World Bank funded research project, culminating in a conference, jointly sponsored by the World Bank and the WTO Secretariat, which took place in Geneva in May 1999. The book includes: case studies focusing on the effects of opening up the financial services sector in various developing countries and transition economies; the motivations for and effects of foreign entry on domestic financial systems; the differences between foreign and domestic financial services; the relationship between internationalization and capital account liberalization; the importance of domestic deregulation and the quality of the institutional framework for internationalization; the political economy of internationalization; the value to countries of committing to internationalization; the WTO Financial Services Agreement of December 1997.

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The individual contributions are: **1.** Overview; *S. Claessens, M. Jansen*. **I: Analytical Aspects and Trade Agreements.** **2.** Internationalization of Financial Services: A Trade-Policy Perspective; *B. Hindley*. **3.** Financial Services and Regional Integration; *M. van Empel, A. Mörner*. **4.** Financial Services Liberalization and GATS; *Y. Qian*. **II: The General Evidence.** **5.** Financial Sector Openness and Economic Growth; *F. Eschenbach, et al.* **6.** How Does Foreign Entry Affect the Domestic Banking Market? *S. Claessens, et al.* **7.** How Does Financial Services Trade Affect Capital Flows and Financial Stability; *M. Kono, L. Schuknecht*. **III: The European Experience.** **8.** Lessons from European Banking Liberalization and Integration; *X. Vives*. **9.** The Impact of the Single Market Programme on EU Banking: Select Policy Experience for Developing Countries; *E.P. Gardener, et al.* **10.** Consequences for Greece and Portugal of the Opening-Up of the European Banking Market; *P. Honohan*. **11.** The Opening of the Spanish Banking System: 1985/98; *J.M. Pastor, et al.* **IV: Experiences of Developing Countries and Transition Economies.** **12.** On the Kindness of Strangers? The Impact of Foreign Entry on Domestic Banks in Argentina; *G. Clarke, et al.* **13.** Foreign Investment in Colombia's Financial Sector; *A. Barajas, et al.* **14.** Foreign Entry in Turkey's Banking Sector, 1980/1997; *C. Deniz*. **15.** Experience with Internationalization of FSP. Case-study: Hungary; *J. Király, et al.* **16.** Foreign Direct Investment in the Banking Sector: A Transitional Economy Perspective; *L. Papi, D. Revoltella*.

Note for editors: You may obtain a review copy of the book (title below) by contacting

Una Flanagan, WTO Publications

41-22-739-5208

una.flanagan@wto.org

The Internationalization of Financial Services

Issues and Lessons for Developing Countries edited by Stijn Claessens and Marion Jansen,

Joint WTO/World Bank **Kluwer Law International, The Hague**

ISBN 90-411-9817-2

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