ired to supplement local resources. And yet another special feature of this behav-
of foreign banks is of great interest for our analyses insofar as it proves a basic
imption (in chapter I) concerning the links between the multinational network and
transnational network. This is that inter-bank international financing is often in
intra bank international financing, the subsidiaries of the foreign banks obtaining
nance from other subsidiaries of their own bank or from its head office. In such
es the subsidiaries and/or the head office are located in international financial
tres.

When deposits are less than credits (Korea, Brazil, Singapore, Philippines and Ivory
ast), varied situations can be observed. Setting aside Ivory Coast, interbank inter-
tional financing plays a predominant role. However, Singapore should be distin-
ished from the three remaining countries. In the Philippines and Korea, foreign
anks rely mainly on international inter-office borrowing. In the case of Korea, these
ows are equivalent to almost 80 per cent of total resources of foreign banks. The
rocedure is ... by ceilings on won/currency swaps set by the Central Bank
hey have been raised during the last three years. In the Philippines, the average
atio of interbank flows to deposits was 1.2 in 1979. In Brazil international financing
epresents 40 per cent of total resources, while the unrecorded intrabank contribution
must be equally large. Interbank flows were equivalent to 62 per cent of credits and
52 per cent of deposits in 1979. The end result of foreign banks using their capacity
to finance themselves from other subsidiaries within their groups, generally those
situated on the capital markets, is an inflow of foreign currencies into the economy.
Hence, the lending capacity of foreign banks has increased without draining local-
currency lendable funds to the detriment of local banks. The situation is different in
the case of Singapore, where the foreign banks turn to the interbank market to finance
themselves, and the Singapore banks control the lion's share of resident deposits and
so are structurally in surplus. In 1979, resources collected from the latter by the
foreign banks were equivalent to 36 per cent of the amount of their loans. More than
one half of these funds are lent to ACUs (Asian Currency Units) and to banks located
outside Singapore. Singapore's status as an international capital market (see the next
chapter) is therefore reflected in capital outflows. In Peru and the Ivory Coast, foreign
banks are re-financed chiefly through rediscounting with the Central Bank. The Ivory
Coast is in a somewhat special situation since it belongs to the Franc Zone. The
differential between lending and borrowing rates in France may give rise to capital
outflows. BCEAO (the Central Bank of the West African countries) has recently been
compelled to raise its discount rate.

A feature of the foreign banks established in Egypt is that deposits exceed
credits. This situation seems partly due to a draining of the liquid funds of Egyptians
who have emigrated abroad to the other Arab countries. With free convertibility of
the Egyptian pound restored after 1974 and with the lifting of exchange controls, the
international interbank markets appear to work in favour of capital outflows (see the
following chapter).

On the other hand, in countries where deposits and credits are in balance—
Argentina, Peru, and India—the interbank and intrabank resources are little resorted
to by foreign banks. In theory, therefore, the presence of foreign banks should have
no impact on the money supply. In the case of Argentina, however, on account of a
structurally very high rate of inflation, it is noted that the foreign banks play a part
in speculative outflows of pesos. The same is reported for Mexico though with entirely
peculiar features. The existence of a bi-monetary system, since the national currency
is convertible into U.S. dollars and both currencies circulate freely between the two
economies, means that there are deposits of Mexican origin in United States' banks.
The very ...
of funds.

## d) Non-banking activities of foreign banks

Besides their purely banking operations, foreign banks in all countries play an
important role as consultants to foreign firms, and to a lesser degree, local firms
seeking to expand their export-import activities and/or outward direct investments.
The worldwide extension of the banks' networks and their sources of information give
them a genuine advantage over the purely local banks. In most countries, the foreign
banks have developed leasing activities either directly or through specialized companies
in which they have an equity interest. This type of activity does not appear to be very
significant, either because the absorptive capacity of the host economy is very limited
or because local banks are competitive. In Brazil, however, four of the ten largest
leasing companies are controlled by four foreign banks; and two of the latter are the
two leaders in this sector and were responsible for one-quarter of total turnover in
1980. Participation in co-financed projects does not appear to be an important line
of business. Project finance is rather the responsibility of head offices, with local
subsidiaries—including representative offices—playing only a secondary role in providing
counsel and information for the parent company.

## e) Competitiveness of foreign banks

The competitiveness of foreign banks may be assessed in terms of competition with
local banks for custom and in terms of profitability.

As regards the market share of foreign banks in the countries of location, the
different points which have just been investigated do not suggest that foreign banks
present any very serious threat to local banks. First, it was noted that except in Egypt,
Korea[1] and the Ivory Coast, the relative share of foreign banks is tending to decline.
Allowing for the fact that foreign establishment has not been halted (except in India
and Brazil) this means that the local banking system has expanded at a faster rate
than the foreign sector. Secondly, the custom of foreign banks is sharply defined
and does not encroach on the custom of local banks. The division of labour is stronger
than competition. It should also be added that the regulation of foreign banks'
activities by local monetary authorities and their attitude in general aims towards
protecting the local sector which is often made up of nationalised banks or banks
in which government agencies have a substantial financial interest. The segmentation
is still more watertight in the case of offshore business. The Philippines and es-
pecially Egypt are virtually the only countries to have followed a more liberal line.

In terms of profitability, the foreign banks in the majority of countries appear
to be more competitive than the local banks.

The only three countries for which it is clearly stated that the profitability of
foreign banks is lower are Singapore, Brazil and Ivory Coast. For the other countries,
the reports generally concur in seeing foreign banks as more profitable. Unfortunately,
the statistical data available do not always provide evidence to support this finding.
In the case of Korea, in 1980 the profits of foreign banks represented 1.5 per cent of
assets as against 0.8 per cent for domestic commercial banks. But during the period
from 1970 to 1980, the profitability of Korean banks was slightly higher. In India,
while foreign banks make 4.3 per cent of credits, they draw off 13.8 per cent of
profits. In Brazil, in 1980, the return on the equity of foreign banks was slightly

First, in the vast majority of cases, the percentage of total deposits and credits
counted for by foreign banks is very low. In addition, the amounts of deposits
d credits attributed to foreign banks include those for joint ventures. Except in
ree countries (Singapore, Lebanon and Ivory Coast), the percentages do not exceed
axima of 13.8 per cent (Brazil) for credits and 18 per cent (Egypt) for deposits.
he lowest rates are 2.36 per cent (Peru) for credits and 1.4 per cent (Korea) for
eposits. Regarding the three countries in which foreign penetration is very high
4 per cent of credits, of which 3.5 per cent for OBUs; and 54 per cent of deposits,
f which 1 per cent for OBUs, in Singapore; 47.6 per cent of deposits and 42.8 per
ent of credits for Lebanon, 75 per cent of deposits for Ivory Coast), two of them
re financial centres.

Secondly, it is worth classifying countries on the basis of the balance of resources
and their employment. On the basis of the statistical data assembled in the table
and of further information in the monographs, the countries can be divided into three
groups:

Countries in which deposits exceed credits: Egypt and Lebanon;

Countries in which deposits are lower than credits: Korea, Singapore, Philippines,
Ivory Coast and Brazil;

Countries in which deposits and credits are roughly equal: Argentina, Peru and
India.

In commenting on these operations we move on from the analysis of foreign
banking penetration to analyse the nature of the local activities of these banks.

## 4. ACTIVITIES OF FOREIGN BANKS

The information available does not enable the activities of foreign banks to be
described in detail. The conclusion of all the studies undertaken by the Group of
Experts is that the traditional operations of foreign banks— foreign exchange,
international transfers and export credits—should be stressed.

The latter type of operation has become of singular importance over which foreign
banks hold a virtual monopoly (which managed 98 per cent of the value of export
credits in Korea in 1980). The data on investment by foreign banks are very limited.
The central Monetary Authorities do not always publish disaggregated statistics exclus-
ively on foreign banks, concerning this type of activity. In some reports, the balance
sheets published by certain foreign banks were used. However we construe, it is
impossible to make inter-country comparisons and to have an overall view. The
analysis will therefore focus on the structure of deposits and credits. At all events
this is the most important aspect of foreign banking activities since it is crucial to
the role of those banks as financial intermediaries.

### a) Credits and deposits

Credits make up the largest employment of foreign banks' resources. They
account for 66.2 per cent of such banks' assets in Korea, more than 50 per cent in
Argentina, 60 per cent in the Philippines, 72.6 per cent in India, 49 per cent in
Brazil, etc. In all cases the ratio is higher than for local banks.

Virtually all lending is short-term. This feature is mentioned for all countries.
Since deposits are also short-term, it is legitimate to conclude that the foreign banks
do not—or only very marginally so—borrow short to lend long. This observation
is important in terms of drawing upon local lendable funds for investment financing,
a key to development policies. It should be added, however, that the behaviour of
local commercial banks does not seem to differ very much, while in certain countries
(India, Egypt, etc.) time-deposits with those banks are more significant even so than
those with foreign banks.

This observation suggests a hypothetical specialisation based not on the distinction
between commercial banks and investment banks but between the banking sector and
the financial institutions providing long-term finance for specific sectors. The dif-
ference between the foreign investment banks and commercial banks seems to be due
less to the maturities of assets which are also short-term than to the origin of their
resources since they are banned in some cases from taking in sight deposits. Since the
resources of local development finance companies are derived mainly from external
resources (borrowing abroad, tied and multilateral assistance), it is apparent that all
in all, the domestic and foreign banking sector plays a very subsidiary role in the
financing of investment by firms in the private or public sector. This finding is con-
firmed by the oft mentioned reluctance of foreign banks to take up holdings in the
equity of local firms.

### b) Customers of foreign banks

In all the countries of the sample, the vast majority of clients of banks is made
up of foreign multinational firms and major local firms. In the case of Korea, for
which we have accurate statistics, the major corporations represent 85 per cent of the
custom of the European banks, 70 per cent of the American and 50 per cent of
the Japanese banks. The relatively smaller percentage for the latter is doubtless partly
explained by the small average size of Japanese industrial firms established in that
country. It is therefore not surprising that in all countries, the sectoral breakdown
of advances gives pride of place to the industrial sector. The service sector lies second
followed by real estate. However as a general rule, the foreign banks are interested
neither in small and medium sized businesses nor in the rural sector. This business
policy explains why they are solely established in cities, usually concentrated in the
capital and perhaps the main industrial centres. By way of example, 72 per cent of
the branches of foreign banks in Brazil are concentrated in four states of the South-
East region. This tendency has been increasing for ten years with the development
of the domestic banking systems. It also to a very large extent explains the structure
of their resources.

### c) Foreign bank refinancing

The narrowness of their networks and the pattern of their custom mean that
foreign banks tap a very small part of local lendable funds. A sizeable share of
deposits is made by their borrowing custom. In the case of Korea, foreign banks
require their clients to deposit at sight 10 per cent of the amount of loans granted.

This imbalance between assets and liabilities is strongly characteristic of the
operations of foreign banks in the developing countries. As we have already pointed
out [section 3 (b)], total credits exceed total deposits in most of the countries of the
sample—this is true of Korea, Brazil, Philippines, Singapore and Ivory Coast—and
the foreign banks accordingly resort systematically to the inter-bank market for refinanc-
ing, thereby identifying themselves more clearly as wholesale banks. There is however
another feature of this large scale recourse to the inter-bank market, namely that it
mainly involves the international inter-bank market inasmuch as external financing is

edit extended when compared with the totals of those items. Consequently, com-
etition between foreign banks and local banks is not very intense, and tends to be
oncerned more with the method of division of labour, or with operating in different
arkets and especially with different customers.

The role of foreign banking establishments in direct private transfers of funds
om the Eurobank system is of secondary importance.

Lastly, non-banking activities are largely undeveloped. Foreign banks appear
ighly reluctant to take direct equity participations in local industrial and commercial
rms.

The interpretation that can be given to this state of affairs hinges on three main
rguments:

*i)* The foreign activity of banks remains the traditional activity of wholesale banking. Activities of foreign banks remain predominantly transnational and international trade financing remains a crucial reason for their presence. For some 20 years it has gone hand in hand with the financing of services for MNEs established in the country. Accordingly, the bulk of their customers for operations *with* foreign countries is made up of industrial or commercial firms, usually large ones. Obviously, these general comments do not mean that foreign banks are entirely cut off from the host economy. The concern here is with highlighting the characteristic features. The evidence from the country studies shows that foreign banks have a more diversified pattern of activity. In this connection it would be worth investigating their interests in local financial institutions. The fact remains nevertheless that in areas unrelated to trade and international investment their activity is extremely limited. All in all, foreign banks appear to be in a position of retrenchment over the longer term. This should cause no surprise when it is remembered that in all the countries sampled foreign banks provided the early nucleus of the banking system. As local banks grew up, and national monetary authorities made their appearance, their influence inevitably declined; but this general observation should not be interpreted as evidence of a lack of drive amongst foreign banks. On the contrary, a fresh spurt of activity was observed in the more buoyant economies of the sample in the 1970s. Similarly, the lifting of bans or the easing of controls may be seen to have resulted in every case in a highly positive response by foreign banks. Admittedly a non-negligible proportion of the new establishments consisted of banks which were returning. It should be noted that the nationality of the foreign banks has diversified over the last ten years. However, the drive behind this pattern of development should not be seen as coming from the banking sector itself, but was largely induced by the expansion of foreign trade and investment.

*ii)* The limited role of the foreign banking sector in the local monetary and financial machinery is also very largely the result of constraints imposed by the central governments concerned. In virtually all the countries sampled, the expansion of foreign banks was inhibited or even halted by regulations governing both authorisation for the establishment of new banks and the score for developing existing networks. In addition to these impediments expressly designed to protect the local banking sector, there are the blanket restrictions connected with monetary policy. The usual instruments for the control of inflation do not usually encourage the expansion of credit and tend to harden existing positions.

*iii)* Lastly, although the profitability of local establishments of foreign banks is generally higher than that of local banks, it is not exceptional—although it is questionable whether the comparison is relevant after what has been said concerning the division of labour between the two groups of banks. The customers of foreign banks are undoubtedly more creditworthy on average than those of local banks. But in return for the limited nature of this risk, those customers have particularly high bargaining power. In addition, the foreign banks are heavily dependent on external sources of finance and hence are vulnerable to interest rate differentials and exchange rate fluctuations. There is no evidence that during the period under review these variables worked against them; rather the reverse. Finally, the profitability factor must be viewed as relative to the competition factor. The decision to have, a presence in a given country must be viewed in the light of worldwide competition amongst the major banks.

• The consequence of the subordinate position of foreign banks with respect to the national economies is that their impact is limited. There is no question of making a normative judgement here as to whether this is a good or a bad state of affairs. It may please—or disappoint—those concerned with the economic dependence of the developing countries. It has certainly not come up to the expectations of countries which have sought and are still seeking to attract foreign banks. The foreign establishments of these banks do not play a decisive role in stimulating foreign currency inflows. If we compare these inflows with external borrowing directly negotiated between the central government, the public sector or major firms and the headquarters of eurobanks, flows generated by subsidiaries (where these are positive balances although this is not generally the case), such inflows may appear negligible. The foreign bank subsidiaries facilitate foreign trade and direct investment, but their role is one of being governed rather than of governing. They follow or arrive with exporters and MNEs. Lastly and above all, they appear to have a negligible role in the financing of investment in manufacturing. Loans are short-term and their maturities are patterned on those of resources. This is a traditional rule of prudent management which disregards the potential afforded by a more up-to-date management concept for financial intermediaries based on the principle of borrowing short and lending long; though it must be said that the behaviour of the domestic commercial banks does not appear to be very different. Foreign banks grant credit very selectively and such credit does not extend to a wide range of sectors. Lastly, foreign banks are generally reluctant to take up equity participations in non-financial local companies, channelling their operations of this kind into the financial sector.

To conclude, an assessment of the overall impact of foreign banks can differ greatly depending on whether it is made from inside or outside the country. The country studies show that foreign banks play a comparatively marginal role in mobilising local savings, capital formation or the financing of domestic activities of firms in any sector. They do not therefore come into direct competition with local banks, as can occur in the case of the MNE. On the other hand, the fact that they concentrate their operations on financing trade and providing services to the MNE helps to steer the economies of the host countries into the international division of labour. Among the countries studied, the weight of their contribution is the greatest in the most open economies such as those of Korea, Brazil and of course Singapore. Their presence undoubtedly stimulates the flow of exports and imports, and is a factor in attracting foreign direct investment. On the whole it would seem that the behaviour of foreign banks as it emerges from the empirical studies follows fairly closely the "supportive"

higher than that obtained for the banking sector as a whole. On the other hand, the ratio of net profit to total assets (0.5 per cent) was below average (1 per cent).

The explanatory factors put forward in the different reports to account for the better results of the foreign banks are:

*i)* Foreign banks' custom consists for the most part of borrowers with creditworthiness such as to guarantee total solvency.

*ii)* Unlike local banks, foreign banks are not required to allot part of their resources to credits in priority sectors of the economy; small and medium-sized businesses, small farming units, etc. Brazil, where the allocation of banking resources is fixed by the central authorities both for local and foreign banks (70 per cent of the credits have to be granted to industrial enterprises and private local commercial companies) is a notable exception.

*iii)* The deposit structure of foreign banks is more highly liquid than in local banks. The lack or scarcity of time deposits reduces their expenses.

*iv)* Offered rates on credits by foreign banks are often lower than the rates of local banks.

*v)* The local borrowing rates are higher than rates on the international markets in which the foreign banks refinance themselves (e.g. Korea).

*vi)* The small size of the networks, and the small number of offices and staff, reduce operating costs.

*vii)* The management of foreign banks is more efficient since their staff are more highly qualified and there is heavier reliance on automated management techniques (the introduction of computers).

Foreign banks, on the other hand, are subject to specific constraints which may reduce their profitability, either because their principal customers, inter alia the MNE, have strong bargaining powers which enable them to obtain advantageous terms; or because exchange losses incurred in the repatriation of profits to the parent company, repayment of external loans, and the requirements of their multinational customers. In Brazil, in 1980, this item represented a loss equivalent to 60 per cent of total income, while Brazilian banks registered surpluses.

In view of all this, the extent to which multinational expansion of banks is profitable should not be overestimated. There is no certainty that this variable is crucial to head-office decisions to establish. In a large number of cases, new establishments are very recent (end of the 1970s). The start-up periods are seldom accompanied by a positive return on operations. Moreover, it should not be forgotten that the subsidiaries of foreign banks do not have total managerial autonomy. For many decisions they must get the go-ahead from their central head office or from regional headquarters, e.g. the granting of loans in excess of a certain amount; the recruitment of higher management staff; the opening of commercial offices, etc. In a first phase, and in the short term it is likely that head offices do not consider it necessary for their different establishments to be autonomous profit-making centres. Among the motivations for the creation of a subsidiary, very heavy weighting is given to competition from other international banks. As already reported, the concern to maintain and increase a domestic custom which is expanding its foreign business is often an overriding consideration. Hence, the creation of an establishment must be assessed in terms of opportunity cost. Also, the close interlocking of activities *in* foreign countries and business *with* foreign countries by international banks should not be forgotten, the practical evidence for it being the size of intra- and interbank flows. Lastly, the results of a subsidiary abroad should be evaluated in terms of the overall strategy of banks, i.e. in terms of worldwide market shares and in terms of the creation of business opportunities which are connected with local activities. This is probably why representative offices can act as substitutes to strictly banking units.

An illustration of this interpretation may be supplied by the question of the role played by foreign banking establishments in the access of host countries to international loans.

**f) Role of foreign establishments in international financing**

As a general rule, the external debt of the countries in the sample is largely in excess of the amount of loans made locally by foreign banks. The comparison is necessary since in the second half of the 1970s, the share of private international loans to developing countries exceeded that of bilateral or multilateral flows. However, foreign establishments do not appear to participate directly to any significant extent in international loan issues by governments and public and private, industrial or banking enterprises of the countries of location.

In the case of Korea, for example, total debt in 1980 amounted to US $ 27 billion. For 85 per cent of the value of that total, the borrowers were Korean. The share of the foreign banks established in Korea scarcely exceeded 10 per cent. On the other hand, the indirect role of local establishments is estimated at 40 per cent of total international lending. This evaluation is based on the share of such lending by banks with a subsidiary in Korea. In the case of Argentina, out of total claims of US $ 15 billion held by foreign banks, only US $ 1.350 million correspond to loans by foreign banks established in the country (equivalent to 8.9 per cent). 70 per cent of debt in Brazil is made up of loans governed by law 4 131 concerning flows to the non-financial sector (three-quarters) and Resolution 63 for banking sector flows which represent the part of the loans to Brazil made through foreign and local banks. From these comments, it will be seen that the distinction between operations *in* foreign countries and operations *with* foreign countries which was made in attempting to analyse the international activities of banks is relevant in this light. Banks may grant euro-credits or subscribe to euro-issues in favour of countries in which they are not established. Negotiations proceed directly between borrower and head office. On the other hand, for banks established locally, it is not necessary for the establishment to be in the form of a banking unit, since a representative office will suffice. The value of a local establishment is nevertheless indisputable. The information supplied to the head office is very valuable in assessing country risk. It also plays a role in providing back-up work for operations and in seeking out potential borrowers. It is interesting to note the correlation between the number of representative offices and the amount of the external debt in the case of Mexico and Brazil. But as already pointed out, this is not the only reason for their presence.

## CONCLUSION

Nothing spectacular results from an analysis of the activities of banks in the developing countries sampled in the study. In general, the role of foreign banks is relatively insignificant—except in the offshore centres—in the financial sectors of the host countries.

From the standpoint of the size of networks, branches of foreign banks are of limited significance. They are also unimportant in terms of funds tapped and of

Apart from the expansion of offshore banking activities in traditional centres (such as London, Zurich, and elsewhere) and the recent creation of the New York offshore banking zone, it is the emergence, development and increasing significance of offshore banking in developing countries which is currently of particular interest to observers. Both the volume of banking transactions in these offshore financial centres and their share in the euromarket (see table 5) are clearly out of proportion to the weight of the relevant national economies.

Table 5. DISTRIBUTION OF EUROMARKET TRANSACTIONS AMONG MAJOR FINANCIAL CENTRES AND MARKETS
June 1980, per cent

| European centres and markets | | | | | |
|---|---|---|---|---|---|
| Belgium Luxembourg | France | Germany F.R. | Netherlands | Switzerland | United Kingdom |
| 12.9 | 10.1 | 1.8 | 4.1 | 2.8 | 32.4 |
| **Non-European offshore centres and markets** | | | | | |
| Bahamas Cayman Islands | Bahrain | Hong Kong | Panama | Singapore | Philippines |
| 11.1 | 2.5 | 2.2 | 2.4 | 3.5 | 0.2 |

*Source: Eurodollar Market*, Grindlays Bank, February 1981.

Accordingly, the fundamental question is whether the emergence of these financial centres and capital markets—and especially the offshore financial centres and markets in developing countries—is the first sign that a financial infrastructure is being laid down in those countries, directly benefiting their economies and the regions in which they lie, or whether it is merely the chosen instrument of the world economy for coping with its various disequilibria (recycling, the over-indebtedness of certain countries, the emergence of NICs and new economic centres, particularly in the Far East, the multinationalisation of production, etc.).

Careful examination of the institutional framework as well as the activities of these offshore centres shows that it is possible to give only a qualified interpretation of the phenomenon, since such an interpretation refers simultaneously to both assumptions. In the examination which follows, the classification of the various offshore financial centres will be in keeping with this interpretation.

Moreover, offshore centres where the domestic market is protected, under differing arrangements and to varying degrees, will be distinguished from those in which the local banking system and the domestic market as a whole are integrated, also to varying degrees, in the offshore system. In the former case, the monetary authorities of the country where the centre is established attempt to guard against possible monetary and financial imbalances. In the latter case, the emphasis is on developing a genuine banking and financial centre with a regional and international bias, enjoying full participation by local banking institutions. Case studies carried out in connection with research by the OECD provide the basis for the information in the sections which follow. When others sources are used, a specific reference is made in the notes at the end of this report.

# I. OFFSHORE FINANCIAL CENTRES AND PROTECTION OF THE DOMESTIC MARKET

While the local banks use a series of protectionist measures to keep the lion's share in the domestic market for themselves foreign banks are encouraged to operate for two basic reasons: the first is to establish controlled competition in the banking sector by way of contacts between local banks and the major international banks in order to conduct foreign banking business; it is hoped in this way to secure the transfer of know-how in this field and gain control over it. The second reason is to channel part of the funds in transit, particularly through foreign banks authorised to conduct offshore operations, towards sectors of the national economy.

This is more in the nature of a realistic and pragmatic choice than of a theoretical and dogmatic approach to the offshore system.

The Phillipines and Egypt are both deficit countries, although they do have a considerable capacity for absorbing financial flows. However, despite the similarity in the interests and declared objectives of both countries, the way their monetary authorities put the offshore system into practice reveals differences which are not unrelated to the issue of recycling petrodollars, preferably towards deficit Arab countries.

## a) The case of the Philippines

### Institutional framework

The domestic market is protected by a ban on the establishment of foreign banks for the purpose of carrying out transactions with residents. There are two exceptions to this general ban. The first concerns four foreign banks (Bank of America, Citybank, Chartered Bank, Hong Kong and Shanghai Corporation) already established in the country before 1945. Since these banks are now autonomous bodies, they carry on their normal business. The second exception concerns shareholdings of foreign banks in the capital of local banks. These must be minority interests in the equity not exceeding 40 per cent, however, in practice, this percentage has never exceeded 30 per cent.

September 1976 marked the beginning of a genuine call for foreign banks to share in the development of an offshore centre, operating alongside the local banking market.

Presidential Decree 1034 of September 1976 and the Central Bank's Implementing Circular 546/1976 brought into being in the Philippines a hybrid, or in other words impure, offshore system. It operates using two separate types of institution, OBUs (Offshore Banking Units) and FCDUs (Foreign Currency Deposit Units), which are each authorised to carry out operations carefully defined by law.

Circular 546/1976 mentioned above lays down the conditions for creating an OBU: it must be a branch or a jointly or wholly owned subsidiary of a foreign bank or a jointly owned subsidiary of a foreign institution duly authorized by the Central Bank, which, as a separate accounting unit and with the agreement of the Central Bank, operates offshore.

The only restriction concerning transactions by OBUs with non-residents relates to deposits by non-resident individuals or non-banking legal entities. Such deposits must not be less than US $ 50 000 or its equivalent in any currency other than Philippine pesos while the minimum capital (either in the form of deposits with the Central Bank or of investments in foreign currency bonds issued by the Philippine Government) is US $ 1 000 000.

Source: Cho Yoon-Je, "How the United States Broke into Korea's Insurance Market", The World Economy, Vol.10, No.4, December 1987, pp.483-496.

# How the United States Broke into Korea's Insurance Market

*Cho Yoon-Je*

IN SEPTEMBER 1985 the Office of the United States Trade Representativ (USTR), a Cabinet post in the Executive Office of the President of the Unite States, initiated an investigation, under Section 301 of the Trade Act of 1974, c an alleged unfair trade practice in the Republic of Korea affecting access b American firms to the country's insurance markets.[1]

The Republic's Government had pursued a policy of preventing foreign insu ance firms from providing certain types of insurance services in the country American insurance firms in Korea accordingly petitioned in Washington for a investigation on the basis that they were not being treated equally with Korea firms in Korean insurance markets. They alleged that the Government of Kore prohibited foreign firms from writing life insurance for Korean nationals, as we as denying them access to the most lucrative non-life market, compulsory fi insurance, in spite of its obligation to provide 'national treatment' (no discriminatory treatment) to American firms under the treaty of friendshi commerce and navigation between the two countries.

Section 301 of the Trade Act of 1974 authorizes the President of the Unite States to take action against foreign trade practices that violate international trad agreements or burden or restrict the commerce of the United States in a unjustifiable, unreasonable or discriminatory fashion. Action may be initiated b the USTR on his own initiative or at the direction of the President; or it may b prompted by a petition from any interested persons, including business or labou If a petition is filed, the USTR has 45 days to determine if an investigation warranted. The law directs the USTR to consult with the foreign country involve in the dispute as part of his investigation. The USTR may also seek advice fro the public and from private-sector groups. Most cases are resolved throug negotiations with the country whose practices are questioned. If the USTR find that unfair trade practices exist and the dispute cannot be resolved throug

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negotiations, or through the dispute-settlement procedures of the General Agreement on Tariffs and Trade (GATT), the USTR is required to make a recommendation to the President as to what action, if any, he should take.

Under Section 301, the President has the authority to take all appropriate and feasible actions within his power to obtain the elimination of unfair trade practices. Specifically, he may impose duties, fees or restrictions on products and services imported from the offending country. These goods do not necessarily have to be related to the goods and services which are the subject of the complaint under Section 301. The President may also deny licences issued by Federal regulatory agencies to foreign service suppliers. The degree and duration of these actions is up to the President.

The Section 301 action initiated in September 1985 occasioned several meetings between the United States Administration and the Korean Government. The upshot was that American firms obtained greater access to Korean insurance markets.

Then in September this year it was decided in Seoul to remove all restrictions on foreign companies wishing to enter the Korean life insurance market. New criteria for regulating the industry are to be formulated by the Ministry of Finance and, after a six-month approval period for applicants, it is thought that the market should be fully open.

The original Section 301 case is interesting for several reasons. It occurred at a time when the United States was pressing hard for the liberalization of trade in services to be put on the agenda of the next round of multilateral trade negotiations under GATT auspices. It thus provides an opportunity to assess the interests of developed and developing countries in trade in insurance services.

On the one hand, the course of the dispute, and its outcome, allows us to see the bargaining forces that have been effective in driving the United States. This may shed some light on the prospects for the discussions on trade in services in the Uruguay Round negotiations launched at Punta del Este in September 1986 and now proceeding in Geneva.

On the other hand, the position of the Korean Government provides an opportunity to investigate the real motives behind developing-country restrictions on trade in services. This may permit an elucidation of developing-country perceptions of, and attitudes towards, trade in financial services.

The article is organized as follows. The next section briefly reviews the recent development of Korean insurance markets. The third section describes the issues between the United States and Korea and their respective positions on the issues. It also investigates the real motives behind the formal arguments of both governments. In the fourth section, the progress of the negotiations in settling the dispute, and the bargaining counters used by each party, is described. Finally several implications for negotiations on trade in financial services between developing and developed countries are considered.



## KOREAN INSURANCE MARKETS

The history of Korea's insurance industry is short. Most Korean insurance firms date from the 1950s. The systematic development of the insurance business started in 1962 when the Korean Government took several measures to foster the industry, including the promulgation of the Insurance Business Act.

TABLE 1

Growth of the Korean Insurance Industry (billion won)

| | *1976* | *1978* | *1980* | *1982* | *1984* |
|---|---|---|---|---|---|
| GNP | 13,381 | 24,225 | 37,205 | 51,787 | 65,380 |
| | (37.5)[a] | (33.7) | (17.4) | (12.4) | (12.6) |
| Premium income | | | | | |
| Life | 85 | 243 | 603 | 1,685 | 3,084 |
| | | (73.6) | (25.9) | (82.8) | (33.0) |
| Non-life | 99 | 202 | 387 | 633 | 874 |
| | | (56.6) | (30.3) | (27.9) | (14.2) |
| Total premiums/GNP (%) | 1.4 | 1.8 | 2.7 | 4.5 | 6.1 |
| Total assets | | | | | |
| Life | 145 | 355 | 998 | 2,488 | 5,314 |
| | | (67.5) | (48.1) | (69.5) | (44.2) |
| Non-life | 141 | 326 | 607 | 918 | 1,111 |
| | | (48.2) | (36.1) | (18.9) | (6.5) |
| Per-capita GNP[b] | 800 | 1,406 | 1,589 | 1,773 | 2,041 |
| | (35.4) | (36.8) | (−4.4) | (3.1) | (6.7) |
| GNP deflator | 46.6 | 65.7 | 100.0 | 124.1 | 137.5 |
| | (15.7) | (21.2) | (15.9) | (3.0) | (3.5) |

Sources: *Insurance Statistics Yearbook*, Korean Insurance Corporation, Seoul, 1985; and *Korean Economic Indicators*, Economic Planning Board, Seoul, 1985.
[a]Figures in parentheses are normal annual rates of growth.
[b]United States dollars.

Since then, the growth of the industry has been rapid. It has been particularly rapid in the 1980s (see Table 1). This growth has been shared with other non-bank financial institutions, such as investment and finance companies, and has been largely due to two factors:

(a) the domestic financial liberalization policy of the Korean Government and

(b) the reduced inflation rate, which has attracted financial savings towards non-bank financial institutions, whose interest rates have been higher than those of the banks.[1]

The insurance industry in Korea is divided into life and non-life insurance. No insurance company is allowed to handle both at the same time.

The life insurance business has been carried out by six companies. Until recently, all firms in the market were domestic, no new entry — either domestic or foreign — having been allowed during the three decades prior to 1986. In 1984, the total premium revenue of the Korean life insurance industry was 3,084 billion won, which was approximately 2.5 per cent of the figure for the American life insurance industry.[4] More than 95 per cent of the total life insurance premiums paid in Korea are for savings plans while less than 5 per cent are for pure insurance. The six life insurance companies are important savings institutions, taking about 11 per cent of the total deposits of financial institutions (including all banks and non-bank financial institutions), as of 1984.[5]

The non-life insurance industry is much smaller than the life insurance industry. Its total premiums were 874 billion won in 1984 — approximately 28 per cent of those of the life insurance industry. Thirteen companies are licensed to sell non-life insurance, including two American firms and three joint ventures between Korean and non-Korean companies.

Insurance firms in Korea are strongly regulated by the Government. Their premium rates, their asset management and the interest rates they charge borrowers are tightly controlled and monitored.

## ISSUES AND POSITIONS

Since 1968, several foreign insurance firms have received licences to underwrite certain life and health insurance policies for resident aliens, including personnel in the United States armed forces and their families. Seven American companies have provided such insurance in Korea.

In 1968, two American insurers, the American Home Assurance Company (AHA) and the American Foreign Insurance Association (AFIA), received licences to underwrite insurance other than life insurance for resident aliens. Later, these companies were also licensed to write fire and other casualty policies for Korean nationals, AHA in 1977 and AFIA in 1978.

In 1979, AHA filed with the USTR a petition, under Section 301, alleging that it was not being treated equally with Korean companies in the Korean non-life insurance market. The complaint was based on AHA's exclusion from the pool for non-compulsory fire insurance (the so-called bank pool) and the pool for compulsory fire insurance (the fire pool).[6] AHA alleged, too, that it had no access to marine insurance.



In 1981, the Korean Government responded to this complaint by an expansion of the licences of AHA and AFIA to permit them to write marine insurance. By 1984, the non-compulsory fire pool was abolished and the American insurers were given unrestricted licences to underwrite non-compulsory fire insurance, pursuant to an agreement with the United States reached in connection with the Section 301 petition filed by AHA in 1979.

In 1984, AFIA was taken over by the Connecticut General Insurance Company of North America (CIGNA), to which AFIA's licence to operate in Korea was transferred.

Life insurance was not an issue in the 1979 petition, but in 1985, the United States again raised the issue of discrimination, prompted by AHA and the American International Group (AIG), a major financial services group in the United States originally founded in Shanghai in 1919. The USTR initiated an investigation under Section 301 into Korea's policy of prohibiting or restricting American firms from providing insurance services. On this occasion, the opening of the life insurance market, of interest to AIG, and the compulsory fire pool became a major issue.[7] The United States Administration initially demanded that the Korean Government should immediately dismantle the compulsory fire pool or permit the two American firms already established in Korea to have access to the pool with the same shares of premium income as the Korean firms. Since the Korean Government opposed the dismantling of the fire pool, the negotiations throughout were focussed only on the participation and shares of the American firms in the pool.[8] In addition, the United States demanded that several American firms should be licensed to sell life insurance by June 1986 and, too, that three additional non-life firms and four additional life firms should be licensed by the end of 1987.

### *American Position and Motives*

The approach of the United States to the case was legalistic. Economic arguments did not play a major role in the formation of the position. Its main argument was based on 'national treatment'. On 28 November 1956 the governments of the United States and Korea entered into a treaty of friendship, commerce and navigation. That treaty provides for national treatment.[9]

AHA and AIG, through their Section 301 petition to the USTR, argued that Korea had continued her long-standing policy of discrimination against American insurance companies in the country. Among other things, the American firms made an issue, as noted, of the Korean Government's restrictions on their access to the life insurance market and to the fire pool. They argued that these policies and practices were inconsistent with the provisions of the treaty of friendship, commerce and navigation, denying to American firms the benefits to which they were entitled under that trade agreement, and that the Korean practices were unjustifiable, unreasonable or discriminatory and burdened or restricted United

States commerce and thus violated Section 301. They alleged that the Korean Government continued to violate its treaty obligations to the United States and violated the international legal norms incorporated in Section 301(e). The USTR repeated these arguments in submissions to the Korean Government.

Turning to American motives, the recent explosive expansion of the life insurance industry in Korea, and the expected continued growth of the insurance market owing to the country's growing income, offers an incentive to American firms to enter the market and work for a growing share. In addition, the relatively inefficient management of Korean insurance firms, and the oligopolistic structure of the markets, make entry into the markets particularly profitable and attractive, for American insurance firms are considered to be quite competitive and efficient compared with Korean ones.[10]

The fire pool, although small, has been the most lucrative part of the non-life insurance market. American firms have a strong interest in sharing in the profits made in this market.

Another motive may have been that the entry of insurance firms permits American firms to invest in Korean capital markets. Currently, investment by foreign nationals in the domestic stock and securities market is restricted. Investments in Korean capital markets by branches of foreign banks, and by special funds managed by foreign finance companies (such as the Korea Fund), have been very profitable.

### *Korean Position and Motives*

The formal position of the Government of Korea at the beginning of the dispute was based on second-best arguments. These were as follows:

(a) In the absence of a social-security system in Korea, life insurance firms play a role in social welfare. The Government therefore regulates and supports the industry as a guarantor of payment and a monitor of the industry.

(b) Insurance firms are often used as a vehicle of monetary control because they are *de facto* savings institutions and are required to purchase government bonds to stabilize the money supply.

(c) The fire pool, which includes government and military buildings, deals with sensitive information related to defence and national security.

Korea argued that entry by foreign firms could make it difficult to achieve the above goals or considerations.

Korea, however, soon realized that the first two of these arguments were not persuasive reasons for restricting the entry of American firms, for the issue that was raised by the United States was 'equal treatment' and American firms, once they entered, would be subject to the same regulations as domestic firms. Since then, the Korean Government's efforts have been focussed on delaying the time of opening the market to the United States on the ground that Korean firms are as yet



very uncompetitive and their profitability is poor. The Korean Government argued that to limit foreign entry does not violate national treatment since the Government has pursued the policy of protecting the industry from over-competition, securing its stability. In so doing, the Government has restricted the entry of not only foreign firms but also domestic ones, limiting the number of firms in life insurance to six during the three decades prior to 1986. It accordingly argued that American firms were treated equally with domestic firms which did not succeed either in entering the life insurance industry.

Behind the formal arguments, the motives for Korea's restrictions seem to have been the following.

#### (a) Loss of market share and the possibility of bankruptcies

First, the Korean Government worried that, because of the relative inefficiency of domestic firms compared with American firms, the entry of foreign firms might lead to a significant loss of market share by domestic firms and this might lead to bankruptcies which might, in turn, trigger serious instability in financial markets.

Secondly, given the regulations and protection of the insurance industry which provide the oligopolistic structure of the markets and resulting rents, the Korean Government wanted this rent to be shared among domestic firms and did not want it to go to foreign firms. This motive is similar to the case for restrictions on foreign direct investment in some manufacturing industries.[11]

The Korean Government admitted that the entry of American firms and the competition with domestic firms would improve the quality of service and the efficiency of domestic insurance firms. But if the improvement of efficiency and welfare was the purpose, the Government thought it could partly achieve it through de-regulation and allowing more competition among domestic firms, not necessarily through the entry of foreign firms.

#### (b) Difficulties of regulating foreign firms

Again, given that the Korean Government wants to continue to regulate and control the insurance industry, and has no immediate plan to de-regulate it for whatever reasons,[12] it feels that the control of foreign firms is more difficult than the control of domestic firms. This feeling of uneasiness does not constitute as strong a motive for restriction as the above-mentioned one. But the experience of dealing with branches in Korea of foreign banks has led officials in the Korean Government to believe that foreign firms providing financial services in the domestic market are not as cooperative with government policy as domestic firms.

The Korean Government, officially, can impose the same degree of regulation on both domestic firms and foreign firms in order to control the industry for whatever reasons it may think necessary to achieve certain policy objectives. It is true, though, that every 'problem' situation which governments may wish to

regulate cannot be fully specified by law and, in those cases, governments may ask firms in the industry — say banks or insurance companies — to cooperate in an informal way. In Korea, for instance, insurance companies are designated as institutional investors in the stock market. When the Government feels that the market is overheated or too dull, it informally asks the insurance firms to help to adjust the market by reducing or increasing their stock assets. Moreover, when the domestic real-estate market is overheated, the Government may wish to limit further the investment of insurance companies, or other financial institutions, in real estate beyond a certain point, even though it may be less than the point specified in the law. In this situation, the common practice is to ask firms for their cooperation through an informal regulatory framework, by making telephone calls to the managers of insurance firms.

Putting aside the question of whether this kind of practice is good or bad, it has been a common practice in Korean society (as it has been in other societies). But such requests for cooperation have not been well received by foreign firms. One of the reasons why domestic firms are more responsive than foreign ones to this type of official control, often called moral suasion, is that the Government can exert more leverage with domestic firms, either through its influence on the personnel management or through its power to authorize their future domain of operation, perhaps a new type of insurance policy.[13] Foreign firms, instead of accommodating government requests, often turn to their home-country government to press the host-country government to drop the matter. The host-country government, which may not be in a politically strong position with respect to the foreign government, does not enjoy this much, even if it is good for the long-run efficiency of the industry.

## NEGOTIATIONS AND RESULTS

The demands of the United States expressed in talks with the Korean Government in Washington in November 1985, and pursued in Seoul in the following month and in the following year, were four altogether:

(a) full participation in the fire pool for the two American firms already established in Korea, namely AHA and CIGNA,

(b) an equal share, with Korean firms, of premium income in the fire pool for the two American firms,[14]

(c) entry for American insurance companies (numbers not specified) to the Korean life insurance market by the end of June 1986 and

(d) entry for three additional non-life insurance firms, and four additional life insurance firms, by the end of 1987.

Korea initially proposed to the United States that the issues should be discussed in the multilateral context of the GATT since she thought she would be better off as



a participant in a multilateral negotiation than as a partner with the United States in a bilateral negotiation. Korea's trade surplus with the United States and her weak political position *vis-à-vis* the United States for various other reasons, some related to her national security, meant that her bargaining position would be weak in a bilateral negotiation. Korea also preferred a multilateral forum because she would be able to postpone the opening of her insurance markets until a final agreement was reached in the multilateral forum — which would take much longer than in a bilateral negotiation. (These considerations helped to induce Korea to assist the efforts of the United States to initiate negotiations on trade in services in the GATT forum.) She submitted to the USTR that a negotiation under the auspices of the GATT would provide a more appropriate forum for the resolution of disputes between the United States and Korea over the opening of Korean insurance markets than a unilateral proceeding under Section 301. The proposal, however, was not accepted by the United States. The USTR threatened that if the issue was not resolved by September 1986 he would make a recommendation to the President on retaliation against Korea's exports to the United States. The Korean Government was also concerned that if Korea did not accept the demands of the United States, it would stimulate Congress to pass more protectionist legislation against Korea's exports. Realizing that acceptance of the United States' demands was unavoidable, the Government sought a way to delay entry, or accept entry on a gradual basis, so as to minimize the shock to domestic firms.

Finally the Korean Government made the following offers in response to the demands of the United States:

On demand 'a' above, Korea would permit the participation of the two American firms in the fire pool by July 1986, but for national-security reasons this would not include government and defence-industry buildings.

On demand 'b', the firms participating in the fire pool should share the total premium income according to the size of the firms, expressed in terms of, say, their total assets.[15]

On demand 'c', Korea would permit one American firm to enter her life insurance market by the end of 1986.

On demand 'd', Korea said it was difficult to specify the number of firms, and the date of entry, that she would permit.

On 21 July 1986 the final results of the negotiations, in which most of the United States' demands were accepted, were announced simultaneously, by both governments. It was agreed that:

(a) the two American firms would participate in the fire pool by July 1986, except with respect to government and defence-industry buildings;

(b) the method of sharing the premium income of the fire pool would be determined through discussion among member companies, but the Korean Government would induce the determination in such a way as to secure a fair distribution of premium income among members;

(c) one American firm would be licensed to enter the Korean life insurance market by the end of 1986; and

(d) qualified American firms would be permitted to enter both the life and non-life insurance markets.

Almost immediately afterwards, in respect of demand 'b', it was announced that the American firms would get the same shares as the Korean firms in the fire pool. In respect of demand 'c', instead of issuing the first licence to AIG, as might have been expected, the Korean Government issued it to the Life Insurance Company of North America (LINA), a member of the CIGNA group, which had not been a party to the Section 301 petition to the USTR in 1985. Earlier this year, however, the American Life Insurance Corporation (ALICO), part of the AIG group, was licensed to operate a life insurance company in Korea — in response to demand 'd'.

*Leverage Used in Negotiations*

The strongest and most effective bargaining force that the United States used was the threat of retaliation against Korea's merchandise exports to its market. The United States is Korea's largest export market (35 per cent of her exports in 1985) and Korea had a trade surplus of about $4 billion with the United States in 1985.[16] In addition, increasing protectionism in the United States, especially in Congress, put the American negotiators in a strong position *vis-à-vis* Korea. The threat of possible cuts in tariff preferences, under the Generalized System of Preferences (GSP), and the threat of restrictions against Korea's major export items, such as electronics, automobiles, textiles and footwear, were the most effective in obtaining concessions from Korea.

Korea, on the other hand, had little leverage in the negotiations. The Korean Government was very worried about possible protectionist action against Korea's exports, which would seriously affect the Korean economy, the growth of which has been largely dependent on export performance (and has been burdened by heavy external debt-service obligations).[17] In this situation, Korea thought the best she could do would be to postpone the entry of American firms. She was anxious to appear reasonable out of a concern that the United States Congress would pass more protectionist legislation. In addition, some observers say that behind this weak negotiating position has been the politically weak position of the Government of President Chun Doo-Hwan, which has needed American political support, even though that risked some loss of domestic support.

## SOME IMPLICATIONS

There are several conclusions that can be drawn from the Section 301 case initiated in September 1985.



First, both governments approached the case with the perception that the main issue was the sharing of profits in Korea's insurance markets. In the negotiations, both governments, especially that of the United States, basically represented the interests of their insurance industries. The effect of what was being sought in the negotiations on other activities, and on the efficiency of the economy as a whole, was not a major consideration. The issues from the beginning were 'national treatment' and American entry to Korean markets through 'establishment'. The effort of the United States Administration was concentrated on improved access and opportunity for American firms in Korea's relatively inefficient and highly-regulated (and also oligopolistic) insurance markets. The relaxation of strong domestic regulation of the Korean insurance industry and freer competition in the market were not important issues. This reflects the fact that dealing with domestic policy reforms in financial markets (including insurance markets) is a sensitive and difficult matter. But it may also indicate that the interest of the United States in the opening of developing-country insurance markets to its firms lies in the sharing of the profits and rents of what are typically highly protected and oligopolistic markets. On the other hand, Korea's major concern was not to lose domestic market share and profits to American firms, although she also recognized some positive aspects of increased competition.

Second, the issue which was crucial in the negotiations was the 'international investment' that generates the financial services, not 'international trade' in the financial services themselves. As usually defined, international trade in financial services occurs when financial institutions located in one country provide financial intermediation services to customers located in other countries. The United States Administration has also suggested that multilateral negotiations on the issue should be restricted to non-factor services — that is, the services which can be traded in the conventional sense of a person or firm in one country selling something to a person or firm located in another country without relocation of either the buyer or seller. Trade in financial services, however, is not possible if there are foreign-exchange controls and restrictions on capital-account transactions in either party to the proposed trade or both of them. In other words, for a person or firm to buy an insurance policy from firms or deposit funds in banks in a developed country, it should first be free to convert its domestic currency to foreign currency. In most developing countries, though, foreign exchange and the capital account are strictly controlled. Furthermore, in certain countries it is necessary to establish a local entity in order to sell financial services.

These factors suggest that a more practical approach at this stage to enhance transactions in insurance services (or, more broadly, in financial services) between developed and developing countries would be to begin negotiating in the context of international investment rather than international trade. For a discussion in the context of international trade in financial services to be effective, a

considerable liberalization of capital-account transactions in developing countries would be necessary.[18]

Third, the case suggests that it is hard, at this moment, to expect active participation by developing countries in that part of the Uruguay Round negotiations concerned with trade in financial services. This will be true especially of those developing countries with which the United States (or any other developed country) does not have a large trade deficit or a strong political position. The main reason why the Korean Government gave in to the American demands was not because it expected any concessions from the United States over access for Korean firms to its markets for services. Nor did it expect substantial efficiency gains in the Korean insurance industry. The Korean Government gave in because it feared retaliation against Korea's merchandise exports the cost of which would be higher than opening the insurance markets. In other words, Korea's opening of her insurance markets did not result from a positive decision, based on a calculation of gains in efficiency or whatever to her economy, but from a need to minimize her losses in the current negotiating environment. The developing countries to whom the cost of increased protection in the United States against their exports is not as great relative to what they perceive to be the cost of opening their service markets, for whatever reasons, would not be obliged to accept American demands on trade in services. In this regard, although the discussions of trade in services have started in a multilateral forum, the prospects for a successful outcome are very uncertain.

Fourth, the Korean Government's decision, on whatever basis it was made, to allow increased entry for the United States into Korea's insurance markets in order to avoid the shrinkage of the country's exports to the United States was economically sensible. It chose the option of more trade rather than the option of less trade which might have resulted from a refusal to accommodate the American insurance firms.

## CONCLUDING REMARKS

Financial industries (including banking and insurance) are highly regulated, protected and oligopolistic in many developing countries. The governments of those countries often see the problem of opening domestic financial markets to foreign competition as the sharing of the profits or rents of domestic firms with foreign firms. Some potential positive effects of de-regulation of service industries and foreign competition, such as efficiency and welfare gains, are not usually carefully considered in their policy-making decisions.

Developed countries, on the other hand, approach the problem in such a way that they push the developing countries to allow the entry of their firms (often exclusively) to highly regulated and oligopolistic markets, entailing considerable



rents without making the case for the liberalization of developing-country markets. It is open to question whether the repeated application of this approach, as seen in the case discussed in this article, would help to improve the welfare of the world economy.

The effects of trade liberalization, in terms of welfare and efficiency gains, have been much studied and are well known with respect to trade in goods. Not much research has been done to provide a basis for policy decisions on trade in financial services. Significant changes in the current perceptions and approaches of both developing countries and developed countries towards trade in financial services would seem to be necessary for freer trade in financial services to be achieved and for it to be beneficial to the welfare of the world economy.

Another important point which arises from the case discussed is that developing countries, such as Korea, should now consider whether it would be better for them (i) to maintain protection and cartelized market structures, and share the rents out of it with foreign firms, (ii) or to de-regulate the market and let the rents disappear with the gains accruing to holders of insurance policies.[19] The case provides an opportunity to reflect on how it may be in the interests of developing countries to de-regulate their financial markets rather than maintain regulation and protection and share the profits out of it with foreign firms. This suggests that a further study on the issue would be useful. It should ask what would best serve the interests of developing countries in the present international economic environment: unilateral de-regulation of markets, bilateral negotiations granting foreign access to regulated markets or multilateral negotiations?

1. The views expressed in this article are mine and should not be attributed to the World Bank or to its affiliated organizations. I have greatly benefited from comments and suggestions by Jagdish Bhagwati, J. Michael Finger, Brian Hindley and Andrzej Olechowski. I am solely responsible for all remaining errors.
2. *Financial Times*, London and Frankfurt, 17 September 1987.
3. For a discussion of the financial liberalization policy and the growth of non-bank financial institutions in Korea, see Cho Yoon-Je, *Status of Korea's Financial Liberalization*, International Economic Research Division (Washington: World Bank, 1986).
4. In 1984, Korea's population was about one sixth, and her per-capita gross national product (GNP) was about one seventh, that of the United States.
5. *Fiscal and Financial Statistics* (Seoul: Korean Ministry of Finance, 1985).
6. Buildings over four floors in seven major cities of Korea are required by law to get fire insurance which is operated in the pool system.
7. The compulsory fire pool accounts for about 3 per cent of the total fire insurance market. But it is the most lucrative part of the Korean non-life insurance market.
8. One of the reasons why the Korean Government could not accept the demand of the United States for the immediate dismantling of the compulsory fire pool was that it could not immediately close down the company which organizes and manages the pool.
9. The treaty specifies that '[n]either party shall take unreasonable nor discriminatory measures that could impair the legally acquired rights or interests within its territories of nationals and companies of the other party in the enterprises which they have established' and that '[n]ationals and

companies of either party shall be accorded national treatment with respect to engaging in all types of commercial, industrial, financial and other activities for gain (business activities) within the territories of the other party, whether directly or by agent or through the medium of any form of lawful juridical entity'.

10. A similar case that might have inspired American insurance firms to see a high-profit opportunity in Korea is the case of foreign banking. The foreign banks in Korea have been very profitable. The Korean banking industry, like the insurance industry, is subject to strong government regulation and domestic banks are quite inefficient. In 1985, foreign banks in Korea made net profits of 91.5 billion won, while Korea's (only) five commercial banks made net profits of 38.8 billion won.

11. In comparison with other developing countries, Korea has been very reluctant to induce foreign direct investment. Foreign direct investment is less than 5 per cent of her total external debt, while it is much higher in other developing countries. (For example, it is more than 20 per cent in Brazil.) Recently, however, Korea substantially relaxed her restrictions on foreign direct investment.

12. Discussion of whether this regulation should be relaxed or not, for the efficiency of the economy, is beyond the scope of this article.

13. Many senior managers, including presidents, of insurance companies in Korea are former government officials.

14. The premium income of the fire pool was being shared equally by eleven Korean firms.

15. The United States claimed an equal share of premium income among companies, while Korea argued for the sharing of premium income according to their size. The two American firms (being branches) are much smaller than the Korean firms. Their total share of the non-life insurance market is less than 2 per cent.

16. In 1985 Korea exported $10.7 billion to the United States, out of total exports of $30.2 billion, and she imported $6.5 billion from the United States, out of total imports of $31.1 billion.

17. At the end of 1985, Korea's external debt was $47 billion, which was the fourth largest among developing countries.

18. It is still very controversial, however, whether it would be desirable for developing countries, where there are still numerous distortions in commodity markets, to liberalize capital-account transactions. The experience with economic liberalization of the countries in the Southern Cone of Latin America suggests that the timing of the liberalization of capital-account transactions is important and that inappropriate or premature opening of the capital account in the presence of distortions in the domestic market may result in macro-economic disruptions and massive capital flight.

19. In this connection, see Brian Hindley, *Economic Analysis and Insurance Policy in the Third World*, Thames Essay No. 32 (London: Trade Policy Research Centre, 1982).

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## Political Support for Liberal Trade

'OVER the longer term, the strength of the multilateral trading system crucially reflects the depth of the political commitment sustaining it. This is not so much a question of the positions of this government or that, but of the appreciation throughout public opinion of the importance of liberal trade to achieving sustained growth and creating new jobs. It is in this broader domain, rather than simply in informing the day-to-day decisions of governments, that research on the costs and benefits of protection acquires its full significance.'

— *Costs and Benefits of Protection* (Paris: OECD Secretariat, 1985)

# Upstart or Flying Start? The Rise of Airbus Industrie

*Badiul A. Majumdar*

INTERNATIONAL competition in the commercial aircraft industry has changed dramatically in the last decade.[1] Historically, American companies like Boeing, McDonnell Douglas and Lockheed have dominated the marketplace. In recent years these companies have faced a serious challenge. In 1966, four countries in Western Europe, namely France, the Federal Republic of Germany, the United Kingdom and Spain, pooled their resources and formed Airbus Industrie in an attempt to gain a foothold in the market for commercial aircraft. The four companies involved are Aerospatiale, Messerschmitt-Boelkow-Blohm, British Aerospace and Construcciones Aeronauticas.

Airbus Industrie began in the mid-1970s with less than 5 per cent of the total free world commercial aircraft market, with the remaining 95 per cent supplied by American manufacturers. By 1986, Airbus Industrie had increased its market share to 25 per cent. More specifically, in the wide-bodied segment of the market, its share increased to as high as 53 per cent in 1981. The rise of Airbus Industrie, coupled with other market forces, has already driven one American manufacturer, Lockheed, out of the commercial aircraft market. The two remaining American manufacturers — Boeing and McDonnell Douglas — have also seriously felt the competitive pressure.[2]

Boeing and McDonnell Douglas attribute Airbus Industrie's success to unfair competition. They are concerned about the level of public assistance, subsidies, which the consortium receives from its four government backers. As a result, the United States turned to the General Agreement on Tariffs and Trade (GATT), under whose auspices a Code on Civil Aircraft was agreed in the Tokyo Round of multilateral trade negotiations of 1973-79.

This article is aimed at investigating and understanding the factors causing the dramatic changes in the patterns of trade in aircraft. By means of a micro-economic analysis of the commercial aircraft industry, it seeks to explain the observed patterns of competition in the industry by evaluating competing aircraft

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ELEMENTS OF A CONCEPTUAL FRAMEWORK FOR TRADE IN SERVICES

FOREWORD

In the context of the OECD work programme on trade in services and with a view to carrying out the mandates given by the Council at Ministerial Level, the Trade Committee has devoted itself since 1982 to exploratory work aiming to define the elements of a conceptual framework which would facilitate broadly the liberalisation of trade in services. This work has been based on the conviction that the liberalisation and expansion of trade in services under conditions of international competition, as in the case of goods, would stimulate growth and contribute to the development of the world economy. It has been recognised that national policies and regulations are an important element to be considered in the services field; and that the achievement of liberalisation in this area could be phased in as a result of negotiations.

This work has been broadly inspired by underlying concepts in existing instruments dealing with trade in goods, but also and especially with services, and by general and sectoral experience acquired in the OECD in this field. As can be seen from the attached document, the work has aimed particularly to identify some major themes which would be covered by multilateral commitments without always choosing between options or predjuding precise solutions. Moreover, reflection is continuing on these an other issues relating to trade in services.

The attached document takes stock of the work at this stage. It remains under the responsibility of the Secretariat and governments have not so far taken any position on it. In light of its relevance for those reflecting on the liberalisation of trade in services, the Secretary General, on the recommendation of the Trade Committee in February 1987 decided to make the document available to the public.

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# ELEMENTS OF A CONCEPTUAL FRAMEWORK FOR TRADE IN SERVICES

## I. INTRODUCTION

1. This document does not constitute a first attempt to provide precise language for a conceptual framework for trade in services. On a number of points, discussion has been no more than preliminary and/or further work is needed. Moreover, while an attempt has been made to set out concepts in a systematic manner and to highlight their possible interrelationships, the order adopted is provisional and certain concepts do not necessarily appear in the order in which they would appear when the work is more advanced. Although the paper covers a number of concepts, it is not exhaustive. Some issues, such as government procurement, technical barriers, etc., have not been treated as separate topics, although it seems that they should be addressed in any framework on trade in services and that the concepts raised are also relevant to them. In another respect, i.e. the linkage between liberalisation of trade in services and economic development, consideration has not yet been given to the approaches which may be followed to address within the overall framework the problems arising from unequal economic development situations.

2. The idea underlying this paper is that a relevant conceptual framework can contribute to strengthening international cooperation as well as the liberalisation and expansion of trade in services, just as a framework of concepts provided the basis for the trading system for goods. The paper has been drawn up without any preconceived ideas as to either the context or the way in which it will be used. It might, for instance, be taken as the basis for a future framework agreement or as a reference source for the elaboration of separate agreements. The hypothesis is that of a multilateral approach. Although the framework is intended to constitute a starting point for future negotiations towards liberalisation, the modalities of such negotiations are not prejudged here.

3. It has been recognised that the expansion of international trade in services can, to a large extent, involve factors related to international investment. The present draft nonetheless focuses on "trade", it being understood that trade in certain services requires an extension of the traditional meaning of the word to include some elements of commercial presence (and if required of investment) without which trade cannot take place. The approach proposed thus includes trade together with those aspects of presence or investment related to trade. It also covers corresponding financial and payment operations.

4. The concepts envisaged in the framework should permit a high degree of liberalisation in trade in services. However, one should not prejudge here the speed of the liberalisation process leading to a full application of all the concepts. In this regard, it seems realistic to envisage a progressive liberalisation process. The objectives of an initial liberalisation phase remain to be specified depending on the context and circumstances. They will no doubt reflect any situations or concerns that may temporarily restrict the possibilities of countries to liberalise. It is in this spirit, keeping in mind the approach mentioned in paragraph 3, that the aim here has been to define the elements of a framework designed to contribute to progress in the

future, and in the first stage of the liberalisation process, to permit the objective of a maximum degree of reasonable and practicable liberalisation to be realised.

## II. DEFINITIONS AND PRELIMINARY COMMENTS

The elaboration of definitions will have to be pursued in the light of progress still to be achieved in the conceptual approach. The following preliminary suggestions do not necessarily tackle all the aspects of trade in services relevant for the sake of applying the framework. In any event, agreeing upon exhaustive definitions should not be seen as a precondition for studying the concepts of the framework.

### a) Definition(s) of trade in services

5. Several possibilities for definitions have been suggested in the discussions to date:

- one would make reference to "services produced by residents of one country and used/received/paid for by the residents of another country";
- another suggestion, deliberately presented in such a way as to allow a broad interpretation, proposes as a formula "services exported from a supplier country and imported into another country";
- finally, a version derived from the former suggestions, but taking more explicitly into account the source of value added (foreign and/or local), refers to "services essentially produced in one country and used/received/paid for by residents of another country". The notion of value added conveys the idea that services may be for the most part produced abroad by the parent firm of a branch or agency. This wording is not appropriate when services are traded by a subsidiary, a possibility which also has to be provided for in the definitions.

In any case, certain points linked to the definition still will have to be clarified. In particular, regarding a request to include labour and personnel services in trade in services, it was argued that temporary displacements of persons in the context of services transactions would have to be included in the trade in services exercise -- but not the whole issue of migration. Some additional remarks on the current status of these definitions and their relationship to statistical issues can be found in Appendix 1.

### b) Relationship of the framework on trade in services to the various ways in which international service activities take place

6. The preceding paragraphs have demonstrated that the final definition will have to take into account the different elements which a possible trade in services framework should address. This framework might have to address movements of services and aspects related to activities abroad involving establishment, circulation of capital, of people, of information and of goods (certain barriers to trade in services are caused by obstacles to trade in goods). Efforts have particularly focussed on clarifying the relationship and the frontier between trade in services and international investment in services.

7. It is clear that trade in services represents only one aspect of international service activity and that investment also plays a major role. In some sectors (e.g. in the financial sector) international investment may be a requirement in order to gain access to substantial parts of the market concerned. It is believed that in many sectors and in some parts of others it will be possible to make considerable progress in liberalisation through an approach focusing on trade, but making due allowance for the conditions in which services are marketed. As in commercial matters, liberalisation would extend to payments corresponding to such trade.

8. So as to facilitate trade, it is accepted that "trade in services" may include sales via a local commercial presence in the customer country; the form of this presence has to be defined according to the circumstances, the sector, the country, and according to what is required in order to gain effective access to the foreign market. Such form may if necessary encompass the constitution of a company under local law where cross-border trade is not possible. Thus, some limited aspects of right of establishment, of direct international investment and of corresponding financial aspects may be considered part of trade in services in some sectors. These notions will have to be clarified in further work or in the course of negotiations. To sum up, it appears generally speaking that, to achieve optimum results towards liberalisation, actions in three areas will have to be combined -- i.e. relating to cross-border trade, to trade based on commercial presence and to inward direct investment where this is necessary for access.

c) <u>The notion of market access in services</u>

9. Reference has been made in the work to the concept of "market access". Liberalisation of trade in services implies that attention will have to be focussed on the various measures which have a bearing on the opening of market access. It should be understood from the preceding paragraphs that the concept of market access will have to be specified and translated into more concrete terms in due time through consideration of the conditions in which various categories of services are marketed in different countries. The following paragraphs do not take into account the specific problems of market access in State trading countries.

10. Broadly speaking, some elements of a positive definition of market access have been identified, in particular the right of foreign firms to sell services under conditions of fair competition. This implies effective access to an adequate distribution network. Other specific elements may include the right to sell under a brand name and access to qualified personnel. It has been noted that in order to sell his services efficiently the foreign provider of services might sometimes need to have direct access to users. It may also be necessary to foresee giving users access to services provided by foreign suppliers. Paragraph 8 above explained the relationship which may exist in certain circumstances with aspects of establishment and international direct investment when cross-border trade is not possible, and when these aspects are required for effective market access (notably when a regulation makes establishment a condition for marketing services). Initial establishment may therefore constitute an element of access in certain cases. A relationship has been established by some, as noted in paragraphs 17 and 18 below, between issues in connection with establishment and national treatment.

11. Negotiations on liberalisation will concern obstacles to trade in services which would have to be reduced or eliminated. The discussions have made it clear that these barriers would have to be identified in a concrete way for each sector and each country. Among those often perceived to be barriers are obstacles to cross-border trade such as prohibitions, restrictions or measures of equivalent effect; obstacles to certain transactions on the basis of local presence (firms or persons) such as restrictions on the granting of licences, authorisations, etc.; any discriminatory operating conditions which may accompany the granting of such licences and, more generally, discrimination within the customer country affecting marketing of services by foreign-controlled firms. The obstacles to be considered are those concerning access to private as well as public markets. Some obstacles may result from the practices of public or private monopolies or dominant firms or from distortions in conditions of competition. Financial and payments barriers would be taken into account to the extent that where they are connected with trade. Administrative formalities and controls which might serve as disguised impediments should also be taken into consideration.

d) Relationship of the framework on trade in services to the various service activities

12. The scope of the general framework would not a priori exclude any service activity which was important in terms of international trade. It will be necessary to review how to treat certain activities for which international arrangements reflecting different philosophies already exist (as those in the maritime or air transport sectors), without excluding the possibility that a liberalisation approach may come to prevail over time. Further study to ascertain the scope for coexistence of the general framework with existing multilateral sectoral agreements has been suggested. It was also suggested that each sector or type of service should be examined to identify any problems which might arise by addressing them through the framework.

13. In any event, references at this stage to various sectors do not prejudge which of their constituent activities might be addressed in a trade liberalisation initiative. The sectors in the following list (without being exhaustive) are considered to be of importance for international trade in services: insurance, commercial banking and other financial services, construction-engineering and related consultancy services, shipping, aviation and other modes of international transport, tourism, the audiovisual sector, computer and data services, telecommunications, advertising, accounting, management and other business services, artistic and cultural services and medical and hospital services.

## III. PRINCIPLES

As mentioned earlier, the sequence in which the concepts are set out does not prejudge their relative importance. The various principles are to be interpreted subject to the "exceptions" referred to at the end of this chapter.

a) Opening up market access

14. While no final formulation has as yet been attempted, the notions relating to this concept are the following. Clearly, working towards liberalisation (which is the objective of this framework) means opening up

access to markets. Countries will provide the conditions necessary to the expansion of internationa trade in services by opening up access to their markets as widely as possible. This includes providing foreign service industries or suppliers the right to sell those services on the national market under no less favourable conditions than those accorded to national industries. More precisely, this means allowing effective access of foreign suppliers or suppliers of imported services to the national distribution systems for the services concerned and access to local commercial presence as required. To this end countries would aim to dismantle or phase out any unjustified measures hampering trade in services; successive stages which may be contemplated to carry out this process are referred to in Section VI.

b) Transparency

15. Transparency in laws, regulations and practices relating to trade in services is acknowledged to be an essential ingredient and a necessary condition of international co-operation concerning such trade, just as it is for trade in goods. Several suggestions were put forward regarding commitments which might form part of a framework on trade in services. While recognising that the means of ensuring transparency in countries' measures still require thorough examination and that the specific provisions will depend upon the legal framework under which commitments would be taken, the following general approaches were put forward. It was suggested that countries should agree to make public all laws and regulations relating to trade in services; they should also agree to notify their trading partners of any aspects of their laws and regulations which can affect foreign suppliers of services. Countries should also accept to reply to requests for clarifications from their trading partners (counter notifications). These commitments would also apply to proposed changes in regulations or the adoption of new regulations. Governments should also aim at making clear and predictable the treatment of foreign suppliers in the context of their regulations and provisions concerning trade in services.

16. These procedures would be effective upon the implementation of a framework and would be applied thereafter. It will also be necessary for the countries participating in such a negotiation on trade in services to have an accurate idea beforehand of the conditions under which each country enters into the liberalisation process. This work is related to the preparatory stage discussed in Chapter VI, regarding the identification of aspects of regulations to be included in the negotiations and that of the instruments of protection (see paragraphs 55 and following).

c) National treatment

17. National treatment has been suggested as an important element of the conceptual framework. Indeed, it appears to be an essential instrument in eliminating the protectionism which is often applied through domestic measures (for similar reasons, some believe that the full application of national treatment may have to depend on whether alternative means of protection exist). In the present case, this concept would draw on the concepts contained both in the GATT for trade in goods and in the OECD instrument concerning international investment, without adhering strictly to either. It would be understood as treatment no less favourable than that granted to domestic firms and which would be given to imported services or to foreign service firms in a number of areas. These areas concern regulation, taxation, and possibly others (e.g. access to government assistance or to appeals

procedures). One way to achieve market access could be to consider regulations which deny national treatment as inappropriate or unacceptable [a notion which is discussed hereafter in e)] (1). As far as the framework is concerned, the concept of national treatment might be defined in a deliberately flexible way, since it must be sufficiently adaptable to apply to a number of different situations -- cross-border trade with no local presence; trade with a local presence; full establishment if this is required by local regulations for the marketing of certain services. The concept may cover, according to circumstances, either "similar" or "equivalent" treatment so as to take account of the conditions for applying regulation to foreign firms in the regulated sectors. In relation to what was explained in paragraph 8 above, it is felt by some that the granting of a licence to a foreign firm to set up a first establishment, in compliance with local regulations on the marketing of services and under conditions similar to those applicable to national firms, should be viewed as the application of national treatment with respect to access and establishment.

18. It was also noted that in areas where access to the activity concerned is closed to all new firms, national or foreign (for example, by virtue of regulation), "national treatment" in the formal sense would have no effect. Such regulation might also be questioned as inappropriate in a liberalisation context and special concessions might be necessary in order to achieve liberalisation. Thus concessions relating to the national treatment concept, and any necessary additional supplementary measures, could be clarified according to the individual context and in the course of negotiations.

19. It was noted that awarding national treatment with regard to internal regulations might not always be an immediate answer to all kinds of difficulties resulting from regulation, especially where certain disadvantages for foreign firms might result from existing national regulations which do not serve restrictive or discriminatory purposes. Furthermore, differences between institutional or regulatory systems may cause problems. When entering into commitments, and during negotiations, some adaptation measures may be warranted.

d) Non discrimination

20. The question as to what kind of non-discrimination clause will be included in a framework, with what implications and where it would appear has to be studied further. A separate question, which is dealt with in Chapter VI, concerns whether negotiation techniques based on MFN can be used.

21. Including a non-discrimination clause in the framework would seem important in order to guarantee that liberalisation of trade in services takes place under an open and multilateral system. It would seen that when a country is making moves towards liberalisation it should be ready to allow all its partner countries, without discrimination to share in such moves. Domestic regulation is however an important aspect of the proper functioning of some service industries. The need for countries opening their markets to each others' industries to obtain certain guarantees in this area may justify attaching an element of conditionality to non discrimination. Countries which negotiate concessions and advantages should be willing to enter into similar negotiations with other countries ready to contribute in the same way.

22. A number of important questions still have to be considered. It was observed that reciprocity clauses are frequent in the area of services, and that they occur in particular with respect to direct investment and establishment in some sectors, and to movement of persons. The impact that existing clauses would have on a multilateral framework still has to be assessed, as does the way they would be dealt with in that framework. It would also have to be considered whether new reciprocity clauses would be acceptable in the future. It has been postulated that reciprocity could under certain circumstances be a way of progressing from a closed-market situation to a selective opening-up which would subsequently be expanded. However, the fear was also expressed that this approach, if pursued, would accentuate market compartmentalisation. It may also appear desirable to look into the implications of non discrimination clauses included in a number of bilateral treaties. From the point of view of an open and multilateral system, one should also reflect on the implications of bilateral liberalisation agreements which may occur in trade in services.

23. Opinions have differed as to whether or not there should be provision for a "regional integration" exception to non discrimination. Such a provision is considered essential by some to guarantee the right to liberalise more rapidly in a regional framework, but what this would mean in practice have not been discussed at any length.

e) <u>Objectives to be taken into account in national regulations</u>

24. Service industries are on the whole more regulated than goods industries, with regulations often applying to the service firms themselves and to their operation (access, investment, setting up of companies, conditions of operation, business practices, surveillance, control of activities etc.). In many instances the regulations reflect accepted needs and the exercise by governments of their nationally recognised responsibilities. But the regulations also have a bearing on trade liberalisation which they may facilitate or hinder in some cases.

25. Regulation bears a relationship to most other headings in the framework, for example: transparency (and the identification of protective measures applied to services); access (which depends on regulations concerning the marketing of services from abroad or on the basis of presence of foreign firms); national treatment (which precisely covers the field of domestic regulation). While it may be concluded that the main concepts already developed in the preceding parts are applicable to regulations, it seems that the framework should include a separate heading to resume some important elements of the issue of regulation. This issue has two aspects which are summarised by the notions, on the one hand, of "appropriate" or "acceptable" regulations and, on the other hand, of "inappropriate" or "unacceptable" regulations.

26. In the first case, the idea is to clarify the principles or objectives towards which governments should aim so as to ensure that national regulations are "appropriate" from the viewpoint of trade liberalisation. Such principles would be included in the framework to provide guidance to governments or regulatory authorities in the future. In the second case, the purpose would be to try and agree on the way in which regulations, or certain aspects thereof, may be made the subject of negotiations, once they are deemed "inappropriate". It is obvious that regulations which deliberately restrict trade, or which would be acknowledged by governments as non-conforming to the framework, would come within the realm of a liberalisation exercise; governments may also request that certain regulations of other countries,