

Chapter Five

Conclusions

This dissertation makes an effort to construct a new financial liberalization index under the WTO, and then examines the impact of the liberalization on economic growth and the determinants of the liberalization. Although this dissertation mainly focuses on the liberalization of the trade in financial services sector, it is interesting to discuss the relationship between trade in services liberalization and trade in the goods sector first. Mattoo, Rathindran, and Subramanian (2006) conclude that services liberalization is different from trade in goods because the former involves factor mobility and leads to scale effects that are distinctive, though not unique. Goods liberalization in the absence of services liberalization could well result in negative effective protection for goods, thus highlighting the need for the latter to keep pace with the former. Deardorff (2001) even stresses that the service liberalization can improve the trade liberalization. Deardorff (2001) also examines the role played by services liberalization and finds that it can stimulate the trade not only in services but also in goods. In particular, international trade in goods requires inputs from trade in services as well. Restrictions on movements in services across borders add costs and barriers to international trade in goods. Liberalizing trade in services could thus facilitate trade in goods.

Our newly calculated financial liberalization index is constructed based on the WTO schedules of commitments in ninety-five countries in relation to the financial services, and covers the two periods, 1994-2000 and 2001-2006. In the analysis, we introduce several revisions, based on the method proposed by Hoekman (1995, 1996), to reassess the financial liberalization indices. These improvements consist of further scoring for partial commitments, covering four modes of supply on trade in services and all activities listed in the *Annex on Financial Services*, and distributing weights to four modes of

supply.

Our results show that the degree of financial liberalization is positively correlated with income level under modes 1, mode 2, and mode 3, but not mode 4. The liberalization index has a higher degree of correlation with the total trade balance than with the net trade balance, regardless of the subsectors. Also, the correlation coefficient between the liberalization index and the financial trade size is exclusively higher than the financial trade openness. In addition, the liberalization in relation to market access and national treatment is highly correlated. Furthermore, a member country with a high degree of liberalization in one of the two financial subsectors, insurance and banking, tends to also have a high degree of liberalization in the other subsector.

We also detect that East Asian and Pacific, and Latin American and Caribbean countries tend to more liberalize mode 3 compared to other modes, whereas European and Central Asian, and North American countries seem to choose to liberalize less under mode 3 as compared with mode 1 and mode 2. East Asian and Pacific, and Latin American and Caribbean countries, which consist of many developing countries, traditionally tend to introduce experienced foreign financial institutions to help develop their own domestic financial industries through foreign direct investment. By liberalizing commitments on mode 3, which enables countries to attract much inward foreign direct investment, these countries not only enhance their industrial development and technology transfer, but also increase their domestic employment in these areas.

Once the financial liberalization index is evaluated, we undertake the regression analyses to investigate the direct and indirect effects of the liberalization of banking services trade on economic growth, where the indirect effect is examined through the concentration ratio of banking industry which is a proxy for banking sector competition. Furthermore, we examine whether the direct effect is affected by the government governance and regulation variable in a broad sense and based on the regional variables. Our estimated results show that the liberalization of banking services trade does directly enhance growth rate when all variables are included. However, it is

only slightly sensitive to the model's specifications. The indirect effect also exists since our computed liberalization index of banking services is found to negatively affect concentration ratio, which will then negatively affect economic growth. Therefore, there is a positive relationship between banking sector competition and our newly assessed banking liberalization, and between economic growth and banking sector competition.

Turning to the case of the interaction variables, the results also show that an increase in official supervisory power and government effectiveness can strengthen the positive effect of banking liberalization on growth. Notwithstanding, an increase in the stringency of the requirements of capital regulations and general condition of institutional environment may mitigate the positive impacts of banking liberalization on growth, the effects are relatively small in magnitude. With respect to the regional effect, liberalization of banking services trade indeed increases economic growth, but this positive effect is lessened only when it is implemented in East Asian and Pacific, and Latin American and Caribbean countries.

In addition, we find that the influence of overall liberalization of financial services trade on economic growth takes the form of a U-shaped curve. That is, when countries start to enact higher levels of liberalization in financial services trade, the burden and costs raised by short-run adjustments from the industries decrease growth rate initially. When more and more liberalization processes and measures are introduced, however, competition will bring about long-run benefits and will raise economic growth eventually.

Finally, we provide new empirical evidence on the determinants of a country's level of commitments in banking services under the WTO. Our results show that European and Central Asian countries, higher per capita GDP, higher financial trade size, greater control of corruption, lower degree of corruption, more power of the legal system, higher quality of bureaucracy, lower level of perceived corruption, and more liberal trade and financial policy entirely play a role in the determination of higher level of liberalization in banking services commitments, whereas Latin American and Caribbean countries, countries with membership in either Cairns Group or so-called MFA

group, higher volatility of inflation rate, and more restrictive bank's activities in securities, insurance, real estate, and nonfinancial firms altogether contribute to the explanation of lower level of banking services commitments.