

Ethiopia's Accession to the World Trade Organization and the Need for Liberalizing Her Banking Service Sector

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OUTLINES

	Page
Acknowledgement-----	i
Abbreviations-----	ii
Chapter One	
Introduction-----	1
1.1. Background-----	1
1.2. Objective of the Study-----	2
1.3. Statement of the Problem-----	3
1.4. Significance of the Study-----	3
1.5. Scope of the Study-----	5
1.6. Research Method and Source of Data-----	6
1.7. Chapter Outlines-----	8
Chapter Two	
International Legal Framework	
Regulating Trade in Financial Services-----	10
2.1. Brief Background-----	10
2.2. Importance of the Financial Service Sector-----	13
2.3. World Trade Organization Rules on Banking Service Sector-----	16
2.3.1. Basic Obligations-----	16
2.3.2. Modes of Banking Services Supply-----	23
Chapter Three	
Ethiopia's Legal Framework Regulating the Banking Sector-----	28
3.1. Historical Survey of the Banking Service Sector-----	28
3.2. Current Policy and Legal Framework-----	31
Chapter Four	
Accession to the World Trade Organization-----	38
4.1. The Process of Accession in General-----	38
4.1.1. Negotiation for Accession-----	39
4.2. Accession of Least Developed Countries-----	43
4.3. Ethiopia's Accession Process-----	46

Chapter five

A Comparative Review of Banking

Services Sector Commitments in Selected Countries:

Relevant Experiences for Ethiopia's Accession to the WTO	49
5.1. Introduction	49
5.2. Review of the Format Schedules of Commitments to the General Agreement on Trade in Services (GATS)	50
5.3. The Level of Banking Service Sector Commitments of Cambodia, Nepal, and China	54
I. Cambodia	54
II. Nepal	59
III. China	62
5.4. Comparative Review of the Commitments and Lessons for Ethiopia	66

Chapter Six

Costs and Benefits Associated with Foreign

Bank Entry into Ethiopia	70
6.1. Introduction	70
6.2. Benefits of Allowing Foreign Bank Entry	70
6.2.1. Effects on Domestic Banks	70
6.2.2. Effects on Consumers	74
6.2.3. Effects on Economy in General	75
6.3. Possible Costs of Allowing Commercial Presence of Foreign Banks	78
6.4. Relevance of Ethiopia's Current Regulatory Framework	85
6.5. Different Forms of Foreign Entry, and Risks and Benefits Associated with Them	88
6.6. Alternative Approaches to Address the Risks of Liberalization	92
6.6.1. Entry Restrictions	94
6.6.2. Restrictions on Operation	100
6.6.3. Supervision	101
Conclusion	102
Bibliography	107
Annexes	115

Abbreviations

ATM	Automatic Teller Machines
DTIS	Diagnostic Trade Integration Study
FDI	Foreign Direct Investment
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
LDC	Least Developed Country
MFN	Most-favored nation
NBE	National Bank of Ethiopia
TRIPS	Trade Related Intellectual Properties
WTO	World Trade Organization

CHAPTER ONE INTRODUCTION

1.1. Background

Ethiopia began its transition from a command economy to a market-led economy following the downfall of the seventeen-years old Dergue administration in 1991. Since then, Ethiopia has been transforming its economy from an inward oriented to an outward oriented economy, with a view to address poverty and raise living standards of its people through trade policy reforms. Especially, we observe improvements in foreign trade and investment facilitating policies.

- Legal and institutional arrangements in the trade sector, have also been designed in such a way that they can promote integration with the world economy by attracting foreign direct investment.

This does not, however, mean that Ethiopia's foreign trade and investment policies offer foreigners unlimited market access opportunities in all sectors. Indeed, there are some areas where foreign traders or investors are not allowed to play a part. For instance, when we see the banking sector, we do not find a single operating bank in Ethiopia that involves the participation of foreigners. Obviously, they are owned by either the state or domestic private investors.

It is in such a situation that Ethiopia applied for WTO membership on 13 January 2003.

- As clearly stipulated in Article VII of the Marrakesh Agreement establishing the World Trade Organization (WTO), States may accede to the WTO on terms to be agreed between the aspirant state and the WTO. The accession process may involve, among others, tasks like clarifying aspects of the Country's foreign trade regime; discussions on issues of discrepancy between the applicant's trade policies and laws, and the WTO rules; and negotiations on specific commitments that could be made by the applicant state.

Even though the WTO has no separate rule on trade in financial services, its General Agreements on Trade in Services (GATS) covers this sector. In addition to its general provisions, its integral part, the Annex on financial services governs the provision of financial services.

- In connection with the accession of LDCs, besides the Marrakesh Agreement the General Council of the WTO has made a decision on 10th of December 2002¹, which is said to have the purpose of facilitating and accelerating the accession of LDCs like Ethiopia. In the Decision, it is stated that: 'Negotiations for the accession of LDCs to the WTO be facilitated through simplified and streamlined accession procedures, with a view to concluding these negotiations as quickly as possible'. And it calls for the WTO members to exercise restraint in seeking concessions and commitments on, among others, trade in services from LDCs; For this purpose, they are required to take into account the levels of commitments and concessions undertaken by existing LDCs members. The decision has also required acceding LDCs themselves to offer market access through reasonable concession and commitment commensurate with their individual development, financial and trade needs in line with Articles IV and XIX of the GATS.

- Accordingly, it is expected that the consistency of Ethiopia's policies and laws with WTO rules on trade in services will be considered. Obviously, trade in service includes among others, the financial sector, and the banking service sector in particular, which is the central concern of this research. And, since the WTO rules on financial services require negotiation based specific commitments, Ethiopia may be expected to negotiate on specific commitments in relation to trade in banking services sector.

1.2. Objective of the study

As has been pointed out above, Ethiopia has applied for WTO membership, that requires, among other things, compliance with the Organization's rules, like rules on trade in financial services, which obviously includes banking service. It is, thus, the central objective of this study:

- To describe the procedures of accession to the WTO;
- To appraise the extent to which Ethiopia has liberalized the banking services sector as depicted in its different legal and policy documents; and

¹ WTO (2003b) **Accession of Least-Developed Countries**, General Council Decision of 10 December 2002.WT/L/508 20 January 2003

- To describe WTO rules governing trade in banking services, and examine the consistency or otherwise of Ethiopia's laws with the relevant WTO rules.

Needless to reiterate, Ethiopia's accession will involve detailed negotiations with the World Trade Organization (WTO). Hence, it is important that the interests and expectations of WTO members be addressed; so that Ethiopia will be able to prepare and adjust its line of negotiation accordingly. In fact, examining negotiation experiences of other countries may serve as one systematic way of forecasting the expectations of the WTO members. To this end, the study has the main objective of undertaking a comparative review of practical accession negotiations (in the banking services commitments) of selected acceded member states.

Obviously, the existing banking services legal framework of Ethiopia is meant there to serve for the attainment of a certain economic objective. Accordingly, Ethiopia may provide different economic reasons to justify the relevance of its current legal framework. In this connection, the research describes the nature of the financial sector and addresses relevant conceptual economic issues associated with banking services liberalization. Particularly, as there are views for and against foreign participation in banking services provision, the main and recurrently raised merits and demerits of foreign participation in Ethiopia's banking services sector are considered.

Together with this, the research aims at investigating and forwarding alternative ways of handling the risks of liberalization by, at the same time, securing benefits of liberalization.

1.3. Statement of the Problem

Based on the above objectives, the study attempts to answer the following basic questions:

- If Ethiopia has to successfully complete its negotiation for WTO accession, it is mandatory to ensure the compatibility of the country's legislations with the WTO rules. If so, are Ethiopia's existing relevant legislation governing banking services provision consistent with the WTO Agreements?

- What challenges, if any, the existing banking services legal framework of Ethiopia will pose on the country's aspiration for WTO membership? In this connection what lesson Ethiopia can learn from the practical negotiation experience of recently acceded countries?
- What are economic issues involved in connection with liberalization in the banking services sector in Ethiopia? How far telling are Ethiopia's justifications to maintain its current legislation? and
- Are there (any) other possible alternative approaches or measures that would enable Ethiopia to minimize the possible future drawbacks of foreign bank entry by, at the same time, reaping benefits of their entry?

1.4. Significance of the study

Ethiopia's accession effort is still at its initial stage. Thus, a lot remains to be done on its part to prepare itself for negotiations, among others, on market access commitments in relation to services sectors in general and the banking services sector in particular. The study addresses this point; hence, it has the significance of clarifying Ethiopia's legal framework governing trade in banking services. By so doing, it enables concerned government personnel to make an intelligent guess as to the challenges the existing legislation would pose on country's accession effort.

The study touches up on the accession negotiation experience and commitments of other acceding countries. Hence, it helps to foresee the expectations (in connection with banking service liberalization) of WTO members in Ethiopia's future accession negotiation.

The study also tries to pinpoint potential merits and demerits of banking services liberalization. Thus, it enables Ethiopia to review the plausibility and relevance of existing legislative measures concerning foreign direct investment in the sector. Besides, the study has the significance of forwarding alternative approaches that would help in handling risks associated with foreign participation in the banking sector.

All these have practical importance for those working on Ethiopia's accession to the WTO. Institutions like the House of Peoples' Representatives, Ministry of Trade and

Industry, Ethiopia Commodity Exchange Authority, Ethiopian Chamber of Commerce, and other stake holders would find the study useful.

The study is also significant for researchers and academicians. Besides, since the study tries to address a relatively recent and emerging area of law; and since we do not find sufficient research works on the area under consideration, it is the other contribution of the study to enrich literature.

1.5 Scope of the Study

As depicted in the GATS Annex on Financial Services, financial services include two categories of services: (1) Insurance and insurance related services; and (2) Banking and other financial services. To make the study manageable, this study is restricted to consider only the banking services sector, excluding others.

Banking service supply may take different modes as recognized in the GATS Article 1:2:

- (1). through establishment of a commercial presence. [That is, through foreign direct investment];
- (2). Consumer abroad;
- (3). Cross border supply; and
- (4). through presence of natural persons.

When this study considers banking service supply, it does not intend to cover all the four modes of service supply. Rather, it is restricted to dwell on the first form; that is, banking services supply through establishment of commercial presence, as defined under the GATS Article XXV III:d. This is based on the consideration of the general understanding that the most important mode of banking services provision is supply through establishment of a commercial presence.

What is more, the GATS stipulates different basic obligations including Most Favoured Nations Treatment (MFN), Transparency, National treatment, and Market Access. The different general and specific obligations [other than Market access obligation] assumed in the GATS by themselves do not guarantee market access; rather they presuppose the existence of market access. Hence, market access is an indispensable guarantee on which

the liberalizing effort of the GATS depends.² That is why, even though the paper touches upon the nature of the other obligations so as to give a brief picture of the different obligations, its central concern is mainly restricted to the ‘**Market Access**’ obligation in relation to banking services supply through establishment of **commercial presence**.

1.6 Research Method and Source of Data

a. Research Method

This legal research involves closer observation of the contents of both Ethiopia's legal framework and WTO rules governing international trade in banking services supply; hence, a qualitative research by its nature.

Taking in to account the identified objectives of the study, the writer relies on descriptive technique, so that one can have clear picture of the relevant domestic and international legal framework regulating banking service.

Obviously, Scholars do not disagree on the undeniable fact that all research methods have their own advantages and limitations; hence, it is common to combine different methods in a single research work using each supplement upon the other. With this point in mind, the writer has also employed a method called 'comparative approach'.

Reviewing the accession experience of other countries might help Ethiopia to appreciate the interests and expectations of the WTO members, thereby reminding Ethiopia to prepare accordingly.

Noting the importance of observing the experience of other countries, Pierre Sauve pointed out:

it is possible to make some observations based on a review of [other countries'] accession experiences that might deliver some insights for countries that are in the accession process in the absence of defined benchmarks for acceding to the WTO.³

² Sydney J.Key, (2003), **The Doha Round and Financial Services Negotiations**, Washington, D.C: The AEI Press-Publisher for the American Enterprise Institute, p.13ff

³ See Pierr Sauve (2005), '**Economic Impact and Social Adjustment Costs of Accession to**

Thus, the paper considers the experience of Cambodia, Nepal and China. Here, the writer opts for purposive sampling method because of the unique nature of these countries.

Cambodia and Nepal:- When we consider the economic status of these two countries, both are Least Developed Countries. The same hold true with Ethiopia. From this perspective, it could be anticipated that in their negotiation with Ethiopia, the negotiation efforts of the WTO member would not greatly diverge from the efforts exerted during the accession of Nepal and Cambodia. More importantly, one can see that these two countries have acceded to the WTO after December 2002. That is, they are the only two least developed countries that have successfully joined the WTO after the coming into picture of the December 2002 Decision of the General Council, which sketches guidelines for the accession of Least Developed Countries.⁴ Thus the relevance of their accession experience also rests to properly appreciate the willingness or otherwise of WTO members to honour their promise to facilitate and accelerate the accession of the Least Developed Countries as declared in the General Council's Decision of December 10, 2002.⁵ So that Ethiopia could understand the prices of accession commitments (from banking services perspective) and prepare itself accordingly.

To fill the possible short comings in examining the experiences of those two countries, it is further attempted to consider the experience of China. The basis of this selection is the simple consideration that: given the market size and economic performance of China, and given the country's historical and existing relationship with other influential WTO members like the United States of America, it does not need special knowledge and experimentation to arrive at the conclusion that WTO members will not expect Ethiopia to enter into commitment that is more burdensome than that of China. Hence, China's experiences could enable Ethiopia to anticipate the maximum expectation of WTO members.

However, such comparison is made with the prior understanding that each accession to the WTO is a unique event. It is even argued that China's accession has been more unique

the World Trade organization: Cambodia and Nepal'; Asia-Pacific Trade and Investment Review, Vol.I, No.I, April 2005

⁴ WTO (2003b) **Accession of Least-Developed Countries**, General Council Decision of 10 December 2002.WT/L/508 20 January 2003

⁵ *ibid*

than others. After all, as Jeffrey L. Gertler wrote, China was one of the original contracting parties to the GATT in 1948 and her application for readmission to the multilateral trading system dates back to July 1986, easily making it the longest and most arduous accession negotiation in the history of the GATT/WTO.⁶

The writer has also kept in mind that the actual level of commitments of countries might be dictated by domestic political and development policy choices. Besides, non economic considerations might have played a role in shaping the accession process. Here, the experience of Iran can be cited as an example. It is alleged that Iran's request to initiate accession procedure was blocked 21 times by the United States of America due to non-trade related considerations.⁷

What is more, the writer has the consideration that albeit the accession process has its own procedures, some steps in the accession process might remain confidential, thereby putting limitations on collecting each and every accession history of the countries.⁸

b. Source of Data

The information used in this work is collected from relevant domestic legal instruments; WTO rules, official reports and documents; books; and articles. Also, the study involves extensive exploitation of accessible websites and press releases.

1.7 Chapter Outlines

The paper falls into six Chapters. The first Chapter is just an introductory. Chapter two is endeavored to address the 'International Legal Framework' governing trade in banking services. Together with a brief background, WTO international trade rules on banking services are considered. Modes of Banking Services Supply are also the focuses of this Chapter.

⁶ **What China's WTO Accession is All About?**, by Jeffrey L. Gertler, WTO Secretariat.14 December 2002; available at:

http://siteresources.worldbank.org/INTRANETTRADE/Resources/gertler_china.pdf

⁷ see Simon J. Evenett and Carlos A. Primo Braga, **WTO Accession: Lessons from Experience**, World Bank Group, Trade Note 22, June6, 2005. Available at:

<http://www.worldbank.org/trade>, accessed on 6 July2006

⁸ *ibid.*,

Chapter three describes Ethiopia's legal framework governing banking service sector. The historical survey of the country's banking service sector and the current legal and policy frameworks are the main concerns of this chapter.

In Chapter Four comes 'Accession to the World Trade Organization'. Here, the accession procedures in general, and the accession of Least Developed Countries including are described.

As has been indicated above, comparative review of the experiences of other acceding countries is chosen as one appropriate research method. Accordingly, Chapter Five of the paper makes a comparative review of the accession negotiations and the levels of specific commitments of Nepal, Cambodia and China.

Chapter six addresses the Costs and Benefits Associated with Foreign Bank Entry into Ethiopia. Particularly, possible costs and benefits of allowing commercial presence of the banks are identified and explained from conceptual perspective. The relevance [in the eyes of WTO members] of Ethiopia's reasons for retaining its existing legal framework governing the banking service provision is another issue to be grappled with in the Chapter. This Chapter is also dedicated to indicate alternative methods of minimizing costs of foreign entry, by at the same time maximizing benefits associated with their entry.

And finally, there are concluding remarks.

CHAPTER TWO

INTERNATIONAL LEGAL FRAMEWORK REGULATING TRADE IN FINANCIAL SERVICES

2.1. Brief Background

From historical perspective, international trade has brought together remote parts of the world and different civilizations.¹ Trade has also played a role in disseminating knowledge and ideas.² Especially, progressive reductions in transportation and communication costs, and relatively lower trade barriers accelerated the increase in international trade relations.³ These in turn necessitated the development of a separate branch of Public International Law called 'International Trade Law', and the establishment of international Organizations like World Trade Organization (WTO).⁴

Even though one may mention the disadvantages of trade, there is a consideration that the benefits of trade exceed its risks. As Andreas F. Lownfield noted in his book 'International Economic law', there is a perception that inter-state trade is beneficial, that gains to society from trade outweigh the losses to those who are hurt by competition from abroad, and that value is created through specialization and exchange in markets.⁵

The current international economic system is said to have been based on the international regulations established by the Bretton Woods Conference of 1944.⁶ Amongst the main outcomes of this Conference is the establishment of the General Agreement on Trade and Tariffs (GATT), on which the post World War II international trade relationship was based.⁷

This agreement has the central objective of liberalizing trade in goods, and it does not cover trade in services of which the financial service sector is a part. However, the growing

¹**Economic Growth in the 1990s: Trade Liberalization, Why so Much Controversy?** Available at: http://www1.worldbank.org/prem/lessons1990s/chaps/05-Ch05_kl.pdf

²ibid.,

³ ibid.,

⁴ibid.,

⁵Andreas F. Lownfield, (2003), **International Economic Law**. Oxford University Press, P.3

⁶ibid.,

⁷ See Ha-Joon and Ilene Grabel, (2004), **Reclaiming Development: An alternative Economic Policy Manual**, ZED BOOKS Ltd, p.8

global economic integration and the changing composition of inter-state trade called for a more comprehensive set of rules governing international trade.⁸

It is due to this, in part, that a series of negotiation rounds were conducted. These include Annecy Negotiation of 1949; Uruguay Negotiation of 1951; Geneva Negotiation of 1956; the Dillon Round (1960_1962); the Kennedy Round (1964-67); the Tokyo Round (1973-1979); and the Uruguay Round (1986-1994).⁹ And it was during the later round of negotiation (i.e. Uruguay Round (1986-1994), and in particular in the Marrakesh Agreement that the World Trade Organization (WTO) was established.¹⁰

The WTO, which is an 'apex' international institution responsible for administering global trade rules,¹¹ is basically built on four main pillars: the GATT (1994), the GATS, TRIPS, (all of which are multilateral Agreements embodied during the Uruguay round) and Dispute Settlement Understanding.¹² From amongst the WTO rules, the concern of this part of the paper is the GATS, which entered into force in January 1995;

As its name implies, and more importantly as stipulated in Part I, Article 1:1, the GATS applies to measures affecting trade in services. The GATS is the first of its kind in that prior to its coming into picture, we do not find a multilateral framework of principles and rules to govern services trade at international level. That is why different scholars¹³ recognized the GATS as an agreement that 'represents the first multilateral effort to establish rules governing services trade'. In the words of Sydney Key, the GATS "marked the first time that rules for opening markets in services were included in the multilateral trading system."¹⁴

⁸ **A comparative Review of financial Services Sector Commitments in Selected SAARC member Countries: Relevant Experiences for Nepal's Accession to WTO** (Prepared by INTERNATIONAL FINANCE DIVISION, Research Department, Nepal Rastra Bank). Available at: <http://www.un-ngls.org/SAWTEE.doc>

⁹ Andreas F.Lownfield, Supra note 4

¹⁰ Visit: <http://www.wto.org>

¹¹ Supra note 14

¹² Andreas F.Lownfield, Supra note 4

¹³ Masamichi Kono, Patrick et. al. '**Opening Markets in Financial Services and the Role of the GATS**' (World Trade Organization).

¹⁴ Sydney J.Key, (2003), **The Doha Round and Financial Services Negotiations**, Washington, D.C: The AEI Press-Publisher for the American Enterprise Institute, p.13ff

Regarding the inspiration behind establishing this multilateral trade agreement, there was a view that the historically low tradability of services may create the impression that the gains from services liberalization are small.¹⁵ From another angle, as well, there might be fears that the extension of negotiations to service sectors could lead to an erosion of government control over sectors generally considered 'public' or 'social' services sectors,¹⁶ thereby jeopardizing service supply to the general public.

Nevertheless, though the latter fear remains common even today specially on the part of economically developing countries,¹⁷ the emerging view is that services are becoming increasingly tradable and that they account for a large and growing share of output in most countries.¹⁸ In the Preamble of the GATS itself, it is stated that members to the agreement have recognized the growing importance of trade in service for the growth and development of the world economy at large; and it is with a view to expand such trade under conditions of progressive liberalization and transparency that members to the agreement decided to establish this multilateral framework of principles and rules for trade in services.¹⁹

As regards the scope of application of the GATS, its Part I Article 1:3(b) and (c) stipulate that the Agreement applies to any service in any sector except service supplied in the exercise of governmental authority. Such excepted services refer to those services which are supplied neither on a commercial basis, nor in competition with service suppliers. However, the Agreement lacks clarity in defining service supplies that are excluded from the coverage of the Agreement. Hence, it invites for different possible interpretations. At any rate, as the GATS makes clear reference to some of the services sectors like movement of natural persons, air transport services, maritime transport services, telecommunications

¹⁵ James Hodge, **Liberalization of Trade in Services in Developing Countries, DEVELOPMENT, TRADE, AND THE WTO**, The World Bank, 2002_Available at:

http://publications.worldbank.org/catalog/content-download?revision_id=1526172

¹⁶ See Rohini, A. and Michael Daly, (2004), '**Selected Issues Concerning the Multilateral Trading System**', Discussion Paper, NO 7, World Trade Organization, Geneva, Switzerland, P.21

¹⁷ *ibid.*,

¹⁸ Aaditya Mattoo, Randeep Rathindran, and Arvind Subramanian, (August 2001),

"Measuring Services Trade Liberalization and Its Impact on Economic Growth: An Illustration." World Bank Policy Research Working Paper

¹⁹ See the Preamble of the GATS

and financial services;²⁰ and since the central focus of this paper is the financial sector in general and 'the banking sub sector' in particular, the writer of this paper does not find it relevant to dwell on the issues concerning the service that are not covered by the GATS.

As already indicated, the GATS Annex on financial services, which is an integral part of the GATS²¹, clearly provides that the Agreement applies to measures affecting the supply of financial services.²² Thus, the banking service sector comes within the scope of the GATS.

2.2. Importance of the Financial Service Sector

Basically, the purpose of this Chapter is to touch upon the international legal framework governing trade in the banking service sector. Nevertheless, the writer does not find it irrelevant to have a prior understanding of the nature of the sector so that readers will find it easier to appreciate the background and purposes of the international legal framework administering trade in the banking service sector. Also, understanding the role of the sector is of great help in the effort to design or reform national legal instruments governing the sector.

Regarding the nature of the financial sector, the GATS described:

A financial service is any service of a financial nature offered by a financial service supplier...Financial services include all insurance and insurance related services and all banking and other financial services(excluding insurance).²³

When this paper makes reference to financial sector, it is referring to the one as defined herein above. Accordingly, one can see that the banking sector, which is the central concern of the paper, is one broad category of the financial sector.

The financial sector is considered as an important component of a country's economy. As Dr.Ashfague H.khan, Chief of Research in Pakistan Institute of Development Economics pointed out, the financial service sector "plays a key role in financial development of a

²⁰See the GATS Annexes

²¹Article XXXIX of the GATS

²²Article XXXIX of the GATS; GATS Annex on Financial Services, Paragraph 5: a

²³The GATS Annex on Financial Services, Paragraph 5

nation by providing payment services,"²⁴ "thereby improving overall efficiency of the economy."²⁵ Without this sector, Dr. Ashfaque H.khan noted, an economy would be confined to barter and the specialization in production [which leads to lower (or average) production costs] would be limited.²⁶ Besides, Dr. Ashfaque H.khan indicated, the financial sector has the role of mobilizing financial savings and allocating the savings to the highest return investment opportunities.²⁷ Mattoo Aaditya shared this later view when he said, citing literature as an authority, that the sector has the role in channeling "investment funds to their most productive uses."²⁸ Mattoo Aaditya further noted that "researchers demonstrate that...financial services contribute to and precede faster economic growth".²⁹ Sydney J.Key has similar but wider view on the role of the financial sector when she wrote:

The financial sector is a critical component of a nation's economy. It not only contributes directly to output and employment but also provides an essential infrastructure for the functioning of the entire economy. The financial system serves as a channel through which savings can be mobilized and used to finance investment and, at the same time, facilitates transactions necessary for internal and external trade. It also helps to manage risks and reduce so-called information asymmetries between providers and users of funds.³⁰

Indicating that the above role of the financial sector can be obtained through a sound and efficient financial system, Sydney J.Key further stated that such financial sector also increases the capacity of a country's economy to recover quickly from setbacks; thereby helping it (the economy) to tolerate external shocks such as movements in exchange rates or major increase in global interest rates.³¹

²⁴ Dr.Ashaque H.Khan, '**Financial Sector Reforms: What are the Issues, "The 20th Seanza Central Banking Course**', Oct 23-Nov24, 1994, State Bank of Pakistan, Karachi, p.205

²⁵ *ibid.*,

²⁶ *ibid.*,

²⁷ *ibid.*,

²⁸ Aaditya Mattoo ,Randeep Rathindran, and Arvind Subramanian, *Supra note24*

²⁹Mattoo Aaditya (2001), '**Developing Countries in the new Round of the GATS**

Negotiations: Towards a Pro-Active Role, World Bank, World Economy.April200, Vol 23, No.4, pp.471-489

³⁰ Sydney J.Key, *Supra note 20*

³¹ *ibid.*,

From the above consideration, it may not be difficult to notice that the sector is the backbone of today's economy. It is difficult to think of any economic activity, except perhaps the ones that remain largely outside the money economy that does not depend upon financial services.³²

Given the indispensable and growing role of the financial sector in an economy, misadministration of the sector would cause serious consequences. Also, it is recognized as very sensitive. Thus, protecting and strengthening the stability of the sector remain indispensable.³³

In addition, what is special about service sectors is, unlike goods, they are considered as basic services to the public at large. This consideration was one reason that forced the negotiators of the GATT to exclude the sector from negotiation.³⁴ Their reason behind was, as Rohini Acharya and Michael Daly pointed to, 'eroding government control over the sector would jeopardize the provision of this basic services to the general population and especially the poor.'³⁵

Hence, a country's legal framework governing the financial sector need to be designed in such a way that the sector could serve its role in an economy, by at the same time saving it from instability that may in turn cause economic crisis. These two efforts (i.e. the effort to reap the maximum benefit from the financial sector and the effort to protect and strengthen the stability of the sector) are not as such irreconcilable. Instead, they are regarded as mutually reinforcing.³⁶

Having this brief understanding on the nature of the financial sector which the banking service sector makes the main part, let us now proceed to specific international legal rules governing the banking service provision.

³² Masamichi Kono, Patrick *et. al.*, Supra note 19

³³ *ibid.*,

³⁴ Rohini, A. and Michael Daly, Supra note 22, P.22

³⁵ *ibid.*,

³⁶ Sydney J.Key, Supra note 20

2.3. World Trade Organization Rules on Banking Service Sector

To repeat what is already said, the WTO-an apex institution responsible for administering international trade rules-is built on pillars like the GATT(1994) ,GATS and TRIPS. Amongst these, the GATS is the only multilateral trade agreement to cover banking services trade. Prior to the adoption of the GATS, there was no international (multinational) Agreement that addressed rules governing international trade in banking services. Thus, when we say WTO rules on trade in banking services, the reference is obviously to the GATS provisions.

As part of the service sector, trade in the banking service is governed by rules stipulated under the GATS.

In principle, the GATS calls for Progressive Liberalization. In that, it does not require a member country to open all of its services sectors immediately, but, as envisaged in the third part of the GATS, it expects that a country will commit to open up some sectors or sub-sectors immediately and others over time. This is envisaged in the third part of the GATS.

2.3.1. Basic Obligations Provided Under the GATS

i. Most Favoured-Nation Treatment (MFN)

A 'Most Favoured Nation' clause in the GATS requires each state to accord to the service and service supplier of other state any advantage of the type covered by the treaty that the state accords to a third state.³⁷ This is an important principle (concept) incorporated in the GATS as one general obligation to be applied across all sectors including banking sector.³⁸

In its 'Most Favoured Nation' clause, GATS provides:

[W]ith, respect to any measure covered by this Agreement [GATS], each member shall accord immediately and unconditionally to services and services suppliers of

³⁷ Coffier and Marroidis(editors), **Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law**, University of Michigan Press, Michigan 1999, p. 13

³⁸ See Article II of the GATS

any other member treatment no less favorable than that it accords to like services and services suppliers of any other country.³⁹

According to this general obligation, therefore, a member state has the obligation to accord immediately and unconditionally to banking services and banking services suppliers of any other country (including countries that are not WTO members) treatment that is not less favorable than it accords to others.

The GATS makes the Most Favoured Nation Treatment (MFN) an unconditional obligation. In that, let us say, if State X has an MFN obligation in favour of State Y, then state Y can benefit from the advantage (or favour) whether or not it (state Y) grants a similar favour (advantage) to state X. What is also important is that the GATS makes the reach of the MFN obligation broad, as it applies to any measure (whether in the form of a law, regulation, rule procedure, decision, administrative action, or any other form)⁴⁰ 'affecting trade in services that are covered by the GATS, not just those for which a member has made specific commitments to liberalization'⁴¹; and it applies across all member countries.

Even though the concept of 'likeness' is incorporated in the MFN provision of the GATS, the concept remained undefined. To talk of the MFN obligation, it remains indispensable to determine whether services or services suppliers of one state are like services or services suppliers of another country. The issue of likeness under the GATS was one concern of the Panel on EC-Banana Case. The panel, considered the issue 'to what extent services and services suppliers of different origin are alike?'⁴² And the panel found that wholesale services are alike, irrespective of the origin of the bananas supplied, on the ground that each of the different service activities taken individually was virtually the same and could only be distinguished by referring to the origin of the bananas.⁴³ The Panel has also found that to the extent entities provide the like services, they are like services suppliers⁴⁴

³⁹ *ibid.*,

⁴⁰ Article XXVIII:a of the GATS

⁴¹ Sydney J.Key, *Supra* note 20

⁴² quoted by Coffier and Marroidis, *Supra* note 43, p.36

⁴³ Cited by William J.Davey and Joost Pauwelyn, as quoted in Coffier and Marroidis, *Supra* note 43, p.36

⁴⁴ *ibid.*,

- In this connection, William J. Davey and Joost Pauwelyn noted:

Irrespective of whether a supplier is a natural person or a multinational company, a branch or a subsidiary, a reputable company or a company on the verge of collapse, as long as both supply like services, they will be considered to be like service suppliers.⁴⁵

Here, one can easily see that the Panel and the writers cited herein above give focus to the services and they use the nature of services as a means to determine the likeness or otherwise of services suppliers. Hence, it remains unclear whether it is always easy and possible to approach the issue of likeness when there is a difference on the basis of the type of service supplier.⁴⁶

- The MFN is not as such an absolute obligation. One can easily see that Article II:2 of the GATS permits inconsistent measures: "A member may maintain a measure inconsistent with Paragraph 1 [which provides for the MFN obligation]." Especially, the MFN obligation does not prevent countries from conferring or according advantages to adjacent countries in order to facilitate exchanges of services in contiguous frontier zones where both such services are locally produced and consumed.⁴⁷ Nor does it prevent members from being a party to or entering into an economic integration agreement liberalizing trade in services without extending the benefits of the agreement to all other WTO members.⁴⁸ But here, the provisions of Article V:1 of the GATS establish strict criteria to exploit this exception. The non fulfillment of the criteria would compel the member to extend the benefit (or the measure) to all other WTO member on MFN basis.⁴⁹

In connection with banking service sector, apart from the general MFN exemption, the Second Annex on Financial Services provides that a member may list in its specific commitment measure (relating to banking services) which are inconsistent with the MFN obligation.⁵⁰

⁴⁵ibid.,

⁴⁶William J. Davey and Joost Pauwelyn were quite aware of this issue. See *ibid.*,

⁴⁷ Article II: 3 of the GATS

⁴⁸ See Article V: 1 of the GATS

⁴⁹ *ibid.*;

⁵⁰ See the GATS Second Annex on Financial Services Paragraph 1

ii. Transparency

As an important and sensitive sector, the banking service is subject to strong government regulation and control. Signatories of the GATS understand this nature of the sector and recognized the need to allow members to take regulatory measures to meet their national policy objectives.⁵¹ However the GATS also recognized the importance of transparency for the achievement of progressive liberalization. Accordingly, Article III: 1 requires members to publish all regulatory or other measures of general application affecting trade in banking services. In this connection, international agreements pertaining to or affecting trade in banking services to which a member is a signatory shall be published.⁵² The GATS has also accepted the possibility that publication may not be practicable for some reasons. In such a situation, however, GATS requires member states to make the information otherwise publicly available.⁵³

In addition to the publication requirement, the GATS transparency provision require member states to establish a mechanism that can provide specific information to other member states, upon request, on measures affecting trade in services (banking services in our case).⁵⁴

Member states are also obliged to notify 'The Council for Trade in Services' of the introduction, if any, of any new or any changes to existing laws, regulations or administrative guidelines, which could significantly affect trade in services covered by that country's specific commitment schedule.⁵⁵

Like the MEN obligation, Transparency obligation has exceptions. Article III bis. of the GATS states, the transparency obligation does not override a member's interest (need) to protect confidential information. As per this Article states may not be required to disclose confidential information, if such disclosure would impede law enforcement, or be contrary to public interest, or prejudice legitimate commercial interests of particular enterprises. In addition to this general exception, the GATS Annex on Financial Services Paragraph 2:2

⁵¹ See the GATS Preamble, and Articles III and VI.

⁵² Article III:1 of the GATS

⁵³ Article III:2 of the GATS

⁵⁴ Article III:4 of the GATS

⁵⁵ Article III:3 of the GATS

- provides that members should not be required to disclose information relating to customers or any confidential or proprietary information in the possession of public entities.

iii. Domestic regulation

The other important obligation applicable to trade in the banking service is the one contained under Article VI, and the Annex on Financial Services Paragraph 2, of the GATS. Normally, the GATS permits member states to take regulatory measures necessary for prudential reasons, including for the protection of investors, depositors, or persons to whom a fiduciary duty is owed by a banking service supplier, or to ensure the integrity and stability of the banking system, and the financial system in general.⁵⁶

- The law has, however, the interest of saving from abuse this regulatory exception so that benefits from liberalization will not be frustrated. For this purpose, paragraph 2:a of the Annex on Financial Services provides a prohibition that those regulatory measures shall not be used as a means of avoiding the members' commitments or obligations under the GATS. Obviously, this obligation is conditional; in that, it applies only when there is specific commitment in the banking services sector.

iv. Market Access

One main pillar of international contestability of market is liberalization aimed at opening markets to foreign services and service suppliers.⁵⁷ It is the objective of the GATS to promote a progressively higher level of liberalization of trade in services in general, and banking service in particular.⁵⁸ Liberalizing trade in banking services requires reducing or removing barriers discriminating against foreign banking services and foreign service suppliers with regard to entry and operation in a host-country's market.⁵⁹

- To state the obvious, the general obligations assumed in the GATS (like the Most Favoured Nation Treatment and Transparency) and specific obligations like national treatment (by themselves) do not guarantee market access; rather they presuppose the existence of market

⁵⁶ The GATS Annex on Financial Services, Paragraph 2:a

⁵⁷ Sydney J.Key, *Supra* note 20 p.13

⁵⁸ For example see the GATS- Preamble Para 3, and Part Three.

⁵⁹ Sydney J.Key, *Supra* note 20

access. Hence, market access is an indispensable guarantee on which the liberalizing effort of the GATS depends.

- Market access obligation is not stipulated in the GATS in the form of general obligation. Rather, as clearly provided under Part III, the obligation depends only on the specific commitment of each member state. That is, the obligation applies to the extent that a member state has undertaken specific commitment with respect to specific service sector (the banking service sector in our case).

Accordingly, if a state is unwilling to open its domestic market to foreign banking services, it has the discretion to do so. However, once a member state undertakes a market access commitment in relation to the supply of banking services, that state has the obligation to accord the access accordingly.⁶⁰ Of course, even here, members are given the right to specify in their commitment schedules, restrictive measures, limitations or conditions to deny entry to foreign banking services or service suppliers.⁶¹ If a member does not maintain any of the measures or limitations in its schedule of commitment, the member is regarded as providing full market access; and hence, the country is prohibited from maintaining or adopting limitations and measures negatively affecting market access. Particularly, Article XVI:2 of the GATS lists different limitations/restrictions, which may not be maintained or adopted unless they are specified in a country's commitment schedule. To mention them: in a service sector (the banking service, in our case) for which a member state has made a market access commitment, that state is obliged to refrain from imposing any limitations on the number of service suppliers whether in the form of numerical quotas, monopolies exclusive services suppliers, or the requirement of an economic needs test.⁶² In addition, the state may not adopt limitations on the total value, the total number, or the total output of services operations.⁶³ Besides, the state cannot put restrictions on the number of natural persons that may be employed by a service supplier; or in a particular service sector who are necessary for and directly related to the supply of a specific

⁶⁰ Article XVI:1 of the GATS

⁶¹ Article XVI:1,2 of the GATS

⁶² Article XVI:2(a) of the GATS

⁶³ Article XVI:2(b, c) of the GATS

service.⁶⁴ Furthermore, the state is prohibited from putting restriction on the type of legal entity, or on the participation of foreign capital by a maximum percentage of shareholding or total value of the investment.⁶⁵

v. National Treatment

Article XVII of the GATS sets out the obligations on National Treatment of Foreign Services and services suppliers. Paragraph 1 of Article XVII prohibited member states from operating discriminatory measures benefiting domestic services or services suppliers. The provision partly reads:

...each member shall accord services and service suppliers of any other member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like service and service suppliers.

- As one can read from the provision of Paragraph 3 of XVII, a treatment that modifies the conditions of competition in favour of domestic services or services suppliers is less favorable to foreign services or services suppliers; hence discriminatory.

This obligation has the objective of liberalizing trade in services by ensuring that foreign services or services suppliers enjoy substantially the same treatment as their domestic counterparts.⁶⁶

Accordingly, each member state has the obligation to grant banking services/banking services suppliers/ of any other member a treatment no less favourable than that it accords to its own (domestic) banking services and banking services suppliers.

However, the important point here is that, like the market access obligation, national treatment obligation applies on a state only to the extent the state has inscribed specific commitment in its Schedule. The extent to and the conditions under which the national treatment obligation apply to individual service sector (for example, the banking sub sector) in any member state can be assessed only by referring to the inscriptions in that state's Schedule of commitment.⁶⁷ What is also important is a state can set out in its

⁶⁴ Article XVI:2(d) of the GATS

⁶⁵ Article XVI:2(e, f) of the GATS

⁶⁶ Sydney J.Key, *Supra* note 20 p.13

⁶⁷ UNCTAD/EDM/Misc.232/Add.31 UNCTAD; **Dispute settlement**, 2003.

schedule a condition or qualification upon which the specific national treatment is applicable.⁶⁸ Hence, the national treatment obligation depends on the voluntary commitment of each state.

2.3.2. Modes of Banking Services Supply

- In defining trade in services, the GATS identifies four different ways or modes by which services can be traded internationally. As stipulated under Paragraph 2 of Article I of the GATS, trade in services is defined as the supply of services:
 - (a) from the territory of one member into the territory of any other member;
 - (b) in the territory of the one member to the service consumer of any other member;
 - (c) by a service supplier of one member, through commercial presence in the territory of any other member;
 - (d) by a service supplier of one members, through presence of natural persons of a member.

The modes of supply enumerated under (a) (b),(c) and (d) are usually referred to as 'cross border supply', 'consumption abroad', 'commercial presence', and 'presence of national persons' respectively.

Paragraph 1:a of the GATS Annex on Financial Services to which banking service is a part, adapted the above definition when it provides "Reference to the supply of a financial services in Annex shall mean the supply of a service as defined in paragraph 2 of Article I of the Agreement [GATS]". Accordingly, banking service can be supplied in any one of the above mentioned four modes.

The focus of this paper is to explain the nature of the mode of banking service supply through '*commercial presence*'. Nevertheless, it may not be irrelevant to have a look at the other modes, so that it will be easy to understand the nature of '*commercial presence*'.

Available at: www.unctad.org.

⁶⁸ Article XVI:1 of the GATS

i. Cross Border Supply

This mode of services supply covers the flow of banking services from the territory of one state into the territory of another. Neither the supplier nor the consumer moves from one state to the other. Only the service 'moves'.

This form of transaction is mainly carried out using modern communication technologies like telephone, fax, or the internet.⁶⁹ This nature of this mode of service may allow one to infer that the development of cross border supply of banking services may, partly depend on the advancement of modern information communication technology.

ii. Consumption Abroad

Generally, consumption abroad happens when either the consumer moves to the territory of another state and consumes (buys) services there, or the property of the consumer is sent abroad for servicing.⁷⁰ For banking services, however, the consumer travels abroad and visits the office of the foreign bank to obtain services.

iii. Presence of Natural Persons

As the name implies, this mode of service supply refers to the presence of service supplying natural person in the territory of another state. Obviously, the person could be the service supplier (by himself) or he could be an employee of the service supplier.

In the banking sector, however, to state the obvious, a natural person can supply services by serving the banking service suppliers.

In relation to this, albeit she also included other financial sub-sectors other than banks, Sydney J. Key noted that "In financial services sector, natural persons with the exception of financial advisors ...virtually always provide services as employees of financial firms rather than as individual service suppliers."⁷¹

⁶⁹ General Agreement on Trade in Services (GATS): Objectives, Coverage, and Disciplines, available at: www.wto.org; Accessed on 20 May 2007

⁷⁰ Services, GATS Chapter 19???

⁷¹ Sydney J. Key, *Supra* note 20 p.10, 25n

iv. Commercial Presence

In this mode of service supply, the services supplier of one country establishes a territorial presence in another country's territory with a view to provide services. Given the nature of banking services, they can be effectively served through this mode of supply.

The GATS attempts to clarify the meaning of "commercial presences" by defining it as follows:

"Commercial presence" means any type of business or professional establishment including through:

- (i) the constitution, acquisition or maintenance of a *juridical person*, or
- (ii) the creation or maintenance of a *branch* or a *representative office*.⁷²

(Emphasis added).

According to this general definition, banks from one state can participate in the banking business of another country's market by creating branches or representative offices or by establishing separate juridical persons in that other state. When the above definition uses the word 'juridical person', the reference is to those banking service suppliers established in the form of joint-venture or subsidiaries, among others. This can be learned from the following provision of the GATS:

"Juridical person" means any legal entity duly constituted or otherwise organized under applicable law...including any corporation, trust partnership, joint venture, sole proprietorship, or association;⁷³

The concept of 'commercial presence' was also the concern of participants of the Uruguay Round when they agreed to establish text of the 'Understanding on Commitments in Financial Services'. This text was adopted to enable states to take on specific commitments with respect to, among others, banking services under the GATS on the basis of alternative approaches to that covered by specific commitment provisions of the GATS. The text of

Understanding defined 'commercial presence' as:

⁷² Article XXVIII: paragraph d of the GATS

⁷³ Article XXVIII: paragraph l of the GATS

an enterprise with in a member's territory for the supply of financial services and includes wholly-or partly-owned subsidiaries, joint ventures, partnerships, franchising operations, branches, agencies, representative offices or other organizations.⁷⁴

Similar to the former definitions, this definition has provided, even in a more explicit manner that foreign banks may make their presence in one country by establishing branches or representative offices; or foreigners may have banks in the form of subsidiaries or joint venture, and the like.

Each of the different forms of establishment (i.e. like branches, subsidiaries, joint ventures, and representative offices) have somehow their own features. To display the features of some of the establishments:-

When we take '*branches*', they do not have their own separate legal status; instead, they remain integral and operational parts of their parent bank.⁷⁵ Their establishment in a host country involves investment. When it comes to '*subsidiaries*', these are banks owned by a foreign bank but separately incorporated under the laws of a host country.⁷⁶ '*Joint Venture banks*' are legally independent entities established under the laws of the host country.⁷⁷ (i.e. similar with subsidiaries). But, unlike subsidiaries (which are wholly owned by foreigners), they are owned by foreigners and local investors jointly.⁷⁸ The other important point in connection with joint ventures and subsidiaries is that like branches, they obviously involve investment. '*Representative offices*' are forms of establishments that concentrate on promotional activities in the host country without doing any actual banking business. The other form called '*shell-banks*' are meant there to keep books of accounts for head offices, and they may not involve investment of foreign capital.⁷⁹

Back to the nature of '*commercial presence*', one relevant point that needs attention in connection with is that while there might be exceptions, such mode of supplying banking

⁷⁴ See WTO Analytical Index P.1147

⁷⁵ See the '**Study Report on the Pros and Cons of Permitting Foreign Banks in Ethiopia.**' (First Draft), National Bank of Ethiopia, June 1999, Addis Ababa, (Unpublished), P. 27

⁷⁶ *id.*, P.28

⁷⁷ *id.*, p.29

⁷⁸ *ibid.*,

⁷⁹ *ibid.*,

services includes services provided through foreign direct investment. Hence, the GATS gives attention to the issue of Foreign Direct Investment. From this angle ,therefore, it may not be difficult to infer that the GATS is meant there for the progressive liberalization of foreign direct investment in areas like banking services. In the absence of a separate WTO Agreement administering (governing) foreign direct investment in services, this nature of the GATS remains promising in liberalizing foreign investment in member countries. Liberalizing investment remains impossible unless domestic investment laws and policies, together with other trade and trade related polices and laws, and measures are designed in a way that do not restrict investment.

CHAPTER THREE

ETHIOPIA'S LEGAL FRAMEWORK REGULATING THE BANKING SECTOR

3.1. Historical Survey of the Banking Service Sector

The history of modern banking services in Ethiopia dates back to 1905, the year when Emperor Minilik-II and the then Representative of the British owned National Bank of Egypt reached an agreement for the establishment of a bank called Bank of Abyssinia.¹

The rights and concessions agreed upon the establishment of the bank included the following:²

- The capital of the bank was agreed to be a sum of Pound sterling 500,000 and one fifth was to be obtained by selling shares in some important cities such as London, Paris, New York, Rome, Vienna, and Addis Ababa;³
- The bank was given full rights to issue bank notes and minting coins, to establish silver coins and abolish the Maria Theresa;
- By way of incentive, to give land to the bank free of charges and allowed to build offices and Warehouses;
- Government and public funds were to be deposited with the bank and payments to be made by cheques ; and
- Ethiopia's government agreed not to allow any other bank to be established in the country within the 50- year concession period.⁴

Following this agreement, the banking operation started on February 16, 1906. The bank opened branches in different parts of the country including Harar, Dire-Dawa, Gore, Dembidolo and Dessie.⁵ A Representative Office was also opened in Gambella.⁶

¹**The History of Banking and Other Financial Institutions in Ethiopia.** Available at: <http://www.nbe.gov.et/History/history.htm>. Also see Belay Gidey (1983 E.C.) 'Genzebe, Bank Ena Medhin Be Ethiopia', (Amharic), p.80

² Belay Gidey, *supra* note 1

³ *ibid.*,

⁴ *id.*, p.81

⁵ *ibid.*,

⁶ *id.*, p.82

Until its liquidation in 1931, the Bank of Abyssinia to render services such as keeping government accounts, some export financing and undertaking various tasks for the government.⁷

There were, of course, other foreign owned banks including, Banque de l' Indochine and the Compagnie de l' Afrique Orientale (established in 1915), and a development bank named –Societe Nationale d' Ethiopie Pourle Development de l' Agriculture et du Commerce (established in 1908).⁸

Since the bank of Abyssinia faced enormous pressure for being inefficient and purely benefit oriented, it was agreed to abandon its operation and be liquidated in order to liberate the banking sector from foreign control and to make the sector responsive to the country's credit needs.⁹ Thus, in 1931 (that is, shortly after Emperor Haile Selassie-I came to power) Bank of Abyssinia was liquidated and replaced by 'Bank of Ethiopia'.¹⁰

Bank of Ethiopia was established by an official Decree on August 29, 1931 with a capital of Pound Sterling 750,000. This bank was purely Ethiopian bank-the first indigenous bank even in Africa.¹¹ The Ethiopian government owned Sixty Percent of the total share of the bank and the bank's transactions were subject to scrutiny by the Minister of Finance.¹² This bank took over the commercial activities of its predecessor and was authorized to issue bank notes and coins.¹³ With branches in Harar, Dire Dawa, Gore, Dessie, and Debre Tabor; a representative office in Gambella; and a transit office in Djibuti, the Bank continued its activities until the Italian invasion.¹⁴

⁷ id., p.83

⁸ Jonse Bane,(2002), **Merits and Demerits of Allowing Entry of Foreign Banks into the Ethiopian Banking Sector: Lessons from Selected Countries**, (National Bank of Ethiopia, Economic Research Department), Paper Presented for the First International Conference on the Ethiopian Economy organized by EEA (January3-5, 2002).Available at: <http://www.addischamber.com/downloads/docs1/29.doc>

⁹ Belay Gidey, supra note 1

¹⁰ ibid.,

¹¹ ibid.,

¹² ibid.,

¹³ ibid.,

¹⁴ ibid.,

Italian banks were also participants in Ethiopia's banking services provision, especially since 1914. In 1914 (i.e. prior to invasion) two Italian banks established branches in different cities of Ethiopia: Banco di Italia that opened nine branches offices in Addis Ababa, Asmara, Assab, Dessie, Dire-Dawa, Gonder, Jimma, Harar and Massawa; Whereas Banco di Roma opened eighteen branches in fifteen cities (i.e. including the above enumerated cities plus Combolcha, Dembi-Dolo, Gambella, Gore, Jijiga and Nekemt).

During the five years of Italian occupation, Italian Banks namely, (1) Banco di Napoli, (2) Banco di Nazionale (De's voro) (established in 1939 with their respective branches in Addis Ababa, Asmara, Dekemehari and Massawa), (3) Casa di Credito Ogrario a Minirario (established in 1933 with one branch in Asmara), and (4) Societe Nazionale di Ethiopia (established in 1939, with one branch in Addis Ababa) were functional.¹⁵

Nevertheless, except branches of Banco di Roma and Banco di Napoli (established in Asmera, Massawa, Assab and Addis Ababa) which remained operational until 1975, all branches of Italian banks ceased operation soon after Ethiopia's liberation.¹⁶

Following evacuation of Italians with the support of British troops, however, British banks in turn became active participants in the Ethiopian banking sector due to, of course, political reasons.¹⁷ That is, in 1941 Barclay's Bank (from Britain) came to Ethiopia with the British troops. It remained in operation in Ethiopia until its withdrawal in 1943.¹⁸

The State Bank of Ethiopia was established in 1941 and commenced its full operation on April 15, 1943.¹⁹ This bank used to act as both the Central Bank and the principal Commercial Bank of Ethiopia until 1963.²⁰

In 1963, the Ethiopian government issued The Monetary and Banking Proclamation No 206/1963, which separated the function of commercial banking and central banking

¹⁵ *id.*, p.84

¹⁶ *ibid.*,

¹⁷ Jonse Bane, *supra* note 8

¹⁸ Belay Gidey, *supra* note 1,p.87

¹⁹ *id.*, p.65

²⁰ *ibid.*,

activities and created a two-tier banking system (i.e. the National Bank of Ethiopia and the Commercial Bank of Ethiopia).²¹ The Proclamation tried to govern the mode of participation of foreigners in Ethiopia's banking services regime. The provision of Article 32(1) reads:

A license to carry on banking business in our Empire may be granted *only to partnerships or companies of Ethiopian nationality at least fifty one percent (51%) of the capital of which is owned by Ethiopia nationals.* [Emphasis added].

As per this provision, foreign investors or foreign banks were allowed to participate in the domestic banking service operation. But they were allowed to do so only in the form of joint venture (partnership), and were permitted to hold only a maximum of forty-nine percent (49%) of the capital.

In addition, the Proclamation required persons carrying on banking business in the country to apply for license to carry on the business.²²

This Proclamation forced the two pre-existing Italian banks (Banco di Roma and Banco di Napoli) to reapply for a new license by rearranging the capital share in such a way that at least fifty-one percent (51%) could be held by Ethiopians.²³

The other privately owned bank that deserves mention is Addis Ababa Share Company, started operation in October 1964 in association with the National and Grindlays Bank, which had forty percent of the total share.²⁴

In those three banks (i.e. Banco di Roma, Banco di Napoli and Addis Ababa Bank Share Company), we do observe a clear case of foreign participation in Ethiopia's banking service sector.

However, the coming to power of the Dergue regime and its declaration of socialism in particular, threatened the existence of privately owned large institutions including those

²¹ *id.*, p.85

²² The Monetary and Banking Proclamation No 206/1963, Article 29(1),(2)

²³ See **Study Report on the Pros and Cons of Permitting Foreign Banks in Ethiopia** (first Draft), National Bank of Ethiopia, June 1999, Addis Ababa, (Unpublished), P.8-9

²⁴ *ibid.*,

three banks. In a while, the government nationalized them on January 1, 1975; and in 1976 the banks merged to form 'Addis Bank.'²⁵ Later on, Addis Bank and Commercial Bank of Ethiopia were merged by Proclamation No 184 of August 1980 to form a single commercial bank in Ethiopia.²⁶ Throughout the seventeen years rule of the Dergue regime, neither domestic nor foreign investors were allowed to participate in the banking service operation.

Two points deserving note from the historical fact described above:

1. The Pre-Dergue history of Ethiopia's modern banking service sector development was closely associated with foreign participation in the sector; and
2. Those different measures taken during the past regimes reveal that increasing resistance to foreign control of the banking system has been the long-standing theme in Ethiopia's modern banking history.²⁷

3.2. Current Policy and Legal Framework

1. Background

Following the 1991 downfall of the Dergue regime—known for its command economy, the new transitional government undertook a series of reforms focusing among others, on deregulating and liberalizing economic activities.²⁸ The early 1990's "marks a period of transition from a command economy to a market based economic policy".²⁹

In the first phase of the country's structural and economic reform programme undertaken during 1992/93-1994/95, Ethiopia's transitional government introduced

²⁵Tony Addison and Alemayehu Geda, (August 2001), **Ethiopia's New Financial Sector and Its Regulation**. (Discussion Paper No.2001/55), United Nations University, World Institute for Development Economic Research. Available at: www.wider.unu.edu/publications/dps/dp2001-55.pdf

²⁶ Belay Gidey, supra note 1

²⁷ Tony Addison and Alemayehu Geda, supra note 25

²⁸ **Ethiopia: Economic Reforms for 1998/99-2000/01**, The Policy Reform Paper. (Prepared by the Government of Ethiopia in collaboration with the International Monetary Fund and the World Bank) September 28, 1998. pp.vii ff

²⁹ **Ethiopia: Memorandum on Foreign Trade Regime**[Unpublished], Ministry of Trade and Industry, Library, p.29

measures focused on economic stabilization and reform measures including the financial services sector.³⁰ The government enacted laws governing banking services: Licensing and Supervision of Banking Business Proclamation NO 84/1994; Monetary and Banking Proclamation NO 83/1994; and the 1992 Investment Proclamation that would encourage investment.³¹

The year 1994/195-1996/97 is a period when Ethiopia's Second Phase of economic policy reform was implemented.³² This phase aimed at limiting the role of the state in economic activities; promoting greater private sector activity and investment; and pursuing a more liberal external trade and foreign exchange policies.³³ Similar measures were observed during the succeeding Phases of the reform programme.³⁴

In general, the overall reform efforts of Ethiopia have the overriding objective of attaining sustainable and fast economic growth with a stable macroeconomic environment; and maintaining financial stability has been the central concern.³⁵

To this end, the government has been introducing economic strategies and policies geared toward integrating Ethiopia into the global markets for goods and services.³⁶ There has been an increasing liberalization and encouragement of foreign trade and foreign direct investment.³⁷ As Mamo Esmelalem called attention to, it may be said that "liberalization and integration into the world trade system [have been] the main directions of Ethiopia's foreign trade policy."³⁸

This does not, however, mean that Ethiopia leaves its domestic market completely free and unregulated.

³⁰ Supra note 28

³¹ Note that this Investment Proclamation is repealed and replaced by the currently working Proclamation No.280/2002, as amended by Proclamation No.375/2003.

³² Supra note 28, p.ix

³³ *id.*, p.x; Also, see the Memorandum on Foreign Trade Regime, supra note 29.

³⁴ *ibid.*,

³⁵ *ibid.*,

³⁶ *ibid.*,

³⁷ *ibid.*,

³⁸ Mamo Esmelalem, (19 January 2005), **Preparation for WTO Accession: the Case of Ethiopia**, Available at:<http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/PreparingforWTOAccessions.pdf>

2. Policy and Legal Framework Governing the Banking Sector

Undertaking reforms in the country's financial sector was considered as one important component of the series of economic reform programmes undertaken since 1992.³⁹ According to Dr.Lakew Alemu, the reforms in the financial sector were conducted with the core target of promoting saving, investment, and economic growth.⁴⁰

To cite some of the measures:-

- In October 1992 the birr was devalued and fixed at Birr 5 to a US Dollar from Birr 2.07/dollar.This had, it is said, enabled to adjust the value of the domestic currency in terms of foreign currency;⁴¹
- In January 1998, the government lifted the control over the lending rates of commercial banks and their deposit rate of commercial banks and kept only a minimum floor on their deposit rate;⁴²
- The government has abolished sectorally discriminating lending rates;⁴³
- Reduction of directed credits to inefficient state owned enterprises;⁴⁴
- A Foreclosure law (i.e. Proclamation NO 651/1997, later repealed and replaced by Proclamation NO 97/98) was enacted with a view to enabling creditor banks to collect their debts from debtors efficiently;⁴⁵
- Strengthening the capital base of the state owned bank (i.e. Development Bank of Ethiopia);⁴⁶

³⁹ Lakew Alemu (Dr.), (May 2001), **Financial Sector Reforms in Ethiopia and Challenges Ahead.** Available at: <http://www.eeaecon.org/econ-focus/vol4%20no4/lakew.htm>

⁴⁰ *ibid.*,

⁴¹ *ibid.*,

⁴² *Supra* note 28, p.14

⁴³ Lakew Alemu(Dr.) *Supra* note 39

⁴⁴*ibid.*,

⁴⁵ See the Preamble of the Property Mortgaged or Pledged With Banks Proclamation No.97/98

⁴⁶ *ibid.*;

- Adopting regulatory and supervisory frameworks for banks and other financial institutions in areas such as capital adequacy in formation disclosure and accounting requirements;⁴⁷
- Improving access to forex for imports through auctions and partial transfer of forex functions to commercial banks;⁴⁸ and
- Introducing a market for short-term government debt instrument (treasury bills of different maturity dates).⁴⁹

The other important measures were: (1) the issuance of Monetary and Banking Proclamation No. 83/94 (which empowered the National Bank of Ethiopia to license, supervise and regulate other banks operating in the country (Article 7:2)); and (2) the issuance of Licensing and Supervision of Banking Business Proclamation No 84/94, which lays down a legal basis for private investment in the banking sector. As stipulated in Article 4(1) of the latter proclamation, "...a license may be issued by the National Bank of Ethiopia to any person duly complying with the provisions of this proclamation concerning application or eligibility for license..."

Shortly after the coming into force of this Proclamation, Awash International Bank was established (1994), followed by Dashen Bank (1996), Bank of Abyssinia (1996), Wegagen Bank (1997), Untied Bank (1998) and Nib International Bank (1999).⁵⁰ Recently other banks namely Oromia Cooperative Bank (2004) and 'Lion Bank Share Company'(2007) have joined the Market.

The Proclamation in black and white prohibited foreign entry in the banking system when it stipulates, "No foreign national shall undertake banking business in Ethiopia."⁵¹

When we consider the investment policy of the country, as part of its market-oriented economic policy, Ethiopia has placed a major emphasis on attracting foreign direct

⁴⁷ *ibid.*,

⁴⁸ *ibid.*,

⁴⁹ *ibid.*,

⁵⁰ Belay Gidey, *supra* note 1.

⁵¹ Licensing and Supervision of Banking Business Proclamation No 84/1994, Article 4(2).

investment as a means of achieving rapid economic growth.⁵² Because of this, Ethiopia has undertaken a series of improvements in its investment law. Since 1992 the government has issued around eight Proclamations including, proclamations NQ 15/992, 37/96, 35/98, 116/98, 168/99, 280/2000 and 375/2003. The re-enactment of those investment laws shows Ethiopia's growing interest and commitment to widen the scope of participation of private investors and foreign investors in particular. Yet, in spite of the efforts to attract the participation of foreign investors, none of the above listed Proclamations tend to invite foreign participation in the banking service sector.

The currently functional investment Proclamation (i.e. Proclamation NQ 280/2002, as amended by Proclamation NQ 375/2003) does not enumerate those investment areas reserved exclusively for Ethiopians. Instead, under Article 6, it authorized the Council of Ministers to issue Regulations specifying areas of investment reserved for Ethiopians and other domestic investors. Accordingly, the Council of Ministers issued a Regulation-'Investment Incentives and Investment Areas Reserved for Domestic Investors Council of Ministers Regulation NQ.84/2003.' Among other things, the Regulation provides that the banking service sector is an area of investment exclusively reserved for Ethiopian Nationals;⁵³ and as per Article 8 of Proclamation NQ 280/2002, the banking sector is not open for foreign participation.

Ethiopia's reluctance to allow commercial presence of foreign banks is also revealed in the country's Industrial Development Strategy Paper. There, it is noted, 'currently there are several reasons justifying the need for prohibiting the entry of foreign banks'.⁵⁴ The government has also reflected this position when it opted for what it called 'Revolutionary Democracy' line of thought (as opposed to liberal Democracy), which is

⁵² DTIS (July 2004), **Ethiopia: Trade and Transformation, Summary and Recommendations-Diagnostic Trade and Integration Study**, Volume 1.p.36

⁵³ Investment Incentives and Investment Areas Reserved for Domestic Investors Council of Ministers Regulation NQ.84/2003, Article 3, the annexed Schedule Article 2(1).

⁵⁴ **Ethiopia's Industrial Development Strategy** Paper, p.111. Ethiopia's justifications for prohibiting foreign bank entry are considered in Chapter 6 of this Paper.

known among other things, for its inclination toward restricting foreign participation in domestic financial service sector.⁵⁵

At this juncture, it is apposite to appraise the consistency or otherwise of this legal position of Ethiopia with that of the WTO rule on market access.

Chapter 2 of the paper thoroughly describes the relevant WTO rules. There, it is described that albeit the GATS has the objective of promoting a progressively higher level of liberalization of trade in services (including the Banking Service sector), the general obligations stipulated under the GATS do not, by themselves, guarantee market access to services trade. Rather, market access obligation is made to depend on the willingness and specific commitment of each member state. That is, a state may be obliged to open its market to foreign participation in banking services provision, only to the extent that state has entered into specific commitment with respect to this sector. If a state remains unwilling to enter into such specific commitment, it has the discretion to do so.

When we evaluate Ethiopia's measure in light of this clear fact, therefore, *even if the measure has the obvious effect of restricting free trade in the banking service sector, it can be easily concluded that Ethiopia's measure has no inconsistency with market access provisions stipulated under the GATS.*

Nevertheless, non-existence of inconsistency may not serve as a valid guarantee to remain unwilling to permit foreign bank entry. If Ethiopia has to complete its accession negotiation successfully, it is still relevant to examine the measure in light of specific undertakings inscribed in schedules of other states particularly that of the recently acceded ones. Because,

- In the first place, as the GATS is a complex web of rights, obligations, exemptions/exceptions, and specific commitments;⁵⁶ and known that GATS required states to enter into specific commitment negotiations that are directed to providing

⁵⁵ **'Be Ethiopia Yedimocraciawi Seriat Genbata Gudayoch'** [Amharic] (May 1994 E.C.), Ministry of Information, Addis Ababa. Here the writer finds it appropriate to cite the existing government's line of thought because it is believed that even such an ideology could have direct influence on the country's trade policy and law formulation.

⁵⁶ **'Module on Dispute Settlement'**. Available at: <http://www.unctad.org>.

effective market access,⁵⁷ the nature of the GATS obligations can be well understood with reference to market access commitments;⁵⁸

- Secondly, it is foreseeable that Ethiopia's accession negotiation will involve negotiations on the country's commitment to liberalize the banking services sector.

It is with these points in mind that Chapter five touches upon the accession experiences of some countries; so that readers would be able to make an intelligent guess as to the expectation and reaction of the WTO members.

⁵⁷Article XIX:1 of the GATS

⁵⁸ Supra note 56

CHAPTER FOUR

ACCESSION TO THE WORLD TRADE ORGANIZATION

4.1. The Process of Accession in General

As pointed out earlier in Section 2.1 of Chapter 2, the WTO is an 'apex' international institution, whose establishment was necessitated by the accelerated increase in international trade relations, so that it (the organization) can be responsible for administering international trade rules.

Even if the Organization was designed to serve as an institutional mechanism through which countries pursue trade liberalization, for different reasons (like the nature of WTO commitments, skepticism about the benefits, etc.), the organization did not succeed in securing the participation of some countries. The negotiators of the Marrakesh Agreement were of the hope that other countries would in due course request for membership to the organization. This was revealed under the Agreement that established the Organization when they agreed to include provisions that allow new members to the WTO and provide brief procedures for accession.

Basically, it is the provision of Paragraph 1 of Article XII that leaves the door open for interested states to join the organization. The provision partly reads:

Any state...possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement [establishing the WTO] on terms to be agreed between it and the WTO.(emphasis added).

The Agreement does not leave the accession unconditional. As the wording of the above quoted provision shows, states desiring for WTO membership need to possess full autonomy to conduct international trade relations. Besides, states are allowed to join the WTO 'on terms to be agreed. Hence, there must be a prior negotiation between the state interested to join and the WTO. The process does not end here. As per the provisions of Article XII:2 of the Agreement, results of the accession negotiation (or the terms of the agreement) need the approval of the WTO's Ministerial Conference.

The Marrakesh Agreement has also provided preconditions on the binding effect of the terms of accession on other WTO members.¹

From among the above noted criteria and procedures of accession, though each point deserves proper attention, the issue of 'negotiation for accession' remains highly relevant for the purpose of this paper.

4.1.1. Negotiation for Accession

The provision of Article XII: 1 of the Marrakesh Agreement requires agreement on the terms of accession. The provision is so brief that it gives no indication as to the procedural approach to be employed for effective negotiation. In the words of Charveriat Celine and Mary K., the provisions of Article XII "does not identify any concrete steps, nor does it provide any advice when it comes to the procedures to be used for negotiating the terms of accession."²

Some observers noticed this limitation of the Marrakesh Agreement and even go further to say, "the scarcity of rules governing WTO accession is a remarkable omission for a self-proclaimed rules-based organization."³ Such dearth of guiding rules has initiated the WTO *Secretariat* to draw up a set of accession procedures to be followed in the pursuit of accession negotiations.⁴ The procedures provide interested applicants and the WTO with a road map for WTO membership process.⁵ With all their vagueness, the established procedures do have their own assistance in guiding the accession. Consultations were made between the WTO members and the secretariat addressing the procedures drawn; and an understanding was reached between WTO members that the procedures would remain practical guide for interested applicants.⁶

¹Article XIII of the GATS

² See Charveriat, Cline and Mary Kirkbride (2003), **Cambodia's Accession to the WTO: How the law of the jungle is applied to one of the world's poorest countries**; Available at: http://www.oxfam.org.uk/what_we_do/where_we_work/cambodia/downloads/Cambodia_accession_facts_final_Aug21.pdf. Accessed on September 22, 2006.

³ Maxine Kennett, Simon J. Evenett & Jonathan Gage (22 January 2005) **Evaluating WTO Accessions: Legal and Economic Perspectives**.

⁴WTO Technical Note by the Secretariat, Accession to the World Trade Organization, Procedure for Negotiations under Article XII, 24th March 1995, Document Number WT/ACC/1, WTO. Available at: <http://www.wto.org>.

⁵ Maxine Kennett, Simon J. Evenett & Jonathan Gage, *supra* note 3

⁶ *ibid.*,

For the purpose of this paper, here, it suffices to briefly describe the negotiation steps involved in the accession process:-⁷

If a state has the interest to join the WTO, first it must send a communication to the Director General of the WTO indicating its desire to join the WTO. Then, this communication will be circulated to all WTO members and a decision will be taken whether to approve the establishment of what is called 'a Working Party'. Membership in this working party is open to all interested members.

Once the General Council of the WTO established a 'Working Party', the next task of the applicant state is to submit to the Working Party a detailed memorandum on its foreign trade regime, describing, among other things, the country's economy, economic policies, and policies affecting international trade in services etc. In this connection, the WTO Secretariat has published different Technical Notes. For instance, it has published a format on how to draft a memorandum⁸ and a note in connection with the information to be provided on policy measures affecting trade in service.⁹

Following the submission and circulation of the memorandum, the Working Party members will examine it and submit questions to the applicant in relation to the memorandum to obtain clarification and more information about that applicant's foreign trade regime, and the applicant will act accordingly. This phase is said to have the significance of enabling the applicant to gain a better understanding of the WTO and its requirements.¹⁰

After collecting all the necessary background information on the applicant's trade regime, the working party will conduct meetings focusing on the issue of discrepancy between the applicant's foreign trade regime and the WTO rules.

⁷ See WTO Technical Note by the Secretariat, *supra* note 4

⁸ *ibid.*,

⁹ See WTO Technical Note by the Secretariat, *Accession to the World Trade Organization, Information to be Provided on Policy Measures Affecting Trade in Services*, 31st October 1996, Document Number WT/ACC/5. Available at <http://www.wto.org>. One important point that deserves mention is, even if submission of memorandum is expected to be preceded by working party establishment, the practical experience of China reveals otherwise, in that China submitted its memorandum before the establishment of working party.

¹⁰ See WTO Technical Note on the Accession Process; Note by the Secretariat, World Trade Organization, WT/ACC/7/Rev.1,(99-5042); November 1999. Available at: <http://www.wto.org>.

Thereafter, series of bilateral negotiations will be conducted between the applicant state and the WTO members. The negotiations will address among other things, commitments on market access and national treatment for goods and services. The results of the negotiation will be informed to the Secretariat so that the draft schedule of commitment will be prepared and circulated to all working party members and reviewed multilaterally.

Finally, the working party will send to the General Council an accession package that includes summary of all working party meetings and draft protocol of accession to which schedule of commitment is attached. Once this organ approves the terms of the accession and then the applicant accepts the same, the applicant state will become an official member of the WTO after thirty days.¹¹

The procedure for negotiation has general applicability; in that it guides the negotiation of any interested state whether developed or least developed. Nonetheless, it may not be difficult to notice some points that would harden the accession negotiation. First, the Marrakesh Agreement Article XII: 1 explicitly provides that any state may accede to the WTO on terms to be agreed between *it and the WTO*. If the Agreement is required to be made with the WTO, the negotiations that lead to an agreement on terms of accession should have been made with the Organization itself. In fact, the Marrakesh Agreement does not require states (aspiring membership) to enter into bilateral negotiations with WTO members. Of course; the Agreement has set procedures whereby the WTO members may safeguard their interest in the accession process. As we can read from Article XIII of the GATS, member states are entitled to express their disagreement with the terms of accession.

They can notify their stand/disagreement, if any, to the ministerial conferences any time but only before the approval of the agreement on the terms of accession. Despite this, however, the accession procedure outlined by the WTO Secretariat requires states to enter into bilateral negotiations with individual WTO members.¹² Hence, the established procedure appears more burdensome than the procedure set in the Marrakesh Agreement.

¹¹ The above noted procedure is copied from literature like Maxine Kennett, Simon J. Evenett & Jonathan Gage (22 January 2005) **Evaluating WTO Accessions: Legal and Economic Perspectives**. Available at: <http://www.evenett.com>

¹² *ibid.*,

On this point, Retnaker Adhikari and Dahal wrote, "Since the WTO is an inter-governmental organization, which does not have any power to negotiate accession agreement with the aspirants, it is the member countries that dictate the terms and conditions for such entry."¹³

In fact, it may not need any mention as to the inter-governmental nature of the WTO. However, even if the writers have the view that the Organization does not have power to negotiate, one can notice at least two clear points. In the first place, needless to mention, it is not difficult to see the fact that the Organization has its own legal personality; and structurally, it has different bodies including, The Ministerial Conference, General Council, Trade Negotiations Committee, Council for Trade in Goods, a Council for Trade in Services, and a Council for Trade-Related Aspects of Intellectual Property Rights. Each of these bodies is assigned to perform separate functions. Second, legally speaking, the Marrakesh Agreement has clearly mandated the Organization itself to enter into an agreement with aspiring states.¹⁴

For sure, the ultimate decision makers on the accession of a state are member states; as it is the ' Ministerial Conference' [which is composed of representatives of all the Members of the WTO] that shall approve the agreement on the terms of accession by a two-thirds majority'.

Bilateral negotiations have also features hampering accession efforts. Quoting a paragraph would clarify this point:

One of the features of bilateral negotiations, that has developed over time, is that WTO members have begun to informally cooperate with one another and to distribute work among themselves. For example, one member may decide to focus on goods, when another member will center on services, so as to reach a deal that is of maximum interest to all WTO members active in the working party. This makes it useless or even counter productive for an applicant to follow a negotiating strategy, which would try to play out one country against another.¹⁵

¹³ Ratnakar Adhikari and Navin Dahal, (2003), **LDCs' Accession to the WTO: Learning from the Cases of Nepal, Cambodia, and Vanuatu. Kathamandu, Nepal.** Available at: <http://www.un-ngls.org/SAWTEE.doc>

¹⁴ Article XII: 1 of the GATS

¹⁵ Maxine Kennett, Simon J. Evenett & Jonathan Gage, supra note 3

For countries with weak economy, bilateral negotiation is meant a unique challenge. Since the states delegates have to visit different countries to negotiate, it may go beyond their human, technical, institutional, and financial capabilities.¹⁶

What is more, the negotiation procedure by itself is considered by some writers as long and complicated, requiring applicants to negotiate on different tracks.¹⁷ First, the procedure provides multilateral track; in that, it requires for examination of the applicant's foreign trade regime and their consistency with the WTO rules. For this purpose, the applicant is required to submit a Memorandum on its foreign trade regime accompanied by rounds of questions and answers.¹⁸ Second, the process involves bilateral negotiations on market access issues. In connection with goods, the negotiations may be on concessions; whereas, in services, the negotiation is on specific commitments.¹⁹ Third, the accession negotiation also involves discussions (with interested WTO members) on specific measures like agricultural domestic support and export subsidies commitments.²⁰

This nature of the accession negotiation procedure, accompanied by its others defects and other factors associated with acceding states themselves, would not make the accession an easy task.

4.2. Accession of Least Developed Countries

Even though the WTO agreement invited any state to join the Organization, and despite efforts by a number of least developed countries, no least developed country has acceded since the coming in to force of has the WTO agreement on 1 January 1995 (until 2002).²¹ Nothing this fact, WTO members found it important to simplify accession proceedings as quickly as possible; and expressed their commitment 'to accelerate the accession of Least Developed Countries.' This was

¹⁶Ratnakar Adhikari and Navin Dahal, *supra* note 13

¹⁷UNCTAD/LDC/2004, **Selected Recent Policy Trends: Accession of LDCs to the WTO;**

The Least Developed Countries Report 2004, United Nations Conference on Trade and Development, UNITED NATIONS, New York and Geneva, 2004.

¹⁸ *ibid.*,

¹⁹ *ibid.*,

²⁰ *ibid.*,

²¹ **'Rethinking accession of LDCs to the WTO in the Light of the General Council Decision of 10 December 2002'**. Available at:<http://www.acici.org/aitic/documents/IBs/IB7-eng.htm>- 33k

expressed in Paragraph 9 of the Doha Ministerial Declarations of November 2001.²² In paragraph 42 of the same Declaration, it is stated that:“...Accession of LDCs remains a priority for the membership. We [members] agree to work to facilitate and accelerate negotiations with acceding LDCs.”

Having regard to this commitment, the General Council of the WTO adopted a decision on the December 2002. In the preamble of the Decision, the General council expressed its concern that no least Developed country has acceded to the organization in accordance with Article XII of the Agreement since 1995.

In addressing the accession of those countries, the General Council also took into account the commitment undertaken by least developed member countries at similar levels of development.²³

Accordingly, the General Council decided that negotiations for accession of least developed countries be facilitated and accelerated through simplified and streamlined accession procedures; so that the negotiations would be concluded as quickly as possible.²⁴ To this end, the Decision of the General Council sets out guidelines covering market access obligations, other WTO rules, the accession process, and trade related technical assistance including capacity building.²⁵

In connection with market access: the guideline sets out the responsibilities of both the WTO members and acceding countries. On one hand, WTO members are required to exercise restraint in seeking concessions and commitments on trade in goods and services from acceding least developed countries.²⁶ For this purpose, the guidelines direct the WTO members to take into account the levels of concessions and commitments undertaken by existing WTO least developed members.²⁷ On the other hand, the guideline required acceding least developed countries to offer market access through reasonable concessions and commitments.²⁸ In doing so, the guidelines directed the countries to make the commitments commensurate with their individual development,

²² See WTO (2001a) Doha Declaration, Ministerial Conference, 4th Session, 9-14 November 2001, Doha, Qatar. 20thNov.2001

²³ WTO (2003b) ACCESSION OF LEAST-DEVELOPED COUNTRIES, General Council Decision of 10 December 2002.WT/L/508, 20January 2003

²⁴ *id.*, Paragraph 1

²⁵ *ibid.*,

²⁶ *ibid.*,

²⁷ *ibid.*,

²⁸ *ibid.*,

financial and trade needs. And this is required to be done in line with the different agreements of the WTO including, among others, GATS provisions dealing with 'increasing participation of developing countries' and 'negotiation on specific commitments'.²⁹

In connection with the 'WTO rules':- the guidelines make it clear that different WTO rules on 'special and differential treatment' shall be applicable to all acceding least developed countries, starting from the date of entry into force of their respective protocols of accession.³⁰ Together with this, WTO members are required not to make the accession of those countries dependant/conditional on their 'commitments to accede to any plurilateral trade Agreement or to participate in other sectoral market access commitments'.³¹ This prohibition is said to have the significance of saving least developed countries from being requested to make commitments beyond the requirement of the WTO agreements.³²

The guideline has also established that transitional periods and arrangements shall be granted (to least developed countries) in accession negotiations.³³ Normally, the transitional periods and arrangements that were negotiated during the Uruguay Round were applied as of 1 January 1995. Thus, for a country acceding in 2000 (or after that), most of the above transitional period had already lapsed. Hence, the guideline on transitional periods/arrangements responds to this problem.³⁴

To make the transitional period or arrangements effective, however, the guideline goes further and required applicant states for an action plan for compliance with WTO rules.³⁵

In connection with the accession Process':- taking in to account the complexity and time-consuming nature of the accession, and being aware of the overall capacity of least developed countries, the decision of the General Council sets out a guideline that may enable WTO members to adopt measures in their bilateral negotiations to streamline and facilitate the process. These

²⁹ *ibid.*,

³⁰ *ibid.*,

³¹ *ibid.*,

³² *ibid.*,

³³ *ibid.*,

³⁴ Rethinking accession of LDCs to the WTO in the Light of the General Council, *supra* note 21

³⁵ *Supra* note 23

measures may include, holding the negotiations in the acceding least developed country; and facilitating the accession by extending technical assistance.³⁶

The Decision of the General Council has also called for the need to extend targeted and coordinated technical assistance and capacity building support, which shall cover all the stages of the accession process starting from the preparation of documents to the setting up of the legislative infrastructure and enforcement mechanisms.³⁷

As one can learn from the General Council's Decision of December 2002, the guidelines embodied do not only address the complex and time consuming feature of the accession process but also acknowledge the poor bargaining power, and the technical and capacity problems of least developed countries. Thus, the guidelines are meant to soften the accession process of least developed countries.

4.3. Ethiopia's Accession Process

As described in the foregoing discussion, the process of accession involves a series of complex steps including, submission by the applicant state of a request for membership; establishment of a working party by the General Council of the WTO'; preparation and submission of a memorandum describing in detail the applicant's foreign trade regime; collection of factual information on the applicant's trade regime; multilateral and bilateral negotiations on terms of accession; and preparation of schedule of concessions and specific commitments.

And so, it is inevitable that Ethiopia should pass through all these procedures, not to mention other tasks like revising and bringing domestic laws and institutional arrangements in conformity with WTO rules, adopting new laws and establishing institutions.

Ethiopia was granted an observer status in the World Trade Organization in October 1997.³⁸ As an observer, it is said, the country 'has tried to be familiarized with WTO agreements, and the workings of the multilateral trading system as well as building a negotiating capacity.'³⁹

³⁶ *ibid.*,

³⁷ *ibid.*,

³⁸ WT/LDC/SWG/IF/11, 24 Jan.2001, **Status of Least Developed Countries Accession to the World Trade Organization, Sub-committee on Least Developed Countries**, World Trade Organization.

After having been an observer for five years, Ethiopia applied for membership to the WTO in January 2003.⁴⁰ Basically, the government's decision to join the Organization is said to have the benefit of securing commercial and economic benefits.⁴¹ 'Whether the benefits of membership outweighs the possible costs' is, of course, an independent issue that deserve independent and thorough study, which is not within the scope of this paper.

At any rate, it should be noted that Ethiopian government has decided to join the WTO after considerable deliberations.⁴² Efforts have been made to examine the merits and demerits of membership to the WTO.⁴³

To refer to some of the efforts, 'two national work shops have been organized in 1998 and 1999 with a view to create awareness among different stakeholders in Ethiopia about the multilateral trading system and the WTO framework';⁴⁴ In 2000 the Ethiopian government assigned a study group to examine the conformity of the country's economic and accompanying laws with various WTO Agreements.⁴⁵ In addition, ten different committees (as per the different WTO Agreements) were set up.⁴⁶ As Quoted in E. Mamo's Work, the study of the committee and the study group ended up in concluding:

...Ethiopia has in place an export-led economic policy and will benefit from wider market access opportunities. Most of the rules and regulations are consistent with WTO Agreements, and complying with these agreements will not bring much pressure on the economic policy of the country. Therefore, the committee recommends that Ethiopia should join the WTO.⁴⁷

³⁹ Mamo Esmelalem, (19 January 2005), **Preparation for WTO Accession: the Case of Ethiopia**, Available at: <http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/PreparingforWTOAccessions.pdf>

⁴⁰ See www.wto.org/english/thewto-e/acc-e/status-e.htm

⁴¹ Mamo Esmelalem, Supra note 39

⁴² DTIS (July 2004), **Ethiopia: Trade and Transformation, Summary and Recommendations- Diagnostic Trade and Integration Study**, Volume 1.p.36

⁴³ Mamo Esmelalem, Supra note 39

⁴⁴ *ibid.*,

⁴⁵ *ibid.*,

⁴⁶ *ibid.*,

⁴⁷ 'A summary of Studies Conducted to consider Ethiopia's Accession to the WTO', June 2000.,p.12, as quoted by Mamo Esmelalem, Supra note 39

Few days after Ethiopia's application for accession, the request was circulated and welcomed by the WTO members at the General Council Meeting of February 2003⁴⁸ and the General Council has agreed to establish a working party on Ethiopia's accession.⁴⁹

The step that follows the establishment of a working party is submission of memorandum on the country's foreign trade regime. Ethiopia has been committed to prepare itself for the accession process; and it prepared and submitted its Memorandum to the WTO Secretariat in December 2006 (that is, about four years after the WTO members welcomed the request for accession).

The memorandum was circulated in January 2007.⁵⁰ And the first questions for additional information by the WTO Accession Working Party Members have been received.⁵¹ Beyond this, no further notable step is observed yet. Collection (by the working party) of information on Ethiopia's trade regime, multilateral and bilateral negotiations, and preparation of accession protocol remain to be done in the future. Hence, it can be said that Ethiopia's accession move is relatively at its infancy. Specially, the negotiation phase will pose a great challenge on the country's accession efforts.

⁴⁸ Supra note 42; Also, see www.wto.org/english/thewto-e/acc-e/status-e.htm

⁴⁹ *ibid.*,

⁵⁰ *ibid.*,

⁵¹ *ibid.*,

CHAPTER FIVE
A COMPARATIVE REVIEW OF BANKING SERVICES SECTOR
COMMITMENTS IN SELECTED COUNTRIES: RELEVANT EXPERINCES
FOR ETHIOPIA'S ACCESSION PROCESS

5.1. Introduction

In this Chapter, we will review the experiences of other acceding countries so that Ethiopia could better be able to appreciate the interests and expectations of the WTO, thereby enabling the country to prepare itself for negotiation in connection with banking services liberalization. In fact, examining past negotiation experiences is one possible way of understanding the concerns of the WTO members.

For this purpose, the accession experiences of Nepal and Cambodia are considered. As explained in Chapter 1, these two countries are selected on the following bases:

First, when we consider the economic status of these two countries, both are least developed countries. The same holds true with Ethiopia. From this angle, it can be anticipated that in their negotiation with Ethiopia, the negotiation efforts of the WTO member would not greatly diverge from the negotiation efforts they exerted during the accession of Nepal and Cambodia. More importantly, one can see that these two countries have acceded to the WTO after December 2002. That is to say, they are the only two countries that have successfully joined the WTO following the coming into being of the December 2002 Decision of the General Council which sketch guidelines for the accession of least developed countries. Hence, the relevance of their accession experience also rests on the fact that it would enable Ethiopia to properly appreciate the willingness or otherwise of WTO members to honour their commitment to facilitate and accelerate the accession of the least developed countries. So that Ethiopia could appreciate the prices of accession (from banking services perspective) and prepare itself accordingly.

To fill the possible shortcomings in examining the experiences of those two countries, it is further attempted to consider the experience of China. The basis of this selection is a simple consideration that: given the market size and economic performance of China, and given the country's historical relationship with powerful WTO members, we may

not need special knowledge and experimentation to arrive at the conclusion that the WTO members will not expect Ethiopia to enter into a commitment more burdensome than that of China. Hence, China's experience could enable Ethiopia to predict the maximum expectation of WTO members.

Accordingly, this Chapter addresses four points. First, it reviews the WTO Format Schedules of Commitments. Next, it considers the level of banking services sector commitments of the selected countries. Then, the Chapter makes a brief comparative review of the commitments of those selected countries so that readers can foresee the hurdles that Ethiopia may encounter.

5.2. Review of the Format Schedules of Commitments to the General Agreement on Trade in Services (GATS)

The procedures for accession to the WTO involves the examination of the foreign trade regime of applicants, and requires negotiation and establishment of a schedule of concessions to the GATT 1994 and a schedule of specific commitment to the GATS.¹

The WTO has adopted an outline format for the preparation of a Memorandum on the foreign trade regime of an acceding country; and applicants are required to submit a memorandum that covers the topics listed in the outline format.² For that matter, the step that immediately follows the submission of Memorandum is examination of its consistency with the outlined format.³

The outline format for a Memorandum on the foreign trade regime includes among others, information to be provided on the applicant's trade related services regime.⁴ Accordingly, the Memorandum should have the general description of the overall market and regulatory structures of services sectors including, the financial service sector.⁵ Besides, the Memorandum shall cover the policies affecting trade in services

¹ WTO Technical Note by the Secretariat, Accession to the World Trade Organization, procedure for Negotiations under Article XII, 24th March 1995, Document Number WT/ACC/1, WTO. Available at: <http://www.wto.org>

² *ibid.*,

³ *ibid.*,

⁴ *Id.*, Outline Format for a Memorandum on the Foreign Trade Regime, section VI.

⁵ *ibid.*,

that addresses issues related with Market Access, National Treatment, and Most Favoured Nations Treatment.⁶ Negotiations with individual WTO members are proceeded based on draft schedules of specific commitments, tabled by the applicant.⁷ The ultimate objective of such approach is nothing but establishing a negotiation based scheduled commitment, as envisaged in the GATS.

As considered in Chapter 2 of this paper, the GATS covers two sorts of obligations: while obligations like Most Favoured Nations and Transparency are general obligations that do not need specific sector based commitments of individual states, other obligations including Market Access and National Treatment are binding on countries only if they negotiate and undertake specific commitments.

The GATS itself has provisions on schedules of specific commitments. According to Article XX of the GATS, States are required to set out in a schedule the specific commitments they undertake in connection with Market Access and National Treatment.⁸ With respect to sectors where specific commitments are undertaken, it is required that the schedule shall specify terms, limitations and conditions on Market Access; conditions and qualifications on National Treatment; undertakings relating to additional commitments; the time frame for implementation of such commitments; and the date of entry into force of the commitments.⁹ Besides, states are required to inscribe those measures inconsistent with Market Access and National Treatment provisions of the GATS.¹⁰

Commitments include two forms: those commitments affecting all included services sectors equally (i.e. usually called Horizontal Commitment), which is usually at the top of the schedule of services sectors commitments;¹¹ and those commitments specific to

⁶ *ibid.*,

⁷ *id.*, paragraph 13

⁸ Article XX:1 of the GATS

⁹ *ibid.*,

¹⁰ Article XX:2 of the GATS

¹¹ **A Comparative Review of Financial Services Sector Commitments in Selected SAARC Member Countries: Relevant Experiences for Nepal's Accession to WTO**

(Prepared by INTERNATIONAL FINANCE DIVISION, Research Department, Nepal Rastra Bank) available at <http://www.un-ngls.org/SAWTEE.doc>.

the sector and are provided for Market Access and National Treatments which are put forward with two separate columns (also called sector specific commitment).¹²

The following tabular form can be of some help to understand easily how the schedules of commitments are structured:

Modes of supply (1) cross border supply (2) consumption abroad
 (3) Commercial presence (4) presence of natural persons

Sector or sub sector	limitations of market access	limitations of National treatment	Additional commitment
Horizontal Commitments			
Specific Commitments			
Banking and other financial services			
a) acceptance of deposits	1) unbound 2) unbound* 3) none 4) unbound	1) unbound 2) unbound except in the horizontal section 3) none 4) unbound	
b) lending	1) none 2) unbound 3) none 4) unbound	1) none 2) unbound 3) none 4) unbound*	

In the first column of the table, the various categories of banking services are included. In the next column, information relating to limitations of Market Access are provided for each services category based on the four modes of services supply (cross border supply,

¹² *ibid.*,

consumption abroad, commercial presence and presence of natural persons). These different modes of services supply are simply stated in the table as (1), (2), (3) and (4) respectively.

Depending on the extent to which a state has put limitations of market access and national treatment for each services commitment with respect to each of the four modes of supply, a state's schedule may include different alternative expressions including, 'unbound', 'none', 'unbound except as indicated in the horizontal section', and 'unbound*'. These are nothing but words expressing the levels of commitments. These words have uniform application in schedules of different states. Their meaning is clearly provided in the 'Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS) adopted by the 'Council for Trade in Services' on 23 March 2001.¹³

'Unbound': refers to the cases where a state remains free in a given service sector and mode of supply to introduce or maintain measures inconsistent with market access or national treatment requirement of the GATS.¹⁴ The state has no commitment; hence, it is free to unilaterally change its trading regime in the identified service and mode of supply, without any responsibility to pay compensation.

'None': this word indicates a state's full commitment not to seek in any way to limit market access or national treatment in that given service sector and mode of supply through measures inconsistent with the GATS.¹⁵

'Unbound except...': this mark indicates a state's commitment with limitations. The Guidelines for the Scheduling of Specific Commitments under the GATS noted:

[W]here market access or national treatment limitations are inscribed, two main possibilities can be envisaged in this case. The first is the binding of an exiting situations ("stand still").The second is the binding of amore liberal situation where some but not all of the measures inconstant with Articles XVI and XVII

¹³ S/L/92, 28 March 2001, **Guidelines for the Scheduling of Specific Commitments under the GATS**, Adopted by the Council for Trade in Services, 23 March 2001, World Trade Organization.

¹⁴ *ibid.*,

¹⁵ *ibid.*,

[of the GATS] will be removed. In either case, the [state] must inscribe in the appropriate column the measures maintained which are consistent with Articles XVI and XVII.

In some cases, a [state] may choose to partially bind measures affecting a given category of suppliers...This may be achieved through an indication in the horizontal section of a schedule such as "unbound except for measures affecting the entry and temporary stay of natural persons in the following categories..." In such cases the corresponding sectoral entry...should be "unbound except as indicate in the horizontal section."¹⁶

Unbound*: This mark is used to express that the state does not enter into a binding commitment due to lack of technical feasibility.¹⁷

5.3. The Level of Banking Sector Commitments of Cambodia, Nepal and China

I. Cambodia

a. The Negotiation Process

Recognizing that joining the WTO would play an important role in accelerating its growth and development,¹⁸ Cambodia applied for WTO membership in October 1994 and the Preparatory Committee for the WTO established a working party in the same year.¹⁹

Cambodia completed the preparation of, and submitted, its memorandum in 1999 (i.e. more than four years after the establishment of a working party).²⁰ The Memorandum was submitted to the members of Cambodia's Working Party, who reviewed it and

¹⁶ibid.,

¹⁷ibid.,

¹⁸Sok Siphana, (January 2005), **Preparing For A WTO Accession Negotiation-Cambodia Country Case Study**. Available at:

<http://siteresources.worldbank.org/INTRANETTRADE/Resources/WB-Training/PreparingforWTOAccessions.pdf>

¹⁹Cambodia's accession process is available at <http://www.wto.org>. N.B. Cambodia became the member of the WTO in October 2004. Along with Nepal, it was the one of the first two Least Developed Countries to accede to the WTO.

²⁰ ibid.,

submitted questions designed to clarify further aspects of Cambodia's foreign trade regime.

In connection with the banking services, WTO members pose the following:

[W]e note that a number of qualification requirements have not yet been formulated and would hope that once complete these will reflect a liberal approach to trade in services, and not be more trade restrictive than necessary. Can Cambodia advise its future intention in relation to establishment of such requirements? A similar point can be made with regard to the separate regulations for branches of foreign banks operating in Cambodia and the potential for constraints on banks for statistical reasons? Can Cambodia describe actions it intends to take in relation to regulations applicable to foreign banks?²¹

In its replay to the questions, Cambodia affirmed that it pursues an open market policy in services by at the same time seeking to maintain the quality of the services supplied in its territory.²² Hence, suppliers are expected to meet established competency requirements, which in no way are aimed at limiting or restricting trade in services.²³ Regarding banking services, in particular, Cambodia further explained,

...the new regulations require banks to provide monthly declaration of flows of foreign capital broken down by category for statistical reasons. Since this information would not constitute additional burden for reporting purpose. This information would provide a sound basis for adjusting prudential measures if necessary and for collecting monetary statistics.

So far, only branches of foreign banks have been established in Cambodia. According to the current provisions of the law on the supervision of financial institutions and subsequent regulations, rules applicable to foreign banks,

²¹WT/ACC/KHM/3, 4 January 2001, ACCESSION OF CAMBODIA: Questions and Replies. WORLD TRADE ORGANIZATION, QUESTION NO.170

²² *ibid.*,

²³ *ibid.*,

- including prudential rules are exactly the same as those applicable to locally incorporated banks.²⁴

Cambodia's provision of answers to the raised questions set the stage for the first meeting of the Working Party, held in May 2001.²⁵ The purpose of this first meeting was to examine Cambodia's trade regime and their compatibility with WTO Agreements.²⁶ The second Working Party meeting was held on 14 February 2002. After this meeting, Cambodia was requested to submit its initial schedule of offers in goods and services that consists of, among others, the commitments Cambodia makes (and the limitations it sets) on providing access to its market for services.²⁷ In its initial offer of specific commitments in services, Cambodia included limitations on market access with regard to the mode of supply called 'commercial presence'. It stated, "Authorization and meeting of established requirements are necessary for operation in sensitive areas of business activities."²⁸

Since Cambodia did not point out those services it considered sensitive, some members of the Working Party requested clarification; and they were of the view that market access and national treatment limitations on sensitive areas of business activities should be addressed in the sector-specific commitments.²⁹

Coming to sector specific commitments and commitment in the banking services in particular, the country put forward a very limited offer under commercial banking services including, (a) acceptance of deposits and other repayable funds for the public; and (b) lending for financing of commercial transactions and productive investment.³⁰ In its initial offer, Cambodia put a sort of limitation on market access with regard to

²⁴ *ibid.*,

²⁵ Sok Siphana, 'Lessons from Cambodia's Entry into the World Trade Organization', ADBI Policy Papers No.7 (Asian Development Bank Institute), Available at: <http://www.adbi.org/files/2005.11.book.lessons.cambodia.wto.pdf>

²⁶ *ibid.*,

²⁷ *ibid.*,

²⁸ See WT/ACC/SPEC/KHM/2, 11Dec.2001, ACCESSION OF CAMBODIA, Initial offer on Specific Commitments in Services, WORLD TRADE ORGANIZATION, WORKING PARTY ON THE ACCESSION OF CAMBODIA.

²⁹ *ibid.*,

³⁰ *ibid.*,

commercial presence of those banks to provide the above two identified types of banking services. And it is provided, "commercial presence is only permitted through authorized financial institutions such as banks."³¹

When Cambodia forwarded this offer, one consideration was that it felt particularly comfortable in taking on commitments in sectors where the country had an open policy regarding foreign participation and where that policy has served the country well, which is the case in banking services.³² Because, Cambodia authorized foreign banks and it used to have three foreign owned banks ever since 1991.³³ Even though some members of the working party expressed their appreciation to this limited initial offer, they further requested Cambodia to include all sub sectors in the GATS Annex on Financial Services and then list any limitations the country sought to maintain in these areas under market access and national treatment columns of the commitment schedule.³⁴ When they requested so, they tried to justify their view by citing possible benefits that Cambodia could get. They said,

there is a correlation between financial sectors open to foreign investment and economic growth, particularly when accompanied by strong financial sector supervision. The introduction of competition from reputable international financial services providers can promote growth by increasing the productivity of financial intermediation. World-class financial institutions can introduce the latest management and risk sharing methods, the latest financial products that improve risk allocation, the best technology and a wide variety of products and services to domestic businesses and consumers at low prices. Further, the presence of well-capitalized branches of foreign firms can expose the home market to advanced supervisory techniques given that home authorities would work closely with authorities hosting their institutions' branches.³⁵

³¹ *ibid.*,

³² Sok Siphana, *supra* note 25

³³ See WT/ACC/KHM/21 Report of the Working Party on the Accession of Cambodia, 15 August 2003.

³⁴ Sok Siphana, *supra* note 25.

³⁵ *ibid.*,

Besides, some members of the working party requested Cambodia to explain whether foreign banks were permitted to establish branches in Cambodia and whether foreign banks were permitted to purchase existing banks. What is more, since Cambodia offered to allow foreign bank participation only in lending and acceptance of deposits and other repayable funds, members of the working party requested Cambodia to explain whether Cambodian commercial banks were allowed to conduct activities other than deposit taking, lending and payment services.³⁶ Cambodia shared the view that sufficient commitment in financial service sector would encourage foreign investment.³⁷ At the same time, Cambodia considered the sector as a very sensitive one where the existence of a sound legal and regulatory framework (which was lacking at that moment) is crucial for protection of the public.³⁸

b. The Scheduled Commitment

Following the conclusion of accession negotiations, Cambodia undertook specific commitment in the services sector. As identified in the GATS, the banking and other financial services (excluding insurance) include twelve different sub sectors:

- a. Acceptance of deposits and other repayable funds from the public;
- b. Lending of all types, including consumer credit, mortgage credit factoring and financing of commercial transaction;
- c. Financial leasing;
- d. All payment and money transmission services;
- e. Guarantees and commitments;
- f. Trading for own account or for account of customers ...;
- g. Participation in issues of all kinds of securities...;
- h. Money broking;
- i. Asset management...;
- j. Settlement and clearing services for financial assets ...;

³⁶ *ibid.*,

³⁷ *ibid.*,

³⁸ *ibid.*,

k. Provision and transfer of financial information, and financial data processing and related software by providers of other financial services;

l. Advisory, intermediation and other auxiliary financial

Services on all the activities listed above (a) through (k).³⁹

From among these different services, Cambodia enter into full market access specific commitment only in the three basic banking services including,⁴⁰ (1) Acceptance of deposits and other repayable funds from the public; (2) Lending of all types including among others, consumer credit, mortgage credit, factoring and financing of commercial transaction; and (3) payment and money transmission services, including credit and debit cards, travelers cheques and bankers drafts.⁴¹ With regard to the rest nine banking service sub-sectors, Cambodia entered into no specific commitment. It remained unbound until its government determines what types of entities can conduct these services, the related laws and regulations are established, and such business is authorized by government or other relevant designated authority.⁴²

II. Nepal

(a) The Negotiation Process

Nepal applied for membership to the predecessor of the WTO- the GATT on May 6, 1989 and a working party for Nepal's membership was established. The accession process was, however, suspended following the GATT's transformation into the WTO in 1995.⁴³ The accession process was resumed in 1995 as WTO accession under Article XII of the Marrakesh Agreement. Following Nepal's conversion of its GATT

³⁹GATS Annex on Financial services ,Paragraph 5:a

⁴⁰ To ease the understanding, part of the Schedule is provided in Annex A.

⁴¹See Cambodia's schedule, www.wto.org

⁴² *ibid.*,

⁴³Ratnakar Adhikari and Navin Dahal,(2003), **LDCs' Accession to the WTO: Learning from the Cases of Nepal, Cambodia and Vanuatu**; Kathamandu, South Asia Watch on Trade, Economics & Environment (SAWTEE). Available at: <http://www.un-ngls.org/SAWTEE.doc>.

membership application to membership to the WTO, the formerly established working party was transformed into a working party on its accession to the WTO.⁴⁴

Nepal submitted its memorandum of foreign trade regime in 1998.⁴⁵ In response, questions from working party members were compiled and forwarded to Nepal in January 1999.⁴⁶ Prior to its accession, Nepal used to allow foreign banks to supply services through commercial presence.⁴⁷ The permission was given to joint venture banks with a maximum foreign equity participation of Sixty seven (67) percent.⁴⁸ In the accession negotiation, however, Nepal was requested to make a larger number of services sector commitments.⁴⁹

b. The scheduled Commitment

As a result of negotiation between Nepal and the WTO members which lasted for about 14 years, a Schedule of specific commitment in services provision was adopted and annexed to the protocol of Accession of Nepal.

Nepal's schedule of specific commitment in services includes horizontal commitments applicable to all services sectors including the banking services. In the horizontal commitment, Nepal expressed its commitment not to seek to limit market access through commercial presence.⁵⁰ In fact Nepal marked the market access column with 'None' and further stated,

The conditions of ownership, operation, juridical form and scope of activity as set out in a license or other form of approval establishing or authorizing the

⁴⁴Kanhaiya B. Matherna (22 Jan2005), **Preparing for WTO Accession: Insights From Developing Countries: Nepal's WTO Accession Negotiation, Lessons for LDCs**(Draft).

⁴⁵ Ratnakar Adhikari and Navin Dahal, supra note 43.

⁴⁶ *ibid.*,

⁴⁷ Supra note 11

⁴⁸ *ibid.*,

⁴⁹ **Rethinking accession of LDCs to the WTO in the Light of the General Council Decision of 10 December 2002.** Available at <http://www.acici.org/aitic/documents/IBs/IB7-eng.htm-33k>. Please note that lack of information and literature on the detailed accession negotiation of Nepal restrained the writer from discussing in detail those negotiations.

⁵⁰ WT/ACC/NPL/16/Add.2, 28 August2003, 'Report of the Working Party on the Accession of the kingdom of Nepal'. (See the Country's schedule of Specific commitments in Services.) Part of Nepal's schedule of Specific commitments in Services is annexed as 'Annex B'.

operation and supply of services by an existing foreign service, will not be made more restrictive than they exist as of the date of Nepal's accession to the WTO.⁵¹

In the sector-specific commitment part of the schedule as well, Nepal entered into specific commitment in the financial service sector, to which the banking sector is a part. It is provided in the form of 'General Condition' that all the commitments in banking service are subject to entry requirements, domestic laws, rules and regulations, and the terms and conditions of the central bank of Nepal.⁵² According to its commitment, financial services can be carried out in Nepal through a locally incorporated company; Branches will be allowed for wholesale banking as of 1 January 2010; Only licensed specialized banks may accept deposits, which are repayable upon demand; The total foreign shareholding in any institution providing financial services is limited to 67 percent of the issued share capital; and representative offices are not prohibited from engaging in commercial business.⁵³

Except the general conditions, Nepal did not maintain limitation on market access through commercial presence. In the schedule, Nepal marked the 'market access' column with 'None' revealing the country's commitment not to seek to put any limitation on commercial presence of banks.⁵⁴ Of course, this does not mean that Nepal did allow foreign participation in the supply of all the twelve different banking service as envisaged under Paragraph 5 of the GATS Annex on Financial Services.

Rather, out of the twelve different banking service types, Nepal remained unbound in those two activities stipulated in paragraph 5:X(C) and 5:XIV of the GATS Annex on Financial Services. The schedule reads,

[1] For derivative products [including but not limited to, futures and options]; and
[2] settlement of and clearing services for financial assets, including securities, derivative products and other negotiable instruments [Nepal remains unbound] until [it] determines what types of entities can conduct these services, the related

⁵¹ *ibid.*,

⁵² *ibid.*,

⁵³ *ibid.*,

⁵⁴ *ibid.*,

laws and regulations are established and such business is authorized by government or other designated authority.⁵⁵

At any rate, Nepal's schedule reveals that the negotiations for membership have forced Nepal not to seek to limit market access in the banking services supply through commercial presence. Of course, in the other three modes of supply (i.e. other than commercial presence) as well, at least exceptionally, Nepal remains somehow committed to allow the participation of foreign banks.⁵⁶

III. China

(a) The Negotiation Process

China began its financial sector reform in 1979, when the monopoly of the People's Bank of China was removed and its commercial functions were separated into four state owned banks.⁵⁷ Efforts were also made to diversify the ownership structure in the banking sector.⁵⁸ Nevertheless, it was the notable feature of China's banking sector that all banks were majority or fully government owned; and foreign owned financial institutions were very small the number.⁵⁹

Foreign banks were first permitted to operate in China in the early 1980s, but only through representative offices.⁶⁰ Since then, restrictions on the operation of foreign banks have declined gradually; and they have been permitted to establish branches although with geographic, services type, and client restrictions.⁶¹

Prior to its accession to the WTO, China limited the operation of foreign banks to foreign currency business in selected cities of the country. While China also permitted

⁵⁵ *ibid.*,

⁵⁶ *ibid.*,

⁵⁷ TRADE POLICY REVIEW Report by the Secretariat PEOPLE'S REPUBLIC OF CHINA WT/TPR/S/161, 28 February 2006, WORLD TRADE ORGANIZATION. Available www.wto.org/english/tratop_e/tp_r_e/s161-0_e.doc

⁵⁸ *ibid.*,

⁵⁹ *ibid.*,

⁶⁰ *ibid.*,

⁶¹ *ibid.*,

foreign banks to conduct local currency business, this was limited to foreign customers in two cities only.⁶²

China submitted its request for membership to the WTO's predecessor-the GATT on 10 July 1986.⁶³ At its meeting on 4 March 1987(about eight months after the request), the General Council established a working party to examine China's request and to submit to the Council recommendations, which may include a draft protocol on the status of China.⁶⁴

Negotiations were conducted under the auspices of the GATT working party until the GATT's transformation into the WTO in 1995 after which China applied for accession to the Marrakesh Agreement establishing the WTO.⁶⁵

Following China's application and pursuant to all General Council's decision (on 31 January 1995), the GATT working party was transformed into a WTO accession working party.⁶⁶

During the accession negotiation, China requested to enjoy the rights to differential and more favorable treatment accorded to developing country members pursuant to the WTO Agreement.⁶⁷ While appreciating the importance of this plea, they stressed on the need for pragmatic approach. In their words,

...because of the significant size, rapid growth and transitional nature of the Chinese economy, a pragmatic approach should be taken in determining China's need for recourse to transitional periods and other special provisions in the WTO agreement available to developing country WTO members. Each agreement and China's situations should be carefully considered and specifically addressed.⁶⁸

⁶² Background Information on China's Accession to the World Trade Organization, 12/11/2001. Available at: <http://www.ustr.gov/index.html>.

⁶³ *ibid.*,

⁶⁴ WT/MIN(01)/3, November 2001, Report of the Working Party on the Accession of China, Ministerial Conference, Fourth Session Doha, 9-13 November 2001.

⁶⁵ *Supra* note 62.

⁶⁶ *Supra* note 64.

⁶⁷ *ibid.*,

⁶⁸ *ibid.*,

The whole accession negotiation of this country lasted for about fifteen years, making it the longest and most arduous accession negotiation in the history of GATT /WTO.⁶⁹

(b) The Scheduled Commitment

Generally speaking, it is said, in the 'services sector', China has made a more comprehensive set of initial commitments than those offered by most developed countries. In this connection, commitments in banking services are cited as one example.⁷⁰

As a result of its accession negotiations, unlike the pre-accession periods, China committed to remove restrictions on the operation of foreign banks in the domestic market.

With regard to the supply of banking services through commercial presence (That is, through foreign Direct Investment), China has, entered into a specific commitment not to seek, in any form, to put limitations on market access for banking services listed under Sub-Paragraphs (V) through (X) of Paragraph 5 of the GATS Annex on Financial Services. That is, (a) Acceptance of deposits and other repayable funds from the public; (b) Lending of all types, including consumer credit, mortgage credit factoring and financing of commercial transaction; (c) Financial leasing; (d) All payment and money transmission services; (e) Guarantees and commitments; and (f) Trading for own account or for account of customers: foreign exchange.

According to the Schedule, China has maintained only some temporary restrictions on market access associated with licensing, geographic coverage, and consumers.⁷¹

In connection with licensing:-

⁶⁹ Jeffrey L. Gertler (14 December 2002), **What China's WTO Accession is All About**. Available at: http://siteresources.worldbank.org/INTRANETTRADE/Resources/gertler_china.pdf. Accessed on 22 February 2007.

⁷⁰ *ibid.*,

⁷¹ WT/MIN (01)/3/Add.2, 10 November 2001, Report of the Working Party on the Accession of China. Ministerial Conference, Fourth Session Doha, 9-13 November 2001, World Trade Organization. Part of China's schedule of Specific commitments in Services is annexed as 'Annex B'.

- China has agreed to grant license to foreign banks based on criteria that are solely prudential (i.e. no economic needs test or quantitative limits on licenses). China has further committed itself to eliminate within five years after accession any existing non-prudential measure.⁷²
- Foreign financial institutions with total assets of more than US \$ 10 billion at the end of the year prior to filling the application are permitted to establish *subsidiary* of a foreign bank.⁷³
- Foreign banks can establish a *branch bank* in China provided that they have total assets of more than US \$ 20 billion at the end of the year prior to filing application.⁷⁴ A Chinese–foreign *joint bank* is allowed to be established in China, on condition that the foreign financial institution has total assets of more than US \$ 10 billion at the end of the year prior to application.⁷⁵ As noted in the horizontal commitment part of China's schedule, *representative offices* of foreign banks are permitted to be established in China; but they are prohibited from undertaking profit–making activities.
- Foreign banks will also be licensed to engage in local currency business, provided that they have three years business operation experience in China and being profitable for two consecutive years prior to the application for license.⁷⁶
- Here, China's commitment makes it quite clear that it has permitted foreign participation through commercial presence in the form of subsidiary, branch, joint venture, or representative office.

In connection with Geographic coverage:-

- China entered into a commitment not to put geographic restrictions on foreign participation in foreign currency business.

⁷² *ibid.*,

⁷³ *ibid.*,

⁷⁴ *ibid.*,

⁷⁵ *ibid.*,

⁷⁶ *ibid.*,

- For local currency business, however, China had maintained geographic restrictions, which would be removed in six successive phases; and all geographic restrictions would be removed five years after accession.⁷⁷

In connection with clients:-

In the schedule, it is noted that:

- Foreign banks are allowed to provide foreign currency services in China without restrictions as to customers as of the date of accession.
- But, for local currency business:- with in two years after accession, foreign banks were to be permitted to provide the service to Chinese enterprises; and within five years after accession, they were to be allowed to provide the services to all Chinese clients. Besides, foreign banks licensed for local currency business in one region of China may do the same in any other region of the country that has been opened for such business.⁷⁸

Beyond the above market access commitments, China has also committed not to put restriction on national treatment (except, of course, the restrictions that could be noted in connection with the above discussed limitations).⁷⁹

5.4. Comparative Review of the Commitments and Lessons for Ethiopia

The writer would like to remind readers that the review is limited to address the countries' (Cambodia, Nepal, and China's) *market access commitments* in the *banking services* provision through *commercial presence*.

To begin with, the pre-accession histories of each of the three countries reveal that these countries had their own respective open policies regarding foreign participation in the banking services provision. This point could not, however, mislead us to forget (or disregard) the variations (differences) in the degree of their pre-accession openness.

Observing the accession experiences of Cambodia, Nepal, and China, one can easily see that the accession process lasted for about 9 years, 14 years, and 15 years, respectively.

⁷⁷ *ibid.*,

⁷⁸ *ibid.*,

⁷⁹ *ibid.*,

The latter two periods include the time when the countries effort for accession to the GATT. Thus, the accession processes of the three countries were not concluded without delay. It was a lengthy process, though the causes of the delay (which require independent research) may vary.

With regard to limitations on market access for banking services supply, the schedules of Nepal, Cambodia, and China show that all countries entered 'unbound' commitments in mode 4; Nepal and China entered 'unbound' in mode 1, whilst Cambodia entered 'none'. In mode 2, China and Cambodia entered 'none'. Regarding mode 3 (supplying services through commercial presence), the three countries committed not to put restrictions on market access for three banking service types including: (1) acceptance of deposits and other repayable funds from the public; (ii) lending of all types, including consumer credit, factoring and financing of commercial transactions; and (iii) all payment and money transmission services, including credit, charge and debit cards, travelers cheques and bankers drafts. These are service types listed in Paragraph 5 subparagraphs (v), (vi) and (viii) of the GATS Annex on Financial Services. For the rest types of banking services, Cambodia entered 'unbound'; whereas, Nepal has agreed not to put restrictions, except maintaining limitations on the two banking services relating to derivative products; and settlement and clearing of services for financial assets. Coming to China, together with the above listed three services types, it included other services [(1) financial leasing; (2) guarantees and commitments; and (3) trading for own account or for account of consumers: foreign exchange] as banking services that China remained committed not to put limitations on their market access, except the restrictions associated with geographic coverage, clients, and licensing.

The important point that should be noted from the comparison is that: although the Countries' commitments contain some restrictions on market access, and though there are differences in the level and forms of those restrictions, all the three countries have made commitments to allow foreigners to participate in the banking services supply through commercial presence. This point is not unique to these three countries, as the comparative review of the experiences of other developing countries like India, Sri Lanka and Pakistan revealed similar facts. In these three countries, a similarity can be

seen that 'supply of banking services through 'commercial presence' has been the choice for commitment in banking service liberalization'.⁸⁰

Comparing China's and Nepal's economy, while China is a country with large size, rapidly growing and transitional economy, Nepal is amongst the poorest countries whose principal economic activity depends on agriculture. What is more, China acceded to the WTO in 2001, whereas Nepal acceded to the WTO after the General Council adopted the December 2002 Decision, which is meant to facilitate and accelerate the accession of least developed countries like Nepal. Despite such disparity, however, the schedules of China and Nepal do not reflect as such a proportionate disparity in the two Countries' market access commitment in the banking services supply through commercial presence. Probably, this point may serve as one basis for some writers, like, Ratnakar Adhikari and Navin Dahal⁸¹ to remark that the General Council's Decision of December 2002 has not softened the hardships of the accession process; and that WTO members want to set precedence of high level commitments in the banking sector.

Basically, the commitments are results of negotiations. And, expectedly, the degree of their negotiations and the request of the WTO members in connection with liberalization of the sector depend on their respective potential benefit in the acceding state; and each acceding state is expected to enter into a commitment in away that can maximize their benefit.

Practically speaking, however, given that it is the WTO members that dictate the terms and conditions of accession; and that only countries willing to comply with the request of WTO members will be admitted for membership;⁸² and given that WTO members are not obliged to give any commitments as the negotiation is not as such reciprocal, it would not be unreasonable to argue that the accession is inherently power based.⁸³ And as indicated above, it is not unwise to suspect that WTO members might have the interest to get maximum commitments by requiring the acceding states to make a large

⁸⁰ Supra note 11

⁸¹ Ratnakar Adhikari and Navin Dahal, supra note 43

⁸² *ibid.*,

⁸³ *ibid.*,

number and higher level of commitments, so that they can set a precedence of high commitments.⁸⁴

When it comes to Ethiopia's situation, the country remains reluctant to allow commercial presence of foreign banks. Examining this firm stand in light of the above noted review of practical experiences, we can arrive at the conclusion that: it will be foolish to hope that Ethiopia will not be requested to open its doors for foreign banking services supply.

Mamo Esmelalem makes note of this point when he wrote:

In services negotiations, working party members are likely to request commitments from Ethiopia to liberalize imports of such services, especially by permitting foreign direct investment by service suppliers. The experience of recent accessions suggests that significant [commitments] by Ethiopia on services imports may be necessary to conclude accession negotiations. Nepal, Cambodia, and Vanuatu made substantial offers in the areas of financial... services.⁸⁵

- Probably, WTO members may not pressurize Ethiopia in the same way they did on China. Nevertheless, the WTO may expect that Ethiopia's banking services liberalization should not diverge greatly from those recently acceded least developed countries including Nepal and Cambodia. Hence, like those acceded countries, it is highly probable that WTO member countries will strongly argue for the importance of foreign participation in Ethiopia and they may request to make Mode 3 (commercial presence) as the country's main choice for specific commitment in banking services liberalization.

⁸⁴ibid.,

⁸⁵ Mamo Esmelalem, (19 January 2005), **Preparation for WTO Accession: the Case of Ethiopia**. Available at: <http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-raining/PreparingforWTOAccessions.pdf>

CHAPTER SIX
COSTS AND BENEFITS ASSOCIATED WITH FOREIGN BANK ENTRY INTO
ETHIOPIA

6.1. Introduction

- For the purpose of this paper, foreign bank entry refers to the supply of banking services by a service supplier of one state through commercial presence in the territory of any other state. Such commercial presence may take different forms like, branches, representative offices, offshore offices, subsidiaries, joint ventures, and shell banks.¹

One can easily learn from the WTO rules (like the GATS) and the different literature that banking services trade liberalization is becoming one main area of concern at international level. Even though the undeniable trend is that international trade in banking services is increasing through time, studies have been conducted on how the commercial presences of foreign banks affect commercial activities and economies of the host country.

Different literature address and identify the benefits and costs of commercial presence of foreign banks. For countries with a very low stage of economic development, like Ethiopia, proper assessment of the pros and cons of foreign bank entry remains indispensable; so that the country would shape its foreign trade regime accordingly. It is thus the purpose of this Chapter to discuss (mainly on a conceptual level) the recurrently raised benefits and costs of foreign bank entry; so that Ethiopia's negotiation for the WTO accession will take them in to account.

6.2. Benefits of Allowing Foreign Bank Entry

With a view to simplify the discussion, attempts are made to identify benefits associated with domestic banks, consumers of banking services, and the national economy at large.

6.2.1. Effects on Domestic Banks

Studies identified different benefits (of banking services trade liberalization) associated with domestic banks, including the following:

¹ See Section 2.3.2(IV) of Chapter Two

1. Improving the Level of Efficiency in the Domestic Banking Sector

Foreign banks (from developed countries) are said to have the ability to operate in a more efficient way than domestic banks in developing or least developed countries. Because, those foreign banks are likely to have larger experience of operating in a competitive environment than those domestic banks in developing and least developed countries.² With this background, studies bear out that foreign bank entry creates competitive environment for domestic banks, thereby improving their efficiency by enforcing them to reduce waste, improve management and quality, and introduce variety of services.³

This benefit is also recognized by the 'study on the pros and cons of permitting foreign banks in Ethiopia' conducted by the National Bank of Ethiopia when it noted, "competition in the banking sector in terms of efficiency and the variety and quality of banking services is likely to be greatly enhanced as a result of the entry of foreign banks in to the domestic banking sector."⁴ What is more, as some literature pointed out, countries could build more efficient banking sector by allowing foreign banks that can introduce international standards and practices.⁵

As increased competitive pressure will spur local banks to become more efficient, they will go to the extent of applying techniques and approaches similar to the ones used in foreign banks.⁶ If domestic banks fail to manage to enhance their efficiency, they may lose their market share, which goes to the extent driving them into financial trouble, and perhaps

²Marion Jansen and Yannick Vennes (March 2006), **Liberalizing Financial Services Trade in Africa: Going Regional and Multilateral**, Staff Working Paper ERSD-2006-03, World Trade Organization.

³ See for example, *ibid.*, Masamichi Kono, Patrick et. al., **Opening markets in financial services and the role of the GATS** (World Trade Organization), Jonse Bane, (2002), **Merits and Demerits of Allowing Entry of Foreign Banks into the Ethiopian Banking Sector: Lessons from Selected Countries**, (National Bank of Ethiopia, Economic Research Department), paper Presented for the First International Conference on the Ethiopian Economy, organized by EEA (January 3-5, 2002). Available at: <http://www.addischamber.com/downloads/docs1/29.doc>

⁴ See Study Report on the Pros and Cons of Permitting Foreign Banks in Ethiopia, (first Draft), National Bank of Ethiopia, June 1999, Addis Ababa, (Unpublished).

⁵ See, Stijn Claessens and Marion Jansen (ed), **The Internationalization of Financial Services: Issues and Lessons for Developing Countries**. Joint WTO/World Bank Kluwer Law International, The Hague, ISBN 90-411-9817-2. (As quoted in ^{WTO} NEWS: 2001 PRESS RELEASES) Press/208, 19 February 2001.

⁶ *supra* note 2, P 5, 11n

even into bankruptcy, depending on how poorly they were managed before the entry of their new competing foreign banks.⁷ Marion Jonsen and Yannick Vennes further argued that "although this transition process [That is, the possibility that domestic banks may be kicked out of the market] may be hurtful for owners, employees and creditors of the relevant domestic banks, it is in principle desirable that underperforming banks exit the market."⁸

There are country case studies that verify this benefit of foreign bank entry. As quoted in Jonse Bane's study,⁹ case studies such as the cases of Philippines, Thailand, China, Argentina, Colombia, Turkey, India and Tanzania revealed that in all cases foreign bank entry corresponds more generally with better efficiency of domestic banks.¹⁰ Similarly, as Marion Jansen and Yannick Vennes quoted, researchers used data from a sample of eighty countries and show that foreign bank entry enhances the efficiency of domestic banks.¹¹

2. Advancement of Domestic Banking Services

There is a prevailing view that foreign direct investment is beneficial to developing countries as it provides them with access to advanced technology, introduces superior managerial techniques and business practices.¹² This view does not, however, remain unchallenged by critics. Ha-Joon Chang and Ilene Grabel rejected the above noted view when they argued, "[h]istorically [Foreign Direct Investment and other Trans-National Corporations'] activities have been associated with numerous problems in the developing world. They said, problems have not disappeared yet.¹³ To support their view they forwarded the argument that "[Transnational] corporations transferred obsolete and 'inappropriate' technology to developing countries, often at inflated prices."¹⁴

⁷ibid.,

⁸ ibid.,

⁹ See ibid., and Jonse Bane, supra note 3.

¹⁰ibid.,

¹¹ supra note 2, P.5

¹² See Ha-Joon and Ilene Grabel, (2004), **Reclaiming Development: An alternative Economic Policy Manual**, ZED BOOKS Ltd, p.135

¹³ id., p.138

¹⁴ ibid.,

In any case, when it comes to commercial presence of foreign banks, there is a presumption that banks from developed countries may be aware of more sophisticated financial instruments than domestic banks and of a more advanced management methods.¹⁵ These banks can bring along with them more sophisticated banking services. Their presence is viewed as being advantageous in order to assist in the process of modernizing the banking services sector in poor countries.¹⁶

In this regard, Jonse Bane cited the practical experience of the Philippines that revealed the possibility that foreign bank entry may lead to benefits like speeding up diffusion of technical improvements and innovations in delivering banking services.¹⁷ Innovative banking services including electronic fund transfers, automated teller machines, automated cleaning houses, point of sale systems, credit cards facilities, computerization and modern management methods are cited to exemplify the possible innovative services likely to be available in countries where foreign banks start operation.¹⁸ It is identified in 'the Study Report on the Pros and Cons of Permitting Foreign Banks in Ethiopia' that "these innovations would lead to positive emulation by local banks by means of tailored training programmes and by the process of "learning by doing."¹⁹, other writers hold similar view on this point when they wrote:

International trade can create significant benefits from the transfer of knowledge and technology. This includes knowledge on best practices in management, accounting, data processing, and in the use of new financial instruments. Such benefits largely depend on the commercial presence of foreign banks...²⁰

3. A Stepping Stone for Local Banks to go International

Participation of foreign banks in developing countries is said to have the benefit of enabling domestic banks to gain a lot from the entrants' various experiences with regard to operations like foreign exchange, lending, money transactions, and other sophisticated

¹⁵ Supra note 2.

¹⁶ *ibid.*,

¹⁷ Jonse Bane, supra note 3

¹⁸ *ibid.*,

¹⁹ Supra note 4., also, Jonse Bane has similar view-See Jonse Bane, supra note 3

²⁰ Masamichi Kono, Patrick et. al., supra note 3

banking services.²¹ Such experiences are expected to build self confidence for local banks to venture out and open their branches outside their home country.²² Hence, foreign bank entry may pave the way for local banks to have access to foreign markets.²³

However, one may reasonably ask whether participation of domestic banks in foreign markets benefits the home country, given that such act of banks from poor countries would cause the outflow of domestic capital, which countries like ours are short of.

6.2.2. Effects on Consumers

Foreign banks especially from developed countries may be aware of advanced management methods and more sophisticated financial instruments.²⁴ Hence, foreign banks are expected to provide variety of banking services to consumers in host (poor) countries; and they may be able to offer better-quality services at a better price.²⁵

What is more, as already said, since the participation of foreign banks would expose domestic banks for increased competitive pressure, thereby forcing them to become more efficient,²⁶ domestic banks would be forced to reduce costs of providing banking services.²⁷

An increase in competition may also imply a reduction in domestic bank profits.²⁸ So that banking service customers (consumers) would gain through reduced net interest margins and lower cost of fee-based services.²⁹

Besides, with increased competition, banks are more likely to be attentive to the needs of consumers, and to advise clients on how best to tailor financing packages to meet their

²¹ Jonse Bane, *supra* note 3., and *supra* note 4

²² *ibid.*,

²³ This view is also shared by Masamichi Kono, Patrick et. al, *supra* note 3

²⁴ *supra* note 2, P.5

²⁵ *ibid.*;

²⁶ *ibid.*,

²⁷ *ibid.*,

²⁸ Empirical evidence supported this point. See Stijn Claessens and Marion Jansen, *supra* note 5.

²⁹ *ibid.*, Also see Jonse Bane, *supra* note 3

specific needs.³⁰ Depositors are also likely to benefit from better advice on business strategies as banks compete for their savings.³¹

6.2.3. Effects on Economy in General

The Financial sector provides an indispensable infrastructure for the functioning of a nation's entire economy.³² Especially, it is said, 'efficient financial services contribute to and precede faster economic growth.'³³

Liberalizing the sector is said to have its own effect on a country's economy. In this regard, several literature establish positive correlation between economic growth and banking service open to foreign investment.³⁴

Researchers discovered that both developed and developing countries with open financial sectors have typically grown faster than the ones with closed system.³⁵ What is more, institutions like World Bank and some writers noted that the growth stimulating effects of financial openness are even greater in developing countries.³⁶ Singapore, Hong Kong, and Indonesia are some of the recurrently cited countries whose economic successes are said to have been facilitated through entry of foreign financial institutions, including banks.³⁷ In this connection a recent study on 'the impact of WTO accession on the financial services sector of Ethiopia' found out that Ethiopia's economy would have grown by about 0.5

³⁰ Masamichi Kono, Patrick et. al., supra note 3

³¹ *ibid.*,

³² Sydney J.Key, (2003), **The Doha Round and Financial Services Negotiations**, Washington, D.C: The AEI Press-Publisher for the American Enterprise Institute, pp.4-6

³³ Mattoo Aadytia(2000), **Developing Countries in the New Round of GATS Negotiations:Towards a Pro-Active Role,World Bank;World Economy** ,April 2000, Vol.23,No.4.,471-489.

³⁴ See Sydney J.Key, supra note 32, p.5., and Jonse Bane, supra note 3

³⁵ Masamichi Kono, Patrick et. al., supra note3

³⁶*ibid.*,

³⁷ Jonse Bane, supra note 3

percentage points over the period from 1990-2004 if it had followed a policy of complete financial openness.³⁸

Also, some WTO members acknowledged the growth stimulating effect of foreign bank entry when they negotiate with Cambodia.

In their view,

...there is a correlation between financial sectors open to foreign investment and economic growth...The introduction of competition from reputable, international financial service providers can promote growth by increasing the productivity of financial intermediation.³⁹

The secret behind the growth stimulating effect of foreign bank entry may include the possibility that: their participation could result in foreign currency inflow, encourage foreign trade, stabilize financial crisis, attract foreign direct investment, introduce advanced management techniques, provide further job opportunities, etc. Some of these are discussed briefly herein below.

1. Inflow of Foreign Capital

There is a general understanding among scholars that foreign direct investment is beneficial to developing countries as it provides them with access to capital.⁴⁰ Capital flows into the host country as foreign banks establish themselves.⁴¹

Beyond this, there is a view that 'the narrowness of their networks in the host market and the pattern of their custom mean that foreign banks tap a very small part of local lendable funds.⁴² Deposits are mainly made by their borrowing customers.⁴³ Meaning, foreign banks operating in countries with poor economies are characterized by imbalance between

³⁸ Robert M. Stern, Solomon Abay, et. al., (April 2007), **The Impact of WTO Accession on the Financial Services Sector of Ethiopia**, (Draft Final Report), A Study Commission by the Ministry of Trade and Industry of the FDRE, Addis Ababa, Ethiopia. See the Executive summary

³⁹ Sok Siphana , **Lessons from Cambodia's Entry into the World Trade Organization.**, ADBI Policy Papers No.7 (Asian Development Bank Institute), Available at:<http://www.adbi.org/files/2005.11.book.lessons.cambodia.wto.pdf>

⁴⁰ See Ha-Joon and Ilene Grabel, supra note 12, p.135ff, Marion Jansen and Yannick Vennes, supra note 2.

⁴¹ Masamichi Kono, Patrick et. al., supra note 3

⁴² supra note 4, p.11

⁴³ *ibid.*,

assets and liabilities (i.e. total credits given to customers exceed total deposits).⁴⁴ In reaction to this imbalance, foreign banks may resort to the international inter-bank markets; or they may rely on international inter-office borrowing;⁴⁵ So that they will increase their lending capacity without draining local currency.⁴⁶ This would in turn lead to an inflow of foreign currencies into the economy of the poor countries hosting the foreign banks.⁴⁷

Especially, foreign bank entry has also the benefit of facilitating the flow of capital from countries with capital surplus to those with shortages.⁴⁸ Banking services provided through commercial presence are also crucial in the attraction of foreign direct investment (even in other areas) by undertaking more direct contacts with businessmen (in their home countries or in other countries where the banks have customers).⁴⁹ By doing so, they may increase inflow of capital from outside.

2. Encourages Foreign Trade

Obviously, countries in pursuit of rapid economic development seek to promote industrialization and encourage export-oriented industries. Such industries might require sophisticated and efficient banking services.⁵⁰ And as indicated above, since foreign banks (mainly from developed countries) are likely to operate in a more efficient way by introducing international practices and standards, their operation will respond to the demands of those industries.⁵¹ By doing so, one can say, presence of foreign banks may help host countries to integrate in to the international economy.

3. Stabilize Economic Crisis

Some case studies indicated the stabilization role of foreign banks during economic stagnation or crisis.⁵² It is argued, the risks for financial system may be "insured" with the help of foreign banks.⁵³ As quoted in the findings of Masamichi Kono et al.⁵⁴ researchers

⁴⁴ *ibid.*,

⁴⁵ *ibid.*,

⁴⁶ *ibid.*,

⁴⁷ *ibid.*,

⁴⁸ Masamichi Kono, Patrick et. al., *supra* note3

⁴⁹ *ibid.*,

⁵⁰ *Supra* note 4.

⁵¹ *ibid.*,

⁵² Jonse Bane, *supra* note 3

⁵³ Masamichi Kono, Patrick et. al., *supra* note3

like Goldstein and Turner (1996) have found that the presence of foreign institutions (like banks) helped to stabilize financial systems in several countries in the wake of the 1994/95 Mexican crisis.⁵⁵ Similarly, Jonse Bane quoted findings of other scholars when he noted:

According to George Clarke et al. (2001), when a host country faces economic crisis, foreign banks with internationally diversified assets...may play a stabilization role. [It is] also argued that during the period of economic crisis, the presence of foreign banks could provide diversified capital and funds for local credits and hence help in stabilizing its supply. Cross-country study... indicated that existence of foreign banks minimizes economic crisis of a host country.⁵⁶

4. Source of Additional Employment

Investment is recognized as a source of additional employment opportunities especially in countries where unemployment is a challenge.⁵⁷ Accordingly, commercial presence of foreign banks (i.e. foreign direct investment in the banking sector) gives additional job opportunity for nationals of the host country.

5. Introduce Advanced Supervisory Techniques

The presence of well-capitalized foreign banks may expose the host market to advanced supervisory techniques provided that home authorities would work with authorities hosting the banks.⁵⁸ They may introduce the regulatory and supervisory services of their home-government,⁵⁹ thereby enhancing the improvement of supervisory and regulatory institutional infrastructure of host countries.

6.3. Possible Costs of Allowing Commercial Presence of Foreign Banks

Commercial presence of foreign banks could not only bring benefits but also carry certain risks. The following are some of the often cited possible risks.

⁵⁴ *ibid.*,

⁵⁵ *ibid.*,

⁵⁶ Jonse Bane, *supra* note 3

⁵⁷ Ha-Joon Chang (2003), **Globalisation, Economic Development and the Role of the State**. Zed Books Ltd, London and New York. p.253

⁵⁸ **Lessons Learned from the Cambodian Experience of Protected areas and Development.**

Available at <http://www.mekong-protected-areas.org/cambodia/lessons.htm>. accessed on September 2006.

⁵⁹ Jonse Bane, *supra* note 3

1. Effect on Local Banks

In countries where only domestic banks are operating, import and export businesses, expatriate individuals, international organizations, non-governmental organizations, local organizations, and business etc... would buy banking services from those domestic banks.⁶⁰ If such domestic banks are not as such strong enough to cope with foreign competition ", as soon as foreign banks enter [the market], it is highly probable that they attract most of these [consumers] due to their generally better quality of services and efficiency."⁶¹ Particularly, a massive in flux of foreign banks could result in over aggressive competition, which would lead to a decline in the market share of domestic banks.⁶² The 'Study Report on the Pros and Cons of Permitting Foreign Banks in Ethiopia' provides:

...as foreign banks of world- wide reputation are generally considered to be more efficient and reliable than domestic banks, the bulk of banking business may gravitate towards foreign banks, depriving domestic banks of sufficient market share ...⁶³

Foreign banks have the tendency to concentrate on certain types of financial activities i.e. selective servicing. In the opinion of Marion Jansen and Yannick Vennes, "foreign banks tend to focus on lending to the manufacturing sector, rather than entering the retail market. Even in the manufacturing sector, they seem to have a preference for serving larger clients."⁶⁴ Such approaches of foreign banks have no result in the usually claimed benefit of improving the efficiency and competitiveness of domestic banks through transfer of new technologies.⁶⁵ Rather, it is argued, since they tend to dominate the most lucrative markets dealing with prime borrowers such as multinational companies, domestic banks are left to meet the credit needs of small or medium sized firms and households with low technology banking.⁶⁶ That is, domestic banks would be driven out of the wholesale and large

⁶⁰ supra note 4, p.14., Jonse Bane, supra note 3

⁶¹ Jonse Bane, supra note 3

⁶² *ibid.*,

⁶³ supra note 4, p.14

⁶⁴ Marion Jansen and Yannick Vennes, supra note 2, p.5, 12n

⁶⁵ African Financial Services Trade and Negotiations, Negotiation Brief No 6, March 15, 2005.

p.14

⁶⁶ *ibid.*,

enterprise segments, and obliged to focus on retail operations only.⁶⁷ And thus, it is said, "it is often feared that by stripping the higher end customers from existing banks, the entry of new foreign banks will [weaken] the whole [banking] sector."⁶⁸

It is further argued that seeing as the competition between foreign banks and domestic banks may not be on even terms, "domestic banks may be more vulnerable to shocks, and may be bought outright by foreign banks through a series of acquisitions, amalgamations, and combinations."⁶⁹

What is more, there is a fear that the competition from foreign banks 'might force domestic banks to merge in order to remain competitive, which could create banks that are "too-big-to-fail" as it is feared that the failure of a single big bank could seriously harm financial markets.'⁷⁰

The ultimate concern of the above noted fear is that foreign bank entry will end up in dominating the domestic banking service market and will abuse this position.⁷¹

Writers like Masamichi Kono recognized that less efficient banks with high operating costs are likely to suffer from competition; and banks that previously benefited from preferential access to credit may lose.⁷² Nevertheless, the weakness of the above arguments is that: one, it always assumes that foreign banks will always be more efficient than domestic ones.⁷³ Second, it always assumes a static condition in which domestic banks fail to gain from the impetus generated by foreign competition, which is an unrealistic assumption given that the rule of the game is a market-led economic system.⁷⁴ And logically speaking, the fear does not appear telling as it seems what is usually known as a 'fallacy of slippery slope'— a mistake made in the process of moving from the premises of an argument to the conclusion, as a result of which the premises are too remote to justify the conclusion.

⁶⁷ Marion Jansen and Yannick Vennes, *supra* note 2, p.5, 12n

⁶⁸ *ibid.*;

⁶⁹ *supra* note 4, p.15/16

⁷⁰ Jonse Bane, *supra* note 3

⁷¹ Masamichi Kono, Patrick et. al., *supra* note 3

⁷² *ibid.*,

⁷³ *ibid.*,

⁷⁴ *supra* note 4, p.14

2. Effects on National Economy in General

a. Capital outflow Problem

There is a dread that foreign banks may repatriate all the profits to their home country.⁷⁵ Besides, if the lending interest rates rise in the home country and /or the perceived interest rates and profitability in the host country decline, it is argued, foreign banks may withdraw their investment;⁷⁶ So that the very objective of using foreign banks to increase the supply of foreign exchange may be jeopardized.⁷⁷ In this connection, Masamichi kono, et. al. pointed out a claim that after foreign bank entry, capital flows can become more volatile if optimism by investors first stimulates capital inflows that are later reversed when policy errors occur and expectations are disappointed.⁷⁸ Such volatility of capital flows will ultimately undermine the stability of the host country's financial system.⁷⁹

However, counter arguments are forwarded against this dread. In the first place, the fear is not supported by empirical evidence.⁸⁰ Masamichi kono, et.al. indicated that even though many countries have liberalized the sector, most indicators of financial instability have decreased over the years in both developing and developed countries.⁸¹ As quoted in Masamichi kono, et. al, the study of World Bank disclosed that in developing countries where there is particularly strong concern about the volatility of capital flows and reserves(i.e. in Asia and Africa), volatility decreased in the 1980s and 1990s despite the liberalization of services trade; and foreign currency reserves have become more stable.⁸² Only Latin American Countries recorded a small increase in the volatility of private capital flows.⁸³ In the second place, it is argued, even if it is difficult to stop foreign banks withdrawing their investments, there is no convincing reason why they should be hurry to withdraw their funds provided that the domestic investment and working climate is

⁷⁵ See supra note 4, p.14, and Jonse Bane, supra note 3

⁷⁶ *ibid.*,

⁷⁷ *ibid.*,

⁷⁸ Masamichi Kono, Patrick et. al., supra note3

⁷⁹ *ibid.*,

⁸⁰ Masamichi Kono, Patrick et. al., supra note3

⁸¹ *ibid.*,

⁸² *ibid.*,

⁸³ *ibid.*,

hospitable enough to make them feel that the host country's economy is part of their global center of interest.⁸⁴

b. Exposure to Economic Shocks and Exacerbating Crisis

According to Jonse Bane, participation of foreign banks in domestic market exposes a host country to economic shocks of the entrants' home countries. This will happen especially when home countries are subject to economic fluctuations and the entrants lack diversified source of assets.⁸⁵

In connection with crisis exacerbation, it is contended: Since the main objective of foreign banks is to maximize their profit, they may not worry about the host country's concerns like: socio-economic developments, income inequality, unemployment problems, and poverty alleviation.⁸⁶ Especially, in the event of economic crisis in host countries, presence of foreign banks may provide an additional channel for further capital flight and they withdraw abruptly from the local market in response to the economic crisis, thereby exacerbating the crisis.⁸⁷ That is, foreign banks can affect the financial stability via its effect on capital flows. To the extent that banking trade liberalization stimulates capital inflows, the reversal of such capital flows in a period of confidence loss can worsen the situation of financial crisis.⁸⁸ In other words, foreign investors are what we call 'loose-foot' by nature-in that they may have the tendency to 'cut and run' thereby exacerbating the crisis.⁸⁹

Some writers tried to substantiate this point by citing the practical experience of Argentina. It is contended, the decision of a number of foreign banks operating in Argentina to leave the country following the beginning of its financial crisis might have exacerbated the crisis.⁹⁰

The counter argument challenging the above contention is that: first, the key causes for financial sector problems lie in poor or unsound macro economic policies, inadequate

⁸⁴ supra note 4, p.15

⁸⁵ Jonse Bane, supra note 3

⁸⁶ ibid.,

⁸⁷ ibid.,

⁸⁸ Masamichi Kono, Patrick et. al., supra note 3

⁸⁹ Jonse Bane, supra note 3

⁹⁰ Marion Jansen and Yannick Vennes, supra note 2

regulation and supervision, and inappropriate intervention in the financial market.⁹¹ The effect of foreign banks is limited to magnifying the adverse effects of poor macroeconomic and regulatory policies on financial stability.⁹² Hence, their presence may strengthen the case for sound macroeconomic and regulatory policies.⁹³ Second, as quoted in 'Marion Jansen and Yannick Vennes', Demergic-Kunt, et. al. have find out an evidence indicating that increased participation of foreign banks tend to lower the probability of banking crisis.⁹⁴ Third, if a host country faces economic crisis, foreign banks with internationally diversified sources of assets may even play a stabilizing role.⁹⁵ It is further argued, during crisis, the presence of foreign banks could provide diversified capital and funds for local credit and hence assist in stabilizing supply.⁹⁶ Even in Argentina-where the most costly financial crisis was observed, researches found out that during the crisis, foreign banks have provided greater loans than observed among local banks and therefore the operation of foreign banks help reducing the volatility of loan growth in the entire financial system of Argentina.⁹⁷

c. Supervision and Regulation Challenges

There is a common understanding that appropriate supervision and regulation of banks remain indispensable for the efficient and proper functioning of the financial market. Sophisticated technologies and techniques used by well-organized foreign banks do not only present a promise for progress to developing countries; but also potentially represent a challenge for regulators in the host countries.⁹⁸

In countries where there is shortage or lack of adequate and qualified supervisory and regulatory institution, sophisticated foreign banks will remain beyond the supervision and regulation of the host country, thereby exposing the financial sector to danger.⁹⁹ Let alone the institutional framework of developing countries, it is argued, strong supervisory central

⁹¹ Masamichi Kono, Patrick et. al., supra note 3

⁹² *ibid.*,

⁹³ *ibid.*,

⁹⁴ Marion Jansen and Yannick Vennes, supra note 2

⁹⁵ Jonse Bane, supra note 3

⁹⁶ *ibid.*;

⁹⁷ *ibid.*,

⁹⁸ Marion Jansen and Yannick Vennes, supra note 2

⁹⁹ This Argument is forwarded in Ethiopia's Industrial Development Strategy Paper.PP.97ff.

banks of some developed countries remain in a difficulty to monitor sophisticated foreign bank practices.¹⁰⁰

d. Skew Credit Allocations

Foreign banks may tend to allocate credit to large-scale industries, manufacturing sector, real estate and service enterprises;¹⁰¹ and they may give less or no attention to small and medium sized firms, cottage industries and risky sectors like agriculture that are the backbones of economies of developing countries.¹⁰² Less credit to these important sectors has its own implication on the overall economy of the host country.¹⁰³

However, though this may be considered the conventional expectation, high competition in a suitably designed macro-economic environment may well drive both foreign and domestic banks to extend credit to areas that are considered relatively unprofitable but important for an economy.¹⁰⁴ Surveying about three thousand enterprises in thirty six developing and transition economies, George Clarke, et. al. "found that the presence of foreign banks improves financing conditions of all types of enterprises"-small, medium or huge."¹⁰⁵ What is more, there is a possibility that the country may encourage foreign banks to extend their operations nationwide. Furthermore, those important sectors could be financed by other measures like establishing or assigning specialized rural financial institutions. And as a recent study recommended, Ethiopia may expand and strengthen the role of state-owned banks to maintain and expand rural lending on a subsidized basis.^{104a} Hence, there are different mechanisms to respond to the issue of skewed credit allocation.

¹⁰⁰ *ibid.*,

¹⁰¹ *Supra* note 4

¹⁰² Jonse Bane, *supra* note 3

¹⁰³ *ibid.*,

¹⁰⁴ *supra* note 4

¹⁰⁵ Jonse Bane, *supra* note 3

^{104^a} See *Supra* note 38, P119

e. Possible Tax Discrimination

The point here is, comparing domestic and foreign banks, the later have more opportunities to shift taxable income out of high tax jurisdiction;¹⁰⁶ and this creates possible tax discrimination between domestic and foreign banks.

6.4. Relevance of Ethiopia's Current Regulatory Framework

To reiterate once again, Ethiopia has issued laws that unequivocally prohibit the participation of foreign investors in the banking services provision through commercial presence. The issue here is, why Ethiopia opts for this approach? What is the relevance of this legal measure?

Justifications of Ethiopia

We have seen that, in general foreign participation in the banking sector has its own advantages and disadvantages. Those advantages and disadvantages may have relevance to Ethiopia's case. That is why the study on the 'Pros and Cons of Permitting Foreign Banks in Ethiopia' and Jonse Bane's study on the 'Merits and Demerits of Allowing Entry of Foreign Banks in to Ethiopian Banking Sectors' cited those different pros and cons of foreign bank entry.¹⁰⁷

Coming to the clearly identified justifications of Ethiopia's government:- In the first place, as recognized in the Country's 'Industrial Development Strategy', Ethiopia is not unaware of some of the potential benefits of foreign bank entry. For example, the strategy recognized that foreign banks might provide efficiency enhancing effects of competition.¹⁰⁸ Nevertheless, the strategy paper provides that Ethiopia has several reasons necessitating the prohibition of foreign bank entry.¹⁰⁹

¹⁰⁶ supra note 4

¹⁰⁷ See Jonse Bane, supra note 3., and Supra note 4.

¹⁰⁸ Industrial Development Strategy of the Federal Democratic Republic of Ethiopia. (1994 EC) , ministry of Information, Addis Ababa, Ethiopia, PP.110-113

¹⁰⁹ *ibid.*,

Accordingly, the Country's main reasons include (but not exclusively) the following:¹¹⁰

1. The National Bank of Ethiopia (which is responsible to supervise and monitor all other banks) has shortage of adequate, qualified, and experienced staff to undertake its responsibility. And if Ethiopia welcomes very sophisticated foreign banks, they will remain beyond the supervision and regulation of the National Bank, thereby exposing the financial sector to danger. Let alone the National Bank of Ethiopia, it is said, strong central banks of some developed countries remain in a difficulty to monitor sophisticated foreign bank practices.¹¹¹
2. With a view to create and maintain a stable macro-economy, Ethiopia's government reserved the foreign exchange services to be supplied through domestic banks. In the view of our government, allowing any one to buy foreign exchange from any shop at any place and time was proved to have caused great damage on other countries. This policy has, it is said, enabled Ethiopia to save its macro-economy from crisis; and involvement of foreign banks would make it difficult to implement this policy, which may go to the extent exposing the macro-economy to instability.¹¹²
3. Even though banks have the mission to play decisive role in strengthening saving and expanding investment, our banking system remains weak and unable to do so. In such a situation and in a situation where domestic banks are not yet strong enough to cope with foreign competition, allowing the participation of foreign banks would put directly or indirectly the fate of the Country's banking regime in the palm of foreign banks' hand. As these banks have international perception by their nature, and since their consideration (perception) to Ethiopia may be very low, the Country's financial system may be forced to be governed by their system, thereby making the sector unable to serve as a strong instrument of national development.

¹¹⁰The following reasons are clearly indicated in the Country's Industrial Development Strategy paper, PP.97-114.

¹¹¹ *ibid.*,

¹¹² *ibid.*,

These three justifications of Ethiopia's government in particular and those other generally considered disadvantages of foreign bank entry (as discussed in section III of this Chapter) do deserve perusal; because, each of them may go to the extent misleading the Country to design policies that would not enable it to exploit the maximum possible benefits of foreign bank entry.

Closer observation of those general disadvantages associated with foreign bank entry in general, and those risks feared by Ethiopia in particular, reveal that most of the reasons are associated with either the competitiveness of local banks, or the regulatory and supervisory capacity of national institutions (in our case, the National Bank of Ethiopia). The other reasons are associated with future risks on economy.

It may be indisputable that, with all their impurities, each of the justifications to prohibit foreign bank entry may give a warning tone to countries designing their foreign trade policies. When it comes to Ethiopia, given the level of its economic development, the efficiency and effectiveness of the existing banks, in particular; and given its crying need for faster and sustainable economic development, the country's identification of the possible risks of foreign bank entry deserve appreciation.

True, the National Bank of Ethiopia (NBE), which is the Country's Central Monetary Authority with the responsibilities of formulating and implementing monetary policy as well as regulation and supervision of financial institutions operating in Ethiopia,¹¹³ does not have full capacity to properly undertake its responsibility.¹¹⁴ The NBE is still in short of the necessary experience, and professional and well-skilled human resources.¹¹⁵ Besides, the Bank needs to build its overall capacity including the capacity to grade the quality of foreign banks.¹¹⁶

¹¹³ Have a look at the Monetary and banking Proclamation No 83/94.

¹¹⁴ **Ethiopia: Memorandum on Foreign Trade Regime** [unpublished], Ministry of Trade and Industry, Library, p.127

¹¹⁵ Tony Addison and Alemayehu Geda, (August2001), '**Ethiopia's New Financial Sector and Its Regulation**'. (Discussion Paper No.2001/55), United Nations University World Institute for Development Economics Research. Available at www.wider.unu.edu/publications/dps/dp2001-55.pdf

¹¹⁶ibid.,

When it comes to commercial banks, the sector is still dominated by inefficient state-owned banks, particularly the Commercial Bank of Ethiopia.¹¹⁷ Although there are a number of privately owned banks, they are young and weak; and hence, need to gain strength in facing challenges of competition.¹¹⁸

Coming to Ethiopia's source of foreign exchange, though it is undertaking different promising efforts to expand its source of foreign exchange, it is still at its low stage, as only some common agricultural products still dominate the export.¹¹⁹ Hence, a lot remains to be done to properly satisfy the country's foreign exchange needs, by at the same time, striving for the maintenance of its macro-economic stability.

By way of conclusion, therefore, we can say that Ethiopia has indeed identified the shortcomings of its banking service regime; and its identification of the possible risks associated with foreign participation in the banking sector is based on telling grounds. However, the next question 'whether those identified risks properly justify its legal measures?' is another equally important issue, which can be addressed by considering the different forms of foreign entry and investigating other alternative methods of handling those identified risks.

6.5. Different Forms of Foreign Entry and Risks and Benefits Associated with them

In section 2.3.2(iv) of Chapter 2, we have seen that foreign banks may have different forms of commercial establishment (or entry), like in the form of Branches, subsidiaries, joint-ventures, representative offices, offshore offices, and shell Banks. These different forms of entry may also be followed by provision of different type of banking services. For that matter, it is quite expected that banks even with similar form of establishment may provide different banking services. For instance, one bank may provide services including lending, acceptance of deposits and financial leasing only, whereas,

¹¹⁷ Supra note 114

¹¹⁸ *ibid.*,

¹¹⁹ DTIS (July 2004), **Ethiopia: Trade and Transformation, Summary and Recommendations-Diagnostic Trade and Integration Study**, Volume 1,p.56ff

another similar bank (similarity in their form of entry) may provide services other than the above three, or other services in addition to these three services.

The point here is, given the possibility of having different forms of establishment, and different types of banking services, can one always expect similar risks associated with each of them? Obviously, the response is in the negative.

In the former discussions on the pros and cons of foreign bank entry, the identified pros and cons are put in general form. Meaning, it does not tell us which form of entry or service type would cause (provide) what type of risk or advantage. This holds true with Ethiopia's identification of risks associated with foreign participation in its banking service regime. This approach may, mislead countries to design policies or laws that would either ignore the real risk (or challenge), or cause the countries lose the possible benefits associated with foreign banks.

For our purpose, therefore, it may be at least sufficient to briefly consider the effects of the different forms (or modes) of commercial establishment so that we can further understand those different risks, thereby leading us to judge the appropriateness or otherwise of Ethiopia's reluctance to open its door to foreign participation.

1. Branches

Foreign banks may make their presence in a host country by establishing branch offices. Branches do not have their own independent legal personality.¹²⁰ Rather, they are integral and operational parts of the parent bank;¹²¹ and there always involved capital transaction between the head office (the parent bank) and the branches.¹²² They often receive funds from the head office, although some branches that succeed in raising funds in host country's market are suppliers of funds to the head office.¹²³ Branches may engage in themselves in traditional banking services like acceptance of deposits and other repayable funds from the public and lending largely in local currency, etc.¹²⁴

¹²⁰ Sydney J.Key, *Supra* note 32, p.19

¹²¹ *Supra* note 4,p.27

¹²² Sydney J.Key, *Supra* note 32, p.19

¹²³ *ibid.*,

¹²⁴ *Supra* note 4,p.26

This nature of branches enables them both to give benefits and cause costs. On one hand, given the service type to be rendered by branches, they may improve the efficiency of local banks by creating competitive environment. They may also provide local banks with access to advanced technology, superior managerial techniques, and business practices. Besides, branches may enable domestic customers to consume variety and quality services at a better price. Their participation may also have its own contribution on the economic development of the host country.

Coming to the risks associated with them, their participation in the provision of traditional banking services may harm domestic banks by exerting uneven and over aggressive competition. The nature of their relationship with their head office would also enable us to suspect that branches may create problems on the domestic economy either by causing capital out flow problem or by exposing host country to economic shocks of the parent banks home country. Besides, they may skew credit allocations; and may cause tax discriminations. What is more, their presence especially in poor countries like Ethiopia may pose supervisory and regulatory challenges, as those countries may be short of the necessary institutional framework.

Thus, branch offices have the potential of causing all the earlier discussed risks and providing the possible benefits.

2. Subsidiaries

Subsidiary is a bank owned by a foreign bank but separately incorporated (established) under the host county's laws.¹²⁵ Unlike branches, subsidiaries are considered separate legal entities; and creditors of the holding bank have no legal claims on any of its subsidiaries.¹²⁶ And the solvency of a subsidiary is largely determined by its own financial performance.

Like branches, subsidiaries may engage themselves in the provision of traditional banking services.

Subsidiaries may give the benefits that could be obtained from branch offices. But when it comes to risks associated with their entry, unlike branches, as an independent entity, their

¹²⁵ Supra note 4,p.28

¹²⁶ *ibid.*,

presence may not expose the host country to economic shocks of the banks home country. Besides, they may not cause capital outflow problem through transfer of funds to its holding bank. Apart from these, other risks posed by branches may also be posed by subsidiaries.

3. Joint Venture

Like subsidiaries, a joint venture bank is an independent entity established under the laws of the host country. In this context, it is a form of establishment whereby the bank is owned by a foreign national and local bank(s) or individual(s) jointly.¹²⁷ Like branches and subsidiaries, they may supply traditional banking services. And due to the nature of their incorporation and the nature of services they supply, joint venture banks may also those risks and benefits caused /provided by branches and subsidiaries.

4. Representative offices

Foreign bank's representative office is a marketing device used to facilitate the cross border provision of financial services.¹²⁸ They are established to undertake promotional activities. They are not permitted to sign loan or deposit contracts-i.e. they do not conduct banking business.¹²⁹

Given the nature and purpose of their establishment, these offices hardly able to negatively affect the market share of local banks, cause capital out flow problem; expose a host country to economic shocks of the entrant's home country; or create serious supervisory and regulatory concerns. Rather, their presence might probably offer opportunities, like transfer of technology and know how, promotion of international trade, as a stepping-stone for domestic banks to go international, etc.

¹²⁷ Supra note 4, p.29

¹²⁸ Sydney J.Key, Supra note 32, p.65, 18n

¹²⁹ *ibid.*,

5. Offshore Banks and Shell Banks

Offshore banks engage in banking business but in foreign currencies.¹³⁰ They keep deposits dominated in a currency other than that of the country in which the deposit is held;¹³¹ The expectation is that these banks receive and make loans from and to foreign banks or non-bank entities.¹³²

When it comes to shell banks, the objective of their establishment is to keep books of accounts for the head office. They have neither decision-making power nor money to transact as their task is limited to simply maintain records as per the instruction of their head offices.¹³³ They are said to have the purpose of enabling their head office to escape tax laws or some other rules and regulations of the country of their incorporation.¹³⁴

These two forms of establishment hardly provide the benefits associated with foreign bank entry. And it may not be easy to safely say that, given the nature of their area of concern, their presence would cause those risks (costs) identified by Ethiopian government.

6.6. Alternative Approaches to Address Risks of Liberalization

Ethiopia remains reluctant to open its doors to foreign participants in the banking services provision. In fact, this measure may avoid or minimize the possible risks. Nevertheless, the measure has totally disregarded the benefits that Ethiopia could reap from foreign participation in the banking sector. Thus, it is highly relevant to explore the possible alternative approaches of enabling Ethiopia to benefit from banking services liberalization, by at the same time, minimizing the risks associated with it. Here, it will also be appropriate to examine whether the alternative approaches are not inconsistent with relevant WTO rules; so that Ethiopia may, if it wishes, adjust its WTO accession negotiation accordingly.

¹³⁰ Supra note 4, p.26

¹³¹ Dominick Salvatore (2004), **International Economics**. (8th ed.,) JOHN WILEY & SONS, INC. pp.486 & 802.

¹³² Supra note 4, p.26

¹³³ *ibid.*,

¹³⁴ *ibid.*,

As there are equally strong views for and against freer and unregulated trade, in-between the two extremes, there are also strong views and empirical evidences suggesting that over-enthusiasm and over-optimism need to be avoided in respect of liberalization and both regulation and deregulation.¹³⁵ This suggestion is of great relevance to countries like Ethiopia that badly needs faster and sustainable development.¹³⁶ Even if it may be next to impossible to find out universal rules for an optimal strategy to minimize or avoid risks, by at same time maximizing benefits of foreign bank entry, the discussion in this part of the paper tries to indicate better approaches. They are recommendable alternatives as they recognize the important suggestion that over-enthusiasms and over-optimism need to be avoided in respect of both regulation and deregulation of the banking service regime.

However, before considering the possible regulatory measures to be taken in response to the possible risks of liberalization, it may not be irrelevant to have a brief literature-based background on the general importance of regulatory measures:

As Ha-Joon Chang wrote, even though there is a popular belief that the fewer regulations there are, the better, it should be remembered that markets need effective regulation regarding certain basic aspects of their operation; and thus, less regulation is not necessarily better.¹³⁷ Quoting the finding of Ronald Coase (the 1992 Nobel Prize-winner and a Leading Institutional Economist), Ha-Joon Chang noted that,

...even the stock market and the commodity exchange, which are thought to approximate the ideal market described in text books most closely, can function well only when they have strict regulations on what can be traded, who can trade, how much prices can vary in a given period of time, and so on.¹³⁸

Coming to the financial system in particular, writers like Sydney J. Key, Marion Jansen and Yannick Vennes emphasize on the importance of appropriate regulation.¹³⁹ To quote Sydney J.Key's words:

¹³⁵ L.M.Bhole, (2004), **Financial Institutions and Markets: Structure, Growth, and innovations.** (4th ed.,) Tata McGraw-hill publishing Company Ltd., P'1.17., Ha-Joon and Ilene Gabel, supra note 12, p.7ff

¹³⁶ *ibid.*,

¹³⁷ See Ha-Joon Chang, supra note 57 .p.177ff

¹³⁸ *ibid.*,

¹³⁹ Marion Jansen and Yannick Vennes, supra note 2., Sydney J.Key supra note 32. p.12ff

*...ensuring adequate prudential regulation and supervision of financial firms and markets, together with other fundamental domestic structural reforms, is essential to obtain the maximum benefits of liberalization while minimizing the risks.*¹⁴⁰

[Emphasis added]

In her view, liberalization and regulation can go together without one affecting the other, provided that the regulations are not intended to create anti-competitive environment.¹⁴¹ She further nicely pointed out the dimensions of relationship between liberalization and regulation: On the one hand, liberalization requires increasing the strength and quality of certain regulations and, in some areas, introducing new regulations; On the other hand, liberalization requires reducing or removing anti-competitive barriers to trade.¹⁴²

Having this in mind, let us now move on to pinpoint some of the available alternative measures.

6.6.1. Entry Restrictions

For our purpose, here, entry restriction simply refers to mechanisms that help a country to reduce risks and maintain sound banking system while enhancing competition. This is intended to address measures to be taken before foreign banking service suppliers establish commercial presence- by establishing branches, or representative offices, subsidiaries, offshore offices, or joint- venture, etc.

The point here is, adequate entry rule would strengthen the health of the banking system.¹⁴³ It is recommended that regulation of the financial system of a given country begins at the market entry stage. The other most common instrument to regulate market entry is the procedure of licensing banking business.¹⁴⁴ Such regulation at the entry stage is required to be stringent to weed out those players whose admission into the domestic banking

¹⁴⁰ Sydney J.Key supra note 32. p.12

¹⁴¹ Sydney J.Key supra note 32. p.11

¹⁴² *ibid.*,

¹⁴³ Masamichi Kono, Patrick et. al., supra note3

¹⁴⁴Supra note 4, p.30

system would be imprudent.¹⁴⁵ Hence, it may be imperative to establish legally qualifying criteria for eligibility to join the market.¹⁴⁶

The entry restrictions may focus, among others, on the following:

1. Restriction on the Type of Legal Entity

It is a common state practice that limitations may be applied on the type of legal entity through which foreign banking service suppliers may participate.¹⁴⁷ That is, depending on their policy to develop national financial industry or their supervisory concerns and other economic considerations, countries may appear to have preferred branches, subsidiaries, joint ventures, representative offices, offshore banks, or shell banks etc.¹⁴⁸

For instance, when we take branches, they are integral parts of their respective parent bank. The supervision of a branch would require information on their head office abroad. However, particularly in countries where their regulatory and supervisory mechanism is not well developed, supervision of branches would be difficult.¹⁴⁹ Such supervisory concern may motivate a country to remain reluctant to allow commercial establishment in the form of branches, unless of course, the country is convinced that its supervisory concern can be addressed by any other measure. This supervisory concern may not as such come into picture when it comes to locally incorporated subsidiaries and joint venture banks.

Thus, a country may prefer, for example, subsidiaries to branches of foreign banks. In fact, 'it is interesting to note, that some countries (for example India and Korea until recently) appear to have preferred branches of foreign banks over subsidiaries.'¹⁵⁰ There are also countries that allow the establishment of branches, subsidiaries, joint-ventures, and representative offices.¹⁵¹

¹⁴⁵ *ibid.*,

¹⁴⁶ *ibid.*,

¹⁴⁷ Sydney J. Key *supra* note 32, p.34

¹⁴⁸ SK/C/W/72, 2 Dec 1998 (98-48317), **Financial Services: Background Note by the Secretariat**; World Trade Organization, Council for Trade in Services, Paragraph 43.

¹⁴⁹ *ibid.*,

¹⁵⁰ *Supra* note 148, Paragraph 43,52n.

¹⁵¹ 'China's Financial Reform—A Case Study', by Mr. Li Rougu, Deputy Director of the International Department of the People's Bank of China to the 19th SEANZA Central Banking Course, Tokyo, Japan (Oct.22, 1992).

The GATS recognizes the right of states to maintain restrictions in relation to the specific type of legal entity to be established. In Paragraph 2(e) of Article XVI of the GATS states are allowed to maintain and specify in their respective schedule measures which restrict or require specific types of legal entity through which suppliers may deliver banking services. Hence, putting restrictions on the form of commercial establishment does not appear inconsistent with WTO rules.

Accordingly, Ethiopia may exploit this alternative (i.e. put restrictions on the form of entry) to minimize the feared risks. To this end, however, detailed and an independent study (in relation to the risks associated with each forms of establishment) remains invaluable. In this regard, the recommendation made by 'Diagnostic Trade Integration Study' (DTIS) may give a clue. This study is the product of joint work undertaken by an international and Ethiopian team of trade and sector specialists.¹⁵² While appreciating the soundness of Ethiopia's reasons for its reluctance to allow foreign bank entry, the study recommended that "complete closing of the door is not consistent with the objective of promoting private-sector-led growth. A compromise solution would be to permit foreign banks to operate in the country through liaison offices (rather than through full-fledged branches)."¹⁵³

2. Restrictions on the Number of Service Suppliers

A massive influx of foreign banks may cause over-aggressive competition that would lead to a decline in the market share of local banks.¹⁵⁴ Countries may respond to such risks by putting restrictions on the number of foreign banks that would participate in the domestic banking sector. When we take the experience of Singapore, for instance, it introduced a restricted licenses in 1970 to protect the then existing domestic banks from further competition. By 1973, it was thought that there were sufficient number of banks to serve Singapore's (domestic) economy; and offshore banking licenses were introduced to allow foreign banks to use Singapore as abase for international banking, without increasing competition for domestic banking business.¹⁵⁵

¹⁵² DTIS (July 2004), **Ethiopia: Trade and Transformation, Summery and Recommendations-Diagnostic Trade and Integration Study**, Volume 1.p.2

¹⁵³ *id.*, p.47

¹⁵⁴ See Jonse Bane, *supra* note 3

¹⁵⁵ *supra* note 4, p.20

Maintaining such market access restriction is considered as a prudential measure and permitted under the GATS Article XVI (2) (a). As per the provisions of this Article, in sectors (like the financial sector, to which the banking service regime is a part) where specific market access commitments are undertaken, states can specify in their schedule, limitations on the number of banking service suppliers. The WTO Secretariat recognized the prudential nature of the restriction when it noted,

[R]estriction on new licenses may have prudential connotation, if countries seek to prevent "over-banking" or excessive competition in the financial sector for the purpose of reducing systematic risks and ensuring un interrupted services.¹⁵⁶

Thus, as the GATS does not prevent Ethiopia from taking such a measure for prudential reason¹⁵⁷, Ethiopia may undertake independent research on the existent of the importance of restricting the number of banking service suppliers so that it can exploit the measure to minimize the risks associated with foreign bank entry.

3. Restriction on the Type of Services

Foreign banks may tend to participate in the provision of all types of banking services, or they may want to specialize in (a) certain type(s) of services. And either of the two or both approaches may probably frustrate a host Country's policy objectives. In such situations, therefore, a need may arise to restrict the type of service foreign banks can (or/and are required to) offer in the domestic market.¹⁵⁸

The experience of different countries may support this point. Take Singapore, which used to have introduced a restricted license to foreign banks since 1970.¹⁵⁹ There, restricted foreign banks were not allowed to compete freely for deposits and rely on inter-bank funds to help finance their local lending.¹⁶⁰ Acceptance of deposits and lending operations of offshore banks were even more restricted.¹⁶¹

¹⁵⁶ supra note 148, Paragraph 44

¹⁵⁷ See the GATS Annex on Financial Services, Paragraph 2(a)

¹⁵⁸ Sydney J.Key supra note 32, p.33

¹⁵⁹ supra note 4, p.20

¹⁶⁰ *ibid.*,

¹⁶¹ *ibid.*,

The recent experience of Cambodia may suffice to further appreciate the point. Cambodia considered the banking sector as a very sensitive area where the existence of a sound legislative and regulatory framework remains vital.¹⁶² For this reason, in its effort for WTO accession, Cambodia put forward initially a very limited offer under commercial banking services including, (i) acceptance of deposits and other repayable funds from the public; and (ii) lending for financing of commercial transaction and productive investment.¹⁶³ At the end of its negotiation, the Country arrived at a decision to undertake commitments in three sub-sectors out of the twelve banking service types enumerated under the GATS Annex on Financial Services Paragraph 5.¹⁶⁴

when it comes to the WTO rule, the provisions of Paragraph 2(c) of Article XVI of the GATS allow states to maintain in their schedule of commitments restrictions on the number of banking services operations or on the quantity of banking services output. This legal license may, in effect enable states to require interested investors to provide only certain banking service types so that the state can pursue its relevant public policy objectives.

4. Restriction on the Participation of Foreign Capital

Depending on their relevant policy objectives, countries may tend to put restrictions on foreign ownership (of banks) to a specified level ranging from minority ownership to majority ownership.¹⁶⁵ It is not uncommon to see the WTO member countries with emerging economy and developing countries maintaining in their commitment schedules restrictions on foreign ownership position which prevented foreigners from holding majority ownership position or where majority ownership is allowed, limit the ownership position to less than hundred percent.¹⁶⁶

The GATS is clear on this point. Paragraph 2(f) of Article XVI prohibited the WTO Members not to maintain or adopt limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding. However, this very Paragraph

¹⁶² *ibid.*,

¹⁶³ *ibid.*,

¹⁶⁴ *ibid.*,

¹⁶⁵ *supra* note 57

¹⁶⁶ Sydney J.Key, *supra* note 32, p.33

licensed states to do so provided that the states specified the restrictions in their respective schedule of market access commitment.

Thus, the experience of other countries, and the WTO rule (the GATS) may help Ethiopia to appreciate the importance and availability of this alternative mode of restriction.

5. Other Entry Regulations

Regulating entry is expected to be stringent to weed-out those investors whose admission into a domestic banking system would be imprudent.¹⁶⁷ For this purpose, a state may establish different qualifying criteria for eligibility to join the domestic market.¹⁶⁸

Before licensing the aspirants, a state may prefer to ascertain whether owners and the managers of a certain foreign owned bank have sufficient skills, knowledge, experience, and financial resources.¹⁶⁹ The state may also find it essential to examine whether the applicant (institution) has no criminal record (i.e. conviction for fraud or other dishonesty);¹⁷⁰ and check whether the applicant has records on contravention of any banking law or any other legislation (of a home country or any other host country) designed to protect the general public against financial loss due to dishonesty, incompetence or malpractice.¹⁷¹

In addition, foreign applicants may be required to commit a specified amount of paid up capital,¹⁷² and to come up with business plan clearly stating policies and procedures on lending and other activities etc.¹⁷³

Besides, a state may require an applicant who has parent company to demonstrate its home authorities properly supervise their parent company's activities; and to prove that home authorities are aware of the applicant's plan to establish commercial presence out side the home country and have given approval of the plan.¹⁷⁴ The requirement may extend to the extent expecting the home authorities to report (to the host country) on the status of the

¹⁶⁷ supra note 4, p.30

¹⁶⁸ *ibid.*,

¹⁶⁹ *ibid.*,

¹⁷⁰ *ibid.*,

¹⁷¹ *ibid.*,

¹⁷² *ibid.*,

¹⁷³ *ibid.*,

¹⁷⁴ *ibid.*,

applicant so that the host country could refrain from granting license to foreigners with poor financial standing at home country.¹⁷⁵ This may enable the host country to license large and reputable foreign banks that can easily produce information on their financial standings from reputable parent companies and strong supervisory authorities; and that pose little supervisory concerns as they also care for their good will.¹⁷⁶

6.6.2. Restrictions on Operation

Other restrictions of foreign participation relates to their operation once they have established a commercial presence in the host country.¹⁷⁷

The restrictions may include limitations on the number of branches a subsidiary of a foreign bank may open, limits on the number of Automated Teller Machines (ATM) machines it may install,¹⁷⁸ and restrictions on geographic scope.¹⁷⁹

If exposure to one borrower is large and the borrower becomes insolvent, the effect of the insolvency may go to the extent causing insolvency of the bank itself. Hence, introducing rules limiting maximum exposure to one borrower may become appropriate.¹⁸⁰ Also, some scholars reported that what is called 'connected lending'-meaning lending to related parties like bank managers or employees—has been one of the reasons for financial sector problems in a number of developing and industrialized countries.¹⁸¹ Thus, a host country may adopt rules responding to this risk.

The lowering of interest rates through government intervention is also considered by some writers as a means to improve the efficiency with which capital is allocated.¹⁸² In many developing countries like India, low interest rates had been regarded desirable in order to reduce a higher rate of fixed capital formation.¹⁸³ Besides, L.M.Bhole pinpointed two other reasons for interest regulation:

¹⁷⁵ *ibid.*,

¹⁷⁶ *ibid.*,

¹⁷⁷ Sydney J.Key, *supra* note 32, p.33

¹⁷⁸ *ibid.*,

¹⁷⁹ Masamichi Kono, Patrick et. al., *supra* note3

¹⁸⁰ *ibid.*,

¹⁸¹ *ibid.*,

¹⁸² L.M.Bhole, *supra* note 135, p.1.15

¹⁸³ *id.*, p.28.2

[First], in a planned economy the government and the public sector have huge financial requirements. It [is] thought that if the interest rates are kept low and stable through direct controls, the cost of public debt is kept low and the stability is maintained in the government securities market which is conducive for debt...management;¹⁸⁴ [and],

[Second], the priorities and objectives of development are determined by [government] authorities. If the course of development is to be in keeping with these priorities, the provision of credit with certainty and at low cost in the desired directions becomes necessary.¹⁸⁵

L.M. Bhole further mentioned the following reasons for controlling deposit and lending rates of banks:

- (a) to avoid unhealthy competition for borrowing and deposit accounts;
- (b) to maintain a kind of uniformity of interest rates on these accounts of all types of banks;
- (c) to keep deposit rates in alignment with the lending rates of banks and with other market rates of interest;
- (d) to aid deposit mobilization;
- (e) to lengthen maturity structure of deposit; and
- (f) to enable the authorities to avoid frequent changes in the Bank Rate, and yet to achieve the results of change in the bank rate.¹⁸⁶

6.6.3. Supervision

Closer supervision of licensed banks operating in the domestic market is necessary and very central because of the risk inherent in the business.¹⁸⁷ The supervisory mechanism may involve:-

¹⁸⁴ *ibid.*,

¹⁸⁵ *ibid.*,

¹⁸⁶ *ibid.*,

¹⁸⁷ Lakew Alemu(Dr.), (May 2001), **Financial Sector Reforms in Ethiopia and Challenges ahead.** Available at <http://www.eeacon.org/econ-focus/vol4%20no4/lakew.htm>

- (1) requiring information disclosure or reporting;¹⁸⁸ inspect the workings of banks in the host country as well as abroad in respect of their organizational setup, branch expansion, mobilization of deposits, man power planning and training, etc;
- (2) conduct investigations, from time to time, into complaints, irregularities, and frauds in respect of banks;
- (3) control appointment, re-appointment, termination of appointment of the chair man of private sector banks and
- (4) Approve or force amalgamations.¹⁸⁹

These and other related supervisions could be conducted by Central Banks, the National Bank of Ethiopia, in our case.

¹⁸⁸ *ibid.*,

¹⁸⁹ L.M.Bhole, *supra* note 135, p.6.6

Conclusion

The banking sector, which is an essential infrastructure for the proper functioning of the country's economy, has been amongst the main focuses of Ethiopia's economic reform measures undertaken since 1991. In this sector, the reform measures have been, conducted with the core target of promoting saving, investment and economic growth in general. With this target, the government has issued different legislations and policies that govern the banking sector. Particularly, the law on the licensing and supervision of banking business, investment laws, and the policy on the Country's Industrial Development lay down a basis for private investment in the banking services sector. These laws and policy documents, however, reserved investment in the banking sector to local investors. Foreigners are totally prohibited from participating in any form of establishment, thereby restricting free trade in the sector.

It is with this background that Ethiopia applied for accession to the WTO, which is responsible for the administration of international free trade rules including the rules governing trade in the banking sector.

The accession process involves a series of negotiations between the applicant state-Ethiopia-and the WTO members. Following the request for membership and the submission of a memorandum on the country's trade regime describing, together with others, policies and legislations affecting international trade in services, such memorandum will be examined and meetings will be conducted to discuss on issues of discrepancy between the memorandum and the WTO rules. This step will be followed by negotiations with the WTO members.

Actually Ethiopia has submitted its memorandum in December 2007. In the following negotiations, therefore, it is inevitable that Ethiopia's legal and policy framework governing the banking service will remain amongst the areas of focus of the negotiation and they will be evaluated in light of the GATS rules.

Basically, the GATS promotes a progressively higher level of liberalization of trade in services. Beyond this, however, the GATS does not go further to set an unconditional obligation requiring a state to open its market to all foreign services/service suppliers immediately. Instead, it expects countries to commit themselves to do so. The obligation to provide foreigners with market access opportunity depends only on the voluntary specific commitment of each state.

Given this nature of the market access obligation, thus, even though Ethiopia's existing legal and policy framework has an obvious effect of restricting international free trade in the banking service sector, it is equally evident that such measure of the country has no inconsistency with a single provision of the GATS. All the same, given the country's interest to join the WTO, mere non-existence of inconsistency of its laws with that of the WTO hardly guarantees to maintain the existing framework.

In the first place, the GATS not only promotes progressively higher level of liberalization but also requires states to enter in to specific commitment negotiations directed to provision of effective market access;

Secondly, the accession process involves a series of negotiations on specific commitments; and given the importance of the banking sector, it is foreseeable that Ethiopia's negotiation with WTO members involves negotiations on the country's commitment to liberalize the sector.

Third, the negotiations and commitment experiences of recently acceded Least Developed Countries (including Nepal and Cambodia), and developing countries (like China, India, Srilanka), reveal that WTO members do give attention to the banking sector and require market access commitments. In their negotiation with these countries, the WTO members have succeeded in securing the states' commitment in market access through commercial presence;

Fourth, despite the adoption of the 2002 Decision of the WTO General Council that requires WTO members to take into account the level of commitment undertaken by existing WTO member LDCs, the practice makes it quite clear that WTO members remain interested in requiring acceding states to make a higher level of market access commitments; so that they can set a precedence of high level commitment.

Fifth, though specific commitments are results of negotiations, it is the WTO members that dictate the terms and conditions of accession. These practical facts accompanied by the poor bargaining power of LDCs, reveals the inherently power based nature of the commitment negotiation.

In view of these factors, Ethiopia's legal and policy framework prohibiting foreign participation in the banking sector will not be tolerated by WTO members. Most probably, the WTO members

expect that Ethiopia's banking service liberalization should not diverge greatly from that of the recently acceded LDCs. Thus it is highly probable that Ethiopia will be requested to allow foreigners to supply banking services at least through commercial presence.

Given Ethiopia's firm stand to totally prohibit foreign entry in the sector on one hand, and the expectation of WTO members on the other hand, we can deduce that Ethiopia's legal framework governing the banking sector has of disruptive impact on the country's aspiration for accession. Unless Ethiopia reconsiders its firm stand, it seems next to impossible to accomplish its accession effort successfully.

In considering its existing legal and policy framework, Ethiopia has to review its justifications necessitating the prohibition of foreign bank entry and assess other risks and available benefits of liberalization.

Actually, Ethiopia's justifications are associated with (1) poor competitiveness of local banks; (2) poor regulatory and supervisory capacity of the National Bank; and (3) fear of future risks on the economy.

In deed, the commercial presence of foreign banks may end up in dominating the local market thereby causing our weak banks lose their market share. It is also acceptable that entrance of sophisticated foreign banks may pose a challenge on the regulatory and supervisory capacity of the National Bank. And it is convincing that foreign bank entry may negatively affect the countries economy by causing out flow of capital; by exposing to economic shocks of the bank's home country; by exacerbating crisis; by skewing credit allocation in the country, etc.

Nevertheless, since there are different forms of commercial presence (like in the form of branches, joint venture, subsidiary, or representative offices); and since there are different types of banking services (like lending, acceptance of deposits, etc), it is not expected that all the above generally state risks would be caused by each form of commercial establishment and each type service.

On the other hand, liberalizing the sector has the benefit of (1) improving the efficiency and facilitating the advancement of local banks; (2) providing consumers with variety of better-quality services at a better price; and (3) supplying an indispensable infrastructure for the proper and better functioning of the country's economy by encouraging inflow of capital and foreign

direct investment, and foreign trade; by stabilizing economic crisis; and by creating additional employment opportunities, etc.

Thus, when Ethiopia prohibits foreign participation in the banking sector, it is in effect sacrificing/disregarding these and other benefits. Ethiopia seems to hold the view that costs of liberalization outweigh its benefits. Total prohibition is, however, not the only available means to minimize risks. Because, there are other several regulatory and restrictive measures that help to address the risks by, at the same time, enabling Ethiopia reap those important benefits of liberalization. Some of the alternatives are: (1) entry restrictions including restriction on the type of legal entity, on the number of service suppliers, on the type of services, on the foreign ownership of banks, etc; (2) putting restrictions on banking business operation by providing restrictions on the number of branches or on the geographic coverage of services by requiring them to depend on domestic savings mobilization or allowing to use foreign loanable funds; and (3) closer supervision and regulation of licensed banks.

Given the benefits of foreign participation in the sector, and given the availability of other relevant alternative measure to minimize or avoid risks of liberalization, Ethiopia's total prohibition of foreign bank entry does not seem the preferred measure.

Hence, if Ethiopia has to complete its accession effort successfully, it need to review it's over-enthusiasm in respect of banking service liberalization.

For that matter, those different regulatory and restrictive measures are not inconsistent with the GATS. In fact, the GATS allows the utilization of the measures, as they can go hand in hand with liberalization.

Of course, Ethiopia's National Bank, which is responsible to supervise and regulate other banks, lacks qualified human resource. On top of this, the bank might not have necessary organizational structure to undertake its responsibilities. And this may pose a challenge on the implementation of regulatory measures to avoid or minimize the risks of foreign bank entry.

In response to this problem, it remains indispensable to take a series of measures to build the overall capacity of the National Bank and other relevant organs like the Ministry of Trade and industry, which is responsible to enforce the country's competition law.

In the mean time, however, Ethiopia may be expected to allow a very restricted commercial presence of foreign banks. After all, foreign bank entry is not alien to Ethiopia as its history of modern banking development was closely associated with foreign participation. Hence, though in a different socio-economic environment, it remains appropriate not to disregard the lessons learnt from the historical experience [for instance in the 1960s, Ethiopia used to have banking regulators and insurer regulators separately, unlike the present day where both are regulated by the National Bank] so that Ethiopia can focus on the real risks of its liberalization measures and the appropriate methods of addressing the risks.

In allowing foreign entry, Ethiopia can utilize those measures that restrict the entry and the operation of foreign banks in such a way that it can allow only those banks that have good records (practical experience), those who care for their reputation and those that pose little supervisory and regularity concerns. In its negotiation with the WTO, Ethiopia should focus on maintaining those different restrictive, regulatory and supervisory measures. Together with this, Ethiopia needs to claim the need for some transitional period until it improves the existing legal and institutional framework including the organizational structure and human resource of institutions including the National Bank and the Ministry of Trade and Industry.

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ANNEXES

Annex- A**. Cambodia's Schedule of Specific Commitments**

Modes of supply: 1) Cross-Border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitations on national treatment	Additional commitments
A. HORIZONTAL COMMITMENTS APPLICABLE TO SECTORS LISTED IN THE SECTORAL PART OF THE SCHEDULE			
Subsidies		(3), (4) Unbound for subsidies, including for research and development.	
Tax measures		(1), (2), (3) None with respect to taxes	
Land		(3) Non-Cambodian natural and juridical persons may lease but not own land.	
Acquired rights	The conditions of ownership, management, operation, juridical form and scope of activities as set out in a license or other form of approval establishing or authorizing the operation or supply of services by an existing foreign service supplier, will not be made more restrictive than those in existence as of the date of Cambodia's accession to the WTO.		
Investment incentives	(3) Investors, seeking incentives under the provisions of the Law on Investment, shall have the obligation to provide adequate and consistent training to Cambodian staff, including for promotion to senior positions.	(3) None	

Annex- A

. Cambodia's Schedule of Specific Commitments

Modes of supply: 1) Cross-Border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitations on national treatment	Additional commitments
Presence of natural persons	<p>(4) Unbound except for measures concerning the entry and temporary stay of a natural person who falls in one of the following categories:</p> <p><u>Business visitors</u></p> <p>A natural person who:</p> <ul style="list-style-type: none"> - enters Cambodia for the purposes of participating in business meetings, establishing business contacts including negotiations for the sale of services and/or other similar activities; - stays in Cambodia without receiving income from within Cambodian sources; - does not engage in making direct sales to the general public or supplying services. <p>Entry visa for business visitors shall be valid for a period of 90 days for an initial stay of 30 days, which may be extended.</p>	<p>(4) Unbound, except for measures affecting the categories referred to under market access.</p>	

Annex- A

. Cambodia's Schedule of Specific Commitments

Modes of supply: 1) Cross-Border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitations on national treatment	Additional commitments
	<p><u>Persons responsible for setting up of a commercial establishment:</u> Persons working in an executive or managerial position, receiving remuneration from an entity as defined below, who are responsible for the setting up, in Cambodia, of a commercial presence of a service provider of a Member, that will support employment of persons described in a, b, and c below. The subject persons are not subject to a maximum duration of stay.</p> <p><u>Intra-Corporate Transferees</u> Natural persons who have been employed by a juridical person of another member for a period of not less than 1 year and who seek temporary entry to provide services through a branch, subsidiary and affiliate in Cambodia and who are:</p> <p>a) <u>Executives:</u> without requiring compliance with labour market tests, persons within an organization who primarily direct the management of the organization, exercise wide latitude in decision-making, and receive only general supervision or direction from higher-level executives, the board of directors, or shareholders of the business. Executives would not directly perform tasks related to the actual supply of a service or services of the organization.</p>		

Annex- A

. Cambodia's Schedule of Specific Commitments

Modes of supply: 1) Cross-Border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitations on national treatment	Additional commitments
	<p>b) <u>Managers</u>: without requiring compliance with labour market tests, natural persons employed by a juridical entity and who possess knowledge at an advanced level of expertise or proprietary knowledge of a juridical entity product, service, research, equipment, techniques, or management, and who primarily direct the organization or a department of the organization; supervise and control the work of other supervisory, professional or managerial employees; have the authority to hire and fire or recommend hiring, firing or other personnel actions; and exercise discretionary authority over day-to-day operations. They do not include first-line supervisors, unless the employees supervised are professionals, nor do they include employees who primarily perform tasks necessary for the supply of the service.</p> <p>c) <u>Specialists</u>: Natural persons, within an organization who possess knowledge at an advanced level of continued expertise and who possess proprietary knowledge of the organization's services, research equipment, techniques, or management.</p> <p>Temporary residency and work permit is required for the natural persons in the categories defined under intra-corporate transferees. Such permits are issued for two years and may be renewed annually up to maximum of total five years.</p>		

B. SECTOR-SPECIFIC COMMITMENTS VII. FINANCIAL SERVICES 2. Banking and other financial services Sector or sub-sector	Limitations on market access	Limitations on national treatment	Additional commitments
<p>The commitments for subsectors (a), (b) and (d) refer to commercial banking only.</p> <p>(a) Acceptance of deposits and other repayable funds from the public (CPC 81115 – 81119)</p> <p>(b) Lending of all types, including, inter alia, consumer credit, mortgage credit, factoring and financing of commercial transaction (CPC 8113);</p> <p>(d) All payment and money transmission service, including credit, charge and debit cards, traveller cheques and bankers drafts (CPC 81339¹)</p>	<p>(1) None, except deposits from the public must be reinvested in Cambodia</p> <p>(2) None</p> <p>(3) None, except only permitted through authorized financial institutions as banks</p> <p>(4) Unbound, except as indicated in the horizontal section.</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) None</p> <p>(4) Unbound, except as indicated in the horizontal section.</p>	
<p>The commitments for subsectors (c) and (e) refer to commercial banking only.</p> <p>(c) Financial leasing</p> <p>(e) Guarantees and commitments</p>	<p>(1) Unbound</p> <p>(2) None</p> <p>(3) Unbound until related laws and regulations are established</p> <p>(4) Unbound, except as indicated in the horizontal section.</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) None</p> <p>(4) Unbound, except as indicated in the horizontal section.</p>	

¹ According to Services sectoral classification list, this refers to only part of the total range of activities covered by the CPC concordance.

<p>(f) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following</p> <p>(A) money market instruments (including cheques, bills, certificates of deposits); (B) foreign exchange (C) derivative products including, but not limited to, futures and options; (D) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements; (E) transferable securities; (F) other negotiable instruments and financial assets, including bullion</p> <p>(g) Participation in issues of all kinds of securities, including underwriting and placement as agency (whether publicly or privately) and provision of services related to such issues;</p> <p>(h) Money broking;</p> <p>(i) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;</p> <p>(j) Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments;</p>	<p>(1) Unbound (2) None (3) Unbound for subsectors (f) – (l), until the Government of Cambodia determines what types of entities can conduct these services, the related laws and regulation are established, and such business is authorized by the government or other relevant designated authority. (4) Unbound, except as indicated in the horizontal section.</p>	<p>(1) None (2) None (3) None (4) Unbound, except as indicated in the horizontal section</p>	
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<p>(k) Provision of financial information, and financial data processing and related software by suppliers of other financial services</p>			
<p>(l) Advisory, intermediation and other auxiliary financial services on all the activities listed in subparagraphs (v) through (xv), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.</p>			

Annex B

Nepal's Schedule of Specific Commitments in Banking Services

Modes of supply (1) Cross-Border supply (2) Consumption abroad (3) Commercial Presence (4) Presence of natural persons

Sector or Sub-sector	Limitations of Market Access	Limitations on National Treatment	Additional Commitments
I. HORIZONTAL COMMITMENTS			
All Sectors included in this Schedule	(2) None, except convertible currency limit of USD 2,000 applies to Nepalese citizens on personal travel.	(1) None, except with respect to foreign exchange provided to foreigners (excluding those categories of persons covered by commitments in this agreement) to pay for any cross-border services (2) None	
	(3) None The conditions of ownership, operation and juridical form and scope of activity as set out in a license or other form of approval establishing or authorizing the operation and supply of services by an existing foreign service supplier, will not be made more restrictive than they exist as of the date of Nepal's accession to WTO. (4) Unbound, except for temporary entry and stay of natural persons of another Member in the following categories: <u>Service sales persons</u> Persons not based in the territory of Nepal and receiving no remuneration from a source located within Nepal, who are engaged in activities related to representing a service supplier for the purpose of negotiating for the sale of services of that supplier where: a. such sales are not directly made to	(3) None, except - A foreign investor reinvesting earnings is required to obtain the permission of the Department of Industry. - All foreign investments except for Financial Services require approval by the Department of Industry. - Incentives and subsidies are available only to enterprises wholly owned by Nepalese nationals. (4) Unbound except for measures concerning the categories of natural persons referred to in the market access column Selling and buying real estate is the constitutional right of every Nepalese citizen. The Civil Code prohibits anyone from selling, mortgaging, gifting or endowing or disposing any real property to a foreign individual.	Except where an environmental impact assessment is required, decisions of the Department are normally provided within 30 days of the date of application. Approval of an investment will not normally be withheld except for failure to meet environmental standards. A foreign investor making an investment in foreign currency shall be entitled to repatriate the following amount outside Nepal: a) The amount received by the sale, in whole or part, of the investors share of equity; b) The amount received as profit or dividend as a result of an equity investment; c) The amount received as the payment of the principal of and interest on any foreign loan; and d) The amount received under an agreement to transfer technology approved by the Department of Industries or the Department of Cottage and Small Industries.

Sector or Sub-sector	Limitations of Market Access	Limitations on National Treatment	Additional Commitments
	<p>the general public, and</p> <p>b. the sales person is not engaged in supplying the service.</p> <p>Entry for persons named in these two categories is limited to a ninety-day period, which may be renewed.</p> <p><u>Persons responsible for setting up a commercial presence</u></p> <p>Persons who are employees of an enterprise not having commercial presence in Nepal and who stay temporarily in Nepal for the purpose of setting up a commercial presence of that enterprise in Nepal. Personnel engaged in setting up commercial presence shall present proof of the commencement of business operation within one year of the date of entry of that person.</p> <p>Entry for the above-listed persons is limited to one year period, which may be renewed.</p> <p><u>Intra-corporate transferees</u></p> <p>Managers, executives and specialists as defined below who are employees of firms that provide services in Nepal through a branch, subsidiary or affiliate established in Nepal and who have been in the prior employment of their firm outside Nepal for a period of not less than one year immediately preceding the date of their application for admission and who fall with one of the following categories:</p> <p>(A) Executives and Managers : persons within an organization who</p>		

Sector or Sub-sector	Limitations of Market Access	Limitations on National Treatment	Additional Commitments
	<p>primarily direct the organization or a department or sub-division of the organization, supervise or control the work of their supervisory, professional or managerial employees, have the authority to hire and fire or recommend hiring, firing or other personnel actions (such as promotion, or leave authorization) and exercise discretionary authority over day-to-day operations.</p> <p>(B) Specialists: persons within an organization who possess technical knowledge at an advanced level of continued expertise and who possess propriety knowledge of the organization's services, research techniques or management techniques. (Specialists may include but are not limited to members of licensed professions.)</p> <p>Entry for the above-listed categories of intra-corporate transferees is limited to a 3 years initial period that may be extended for up to 7 years for a total period not to exceed 10 years.</p> <p>Temporary entry and stay of natural persons considered to be intra-corporate transferees may be limited to 15 percent of local employees. This commitment shall be further liberalized after five years from the date of accession.</p>		

II. SECTOR SPECIFIC COMMITMENTS

VII. FINANCIAL SERVICES

General Conditions

The commitments in financial services are made in accordance with the General Agreement on Trade in Services and the Annex on Financial Services. All the commitments are subject to entry requirements, domestic laws, rules and regulations and the terms and conditions of the Nepal Rastra Bank (the central bank of Nepal), Insurance Board and any other competent authority in Nepal, as the case may be, which are consistent with Article VI of the GATS and paragraph 2 of the Annex on Financial Services.

The commitments in Insurance Services are given to the nationals and financial institutions of the Members whose law and policies do not bar the provision of similar commitments to the Nepalese nationals and financial institutions. No such limitation will exist as of 1 March 2004.

Financial Services in the form of operations identified below in the Schedule can be carried out in Nepal through a locally incorporated company. Branches will be allowed for insurance services and wholesale banking as of 1 January 2010. Only a licensed commercial bank, a licensed specialized bank or a registered finance company may accept deposits. Only a licensed commercial bank may accept deposits, which are repayable upon demand. Only financial institutions with rating of at least 'B' by Credit Rating Agency e.g. MOODI, Standard & Poor can have commercial presence in Nepal. The total foreign shareholding in any institution providing financial services is limited to 67 per cent of the issued share capital. It has, nevertheless, been bound for the existing foreign financial service providers as to their scope of operation and equity structure. The shares held by foreign nationals and foreign financial institutions in their locally incorporated companies are not transferable without the prior written approval of the Nepal Rastra Bank (the central bank) or any other competent authority as the case may be. Representative offices may not be engaged in commercial business. The members of the Board of Directors of a financial service supplier will be in proportion to equity representation of that financial service supplier.

2. Banking and Other Financial Services

<p>(a) Acceptance of deposits and other repayable funds from the public</p>	<p>(1) Unbound, except for (k) provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services and (l) advisory services on all the activities listed above were none</p> <p>(2) Unbound, except for (k) provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services and (l) advisory services on all the activities listed above were none</p> <p>(3) None, except as indicated in general conditions. For derivative products under sub-sector 'f' and settlement of and clearing services for financial assets, including securities, derivative products, and other negotiable instruments under 'j' unbound until HMG/Nepal determines what types of entities can conduct these services, the related laws and regulations are established and such business is authorised by the government or other designated authority.</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) None, except as specified in the general conditions and horizontal section</p>	
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<p>(b) Lending of all types, including, inter-alia, consumer credit, mortgage credit, factoring and financing of commercial transactions.</p> <p>(c) Financial leasing</p> <p>(d) All payment and money transmission services</p> <p>(e) Guarantees and commitments</p> <p>(f) Trading for own account or for account of customers, whether on an exchange, an over-the-counter market or otherwise, the following:</p> <ul style="list-style-type: none"> - money-market instruments (cheques, bills, certificates of deposits, etc.) - foreign exchange - derivative products including, but not limited to, futures and options - exchange rate and interest rate instruments, other than swap. - transferable securities - other negotiable instruments and financial assets, including bullion. <p>(g) Participation in issues of all kinds of securities, including under-writing and placement as agent (whether publicly or privately) and provision of service – related to such issues.</p> <p>(h) Money broking</p> <p>(i) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial depository and trust services.</p> <p>(j) Settlement of and clearing services for financial assets, including securities, derivative products, and other negotiable instruments</p> <p>(k) Provision and transfer of financial information, and financial data processing and related software by providers of other financial services.</p> <p>(l) Advisory services on all the activities listed above</p>	<p>(4) Unbound, except as specified in the horizontal section.</p>	<p>(4) Unbound, except as indicated in horizontal section.</p>	
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Annex C

China's Schedule of Specific Commitments on Banking Services

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitation on national treatment	Additional commitments
I. HORIZONTAL COMMITMENTS			
<p>ALL SECTORS INCLUDED IN THIS SCHEDULE</p>	<p>(3) In China, foreign invested enterprises include foreign capital enterprises (also referred to as wholly foreign-owned enterprises) and joint venture enterprises and there are two types of joint venture enterprises: equity joint ventures and contractual joint ventures.¹</p> <p>The proportion of foreign investment in an equity joint venture shall be no less than 25 per cent of the registered capital of the joint venture.</p> <p>The establishment of branches by foreign enterprises is unbound, unless otherwise indicated in specific sub-sectors, as the laws and regulations on branches of foreign enterprises are under formulation.</p> <p>Representative offices of foreign enterprises are permitted to be established in China, but they shall not engage in any profit-making activities except for the representative offices under CPC 861, 862, 863, 865 in the sectoral specific commitments.</p>	<p>(3) Unbound for all the existing subsidies to domestic services suppliers in the sectors of audio-visual, aviation and medical services.</p>	

¹ The terms of the contract, concluded in accordance with China's laws, regulations and other measures, establishing a "contractual joint venture" govern matters such as the manner of operation and management of the joint venture as well as the investment or other contributions of the joint venture parties. Equity participation by all parties to the contractual joint venture is not required, but is determined pursuant to the joint venture contract.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitation on national treatment	Additional commitments
	<p>The conditions of ownership, operation and scope of activities, as set out in the respective contractual or shareholder agreement or in a licence establishing or authorizing the operation or supply of services by an existing foreign service supplier, will not be made more restrictive than they exist as of the date of China's accession to the WTO.</p> <p>The land in the People's Republic of China is State-owned. Use of land by enterprises and individuals is subject to the following maximum term limitations:</p> <ul style="list-style-type: none"> (a) 70 years for residential purposes; (b) 50 years for industrial purposes; (c) 50 years for the purpose of education, science, culture, public health and physical education; (d) 40 years for commercial, tourist and recreational purposes; (e) 50 years for comprehensive utilization or other purposes. <p>(4) Unbound except for measures concerning the entry and temporary stay of natural persons who fall into one of the following categories:</p>	<p>(4) Unbound except for the measures concerning the entry and temporary stay of natural persons who fall into the categories referred to in the market access column.</p>	

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitation on national treatment	Additional commitments
	<p>(a) Managers, executives and specialists defined as senior employees of a corporation of a WTO Member that has established a representative office, branch or subsidiary in the territory of the People's Republic of China, temporarily moving as intra-corporate transferees, shall be permitted entry for an initial stay of three years;</p> <p>(b) Managers, executives and specialists defined as senior employees of a corporation of WTO Members, being engaged in the foreign invested enterprises in the territory of the People's Republic of China for conducting business, shall be granted a long-term stay permit as stipulated in the terms of contracts concerned or an initial stay of three years, whichever is shorter;</p> <p>(c) Service salespersons – persons not based in the territory of the People's Republic of China and receiving no remuneration from a source located within China, and who are engaged in activities related to representing a service supplier for the purpose of negotiation for the sale of services of that supplier where:</p> <p>(a) such sales are not directly made to the general public and</p> <p>(b) the salesperson is not engaged in supplying the service: entry for salespersons is limited to a 90-day period.</p>		

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitation on national treatment	Additional commitments
II. SPECIFIC COMMITMENTS			
7. FINANCIAL SERVICES			

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitation on national treatment	Additional commitments
<p>B. Banking and Other Financial Services (excluding insurance and securities)</p> <p>Banking services as listed below:</p> <p>a. Acceptance of deposits and other repayable funds from the public;</p> <p>b. Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transaction;</p> <p>c. Financial leasing;</p> <p>d. All payment and money transmission services, including credit, charge and debit cards, travellers cheques and bankers drafts(including import and export settlement);</p> <p>e. Guarantees and commitments;</p> <p>f. Trading for own account or for account of customers: foreign exchange.</p>	<p>(1) Unbound except for the following:</p> <ul style="list-style-type: none"> - Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services; - Advisory, intermediation and other auxiliary financial services on all activities listed in subparagraphs (a) through (k), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy. <p>(2) None</p> <p>(3) A. <u>Geographic coverage</u> For foreign currency business, there will be no geographic restriction upon accession. For local currency business, the geographic restriction will be phased out as follows: Upon accession, Shanghai, Shenzhen, Tianjin and Dalian; Within one year after accession, Guangzhou, Zhuhai, Qingdao, Nanjing and Wuhan; within two years after accession, Jinan, Fuzhou, Chengdu and Chongqing; within three years after accession, Kunming, Beijing and Xiamen; Within four years after accession, Shantou, Ningbo, Shenyang and Xi'an. Within five years after accession, all geographic restrictions will be removed.</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) Except for geographic restrictions and client limitations on local currency business (listed in the market access column), foreign financial institution may do business, without restrictions or need for case-by-case approval, with foreign invested enterprises, non-Chinese natural persons, Chinese natural persons and Chinese enterprises. Otherwise, none.</p>	<p>For financial leasing services, foreign financial leasing corporations will be permitted to provide financial leasing service at the same time as domestic corporations.</p>

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitation on national treatment	Additional commitments
	<p>B. Clients For foreign currency business, foreign financial institutions will be permitted to provide services in China without restriction as to clients upon accession. For local currency business, within two years after accession, foreign financial institutions will be permitted to provide services to Chinese enterprises. Within five years after accession, foreign financial institutions will be permitted to provide services to all Chinese clients. Foreign financial institutions licensed for local currency business in one region of China may service clients in any other region that has been opened for such business.</p> <p>C. Licensing Criteria for authorization to deal in China's financial services sector are solely prudential (i.e., contain no economic needs test or quantitative limits on licenses). Within five years after accession, any existing non-prudential measures restricting ownership, operation, and juridical form of foreign financial institutions, including on internal branching and licenses, shall be eliminated.</p> <p>Foreign financial institutions who meet the following condition are permitted to establish a subsidiary of a foreign bank or a foreign finance company in China:</p>		

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitation on national treatment	Additional commitments
	<p>- total assets of more than US \$10 billion at the end of the year prior to filing the application.</p> <p>Foreign financial institutions who meet the following condition are permitted to establish a branch of a foreign bank in China:</p> <p>- total assets of more than US \$20 billion at the end of the year prior to filing the application.</p> <p>Foreign financial institutions who meet the following condition are permitted to establish a Chinese-foreign joint bank or a Chinese-foreign joint finance company in China:</p> <p>- total assets of more than US \$10 billion at the end of the year prior to filing the application.</p> <p>Qualifications for foreign financial institutions to engage in local currency business are as follows:</p> <p>- three years business operation in China and being profitable for two consecutive years prior to the application, otherwise, none.</p> <p>(4) Unbound except as indicated in Horizontal Commitments.</p>	<p>(4) Unbound except as indicated in Horizontal Commitments.</p>	

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitation on national treatment	Additional commitments
<p>- Motor vehicle financing by non-bank financial institutions</p>	<p>(1) Unbound except for the following: - Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services; - Advisory, intermediation and other auxiliary financial services on all activities listed in subparagraphs (a) through (k), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.</p> <p>(2) None (3) None (4) Unbound except as indicated in Horizontal Commitments.</p>	<p>(1) Unbound</p> <p>(2) None (3) None (4) Unbound except as indicated in Horizontal Commitments.</p>	
<p>- Other financial services as listed below: k. Provision and transfer of financial information, and financial data processing and related software by supplier of other financial services; l. Advisory, intermediation and other auxiliary financial services on all activities listed in subparagraphs (a) through (k), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.</p>	<p>(1) None (2) None (3) None (Criteria for authorization to deal in China's financial services sector are solely prudential (i.e., contain no economic needs test or quantitative limits on licenses). Branches of foreign institutions are permitted. (4) Unbound except as indicated in Horizontal Commitments.</p>	<p>(1) None (2) None (3) None</p> <p>(4) Unbound except as indicated in Horizontal Commitments.</p>	


Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or sub-sector	Limitations on market access	Limitation on national treatment	Additional commitments
<p>- Securities</p>	<p>(1) Unbound except for the following: - Foreign securities institutions may engage directly (without Chinese intermediary) in B share business.</p> <p>(2) None</p> <p>(3) a. Unbound, except for the following: - Upon accession, representative offices in China of foreign securities institutions may become Special Members of all Chinese stock exchanges. - Upon accession, foreign service suppliers will be permitted to establish joint ventures with foreign investment up to 33 per cent to conduct domestic securities investment fund management business. Within three years after China's accession, foreign investment shall be increased to 49 per cent. Within three years after accession, foreign securities institutions will be permitted to establish joint ventures, with foreign minority ownership not exceeding 1/3, to engage (without Chinese intermediary) in underwriting A shares and in underwriting and trading of B and H shares as well as government and corporate debts, launching of funds. b. Criteria for authorization to deal in China's financial industry are solely prudential (i.e., contain no economic needs test or quantitative limits on licenses).</p> <p>(4) Unbound except as indicated in Horizontal Commitments.</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) None</p> <p>(4) Unbound except as indicated in Horizontal Commitments.</p>	

Declaration


I the undersigned, declared that the thesis is my original work and has not been presented for a degree in any other university and that all sources of material in the thesis have been duly acknowledged.

Declared by
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June15, 2008

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Approval Sheet by the Board of Examiners

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