

ETHIOPIA'S ACCESSION TO WORLD TRADE ORGANIZATION AND THE IMPLICATIONS TO ITS FINANCIAL SECTOR POLICIES¹

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Abstract

Ethiopia's Accession to World Trade Organization (WTO) has a number of implications to existing economic and financial sector policies of the country. Assessing major areas of possible policy amendments and reversals is critically important in the financial sector for the accession process as well as its aftermath. This paper attempted to deal with this issue based on qualitative policy analysis. It is found that a comparative analysis of the existing financial sector policies vis-à-vis the principles and practices of WTO suggests that there are different policies in the financial sector system that are incompatible with requirements of the General Agreement on Trade in Services (GATS) and the practices in trade negotiations. One of such incompatibility is related to the existing policy that prohibits the participation of foreign financial institutions in the domestic financial market. It is submitted that the way forward for Ethiopia is gradual and selective liberalization of the financial sector that may balance protection of social and economic policy objectives on the one hand and integrating the financial sector to the ever expanding global financial market rather than complete closure of the sector from international competition. In addition to this, since accession to WTO and undertaking any commitment in the service sector under GATS require the existence of transparent financial laws and regulations, effective judicial system and strong financial regulatory organ including the need to revisit the existing restriction in international payments, there is compelling need to make the necessary policy amendments in the financial sector regulatory framework.

Key Words: GATS, WTO, Liberalization, Accession, Financial Sector, NBE

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1. Introduction

Before the establishment of WTO in 1995, the multilateral trading system was regulated by the General Agreement on Trade and Tariffs (GATT) signed in 1947. Before Uruguay Round of multilateral trade negotiations that held between 1986 and 1994, there was no special multilateral trade agreement that regulates trade in services. After stiff negotiation between developed and developing WTO member countries, a comprehensive agreement that regulates trade in services emerged in 1994. This agreement is known as the General Agreement on Trade in Service (GATS).

The agreement lays down the principles for regulating the multilateral trade in services.³ One of the services that are regulated by GATS is the financial sector⁴. The circumstances that led to the enactment of GATS are surrounded by the debate on the benefits and related risks of liberalizing the financial sector. The debate is even intense after the recent economic crisis that hit hard financial institutions in 2008. Leaders of different countries are now calling for strengthened control of the financial institutions to avoid such crisis in the future.⁵

There are different arguments in favor and against liberalization of the financial sector. Many scholars argue that liberalizing the financial sector has a number of advantages. One of the advantages of liberalization is increasing the efficiency of the financial sector enhanced by the competition among the financial institutions.⁶ It is also believed that the entry of foreign banks in emerging markets is healthier than domestic banks; implicitly allowing a country to import stronger prudential regulation and increase the soundness of the local banking sector.⁷ As a part of

³ There are 12 core service sectors and 160 sub sectors regulated by the agreement.

⁴ Financial service in the GATS refers to liberalization and regulation of banking and insurance services.

⁵ One of the crucial agenda of G 20 meeting that held in April 2009 in London had discussing on tougher regulation of the financial institutions.

⁶ Joseph E. Stiglitz, Knowledge for Development: Economic Science, Economic Policy and Economic Advice, Paper prepared for the Annual World Bank Conference on Development Economics, Washington, D.C, April 20–21, 1998.p.28

⁷ Kono Masamichi, , et al, WTO Opening Financial Markets in Financial Services and the Role of the GATS,WTO Special Studies. p.97

financial sector liberalization, the privatization of state-owned banks is believed to be important option to further enhance the efficiency of the banking sector.⁸ Numerous studies have confirmed that state-owned banks are less efficient than private banks and privatization generally has positive effects on bank performance.⁹ Despite the range of evidences that suggest liberalization of financial sector has its own advantages, there are also credible concerns. One of the concerns is related to the fear that financial sector liberalization may cause financial fragility rather than financial stabilization due to weakening of domestic banks.¹⁰ Some studies suggest that due to such fragility, banking crises are more likely to occur in countries whose financial system is liberalized.¹¹ Furthermore, liberalization of the financial sector in developing economies could not also effectively be undertaken due to the inefficiency of the capacity of the regulatory organ.¹² The fact that foreign banks target high investments may also marginalize low-income savers and borrowers¹³. Against the background of increased significance of WTO and globalization of the economies of the world, Ethiopia has formally applied for membership to WTO in January 2003 and submitted Memorandum of Foreign Trade Regime (MFTR) in January 2007. Questions and answers sessions took place in February 2008 while the first working party meeting has been taken place in May 2008 and the next phase of the accession process would be bilateral negotiation with WTO member countries in relation to commitments in goods and service sectors. The country is currently preparing for trade negotiation with WTO members.

As it has been observed during accession process of many of the developing countries, developed member countries of WTO pressure opening up of specific sectors like banking and telecom services of the acceding country. In fact, countries

⁸ Ibid

⁹ Nakane L. Maricio & Weintraub B. Daniel, Bank Privatization and Productivity: Evidence from Brazil, World Bank Policy Research Working Paper Series no 3666 (2005), p.3

¹⁰ Kozo Kiyota, et al, The Case for Financial Sector Liberalization in Ethiopia, Discussion paper no 565, Gerald R. Ford School of Public Policy. The University of Michigan (2007), p.14

¹¹ IMF has suggested that the greater frequency of banking crises world-wide since the 1980s is "possibly related to the financial sector liberalisation that occurred in many countries during this period" (see World Bank , Global Development Finance , New York. Oxford University Press (1998), p.15

¹² Supra at 7

¹³ Ibid

that have negotiated their accession to the WTO since 1 January 1995 have encountered members' high expectations for GATS commitments on financial services and no country has joined WTO without making substantial commitments in most financial services sub-sectors.¹⁴ Thus, one can reasonably assume that one of the challenges Ethiopia may face during the accession process is issue related to liberalization of the financial sector. There have been initial indications to such pressures.¹⁵ Continued resistance to liberalization of the financial sector by Ethiopian government in principle cannot be a barrier to Ethiopia's accession to WTO since GATS does not specifically attach financial liberalization with the accession process. But there are stringent 'WTO plus' demands during the accession negotiations that may complicate Ethiopia's accession to WTO. There are practical experiences that justify this assumption.

One of the reasons that delayed the accession process of China for 15 years is China's resistance to meet the demands of the western countries on financial liberalization. In the same token, one of the major thorny issues that are delaying the accession process of Russian Federation to WTO is its failure to meet the demands of the United States on financial sector liberalization.¹⁶ Furthermore, strength and capacity of the country determines its gains from the bilateral and multilateral negotiations during the accession process. For instance, China has forcefully held that the opening of domestic markets, especially in the financial sector by developing countries, should be a gradual process to which the developed countries forced to accept China's negotiation position.¹⁷ The United States, the EU, and other advanced developed WTO members have argued that Russia needs an efficient financial services industry to promote economic growth and development

¹⁴ Daniel C. Crosby, Banking on China's WTO Commitments: 'Same Bed, Different Dreams' in China's Financial Services Sector, Advance Access publication (2007),p .81

¹⁵ Peter F. Allgier, deputy US representative to the World Trade Organization expressed that opening up the financial and telecom sectors may help Ethiopia speed up its WTO accession process (see Addis Fortune. Volume 9, Number 464, March 22, 2009)

¹⁶ Russian officials and business representatives claim that their service industries (including the financial sector) must have government protection as "infant industries," because they are too immature and would be wiped out if they had to face foreign competition too soon.

¹⁷ Long Yongtu, China: The Implications and Key Lessons Learned through WTO Accession in East Asian Visions: Perspectives on Economic Development, A co-publication of World bank and Institute of Policy Studies, Singapore (2007),p.130

and that opens the industry to foreign investment; introduce expertise and new capital while Russia insists protection of the banking sector for some time to come.¹⁸ At this point in time, it is not yet clear what kind of approach and commitments Ethiopia may undertake in financial services. However, it is important to assess the implications of Ethiopia's accession on its overall economic policies in general and the implications of GATS rules on Ethiopia's service sectors including policies in financial services. The purpose of this paper is therefore to make an assessment of the possible implications of GATS rules on the financial sector policies of Ethiopia. The paper does not intend to provide a complete list of financial policy issues but rather attempts to initiate discussions on some of the basic financial policy implications in the Ethiopian context and provide its own inputs for further research. The study uses qualitative comparative policy analysis techniques in terms of the WTO policy requirements vis-à-vis what is one the ground in the case of Ethiopia. The paper consists of three parts. The first part of the paper deals with the general frame work of the General Agreement on Trade in Services(GATS) on the rules regulating the multilateral trade in services under WTO including the rules pertaining to the financial sector. The second part of the paper discusses the implications of GATS on existing financial sector policies of Ethiopia. At the end, conclusion and some recommendations are forwarded.

2. The GATS Framework for Financial Service Liberalization

Compared to the rules on multilateral trade in goods, creation of a multilateral trade rule on services is very recent. This is generally due to the special features of the service sector itself. The General Agreement on Trade in Services (GATS) is the first multilateral trade agreement that emerged to cover all aspects of trade in services. Its creation was one of the major achievements of the Uruguay Round of Trade Negotiations that took place from 1986 to 1994. The incorporation of GATS into the multilateral trading system is realized almost half a century after the entry in to force of the General Agreement on Tariffs and Trade (GATT) in 1947. The inclusion of GATS into the WTO system was also made after a tense negotiation between developing and developed countries especially the United States. The initiative for

¹⁸. William H Cooper, Russia's Accession to the WTO, Order Code R L31979 CRS Report for Congress (2006), p.15

an enlargement of the GATT system came from the United States and was later supported by other industrialized countries.¹⁹In contrast, the developing countries saw dangers for development of their own economies through substantial liberalization of the service sector and feared the erosion of state control in this sector. Despite such controversies, the service sector included as an agenda to the Uruguay multilateral trade negotiation and finally GATS was emerged from the Uruguay Round.

The agreement is subdivided into six parts. Part I of the agreement defines what constitutes "trade in services" and scope of application of the agreement. Part II of the GATS deals with "General Obligations and Disciplines". Under this section minimum standards applicable to all aspects of trade in services are discussed. The most important principles addressed under this section are: Most-Favored Nation Treatment, Transparency, Domestic Regulations, Monopolies and exclusive service suppliers, Safeguard measures and other rules with general application. The third part (Part III) of GATS deals with specific commitments. These rules do not have general application. These rules came to the play when members enter into special commitments during negotiations in the service sector. The building blocks of this part of GATS are market access and national treatment principles as well as rules on additional commitments.

Part of IV of the GATS provides further principles on further liberalization of the services sector. Part V of the agreement provides for institutional aspect of the application of the GATS. The last part of the agreement deals with additional rules on definitions and annexes. In addition to the main text of the GATS, the agreement has eight additional annexes. Two of these annexes deal with financial sector services. The other annexes deals with different specific service sectors: Movement of natural persons, air transport service, maritime transport service, telecommunications and negotiations on basic telecommunications.

¹⁹ Stoll & Schokof, WTO-World Economic Order, World Trade Law, Leiden (2006), P.182

2.1. Purpose of GATS

The objectives of the GATS are provided under the preamble of the agreement. The objectives of GATS are twofold²⁰: Ensuring increased transparency and predictability of relevant rules and regulations and progressive liberalization through successive rounds of negotiations. The liberalization of the services in the context of GATS aimed at improving market access and extending national treatment to foreign services and service suppliers. The agreement clearly recognizes governments' right to regulate and introduce new regulations to meet national policy objectives and particular needs of developing countries to exercise their rights.

2.2. Modes of Supply of Services

Pursuant to Art. I: 2, the GATS covers four modes of supply in the service sector: Mode 1: *Cross-border supply*,²¹ Mode 2: *Consumption abroad*²² Mode 3: *Commercial presence*²³ and Mode 4: *Movement of natural persons*²⁴. By encompassing these four modes of supply, GATS provides for almost full coverage of all possibilities of trade in services.

²⁰ Preamble of General Agreement on Trade in Services (GATS)

²¹ It refers to a service provided from one member into the territory of any other member. In other words, a user in country A receives services from another country through its telecommunications or postal information structure. Such supplies may include consultancy or market research reports, electronically advice, distance learning or architectural drawings.

²² Service in the territory of one member is used by consumer coming from other member country. Such service includes tourists, students or patients went abroad to consume the respective services in other countries.

²³ Service provided by a service supplier of one member, through commercial presence in the territory of any other member. In this mode of supply, the service is provided with in member country by locally established office, subsidiary or representative official of a foreign owned and controlled company. (Bank, Hotel, Construction Company etc).

²⁴ Service supplier of one member, through the presence of natural persons of a member in the territory of any other member

2.3. General Obligation of the GATS

2.3.1 Rule on Most Favor Nation Treatment (MFN)

As in the GATT law, the treatment of MFN provides for an equal treatment of all foreign services and service suppliers. According to Article II:1 of GATS, as far as products originating from different member countries are qualified as "like" products, discriminatory treatment between two foreign services or service providers is prohibited. The application of the clause has been amplified by Panel and Appellate Body rulings of WTO. In *EC-Banana III case*, the Appellate Body held that Article II: 1 of GATS is not only applicable to *de jure* discriminations but also the MFN clause is applicable to any *defacto* discrimination.²⁵

One of the problems in applying MFN clause under GATS as well as GATT is the problem of determining what constitutes "like products." There is no definition of like products under GATT or GATS. The meaning of "like product or like service providers" is largely determined by the meaning of the phrase interpreted by Panel or Appellate Body of WTO. One of the approaches followed by the panel is that "to the extent that the service suppliers concerned supply the same services, they should be considered like for the purpose of this case."²⁶

Unlike Article I of GATT, which is applicable unconditionally, the MFN obligation in the GATS is qualified by derogations. Article II: 2 of GATS permit a member to maintain a measure in consistent with paragraph 1 if such a measure is listed in the Annex on Article II exemptions. For this purpose, a special Annex on Article II adopted to deal with the exemptions attached to the GATS. If any member uses the exemption clause, it is applicable if it prefers to treat some services or service suppliers better or preferentially to all other Foreign Service suppliers. But the application of the exemption clause itself is characterized by different prerequisites. One of such prerequisite is deviation from MFN clause is accepted only when the country is entering to the agreement or it is applicable at the time of acceding to

²⁵ Appellate Body Report on EC-Banana III, Para.231-234

²⁶ The Panel Report on Canada -Autos, Para.10. But the Report of the Panel on EC-Banana III indicates that the interpretation of "like services" in the GATS lacks consistency and there is not yet objective standard developed..

WTO.²⁷ Thus, the exemption right is “one time” chance. But in some specific sectors like in financial services, maritime transport services and basic telecommunications, exemptions are still possible even after accession. Furthermore, any exemption listed should not remain in force in excess of 10 years. Any exemption is also subject to review by the Service Council after five years.

The existence of exemptions does not mean the country applying the exemption has free ride to violate the MFN rule. The country taking the measure is not allowed to accord treatment less than the minimum standard to services originating from other member countries. In other words, a member may accord treatment in that sector more favorable than the minimum standard to some members while all other members receive that minimum standard. In financial services only about twenty-five WTO members have taken exemptions according to Article II.²⁸

2.3.2. The Principle of Transparency

The other general obligation of GATS is the requirements of transparency. According to Article III: 1 of GATS:

Each member shall publish promptly and except in emergency situations at the latest by the time of their entry into force, all relevant measures of general application which pertain to or affect the operation of this agreement, international agreements pertaining to or affecting trade in services to which a member is a signatory shall also be published.

The requirements of Article III: 1 are applicable to all measures of general application which pertain to the operations of the GATS. For this purpose, each member shall establish one or more enquiry points (like websites) to provide specific information to other members.²⁹ This requirement includes prompt response to all

²⁷ Annex on Article II Exemptions on GATS, No 2

²⁸ Sydeny J. Key, Doha Round and Financial Services Negotiations, AEI Press (2003), p. 34

²⁹ GATS Art III: 4. Many of such exemptions are relatively narrow. The United States, for example, has taken an MFN exemption for granting primary status for foreign financial firms operating in the U.S government securities market while a number of developing countries have taken MFN exemptions for measures applicable to neighboring countries that do not

requests by any other member for specific information on any of the measures of general application or international agreements. Furthermore, as per Article III: 3, each member shall promptly and at least annually inform the Council of Trade in Services of the introduction of any new, or any changes to existing laws, regulations or administrative guidelines which significantly affect trade in services by the agreement.

2.3.3. Rules on Domestic Regulation

Due to the fact that several service sectors are highly regulated domestically, it is not sufficient to have disciplines that prohibit discriminatory measures. Article VI of the GATS is designed to ease the burdensome of domestic regulations to market access. There are a number of issues addressed in relation to domestic regulation. Article VI: 1 imposes members an obligation to ensure that in sectors where specific commitments have been taken, measures of general application affecting trade in services are administered in reasonable, objective and impartial manner. This requirement is not dealing with the substance of the rules rather the manner how such rules should be used. Under Article VI: 2 (a) of the agreement:-

Each member shall maintain or institute as soon as practicable judicial, arbitral or administrative tribunals or procedure which provide, at the request of an affected service supplier for the prompt review of, and when justified, appropriate remedies for, administrative decisions affecting trade in services.

This rule obliges members to have effective judicial and administrative system to address disputes in trade services. But the agreement recognizes the right of members to organize such tribunals in line with the constitutional system or the nature of its legal system.³⁰The other significant aspect of Article V is its rule on measures relating to qualifications and procedures, technical standards and licensing requirements. Article VI: 4 reads:

qualify as economic interquarantine agreements. Other exemptions are used by countries for reciprocal treatment.

³⁰ GATS Article VI:2(b)

With a view to ensuring measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services, the Council of Trade in Services shall, through appropriate bodies it may establish, develop any necessary disciplines to ensure such requirements, inter alia, based on objective and transparent criteria, such as competence and the ability to supply the service, not more burdensome than necessary to ensure the availability of the service, in the case of licensing procedures, not in themselves a restriction on the supply of the service.

But the application of this rule is largely dependent on the issuance of the necessary disciplines in specific sectors. To date, disciplines have only been developed pursuant to paragraph 4 in the Accountancy Sector.³¹ Until disciplines are developed in other sectors; paragraph 4 cannot be applied. But Article VI: 5 of the agreement is applicable to members without any further discipline.³² In determining whether a member is in conformity with the obligation under this paragraph, account shall be taken of international standards of relevant international organizations applied to the member. Until specific disciplines and WTO jurisprudence are developed, the application of these principles may not be binding.

2.3.4. Rules on Recognition

Article VII of the GATS addresses the issue of the recognition by a host member of educational or experience obtained, requirements met, or license or certifications granted in another member. This recognition can be made on an agreement between the two members or through unilateral recognition by the host member. When the recognition granted to a certain member is based on an agreement or arrangement, the host member shall afford adequate opportunity for other interested members to negotiate their accession to such an agreement or if a

³¹ WTO, Disciplines on Domestic Regulation in the Accountancy Sector

³² This Article provides that in sectors in which a member has under taken specific commitments, pending the entry into force of disciplines developed in these sectors pursuant to paragraph 4, the member shall not apply licensing and qualification requirements and technical standards that nullify or impair such specific commitments in manner which it does not comply with the criteria outlined in sub paragraph 4(a),(b) or (c) and could not reasonably have been expected of that member at the time the specific commitments in those sectors were made.

member accords recognition autonomously, it shall afford adequate opportunity for any other member to demonstrate that education, experience, licenses, or certifications obtained or requirements met in that other members territory should be recognized.³³The agreement forbids member countries not to accord recognition in a manner which constitute a means of discrimination between countries in the application of its standards for the authorization, licensing or certification of service suppliers, or a disguised restriction on trade in services.³⁴To avoid any disguised discrimination in applying standards or related requirements, recognition should be based on multilaterally agreed criteria.³⁵

2.3.5. Rules on Monopolies and Exclusive Service Suppliers

Article VIII of the GATS imposes an obligation on a member to ensure that monopoly suppliers of services in their territory do not, in the supply of monopoly service in the relevant market, act in a manner inconsistent with their obligations under Article II (MFN obligation) and its specific commitments. Furthermore, where a member has monopoly supplier that competes, either directly or indirectly, in the supply of a service outside of the scope of its monopoly rights, that member is required to ensure that such a supplier does not abuse its monopoly position to act in a manner inconsistent with that member's commitments under the GATS.³⁶

These obligations are aimed at preserving the integrity of the specific commitments taken by the member, that is, at preventing that the market access granted by a member through its specific commitments be rendered ineffective by the action of monopoly service suppliers authorized by the member. If monopoly rights are granted with regard to services covered by a member's specific commitments after 1 January 2005, that member must enter into negotiations with the other WTO members in order to reach an agreement for compensatory adjustment.³⁷ The rules on monopolies will also be applicable to cases where a member, formally or in effect

³³ GATS Article.VII:2

³⁴ GATS Article VII: 3

³⁵ GATS Article VII: 5

³⁶ GATS, Article VII:2

³⁷ GATS, Article VII:4

authorizes or establishes a small number of service suppliers and substantially prevents competition among to those suppliers in the territory.³⁸

2.3.6. Rules on Payments and Transfers

Art. XI of the GATS contains obligations on payments and transfers that, needless to say, are important in the context of trade agreements on services that covers cross-border activities. Art. XI: 1 provides that a member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments. The concept of payments for “current transactions” covers payments for services, including financial services facilities. According to Article XXX (d) of Articles of Agreement of international Monetary Fund, payments for current transactions mean payments which are not for the purpose of transferring capital and includes payments in connection of foreign trade, interests on loans, remittances and other related payments.³⁹As far as the transactions is categorized as current transactions as specified here above, member countries are not allowed to take measures limiting flow of hard currency from one country to the other.

As per Article XI:2 of GATS, rights and obligations of the members of International Monetary Fund concerning the use of actions provided that a member shall not impose restrictions on any capital transactions inconsistently with its specific commitments regarding such transactions. In other words, if a member has taken commitments to allow provision of service under the cross border mode of supply, the member should allow such international payments associated to the services. Furthermore, if a member has undertaken a commitment to allow the supply of a service under the commercial presence mode of supply, it has to allow related transfers of capital into and out of its territory. This does not, however,

³⁸ GATS Article VII:6

³⁹ Payments for ‘current transactions’ includes:all payments due in connection with foreign trade, other current business, including services, and normal short term banking and credit facilities, payments due as interest on loans and as net income from other investments, payments of moderate amount for amortization of loans or for depreciation of direct investments; and moderate remittances for family living expenses. The fund may after consultation with the members concerned, determine whether certain specific transactions are to be considered current transactions or capital transactions (Article XXX (d) of Articles of Agreement of international Monetary Fund)

mean that members may not have rights to intervene in capital transactions. Members are authorized to take restrictive measures in the event of serious balance of payment difficulties.⁴⁰ Nevertheless, there are a number of conditions to be considering when taking such measures.⁴¹ Except under the circumstances provided under Art. XII of the GATS, a member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments.

2.2.1. Specific Obligations of GATS

Unlike principles of general obligations discussed above, specific obligations of the GATS are applicable with respect to specific service sectors included in the schedule of specific commitments of member countries. These principles are: market access, national treatment rule, additional commitments and schedule of specific commitments. These specific commitments would be applicable only when a member has undertaken specific commitments with respect to the service sector.

2.4.1. Market Access Rule

Art. XVI: 1 provides that with respect to market access conditions through the modes of supply identified in Article 1 of GATS, each member shall accord services and service suppliers treatment no less favorable than that provided for under the terms, limitations and conditions agreed and specified in the schedule. By inscribing market access commitment for a particular service sector in its schedule, a member binds itself to the minimum treatment that is required to accord to foreign services or suppliers in the sector. Market access generally is applicable in terms of addressing non-tariff barriers to trade in services. Unless otherwise specifically indicated in schedule of commitments, the member country may not maintain the certain limitations with respect to sectors where market access commitments are

⁴⁰ GATS, Article XII:1

⁴¹ GATS, Article XII:2 :The member shall not discriminate among members, the measure shall be consistent with the Articles of Agreement of the International Monetary Fund, the member shall avoid unnecessary damage to the commercial, economic and financial interests of any other member, the measure shall be phased and be phased out progressively as the situation improves, the measure shall not exceed those necessary to deal with the serious balance of payments and external financial difficulties which led to the impositions

undertaken. In other words, the acceding country can undertake a number of limitations in its service sector schedule ranging from limiting the number of service suppliers, monopolies, quotas, requirement of joint venture, limitation of participation of foreign capital and related limitations.⁴²In addition to market access, rule under Art. VIII, Understanding on Commitments in Financial Services provides further rules on market access issues related to financial sector services.

2.4.2. National Treatment Rule

The national treatment rule of the GATS is provided under Article XVII of GATS. It provides:

In the sectors inscribed in its schedule, and subject to any conditions and qualifications set out there in, each member shall accord to services and service suppliers of any other member in respect of all measures affecting the supply of services treatment no less favorable than that it accords to its own like services and service suppliers.

The national treatment rule of the GATS is the same as national treatment rule provided under GATT and it aims at addressing discriminatory treatment of the host member with respect to domestic and Foreign Service providers that are engaged in the same service trade. When a member accord formally identical or formally different treatment that it accords to its own like service and service suppliers, it will be considered less favorable if it modifies the conditions of competition in favor of

⁴² Article XVI:2, GATS : (1)Limitation on the number of service suppliers, whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test (2)Limitation on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test (3)Limitation on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test (4)Limitations on the total number of natural persons that may be employed in a particular service sector or that of service supplier (5)Measures which restrict or require specific type of legal entity or joint venture through which a service supplier may supply service; and (6)Limitations on the participation of foreign capital in terms of maximum percentage limit on foreign share holding or the total value of individual or aggregate foreign investment.

services or service suppliers of the member compared to like services or service suppliers of any other member.⁴³

Such discrimination can be *de facto* or *de jure*. *De jure* discrimination relates to cases where by the law, regulations or policy discriminates against services or service providers of other members as compared to "like" services or service suppliers of the member maintaining the measure. Discrimination can be a *de facto* one, when applying the measures or the laws, there is discrimination between domestic and foreign like services. With respect to the application of national treatment rule to financial services, an alternative rule is provided under paragraph C of Understanding on Commitments in Financial Services:

Under terms and conditions that accord national treatment, each member shall grant to financial services suppliers of any other member established in its territory access to payment and clearing systems operated by public entities, and to official funding and refinancing facilities available in the normal course of ordinary business. This rule is applied together with national treatment rule of the GATS.

2.4.3. Schedule of Specific Commitments

Specific commitments assumed by member countries are inscribed in GATS schedule prepared as per Article XX of GATS. Each member shall set out schedule on market access and national treatment commitments in the four modes of supply. Each schedule of commitment shall specify terms, limitations and conditions on market access, conditions and qualifications on national treatment undertakings, relating to additional commitments where appropriate, the time frame for implementation of commitments and the date of into force of such commitments⁴⁴. As per Article XVI of GATS, member countries may not maintain any other market access limitations that is not provided in its schedule of commitment.⁴⁵ The level of commitment of

⁴³ WTO, Understanding on Commitments in Financial Services (1994) Section C

⁴⁴ GATS Article 20

⁴⁵ Some of the limitations used by countries include: limitation on the number of service suppliers, limitation on the total value of transaction or assets, limitation on the total number of service operations or quantity of service output, limitation on the total number of

member countries in the service sector can be expressed in various ways *Full commitment, Commitment with limitations, No commitment and No commitment technically visible*⁴⁶

Market access limitations entered as per Art. XVI may also be applicable as limitation to national treatment rule under Article XVII. Thus, while there may be no limitation entered in the national treatment column, there may exist a discriminatory measure inconsistent with national treatment rule inscribed in market access column. The member, therefore, has to clearly stipulate under National Treatment limitations in its schedule. Specifically, if any act of the government discriminates in favor of services of national origin; such act is subjected to scheduling.⁴⁷ Many of the limitations are largely related to licensing and qualification requirements, registration requirements and other measures.⁴⁸ A commitment once entered by the member remains in force for three years.⁴⁹ A member is free to modify or withdraw any commitment in its schedule at any time after three years elapsed from the date on which the commitment entered into force.

3. Implications of GATS on Ethiopia's Financial Sector Policies

In the preceding sections, an attempt has been made to highlight the frame work of the GATS and its major principles. The remaining part of the paper is dedicated to

natural person, restrictions or requirements regarding type of legal entity or joint venture, limitation on the participation of foreign capital or market access.

⁴⁶ Full commitment: If the member agrees to accord full market access or national treatment rights with no conditions or qualifications to this services and service suppliers of other member. To indicate the member inscribes "None" in the schedule under the relevant mode of supply. Commitment with limitations: If the member wants to maintain specific limitations, conditions or qualifications they limit the scope of market access or national treatment commitments, it has to inscribe in its schedule of commitment. No commitment: This indicates that the member remains free to maintain or establish any measure inconsistent with the market access or national treatment obligations. This is expressed by inscribing "un bound" under the relevant schedule. No commitment technically visible: when the supply of the service cannot occur under one of the modes, the member indicate this by inscribing "no commitment technically feasible" in the column of corresponding mode of supply.

⁴⁷ WTO, Trade in Services. Basic Documents (2004) p.69

⁴⁸ Ibid

⁴⁹ GATS Article XXI

assess the overall financial sector regulation in Ethiopia and possible implications of the GATS on the various financial policies of the country. Since GATS is a comprehensive agreement that is designed to regulate all service sectors and Ethiopia has yet not undertaken any financial sector commitments under GATS, the section that follows only attempts to assess implications of principles of GATS that have implications during Ethiopia's accession process.⁵⁰ Thus, the comparative study focuses on the impacts of Market Access, National Treatment, International Payments, Principle of Transparency and Rules on Domestic Regulations on the existing financial regime of the country.

3.1. Financial Sector Development in Ethiopia

The agreement that was reached in 1905 between Emperor Menelik II and the British owned National Bank of Egypt marked the introduction of modern banking in Ethiopia with the establishment of Bank of Abyssinia.⁵¹ The Bank was wholly owned by foreign nationals. In 1931 the Ethiopian government purchased Abyssinian Bank and renamed it as "Bank of Ethiopia"⁵². It was also the first indigenous bank in the African continent. During the Italian occupation (1936-1941), many Italian Banks were operating in the country. Soon after liberation, many of Italian Banks withdraw except Banco Di Roma and Banco Di Napoli that continued their activity in Asmara.⁵³

On 15th April 1943, the State Bank of Ethiopia commenced full operation. It acted as rental power of Ethiopia and had power to issue bank notes and coins as the agent of the Ministry of Finance. Until 1963, State Bank of Ethiopia continued to act as a central as well as commercial bank.⁵⁴ The Ethiopian Monetary and Banking Law that came into force in 1963 separated the function of commercial and central bank by creating National Bank of Ethiopia and Commercial Bank of Ethiopia.⁵⁵ The first privately owned bank, Addis Ababa Share Company, become operational in 1964.

⁵⁰ Principles of GATS such as Most Favoured Nation Treatment or rules on Domestic Monopoly will be relevant when Ethiopia undertakes commitments under GATS

⁵¹ National Bank of Ethiopia, History of Banking and Money in Ethiopia (2002), P.1

⁵² Ibid, P.2

⁵³ Ibid

⁵⁴ Since there was no central or national bank during that period, this bank was entrusted with the power to issuing currency and deal in foreign currency

⁵⁵ Supra at 43,p.6

Other financial institutions were also flourishing in 1960's and 1970's. Later, all privately owned financial institutions including three commercial banks, thirteen insurance companies and two non-bank financial intermediaries were nationalized on 1st of January 1975.⁵⁶ From 1974 to 1991, the country was under state socialism that weakened the private sector in many respects.

In 1992 a change in economic policy was taken place and a new Monetary and Banking Business Proclamation was issued.⁵⁷ Following the adoption of the proclamation, the country witnessed a proliferation of private financial institutions.⁵⁸ But the banking investment is reserved only to Ethiopian nationals.⁵⁹ Despite the proliferation of privates owned companies, their relative share in the market is not yet significant. Still Commercial Bank of Ethiopia monopolize the market in terms of deposit and total asset.⁶⁰ But recent trends suggest that private banks are gathering momentum by snatching long-lived monopoly of Commercial Bank of Ethiopia.⁶¹

3.2. Overview of the Financial Policies of Ethiopia

After restoration of free market economic policy in 1992, series of measures were taken in the area of financial sector reformation. These reforms include, among others, devaluation of birr, liberalization of foreign exchange market, reforming interest rate. The National Bank of Ethiopia (NBE) is granted with the power related to determining exchange rate, interest rate and licensing of banks and other

⁵⁶ *ibid*

⁵⁷ The foundational proclamations are: pro. No. 83/1994, Monetary and Banking Proclamation and Pro. No. 84/1994, Proclamation for Licensing and Supervision of Banking Business (amended as National Bank of Ethiopia Establishment Proclamation no 591/2008 and Banking Business Proclamation No. 592/2008,

⁵⁸ Currently there are three states-owned and twelve private-owned commercial banks in the country.

⁵⁹ Article 9, Pro.No 592/ 2008

⁶⁰ In 2000/01, Commercial Bank of Ethiopia had 81.3% of total deposit and 74% of total bank asset.

⁶¹ In 2010 the 12 private banks that have been operating in the country, managed to get an average return of 22 percent of the investments (and showed a 45 percent increase in their profits from the previous fiscal year of 974 million birr to 1.4 billion birr during the last Ethiopian budget year.)

financial institutions⁶². The current exchange rate reform began with devaluating the local currency from at Birr 2.07 to per 1 S\$, to 5 Birr per 1 S\$ in October 1992. In 1993 the government introduced the auction based exchange rate system. The marginal exchange rate was determined based on the outcome of the auction conducted on weekly basis for computation of the applicable exchange rates issued on daily basis. The retail auction was changed to whole sale auction in September 1998 until October 2001. As part of liberalizing its system, NBE issued directives aimed at establishing Inter Bank Foreign Exchange (IBFEM) and Inter Bank Money Markets (IBMM).⁶³The establishment of IBFEM enabled banks to have daily access to the forex market and freely bid their own rates for buying foreign exchange and accept offers based on the guidelines of NBE. The establishment of this market is motivated by the recognition that the foreign exchange supply by the NBE through the auction system is not sufficient to satisfy the demand of banks.

In relation to regulation of foreign exchange and foreign currency no person shall engage in any transaction in foreign exchange except with authorized bank or authorized dealer or without the permission of the bank.⁶⁴ It is also provided that the Ethiopian Revenues and Customs Authority shall not allow import or export of valuable goods or foreign exchange unless conditions, circumstances and terms determined by the National Bank are fulfilled.⁶⁵ Account opening in foreign exchange is limited to establishments and bodies like international organizations, diplomatic groups, non-governmental humanitarian agencies, foreign investors, foreign nationalities working in such institutions and foreign citizens of Ethiopian origin and Ethiopians in Diaspora. No Ethiopian national resident in Ethiopia or resident Ethiopian company is allowed to maintain a bank account abroad without the authorization of National Bank of Ethiopia. Banks registered in Ethiopia can open accounts with banks abroad. But when banks open accounts in foreign banks they have the duty to report to NBE.

⁶² For other powers of NBE, Proclamation 592/2008, Art. 5,15-21

⁶³ Inter Bank Foreign Exchange Directive No. IBM/01/1998, National bank of Ethiopia and Inter Bank Money Markets (IBMM IBM/02/1998, National bank of Ethiopia

⁶⁴ Proclamation No. 592/2008, Art .20 (1)

⁶⁵ Ibid, Ar. 20(4)

National Bank of Ethiopia has also introduced directive that allows some institutions accept payments in credit cards. This right is available to establishments whose operational activities involve catering services and sales of goods to foreign customers and guests.⁶⁶The directive provides acceptable types of credit cards. The establishments allowed to accept such payments would submit vouchers to commercial banks and receive the proceed in terms of birr. Commercial banks in turn are required to dispatch the items for collections to the credit card issuer or the agent bank as the case may be.⁶⁷ Some entities are also eligible to accept payments in foreign cash notes and traveller's cheques. These entities are: Hotels certified by Ethiopian Tourism Commission, Duty free shop operators, Immigration office, and Civil Aviation Authority and Air line ticket offices.⁶⁸ Establishments are required to forward all foreign currency items collected during one working day to the nearest bank for conversion or deposit within two working days.

The other most important aspect of the Ethiopia's financial sector policy is related to the role of IMF. Ethiopia's relation with the IMF has evolved overtime since the introduction of Structural Adjustment Program (SAP) that took place in 1992/93. Under SAP program a number of reform measures were taken: devaluation of the currency, rationalization of public expenditure, removal of subsidies and export tax except on coffee, reduction of import tariffs and other measures. The second phase of ESAF program, however, was suspended due to Ethiopia's disagreement with IMF.⁶⁹ The points of disagreement with IMF with respect to the financial sector were on two issues. First IMF argues that the major government owned bank, Commercial Bank of Ethiopia split in to three or four banks through privatization.⁷⁰ The second contention was that the fund pressed the government to open the financial sector to foreign banks.⁷¹ The fund was also pushing the policy of determining interest rates by market forces.⁷²The Ethiopian government feared that the liberalization

⁶⁶ Foreign Exchange Directive No. FXD/21/2003, National bank of Ethiopia

⁶⁷ Some of the acceptable credit cards are: American express, Visa Card, Master Card, Euro Card, Diners Club Card, Cart Blanche

⁶⁸ Supra at 57, Art. 3.1

⁶⁹ Tony Adison and Alemayew Geda. Ethiopian's New Financial Sector and its Regulations, WIDER Discussion Paper (2001) P.9

⁷⁰ Ibid

⁷¹ Ibid

⁷² Supra at 3.p.31

may have devastating impact on its economy especially liberalization of banking sector may affect credit facility of the poor to cheap credit or the poor may be forced to pay higher interest rates which they could not afford. The dispute was finally resolved with the announcement of reducing the total non-performing loans of Commercial Bank of Ethiopia (CBE) to 15.4 percent and total loans by the end of 1999. Still IMF is pushing the privatization of CBE and liberalization of banking sector to foreigners.

3.3. Impacts of the GATS on Ethiopia's Financial Sector Policies

Comparative assessment of GATS in light of Ethiopian financial sector policies shows the incompatibilities of the country's policies in areas of transparency of the financial policies, market access, domestic regulation and international payment principles of GATS. The subsequent sections illustrate these incompatibilities.

3.3.1. The Implications of Transparency Principle of GATS

One of the general obligations of the GATS is the principle of transparency provided under Article III of the GATS. According to the principle of transparency, each member shall publish promptly all relevant measures affecting the GATS agreement and other international agreements affecting trade in services. The principle further requires establishing enquiry points (like websites) and providing adequate information for members seeking specific information. This principle is also linked to the law making procedure of the member in making laws that affect trade in services. In Ethiopian context, there are three hierarchies of laws. The higher law next to the constitution is Proclamation issued by the House of Peoples Representatives. The next in the hierarchy of laws is regulations issued by the Council of Ministers while directives are issued by different ministerial offices.

Since Proclamations and regulations are published in the Federal Gazette called *Negarit Gazzeta* which is available to the public. There are a number of proclamations and regulations that have implications on the financial sector. All are officially published on the *Federal Gazette*. The problem of transparency largely related to directives issued by National Bank of Ethiopia. There are more than 50 directives issued by the National Bank of Ethiopia. The most serious problem is

related to publication. All the directives are not published by official Gazette. Absence of such publication creates problem of identifying which versions of the directives are authentic or binding and which of them are amended or null and void. In addition to this, access of the directives to the public is very limited. It is also not clear what procedures the bank employs in issuing directives. Since directives are binding laws significantly regulating the country's financial sector, there has to be transparent law making procedure and official publication to make the transparency of the legal rules up to the standards of GATS.

The other problem with respect to directives of NBE is that they are written only in the English language, they are technical and in some instances they are ambiguous. Since the working language of the federal government is Amharic, there has to be Amharic version of the directives of NBE. The Amharic version of the directives may help people understand the directives and enforce them in courts of law. An attempt should also be made to reduce the technical aspect of the directives. The other problem related to the transparency of NBE is the absence of central office that provides information about the over all activities of the bank. The laws and other relevant information are scattered in the three main departments of NBE. To get banking information, one has to visit the Banking Department, to get insurance related information one has to visit the Insurance Department, and the same applies to Microfinance Department.

An important measure that has been taken by the NBE in relation to transparency of its rules and regulations is posting financial laws on its official website. One can access the directives, regulations and proclamations dealing with financial issues on its official website. But the directives and other laws available in the webpage are very limited. Many of the directives are not incorporated. Due to the limited access to the internet in the country, there has to be also another alternative to access legal and other related documents. An efficient and transparent information system seems to be essential in the financial sector since such issue of transparency will be raised by member countries.⁷³

⁷³ Before China joined the WTO, domestic authorities were not required to publish regulations, operated under a system of 'internal' regulations that were only available to the regulators. This regulatory system had complicated commercial operations and allowed regulators to make inconsistent or discriminatory decisions which businesses could not

3.3.2. The Implications of Domestic Regulation Rule of GATS

Art. VI: 1 of GATS provides that in sectors where specific commitments are undertaken, each member shall ensure all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner. This obligation is applicable to Ethiopia when it accedes to WTO and when there are specific commitments to be undertaken under the GATS. But other provisions of Article VI are relevant even before accession process is completed. Sub article 2 of Art. VI provides that each member is expected to maintain judicial, arbitral or administrative tribunals for review of administrative decisions affecting trade in services. In light of this, Article 78 of constitution of Federal Democratic Republic of Ethiopia (FDRE), guarantees independence of the judiciary. But when we come to the actual practice, there are a number of problems related to the judicial system. The most serious problem is delay of justice, independence and competence of the judiciary. The recently published United States State Department Human Rights Report noted the Problems related to the judiciary in the following way:

The law provides for an independent judiciary. Although the civil courts operated with independence, the criminal courts remained weak, overburdened, and subject to significant political intervention and influence. Constitutional interpretation remains solely the responsibility of the upper house of parliament, consisting exclusively of ruling party members, which also handles judicial appointments and reviews judicial conduct. In practice courts have discretion to convict defendants on charges not raised by the prosecution. Some local officials believed they were not accountable to a higher authority. The judicial system severely lacked experienced staff, sometimes making the application of the law unpredictable.⁷⁴

challenge on the basis of written regulations. In order to ensure that opaque regulation would not undermine the benefits of China's WTO commitments, members of Working Party on China's accession negotiated additional commitments that require on-going regulatory transparency and WTO institutional monitoring of the China's WTO commitments over a transitional period. (see supra at 14 p.87)

⁷⁴ see United States Department of State Human Rights 2009 Report on Ethiopia www.state.gov/g/drl/rls/hrrpt/2009/af/135953.htm

Due to limited number of judges and benches in Federal Courts, lack of qualified judges in sufficient number, political interventions and lack of accountability of government officials to rule of law, the judicial system remains weak. This has an effect in terms satisfying standards and principles set by multilateral organizations like WTO. The government needs to ensure the independence and effectiveness of the judiciary and other administrative tribunals. In addition to this, Article VI of GATS require member countries to have qualification requirements, technical standards and licensing requirements that do not impose unnecessary barriers to trade in services.⁷⁵ If Ethiopia chooses to open up its markets in the financial sector to foreign financial service providers, its licensing requirements need to be reasonable and objective.

3.3.3. The Implications of Payments and Transfers Rules of GATS

Art. XI of GATS requires members not to apply restrictions on international transfers and payments relating to 'current transactions'. According to Article XXX (d) of Articles of Agreement of International Monetary Fund, current transactions include 'payments in connection to foreign trade, payments for loans, remittances for family expenses and the like.' Such international payment transactions may arise in different modes of supply in international business transactions if a member country undertakes specific commitment in a certain service sector. If Ethiopia may undertakes commitments in cross border, consumption abroad or commercial presence modes of supply in any of the service sectors, it has to develop system that allows international payments for various transactions related to these modes of supply.

In principle, no Ethiopian national resident in Ethiopia or resident company allowed to open bank accounts abroad or obtain external credit from foreign bank or open bank accounts in foreign exchange.⁷⁶ For opening bank account in foreign banks, special authorization from NBE need to be secured and this is generally permitted to banks registered in Ethiopia.⁷⁷ Borrowing from foreign banks is not allowed except

⁷⁵ GATS Article VI:4

⁷⁶ Foreign Exchange Directive No. FXD/67/1998, National bank of Ethiopia

⁷⁷ Ibid

for foreign investors. The purchase of goods with the financing of the supplier has also its own prerequisites. Transfer of foreign currency from and into the country is also strictly regulated. Availability of Foreign currency for importing goods from abroad has its own procedures. To receive foreign currency in foreign trade, the person engaged in import-export trade has to apply for opening of Letter of Credit (LC) or Cash against Documents (CAD) arrangements. For each arrangement there are different procedures to be applied.⁷⁸ All these rules indicate that Ethiopian financial sector related to international payments is highly regulated and characterized by a number of restrictions. This is due to the fact that Ethiopia's economy is characterized by serious balance of payment problems.

These restrictions on international payments and transfers affect cross-border mode of supply in any service sector. Commitments to cross-border trade liberalization (Mode 1) require the liberalization of inflows and outflows of capital, which are essential components of the concerned services. If Ethiopia chooses to undertake commitments in cross-border mode of supply of services, it needs to relax its rule on international payments and other forms of inflow and out flow of capital. Upon accession to WTO, Ethiopia may have two options with respect to commitment of services in cross-border mode of supply. Either it may choose not to undertake any commitment in cross-border mode of supply or it undertakes commitments with various limitations so that it may be able to manage its foreign currency properly. Ethiopia can use Article XII of the GATS that allow members to take various measures to its ease balance of payment problems.

With respect to consumption abroad mode of supply, there is no direct policy in the existing financial policies of the country that prohibits Ethiopian nationals or residents to use services outside Ethiopia. But there are rules on how a person may get hard currency for various purposes.⁷⁹ There is special directive dealing with what amount of foreign currency may be granted for holiday, business, medical and educational expenses. To obtain foreign currency for such purposes, there are procedures to be applicable and the amount to be granted is very limited. Even if Ethiopia may undertake commitments in this mode of supply under GATS, the

⁷⁸ Foreign Exchange Directive No. FXD/07/1998, National bank of Ethiopia

⁷⁹ Foreign Exchange Directive No. FXD/09/1998, National bank of Ethiopia

recurring balance of payment problems of the country continue to hamper the implementation of such commitments.

Probably the most serious challenge for the existing restrictions on international payments arises if Ethiopia allows foreign financial sector providers to operate in Ethiopia. In other words, unless this policy is to be amended during Ethiopia's accession to WTO, commercial presence of Foreign Service suppliers in the financial sector is not allowed. If a commitment is to be undertaken to the effect that permits such financial providers, Ethiopia may have to tolerate international payments in relation to international transactions of foreign banks. Issue of international payment may also arise in relation to commercial presence mode of supply in other service sectors. If Ethiopia undertakes any commitment in commercial presence in business, communication, education or any other services, issues of international payment are applicable.

3.3.4. The Implications of Market Access rules of GATS

Art I of GATS provides for of specific commitments to be under-taken in the four modes of supply by member countries. In principle there is no obligation for member countries to undertake commitments in any of the four modes of supply. The extent of commitments to be undertaken by a member is to be determined by the decision of member government. If a member country choose to undertake any commitment under one of the modes of supply, that member is required to accord services or service suppliers of any other member treatment no less favorable than that provides for under the terms, limitations and conditions agreed and specified in the schedule.⁸⁰ In sectors where market commitments are undertaken, member countries should not take other specified measures unless the measures are specifically provided under the schedule.⁸¹

In Ethiopian financial sector, the most important market access limitation in the existing banking and insurance law is that the sectors are only open to Ethiopian

⁸⁰ GATS Article XVI:10

⁸¹ GATS Article XVI:2

nationals.⁸²In his recent press conference, the Prime Minister reaffirmed that foreign banks will not be allowed to enter the Ethiopian financial market and the government has no intention to reverse its current policy.⁸³According to an interview made with government officials, the fierce opposition of the government to liberalization of the financial sector is basically due to five concerns:

(1)The government believes that the development of a viable domestic banking sector will be threatened by foreign banks, because they have more capital, more experience, and better reputations. (2) Ethiopian government officials also believe that entry by foreign banks will further skew credit allocation towards large-scale industrial, real estate and service enterprises (including trade) and away from agriculture, small-scale and cottage/micro enterprises (sectors which are the priorities for the government's development strategy). (3)Domestic savings mobilization has been identified as an area of concern to Ethiopian officials, who have suggested that foreign banks would lend in their home or other foreign currencies and would not be interested in mobilizing domestic savings. (4)There is concern that foreign banks may serve as conduits for the inward and outward flows of capital (e.g., through capital and money-market transactions; credit operations; personal capital movements; etc.). (5) It is strongly believed that the authorities will be unable at present to regulate and supervise foreign banks effectively.⁸⁴

Consistent to these concerns, scholars also note that when a developing country carries out financial liberalization before its institutions or knowledge base is not prepared to deal with the consequences, liberalization process opens itself to the possibility of tremendous shocks and instability associated with inflows and out

⁸² Foreign nationals or organizations fully or partially owned by foreign nationals may not be allowed to open banks or branch offices or subsidiaries of foreign banks in Ethiopia or acquire the shares of Ethiopian banks Banking Business Proclamation No 592/2008, Article 9

⁸³ Capital, Volume 12 no. 12,September 7, 2010

⁸⁴ These concerns were raised by government officials, senior bankers and representatives of the bankers' association in Ethiopia in February-April 2007 during interviews with the authors, who were preparing a study on the economic impact of WTO accession on Ethiopia's financial sector (see Kozo Kiyota, et al, The Case for Financial Sector Liberalization in Ethiopia, Discussion paper no 565, Gerald R,The University of Michigan (2007) p 14-15)

flows of funds.⁸⁵ Despite the fact that these concerns are legitimate that needs to be taken seriously, there are more compelling justification for liberalizing the financial sector. According to studies internationalization of financial services can help countries build more robust and efficient financial systems by introducing international practices and standards; by improving the quality, efficiency and breadth of financial services; and by allowing more stable sources of funds, increased competitiveness enhanced through financial sector openness and spurs economic growth⁸⁶

The most important way of preserving national policy objectives in the financial sector is through applying various limitations that are allowed under the GATS rather than total closure of the sectors from foreign financial service providers. Article IV of GATS provides that the increasing participation of developing country Members in world trade shall be facilitated through (a) the strengthening of their domestic services capacity and its efficiency and competitiveness, inter alia through access to technology on a commercial basis; (b) the improvement of their access to distribution channels and information networks; and (c) the liberalization of market access in sectors and modes of supply of export interest to them. In addition to this, Least Developed countries will only be required to undertake commitments and concessions to the extent consistent with their individual development, financial and trade needs, or their administrative and institutional capabilities.⁸⁷ WTO provides for special treatment for developing countries in a way that countries are not expected to maintain the same level of commitment with the developed ones and have more time to execute the process. They are not also supposed to come up with all the requirements before joining the organization.

The other most important guarantee for member countries to limit the adverse impacts of liberalization of the service sector is Article XVI: 2 of GATS. This provision

⁸⁵ Keynesian- Tobin-Stieglitz school of thought advocates for strict regulation of the financial sector to resist the adverse impacts of financial liberalization.(see Abedullahi D Ahmed and Islam M. N. Sardar, Financial Sector Liberalization in Developing Countries: Issues, Time Series Analysis and policy Implications, Heidelberg (2010) p. 5-6

⁸⁶ WTO,The Internationalization of Financial Services: Issues and Lessons for Developing Countries (2001)

⁸⁷ WTO,Decision on Measures in Favour of Least-Developed Countries (1994)

provides a number of rights to the acceding country to limit the extent of liberalization of the service sector such as : limitation on the number of service suppliers, whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test ,limitation on the total value of service transactions, limitation on the total number of service operations, limitations on the total number of natural persons that may be employed in a particular service sector or that of service supplier, measures which restrict or require specific type of legal entity or joint venture through which a service supplier may supply service; and limitations on the participation of foreign capital in terms of maximum percentage limit on foreign share holding or the total value of individual or aggregate foreign investment.

Different countries use such clauses to protect their national interest. China, for instance maintains different limitation measures under its commitment of GATS in the financial sector despite it has made substantial commitments in the banking sector during WTO negotiations. It undertook commitments to open financial markets on a step-by-step basis. Two years after China's entry into WTO, foreign banks will be allowed to undertake some local currency business with all their customers (including Chinese residents). Five years after China's entry, foreign banks will be able to fully engage in local currency services and receive national treatment of banking service without restrictions in terms of geography, branching and scope. Until such time foreign investment in a joint venture should be no less than 25 percent of the registered capital and regarding presence of natural persons, senior employees of a corporation are permitted for an initial term of three years.⁸⁸

By striking a balance between liberalization of the financial sector and maintaining its policy objectives, China has maximized the benefits of liberalization of the financial sector. Despite the fact that there are 76 foreign banks are operating in country, China's financial sector is still one of heavily regulated financial system. But the regulatory system is within the frame work of the GATS which indicates that liberalization of the financial sector does not necessarily deprive new acceding

⁸⁸ Yun-Hwan Kim. Financial Opening under the WTO Agreements in Selected Asian Countries: Progress and Issues, Working Paper No. 24 (2002) p.5

countries like Ethiopia the power of the government to promote its socio-economic policy objectives through various regulatory mechanisms.

India maintains a number of limitations in mode 3 mode of supply. For instance India opened up its financial sector in 3rd mode of supply (commercial presence) by maintaining the following market access limitations: ⁸⁹Banks are allowed only through branch operations of a foreign bank licensed and supervised as a bank in its home country, grant of license as permissible under existing laws and a limit of twelve licenses per year both for new entrants and existing banks. Indonesia allows foreign entry of financial service providers only when foreign legal entities establish the bank in cooperation of Indonesia nationals.⁹⁰ When we review the financial sector commitment of Nepal, it undertook commitments on maintain various conditions:

Financial Services 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, 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.⁹¹

In the case of Vietnam, the schedule of commitments to GATS in the financial sector maintains the following limitations:

With respect to foreign commercial banks: representative office, branch of foreign commercial bank, commercial joint venture bank with foreign capital contribution not exceeding 50% of chartered capital, joint venture financial leasing company, 100% foreign-invested financial leasing company, joint venture finance company and

⁸⁹ WTO Commitments in the Financial Sector at URL:<http://www.wto.org/English>

⁹⁰ Supra at 79, P.6

⁹¹ The Kingdom of Nepal ,Schedule of Specific Commitments, Trade in service (2004)
www.wto.org

100% foreign-invested finance company, and, beginning on 1 April 2007, 100% foreign-owned banks are permitted⁹²

In addition to the experiences of these acceding countries who have effectively undertaken a number of limitations to protect their economic objectives, scholarly researches found out that any financial commitment under GATS will not prevent member countries to take measure to protect the stability of the financial system. According to scholars:

The General Agreement on Trade in Services (GATS) allows WTO Members to take prudential measures to protect investors and to ensure the integrity and stability of their domestic financial systems. It also permits the use of temporary non-discriminatory restrictions on balance-of-payments and transfers in the event of serious balance-of-payments and external financial difficulties. Moreover, the management of monetary and exchange rate policy falls outside the scope of the GATS.⁹³

The experience of these countries and the GATS regime indicates that opening up market to foreign banks does not necessarily mean that there is no any room to apply social and economic objectives. Therefore when Ethiopia accedes to WTO, it has different options to limit the operation of foreign banks and insurance companies in its territory to address its socio-economic concerns. Since the GATS system provides sufficient mechanisms for protection of pro-poor policies or illegitimate flight of capital from the country, resisting liberalization of the financial sector under the Ethiopian government by the pretext of economic concerns may not be watertight argument.

Economic concerns alone could not explain the position of the Ethiopian government that strongly resists financial sector liberalization. The resistance may rather be linked to the ideology of the ruling party. The ruling party follows 'revolutionary democracy' that asserts neo-liberal ideals do not bring about socio-economic development in poor countries like Ethiopia. The Prime Minister has

⁹² Vietnam, Schedule of Specific Commitments (2007) www.wto.org

⁹³ Supra at 4.p.6

declared his view against neo-liberal ideals. In his text, *African Development :Dead Ends and New Beginnings*(2006), the Prime Minister indicates that the neo-liberal paradigm is not working in Africa and the best way to achieve development ,he argues, is by the paradigm of developmental state where the state will have strong power and involvement in directing the political economy of the country. Such endeavour to monopolize development activities by the state traced its roots in the strong communist ideological background of the party. This ‘developmental state’ discourse that calls for maximum involvement of the government in economic activities has become the rhetoric of the government in the last few years. Such ideological convictions are more obstacles to the liberalization of the financial sector in Ethiopia than mere economic concerns.

Whether the resistance to liberalization of the financial sector is due to economic or ideological reasons, Ethiopia would face serious pressure from WTO members for opening up the sectors to foreign financial service providers. The writer of this paper submits that total closure of the financial sector from foreign financial service providers is out of the context of globalization and increasingly isolates the country’s financial sector from the ever integrating network of international financial system. Closure of the sector from foreign financial service providers would weaken the effectiveness and competitiveness of the sector and prevents the country from accruing various benefits related to the liberalization of the financial sector.

3.3.5. The Implications of National Treatment rules of GATS

One of specific obligations of the GATS is the principle National Treatment.⁹⁴ This principle upholds that each member shall accord to 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 services and services suppliers. In other words, national treatment rule requires member countries to treat like domestic and Foreign Service providers equally. In sectors where Ethiopia undertakes schedules specific commitments, it must afford national treatment to foreign services and services suppliers, except as indicated in its GATS schedule. Under the national treatment rule, Ethiopia may not, for example, require higher

⁹⁴ GATS Art. XVII

minimum capital requirements for foreign-owned banks established in its market than it requires for national-owned banks, unless it has scheduled this limitation.

GAT allows members to maintain different limitations to the National Treatment rule in order to protect domestic service providers. It is common practice to find limitation on specific commitments of WTO member countries in their schedule on national treatment. Ethiopia needs to develop its own limitations on national treatment rule when it prepares its commitments in the financial sector. Since the domestic financial sector in Ethiopia is at low stage of development, it is unlikely that domestic financial service providers would resist fierce competition from foreign banks during the first few years. Thus, the Ethiopian government may consider various conditions and qualifications such as: reserving eligibility for subsidy for nationals, higher license fees for non-nationals, nationality requirement for agents or managers, licensing and qualification requirement for non-nationals, technology transfer requirement and other similar requirements.⁹⁵

3.3.6. Impact of GATS on Regulatory Power of National Bank of Ethiopia (NBE)

It is now become an open secret that the effectiveness of trade liberalization and the potential gains from it is increase depend on the degree to and manner in which the domestic sectors are being regulated and this is especially true in the case of financial services.⁹⁶ Liberalization of the financial sector alone may not bring about the desired result without parallel institutional development necessary to accommodate the changes. Due to technological changes in the information and communication services, the financial service has become more complex. For instance, technology has allowed for financial institutions to deliver services at greater distance, as when banks deliverer financial services without a close presence making cross border provision of financial services easier and cheaper.⁹⁷ Globalization and deregulation of financial services is also another factor that calls for existence of efficient regulatory and supervisory system. The

⁹⁵ Supra at 39,P.69

⁹⁶ Stijn Claessens, 'Regulatory Reform and Trade Liberalization in Financial Services' 2003 in Aaditya Mattoo and Pierre Sauvé (Eds.), Domestic Regulation and Service Trade Liberalization, Oxford University Press (2002) p.2

⁹⁷ Ibid P.4

technological advancement in the sector specially the e-commerce has greatly challenged the supervisory role of central banks. This globalization has created increased integration of financial services especially cross-border capital flows has been very important. In the light of such complex and fast challenges, every central bank has responsibilities to cope up with such developments.

In light of such complexities, NBE has a number of responsibilities. In liberalized financial sector system, NBE in the first place has the duty to protect investors as well as consumers. In light of liberalization of the financial sector, regulating the quality of services delivered to customers and other investors from fraud and other criminal activities and coping up with the complex nature of the financial transactions will pose challenges to NBE. It needs to have legal framework that can enable itself to protect customers from unsafe banking transactions and illegitimate flow of hard currency. NBE may also need legal framework for addressing unfair competitions among financial service providers, since existence of unfair competition may lead to the abuse of their mandate and leads to crisis in the financial sector.

The other important area of regulation a head of NBE is managing capital account liberalization. Commitments under the GATS require some degree of capital account liberalization. NBE needs to plan how it may maintain or relax capital account markets. If Ethiopia is to undertake financial sector commitments in mode 3 (Commercial Presence) Mode of Supply, there are a number of legal frame works to be in place for applying liberalization in this mode of supply. One of the legal frameworks to be in place is how and to what extent foreign banks may exist in Ethiopia's financial sector environment. The frame work may deal with whether participation of foreign banks is in joint venture with Ethiopian nationals or full share of foreign ownership in the financial sector or limiting geographical operation of foreign banks in the country.⁹⁸

⁹⁸ These are only few of the issues to be addressed in relation to liberalizing the financial sector. A lot of other issues like the capital requirement for foreign banks, the banking activities they are allowed to do, to what extent the banks provide loans to Ethiopian residents and non-residents and other related issues.

Since the financial sector is heavily regulated in Ethiopia, there has to be legal framework that balances the macroeconomic stability at the same time maintaining prudential regulation. GATS require administration of domestic rule in objective, reasonable and impartial manner.⁹⁹ This is the underlying principle of non-discrimination under GATS. Since domestic financial service providers in Ethiopia are weak, they need some protection when foreign financial service providers are allowed to operate. But the protection mechanism should be on the basis of the framework of GATS. Based on the framework of the GATS, the government can provide subsidies to domestic financial service providers so that they may develop some form of competitiveness. The government can also come up with qualification requirements and technical standards applicable to foreign financial service providers. NBE should make itself prepared to tackle such legal challenges ahead of the WTO accession process. Recognizing the problem related to the capacity of NBE, former minister of Trade and Industry Girma Birru quoted saying 'The Ethiopian central bank lacks the capacity to regulate large foreign financial institutions.'¹⁰⁰ To cope up with all the changes in relation to liberalization of the financial sector with Ethiopia's accession to WTO, NBE needs to have more autonomy and mandate for effective administration of the financial sector.

3.4. Few Points on Possible Policy Options to Financial Commitments under GATS

Before undertaking any commitment in the service sector, Ethiopia needs to develop negotiation strategy in the service sector in general and the financial sector in particular. The negotiation strategy needs to address important issues such as: evaluation of existing laws and regulations, administrative procedures in financial sector policies, evaluation of the capacity of domestic financial service supplier, undertaking regulatory adjustments including prudential and supervisory regulations required for the implementation of WTO rules, preparing an action plan to prepare domestic service suppliers to face domestic and foreign competition and evaluation of schedule of commitments of other countries with particular attention to the type

⁹⁹ GATS Article VI:1

¹⁰⁰ Girma Birru, former Minister of Trade and Industry responded to the question as to whether the government has any plan to allow foreign investors in the financial sector as the country prepares for membership of the WTO. Bloomberg on February 17, 2009.

of limitation and qualifications they have included in their schedules in financial sector services.¹⁰¹

It is also advisable to select service sectors or sub sectors to be liberalized based on the country's policies and laws and to analyze the impact of liberalization on efficiency of the sectors, its contribution to other sectors and socio-economic objectives.¹⁰² This is prioritizing. This is especially applicable in undertaking commitments in the financial sector:

Certain sectors could be opened more gradually by indicating in the schedule a transitional period. Traditional banking services could be opened first, new financial services could be opened at latter stage, and specific sensitive sectors could be excluded from the schedule. The sectors and limitations needed to protect domestic industries should be selected very carefully to ensure that countries would not enter to commitments that would not be sustainable and ensure that commitments would reflect domestic policies.¹⁰³

After preparation of the negotiation strategy there are different approaches that can be followed in negotiation process. Approaches of different countries in service negotiations are different from country to country. There are basically three patterns of financial sector negotiations.¹⁰⁴ The first kind of financial sector negotiation is called *binding the status-quo*. This type of sector commitment is giving an offer without any change to existing market conditions in the financial market. The positive aspect of such kind of commitment is that it is easy for government to undertake financial commitments without making any further policy change.¹⁰⁵ The other type of negotiation in the financial sector is *binding below the status quo*. Several countries like Korea and Philippines undertook financial sector commitments

¹⁰¹ Kono Masamichi et al, WTO Opening Financial Markets in Financial Services and the Role of the GATS WTO Special Studies (1997) P.31-32

¹⁰² Ibid, P.28

¹⁰³ ibid

¹⁰⁴ Aadita Mattoo, 'Financial Services and the WTO: Liberalization Commitments of Developing and Transition Economies, The World Economy, Vol 23, Issue 3, no 3 (2000) P.369.

¹⁰⁵ Ibid, P. 369

below the status quo with respect to certain aspects of their regimes.¹⁰⁶ There are different reasons for this. One of the reasons is due to domestic macroeconomic instability and regulatory weaknesses. In addition to this, commitment undertaken below the status quo may also help to generate domestic support for liberalizing the financial sector.

The other approach is to take *commitment for liberalizing the financial sector*. In Undertaking liberalization at present or in future times, governments balance their interest to protect domestic financial service providers from fierce competition as well as their endeavour to bring about liberalized financial system. The various modalities of negotiation in financial services are largely applicable to original members of WTO that can use the flexibilities within the GATS. As far as new acceding countries to WTO are concerned, they have to negotiate with each WTO country on various trade sectors before accession process is finalized.

Even though GATS allows members to undertake service commitments in accordance with their choices, WTO member countries require further liberalization of the service sector beyond GATS through so called "WTO-plus" demands. In light of such circumstances, it is unlikely that Ethiopia can undertake financial sector commitment as *per the status quo* or *below the status quo*. Even though such chance is not totally blocked, it requires the country to convince WTO member countries as to why it can only undertake as per the status quo. If Ethiopia is to liberalize the financial sector in any of the four modes of supply, the third approach nears the reality of the negotiation of acceding countries. Ethiopia should single out a financial sector service or sub sector whose liberalization may not have serious implication on the macroeconomic stability of the country and where there is effective regulatory and supervision capacity.

This approach is in line with *gradual approach* Ethiopian government is following in the liberalization of the financial sector. The gradual liberalization could be national or international. Starting with domestic liberalization which includes deregulation measures such as removal of control over deposits and lending rates, reducing reserve requirements and reducing entry barriers to entry to financial industry may

¹⁰⁶ Ibid

pave the way for the more challenging international liberalization. After such domestic deregulation measures are taken the government may undertake international liberalization measures such as allowing entry of international financial institutions in the country and gradual relaxation of strict regulation on flow of capital. After such deregulation measures are taken, the government may undertake financial sector commitments under GATS in the modes of supply that may not pose serious challenge to the regulatory capacity of the National Bank and that may not seriously affect the fiscal and monetary policies of the country.

To protect Ethiopia's ideological and economic concerns related to the financial sector liberalizations, GATS provides sufficient framework. One of the most important principles that may be properly utilized by the Ethiopian government is special rights related to developing countries. Article IV of GATS provides that the increasing participation of developing country Members in world trade shall be facilitated through (a) the strengthening of their domestic services capacity , the improvement of their access to distribution channels and information networks and the liberalization of market access in sectors and modes of supply of export interest to them. In other words, Least Developed countries will only be required to undertake commitments and concessions to the extent consistent with their individual development, financial and trade needs, or their administrative and institutional capabilities.¹⁰⁷ This is an important rule that can help the acceding country to protect its balance of payment problem and protection of domestic service providers.

The other most important guarantee for member countries to limit the adverse impacts of liberalization of the service sector is Article XVI:2 of GATS .This provision provides a number of rights to limit the liberalization of the service sector such as : limitation on the number of service suppliers, limitation on the total number of service operations, limitations on the total number of natural persons that may be employed in a particular service sector or that of service supplier, measures which restrict or require specific type of legal entity or joint venture through which a service supplier may supply service and limitations on the participation of foreign

¹⁰⁷ Decision on Measures in Favour of Least-Developed Countries, http://www.wto.org/english/docs_e/legal_e/31-dlldc_e.htm#31

capital in terms of maximum percentage limit on foreign share holding or the total value of individual or aggregate foreign investment. As it has been pointed out earlier, many members of WTO have used these rules to protect their socio-economic policies in the financial sector at the same time integrating their financial sector to the global market. The writer submits that the best possible scenario for Ethiopia is to follow the footsteps of other countries in similar economic situations and open up its financial sector and undertake commitments under GATS in selected areas. At the same time, the government needs to develop a number of limitations that can effectively protect financial service providers and its regulatory power by effectively utilizing the exemptions and preferential treatment rules guaranteed under Art. IV and Art XVI: 2 of GATS.

4. Conclusion and Recommendations

Due to ever-increasing significance of international trade in services, after a tense negotiation on the subject by contracting parties to GATT, an agreement was reached on the inclusion of a separate agreement (GATS) into WTO system. Currently there are 12 core service sectors and 160 sub sectors covered under the GATS. One of the services covered under the GATS agreement is the financial services. Existing principles that currently regulate the multilateral trade in financial services are: the General Agreement on Trade in Services (GATS), the Annex on Financial Services, and Understanding on Financial Services. On the other hand, Ethiopia is in the process of acceding to WTO and one of the immense impacts of the accession process is on the service sector in general and the financial sector in particular. The financial policies of Ethiopia are highly restrictive in many ways and this will be one of the challenges the country may face during the negotiation process. The challenges arises due to the existence of incompatibility in the financial sector laws vis-à-vis rules of WTO in areas such Market Access Limitations, Transparency, Domestic Regulation of the financial sector and the competence of NBE.

Based on the discussions provided here above, it is submitted that the government may consider the following measures in its bid for liberalizing the financial sector under WTO system. The most important step to be taken by the government is to develop specific negotiation strategy in the financial sector that may serve as

guideline in the negotiation process during the accession process. The negotiation strategy needs to address evaluation of existing laws, evaluation of the capacity of domestic financial service suppliers, undertaking regulatory adjustments including prudential and supervisory regulations required for the implementation of WTO rules, preparing an action plan to prepare domestic service suppliers to face domestic and foreign competition, evaluation of schedule of commitments of other countries with particular attention to the type of limitation and qualifications they have included in their schedules in financial sector services. Such strategy should be supported by gradual approach of the liberalization process starting with taking some deregulation measures related to deposits and loans before initiating the full scale financial liberalization process.

After such preparatory works are done, the government needs to take measures related to opening up of the financial sector to foreign financial institutions as part of its commitments under GATS. This will be an important step that will contribute a lot in terms of creating efficient financial sector that may contribute its share in the socio-economic development of the country and help the financial sector integrate to the ever expanding global financial service. To address its concerns related to financial sector liberalization, the government can effectively utilize Art IV and Art XVI: 2 of GATS. For such purpose, it needs to develop what kind of market access and national treatment limitation it needs to maintain to protect its own socio economic policy objectives. The government needs also to develop qualification requirement, technical standards and licensing requirements for entry and participation of foreign financial service providers in Ethiopian market. In the process, the government may develop its own system to protect its financial objectives in terms of controlling the undue flow of capital and other pro poor initiatives. It can also develop subsidy and other supporting mechanisms within the framework of GATS.

Related this, the government need to reconsider some financial sector polices that are directly related to undertaking financial sector commitments under GATS. Such rules include the existing rules on foreign exchange and international payments. Even though, the government may have its own justifications to maintain existing strict rules on these services, to accrue the benefits of liberalization, it needs to relax its rules on international payments and movement of capital to and from

the country. The other measures need to be taken are related to developing the capacity of regulatory bodies, the judicial system and developing prudent financial regulations. In light of this, there has to be measures to be taken strengthening the capacity of the National Bank of Ethiopia (NBE) in terms of adopting and executing laws and its regulatory capacity of complex international financial transactions that may sooner or later come in the scene of domestic financial market. NBE needs to improve the transparency of its financial rules that deals with financial institutions. In addition to this, it is commendable the government strengthen existing judicial system by ensuring the independence and capability of judicial organs.

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