Opening Doors to the World

A New Trade Agenda for the Middle East

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Edited by Raed Safadi

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Introduction

Rapid advances in information and telecommunication technology are expanding the boundaries of tradability in services – the fastest growing component of both trade and foreign direct investment. Until recently, it was common to view the services sector as a collection of mainly non-tradeable activities with low productivity growth potential. This conventional view of services is fast changing; the development of certain services activities is increasingly being regarded not as a consequence of common growth but as one of its preconditions. Trade in commercial services has grown faster than trade in merchandise over the past decade.[1] Commercial services encompass transport, travel, insurance and financial services among others. Services now account for close to one-quarter of world trade. The internationalization of services will likely lead to the next stage of economic globalization.[2] Liberalization of trade in services provides for important new opportunities and at the same time brings new challenges for developing countries and for the countries in the Middle East and North Africa (MENA) region as well.

This chapter discusses the prospects for trade liberalization in services, specifically in financial services, for developing countries in general and Arab countries in particular. It is worth noting at the outset that assessing the impact of liberalization of trade in financial services is a difficult task. Meaningful data on flows of financial services by category and by trading partners are not available. Cross-country comparisons regarding the costs of providing the service do not exist.[3] Apart from the OECD data set for 1984-85, which was published in 1990 in restricted distribution,[4] other publications such as those of the International Monetary Fund (IMF) do not provide adequate data for empirical analysis of trade in financial services. Moreover, the analytical literature does not sufficiently cover the special economic characteristics of financial services that take place over time, that is, banking; or those between agents, such as retailing and wholesale.[5] Accordingly, this chapter adopts a cautious approach in its assessment of the prospects of freeing trade in financial

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services in selected Arab countries.

The chapter is organized in seven sections. The following section discusses the achievements of the Uruguay Round in the area of trade in services. The next section highlights the characteristics of trade in services, including trade in banking services, regulation and protection of services, and the different kinds of barriers to trade in financial services. Then, the chapter discusses financial liberalization and the issue of appropriate sequencing, and then compares the commitments undertaken in the General Agreement on Trade in Services (GATS) and those that are found in regional agreements with respect to liberalization in the services sector. The next section highlights the distinctive characteristics of the structure of the banking system and its regulation in selected Arab countries. The final section offers some concluding remarks.

The Uruguay Round

The Uruguay Round (UR) was the eighth time in which contracting parties (now Member countries following the establishment of the World Trade Organization on 1 January 1995) negotiated on a multilateral basis the reduction of tariffs and non-tariff barriers (NTBs) to trade. The UR was the most comprehensive and hence complex round of multilateral trade negotiations (MTNs) ever undertaken. It was entrusted with a comprehensive agenda which aimed, among other things, to deal with shortcomings of the General Agreement on Tariffs and Trade (GATT) which were undermining the institution's systemic integrity. The UR was in addition unique from the viewpoint of developing countries. More than ever developing countries engaged actively as their interests in the UR's outcome heightened. At stake were issues that concerned: (i) the extension of trade liberalization in traditional areas as well as in areas not yet covered by the GATT; (ii) bringing trade that has moved outside the multilateral framework back into the GATT; (iii) bringing discipline to the trade-related aspects of intellectual property; (iv) enhancing the provisions concerning trade-related investment measures; (v) providing a framework of principles, rules and disciplines on trade in services; (vi) improving the rules and dispute settlement system of the GATT; and (vii) the creation of a World Trade Organisation, and doing so as a single undertaking.[6]

The inclusion of trade in services and trade-related investment measures (TRIMs) under the umbrella of the WTO has brought a vast new sphere of economic activity within the purview of the multilateral trading system. While services exports accounted for some 17 percent of world trade in 1980, the share had risen to over 22 percent in 1993. Annual average growth in services trade was approximately 8 percent from 1980 to 1993, compared to some 4 percent for merchandise trade. Moreover, it is important to note that the preferred choice for delivery of many services is through commercial presence of a supplier in the jurisdiction of consumers. And foreign direct investment (FDI) in services industries has been the most dynamic component of international FDI flows (Safadi, 1997).

Notwithstanding the fact that the General Agreement on Trade in Services (GATS) is the most comprehensive attempt to negotiate services liberalization based on reciprocity, the Agreement is a cautious one. It provides signatories with ample scope to condition their multilateral commitments. The GATS rests on the concept of the most-favored nation (MFN) treatment. MFN is a general obligation, though its application is subject to a negative list approach to the extent that countries may invoke exemptions to MFN for specific industries and for a limited time. Market access and national treatment are, however, specific obligations in the sense that they apply only to identified services activities listed by each country in its schedule of commitments at the level of each mode of supply and subject to the limitations made explicit in the offer;[7] in other words, a conditional positive list approach has been adopted in defining the coverage of the commitments.

If one examines the commitments of developing countries (LDCs) with respect to trade in services in the Uruguay Round, it seems clear that the majority of these countries did not use the GATS negotiations as a vehicle to promote further liberalization of their services industries. This is not a surprising finding to the extent that the GATS results entail mainly a standstill promise in terms of protectionist policies, that is, a commitment not to introduce new distortions in the services sector. Nonetheless, LDCs covered fewer services in their commitments than did industrial countries. Tourism and travel–related services were the only activities in which a substantial number of developing countries made commitments. By late 1994, seventy eight developing countries had offered commitments in services, indicating their support for multilateral discipline for services.[8]

Table 1 breaks down the number of commitments in services activities by region. North America was the region most committed to liberalization of services activities, followed by Western Europe. The MENA region stands out as the one which offered the lowest number of commitments compared to other regions (106). As a percentage of maximum possible services commitments, the only other region which offered less than the MENA region was Africa. Thus, it is evident that the countries in the MENA region remain the least convinced of the necessity to subject their service providers to the rigors of international competition.

Table 1. Commitments on Market Access for Services

Country Group[9]	Number of commitments in services	Services commitments as share of maximum possible (%)
High-income countries	2423	53.8
Developing countries	2159	17.2
North America	193	59.9
Latin America	738	15.3
Western Europe	2002	59.2
Central Europe	351	43.6
Africa	396	9.8
Middle East	106	16.5
Asia	796	26.0

Source: GATT 1994. reprinted in World Bank (1995).

Trade in Services

Two particular features of services activities that distinguish them from production and trade in goods should be noted at the outset. First, production and consumption of a service may occur simultaneously, since no possibility exists of storing certain services produced now for consumption later. In such cases, a transaction requires that the consumer and the supplier of the service must be in one location. For other services, arms-length supply is not possible since the service is not transportable. This implies that if a government grants market access rights to foreign suppliers in relation to non-storable or non-transportable services, it may have to accept either that foreign enterprises can establish a commercial presence in its territory, or that the service suppliers in question may enter its territory on a temporary basis. Traditional banking and insurance services can, in principle, be supplied at arms-length since loans could be secured by mail or phone and insurance policies are often so purchased (Bhagwati, 1987). The second distinguishing feature of services activities is that they tend to be subject to a greater degree of regulatory supervision than are physical goods. In part, this reflects concerns about consumer protection, or in case of financial services, prudential issues.

International trade is traditionally seen as an activity involving the movement of goods across borders. However, a quarter of world trade flows, representing some $600 billion annually, is now accounted for by services such as banking, insurance and telecommunications (Watkins, 1992). These exports have become increasingly significant to the OECD economies where the services sector now accounts on average for half of national income (70 percent in the United States). This is not a surprising result in view of the fact that services industries rely heavily on information technology which is a high capital, high skill industry. In addition, OECD countries have been exhibiting the highest total factor productivity (TFP) in the services sector. For example, TFP in transportation and communication in OECD countries rose 2.4 percent on an annual basis during the period 1979-93, three times faster than the 0.8 percent overall TFP growth rate during the same period (World Bank, 1995). In summary, the export advantage in many services as revealed by existing patterns of trade in services, seems to lie substantially with the OECD countries.

Services account for nearly 20 percent of total exports of goods and services from OECD countries to developing countries, but only 7 percent of total trade flows in the opposite direction. Because LDCs are net importers of services, they have not offered wholehearted support to the GATS. Developing countries fear that many of their own services industries are insufficiently developed to withstand foreign competition.

Trade in Banking Services

The most used estimates of trade in services, in general, are derived from the IMF's reports on Balance of Payment (BOP). The reports use trade in invisibles to refer to transactions that relate neither to goods nor to capital flows. Remaining services, which appear in one miscellaneous category, cover a wide range of financial and non-financial transactions such as insurance, commissions, advertising, and so forth. Clearly, separating financial services on a functional basis using the BOP reports is not possible.[10] A direct measure of the value of each financial service traded internationally is required. As suggested by Whalley (1995), this measure should include all fees and charges received by domestic banks from non-residents and has to adequately cover the value of financial intermediation. It is worth noting that the treatment of financial services within an economy requires the same suggested improvement which should be reflected in the national accounts.

The methodology developed by Whalley (1995) to estimate international trade in banking services in three developed countries can in principle be replicated to derive similar statistics for the Arab countries, Turkey and Iran. Because the BOP estimates do not distinguish between the different components of receipts and payments related to banking services, Whalley constructed estimates for international trade in banking provided by domestic and foreign intermediaries:

> The method used involves applying estimates of the spread between deposit and lending rates both for US, UK, and Canadian banks and banks in their largest partner countries to corresponding data on assets and liabilities of both domestic banks with non-residents, and with non-resident banks with residents. These yield an estimate of the value of intermediation services provided by domestic banks to both depositors and borrowers abroad, and by non-resident banks to domestic depositors and borrowers. The combined financial intermediation charge is apportioned between the parties to calculate the internationally traded component. (Whalley, 1995, p. 29)

Whalley's results, which assume that the costs are borne equally by depositors and borrowers are summarized in Table 2 below. Unfortunately, most of the data required for this straightforward exercise are not available for any country in the MENA region.

Table 2: Estimates of International Trade in Financial Intermediation Services, US, UK, and Canada in 1984 (billions of US dollars)

	USA	UK	Canada
Estimate of exports of banking services	4.03	2.55	0.72
Estimate of imports of banking services	3.04	4.40	0.42

Source: Whalley (1995).

Regulation and Protection of Services

As has been stated earlier, regulation applies more pervasively to services than to goods' trade. Since fraud and sub-standard output may be difficult or impossible to detect and prevent before the damage is done, governments feel obliged to control supply ex ante rather than output on an ex post basis. Another consideration is that some services sectors, such as banking, have economy-wide effects, such that regulation erring on the side of caution is considered necessary to avoid the widespread damage that would be caused by specific sectoral failures. What this regulatory difference between services and goods implies is that, while local establishment by a foreign entity to provide a service will permit the fulfillment of local regulatory criteria, sale of such services from a base abroad will not. (Bhagwati, 1987).

Services industries are heavily protected by investment regulations. Such regulations are especially extensive in LDCs where governments regard the development of indigenous financial services industries as vital for both social and economic reasons. Hesitant LDCs regard some services activities, such as banking, as part of their infrastructure which they must control for political reasons. The structure of LDCs' banking sector illustrates some of the factors that underline state intervention. In the majority of LDCs, there are two sub-markets where the banking sector operates: a well diversified modern sector integrated with insurance and other operations, and a relatively underdeveloped rural sector. The latter, which serves the vast majority of agricultural producers, has limited access to capital and operates with lower returns because of income differentials between rural and urban sectors. Countries have several devices for protecting domestic suppliers of services from foreign competition. These include, inter alia, visa requirements, investment regulations and restrictions on the ability to repatriate earnings.

A feature common to many services activities is that they are used as intermediate inputs. For example, banking and insurance services translate to higher costs of providing the service. This not only impedes the development of efficient banking and insurance sectors and their ability to compete in the international market, but in addition, it hinders export opportunities of goods. The effects of protecting intermediate services are similar to those that result from raising the cost of intermediate inputs used in goods production. In some instances, such as in the present example of banking and insurance services, protective policies not only deny access to cheaper credit, but in addition, they deny exporters access to the entire vector of services that modern international banks can provide so as to facilitate international commerce. Therefore, the protection of intermediate services generates direct and indirect costs both of which have not been presumably properly assessed by LDCs (Bhagwati, 1987).

There is a wide variety of policy instruments that can be used to restrict access to markets. Five broad categories of policy instruments can be distinguished as impediments to trade in services:

i) measures that are quantity-based (that is, those that explicitly restrict the volume or value of transactions);
ii) those that are price-based;
iii) those that require physical or commercial presence in a market;
iv) those relating to standards, certification requirements and industry-specific regulations, and
v) measures relating to government procurement practices and subsidization.

Quantitative restrictions and standards are the most important access restrictions in the services context. Although import tariffs rarely impede trade in services, price controls are common. These involve either price-setting by government agencies and/or price monitoring and approval procedures. Examples of services activities that are subject to price controls in many countries include financial services.

Sapir (1985) argues that many modern services activities embody technology. The acquisition of these services is equivalent to technological transfer. Therefore, import of certain services leads to capital accumulation which will have a wholly beneficial effect on the development and future patterns of trade. The newly industrialized countries all have small positive patterns of trade, but they have been successful in accumulating human and physical capital.

Barriers to Trade in Financial Services

Barriers to trade in financial services have existed for many years, but in recent years they have experienced significant growth. Such barriers are measures that accord different treatment to competing domestic and foreign suppliers of the same financial service.[11] In the selected sample of countries in the Middle East, these barriers include one or more of the following:[12]

1. Discrimination against services supplied to the domestic consumers by foreign-based firms.
2. Limitations on the establishment of branches for foreign financial firms.
3. Various restrictions on the activities of foreign firms in the domestic markets, and so forth, restriction on the number of branches and their location and constraints on the transfer of profits.
4. Certain restrictions on the number of foreign staff and their movement in the host country.

These restrictions have existed for a long time and were introduced historically for different reasons. Exploring the underlying reasons will help us better understand the position of the sampled countries in respect of their hesitation to liberalize trade in services all the while providing some policy initiatives that would help to alleviate any possible negative effects of the removal of these barriers. These reasons can be grouped under six main categories:

1) OECD countries enjoy a comparative advantage over LDCs in the services sector. Recent regression estimates show that countries with relatively abundant human capital have a comparative advantage in insurance and other financial services.[13] One response may be to protect the financial service industry in LDCs. However, this response is based on a static understanding of comparative advantage. Accumulation of physical and human capital would help a developing country to gain a comparative advantage over time in certain financial services.

2) We argue that even if a developing country manages to accumulate physical and human capital, this would not be necessarily reflected in substantial gains in the international financial industry in which reputation has an

important role to play. Hence, efficient new entrants in the market of international financial services will not be able to compete with well-established firms, especially when customers are not adequately equipped to differentiate between the products supplied by the new and old firms through the study of their characteristics and attributes. So, if a developing country manages to improve its comparative advantage in financial services, a developed country would still be in a superior position owing to both its comparative and competitive advantages. This enforces the argument for protection or at least according a developing country a differential treatment in the competition game.

3) The previous two issues indicate that the infant industry argument may be a relevant one for the financial services industry in LDCs; they in addition help explain why the majority of LDCs were reluctant to offer more GATS commitments as they feared for the very survival of their domestic financial services industry. Their fear is justified by the fact that the internationally traded financial services are based on sophisticated technology and are capital-intensive, in both human and physical terms.[14]

4) The financial repression school views the sector as a source of cheap funding for the public sector and the state budget deficit in LDCs. This school believes that allowing foreign firms to enter the domestic market would jeopardize the stability of such funding and raise its costs.

5) The experience of LDCs with foreign banks, before and after independence, has not overall been very satisfactory. Foreign banks have been regarded as institutions that more often than not concentrate their activities in short term credits which are usually directed towards financing trade and a few services. They are also accused of cream skimming.[15]

6) In addition, LDCs had other reasons for erecting barriers to trade in financial services such as controlling key sectors of the economy as a way of ensuring their independence and national security; employment policy that favors the employment of nationals, and so forth.[16]

Financial Liberalization

Following the conclusion of the Uruguay Round and reaching a WTO deal on freer trade in financial services,[17] LDCs are now encouraged to liberalize their financial restrictions that discriminate between domestic and foreign providers. Technological innovations, especially in information technology, together with liberalization are contributing to rapid movement of capital across borders in pursuit of the best available returns, and that these flows are increasingly independent of trade in goods. According to Peter Drucker, "capital movements unconnected to trade – and indeed largely independent of it – greatly exceed trade finance." He cites two sets of figures to support this conclusion: first, the London Eurodollar market, where the world's financial institutions borrow from and lend to each other, turns over of world trade; second, foreign exchange transactions, in which one currency is traded against another, run to 35 trillion dollars a year – twelve times global trade in goods and services (Kakabadse, 1987).

No single event accounts for the outburst of capital flows, but the speed of change is such that the politics and economics of deregulation in capital markets have received less attention than they deserve. Deregulation in one financial market inevitably leads to some deregulation in another if the latter is to remain attractive to investors. Simultaneously, protectionist measures that discriminate against foreign suppliers are exacting heavy tolls on the domestic economy: this denies the economy access to new technologies and it limits the development of financial instruments. More efficient markets are being demanded by users as technology continues to decrease the economic distance among nations.

Although different countries may have different political reasons to move to deregulate their domestic markets, they all share the desire to stimulate competition and to attract more international financial business. Overall, the pronounced deregulatory drive reflects the intense competition between different financial centers and also the inability or unwillingness of governments and central banks to resist the changes that the accelerating pace of international capital flows is forcing upon them. As far as the banks are concerned, these changes are apparently quite timely because they coincide with the trend towards investment banking. Commercial banking (converting deposits into loans) is now less important than investment banking (the business of raising funds for customers by underwriting and dealing in securities). For many capital users, securities finance is cheaper and more flexible than loans. With tight government monetary policies limiting the expansion of banks in the foreseeable future, entry into securities has become for many banks the only option to grow. However, the commitment and costs of setting up competitive securities operations in the world's major markets are daunting.

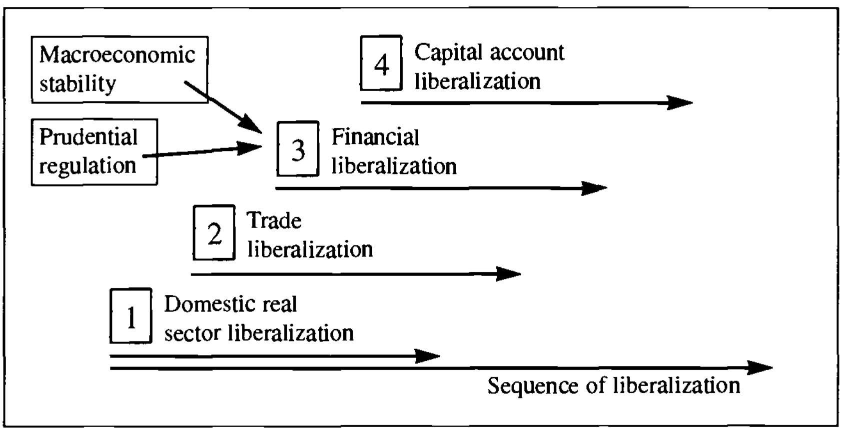
Successful banks will need the widest possible geographical reach, an ability to deal in all the big financial markets, a strong dealing team in securities backed by top-class research and technology, and a wide range of institutional and corporate contacts. International banking is going through a fundamental process of change. Traditionally, it was the jealously guarded flagship of each sovereign state but now it is under pressure to become a single and highly competitive world market with a much wider choice to borrowers and investors. Corporate strategy, once a luxury the banks could do without, is now a condition of survival (Kakabadse, 1987, pp. 29-43).

Sequencing of Financial Liberalization

It has been argued that "the main objectives of external and internal financial liberalization are the integration of the domestic financial market with the international market in order to improve the role of the financial markets in the allocation of resources."[18] However, judging from the liberalization experience in Latin American countries, it is argued that if the domestic financial sector suffers from financial repression and noncompetitive structure, then the external financial liberalization should take place after internal financial liberalization.

Despite the fact that the literature on the issue of sequencing is still inconclusive,[19] there is nonetheless a wide agreement, based again on the Latin American experience, that the domestic financial sector should be liberalized after the reform of the domestic real sector. It is also widely accepted that controls on capital movements should be maintained until the domestic financial sector and the external trade sector are liberalized and until the stabilization program is implemented.[20]

Figure 1: Sequencing of Economic Liberalization



Source: Mohieldin (1994), p. 40.

The capital account should be the last in the liberalization sequence as shown in Figure 1. Several reasons have been put forward in support of this recommendation:

1. It is argued that capital markets adjust faster to changes in incentives than goods and labor markets and hence need a shorter period to respond to liberalization measures.[21]
2. If the liberalization of the domestic financial sector is undertaken before that of the trade sector, this would result in a higher allocating of credit to

the tradable sector owing to the existence of trade barriers.[22]

3. If capital controls are removed before the full liberalization of the domestic financial sector, then capital flight would be inevitable.[23]
4. Further to the previous point, capital flows into an economy that lacks an efficient and a liberalized financial system may be inefficiently allocated.[24]
5. If the capital account is liberalized before the external trade sector, then capital inflows into the economy may result in an exchange rate appreciation. This, in turn, would undermine the competitiveness of tradable goods and add more difficulties to trade liberalization attempts.[25]
6. If the inflow of capital precede fiscal discipline, this may lead to further complication of the budget deficit problem.[26]

It should be said that the sequencing of liberalization outlined above should not be considered immutable. The initial economic condition, political environment and credibility of government have important contributions to sequencing decisions as well as the extent of success or failure of financial opening.

Regional Integration Agreements[27]

Considerable interest has been generated in recent years by the dynamism driving regional integration agreements and the lessons this may provide for other countries contemplating such initiatives. The formation of the North American Free Trade Area (NAFTA), the Central European Free Trade Area (CEFTA) and the South American common market formed by Argentina, Brazil, Paraguay and Uruguay (MERCOSUR), the continuous widening and deepening of the European Community, major developments in the Asia-Pacific Economic Cooperation Forum (APEC), preparatory work on a Free Trade Area of the Americas (FTAA) and a New Trans-Atlantic Agenda, and the range of initiatives elsewhere all provide evidence that the fever of regional trading arrangements has taken hold. It is worth noting that back in 1990, regional trading arrangements affected approximately 40 percent of international trade flows on a global scale, up from 30 percent during the 1960s.

The expansion of regional trading arrangements has generated its own competitive momentum. In a world in which national barriers are becoming so many self-inflicted wounds – a sure way of being isolated from increasingly global investment and production decisions – all countries are facing irresistible pressures to keep pace with market liberalization. Countries enter into free trade relations only to find others joining the race for fear of losing out on investment, technology and market access. And the time has come for countries in the MENA region to revisit this option.

For those familiar with the history of regional initiatives in the MENA region, the above proposition may raise more doubts than excitement. However, it would be erroneous to judge the chances of success of any new arrangement (or the injection of new life into existing ones) by the failures of the past. The underlying premise is whether or not the current policy environment in the region is different from the one that characterized earlier experiments.

First, a cursory examination of the trade instruments still "in vogue" in the MENA countries reveals the presence of a multitude of trade-inhibiting measures, be they at the borders (of the tariff and non-tariff barriers kind) or increasingly within each countries' borders.[28] Such a picture emerges even where account has been taken of the trade preferences countries in the region accord each other through a multitude of minilateral and plurilateral agreements. True, many countries in the region have started to shift direction, though the pace of implementation and the strengths of reforms vary significantly across countries. However, and as of this day, much remains to be done in order to end up with trade and payments regimes that will further promote the openness of markets to regional competition, and eventually to global competition.

Second, intra-regional infrastructure including the institutional kind that should facilitate intra-regional trade remains either absent or at best non-responsive. For example, the Inter-Arab Investment Guarantee Corporation (IAIGC) – which was set up in 1974 and started activities in 1975, provides guarantees against non-commercial risks for Arab investors, including guarantees for trade credits, and loans to promote investments within Arab countries. In 1993, the value of guarantee contracts signed by IAIGC amounted to US$ 14.4 million for investment contracts and (a mere) US$ 47 million for export credit contracts. Another pan-Arab institution, the Arab Trade Financing Program (ATFP) was set up in 1989 with the objective of promoting inter-Arab trade through rediscounting of trade financing instruments from member countries covering pre-and post-shipment finance, loans and lines of credit, and guarantees accepted if issued by IAIGC. Between 1991 and 1993, ATFP approved 94 applications for lines of credit totaling US$ 263 million.

The third and last aspect to consider in this respect is whether or not the economies in the region have become more interdependent in trade, finance, or production over the last two or three decades. If the answer is yes, this would be a positive factor favoring further integration efforts. Growing interdependence might manifest itself in numerous ways, including increasing intra-industry trade, a rising share of intra-regional trade in total imports or exports, or by increased trade in components that will be assembled in the importing country. Whether the comparative advantage of MENA countries has evolved along complementary (or competing) lines would also be a consideration, as would persistent regional trade imbalances (a negative factor). Space limitations do not allow a comprehensive analysis of all these factors. Suffice it to say that in 1995, intra-regional trade in the region accounted for 7 percent of the total trade, and that share has remained more or less constant, at least during the last decade. However, this apparently low level of intra-regional trade should be put in perspective as the countries in the region absorb a total of 4 percent of global exports; in other words, MENA countries trade amongst themselves twice as much as they trade with the rest of the world.

Moreover, MENA countries continue to exhibit divergent interests as each one of them finds itself at a very different stage of economic development than the other. Development disparities amongst MENA countries remain much wider than among any other group of countries that have attempted to integrate their economies. In 1993, per capita incomes in the region ranged from a low US$ 660 in Egypt to a high of US$ 21,430 for the UAE, a difference of over 32 fold. In contrast, the largest difference in the European Union in the same year was between Greece and Denmark: the first recorded a per capita income of US$ 7,390 while the second achieved a high of US$ 26,730, a difference of only 3.6 fold. By the same token, the divergence in incomes under NAFTA between Mexico and the United states is only sevenfold.

While the above may lead one to question the merits of new regional initiatives in MENA, the analysis that follows will show that such pessimism may not after all be warranted.

First, it is no revelation to state that in the past, regional trading arrangements had set themselves an ambitious scope. What is less known is perhaps the fact that the emphasis was on using regional integration arrangements to advance the goals of import substitution industrialization. The anti-export bias inherent in such a development strategy, however, tended to choke off opportunities for specialization, and hence retarded economic development and the opportunities to expand the export base of countries in the region in line with their comparative advantage. Fortunately, more and more countries in the MENA region are in the process of abandoning such policies.

Second, it is worth noting that much of the excitement surrounding the new regional trading initiatives around the globe reflects expectations about North-South arrangements,[29] and countries in the MENA region are no exception as evidenced by the large number of countries that are negotiating FTAs with the EU. Although these agreements may implicitly increase trade barriers against non-members (and so forth, factories that outsource inputs in the regional market may be forced to redirect their purchases in order to qualify as local producers), the concerned countries in the MENA region have demonstrated their willingness to pay this premium for the "insurance effect" of an FTA with a large country. Moreover, the potential investment-diversion effects of such an agreement generate an additional incentive for countries that are interested in attracting large transnational corporations. The FTAs with the EU, which should be concluded by 2010, would provide for free circulation of manufactured products, progressive liberalization of trade in agricultural products, liberalization of the right of establishment for companies, provision of trans-border services, and free movement of capital. There would be largely identical rules of origin among the different parties, mutual recognition of standards, a high level of protection of intellectual property rights and provisions concerning rules of competition. What is important to note in this respect is the potential role of the EU in new initiatives in the MENA region. Specifically, to the extent that the MENA countries that have concluded an FTA with the EU extend (at the very least) the same preferences they have granted to the EU to other regional partners, this would go a long way in promoting both opportunities for intra-industry trade among MENA countries through the rationalization of economic activities, as well as external and internal investment flows to the region.

Third, while unilateral liberalization by each of the MENA countries, at whatever speed and sectoral composition, is to be preferred to preferential liberalization, from a political perspective it might be easier to pursue such liberalization as part of coordinated efforts in the MENA region. Coordinated liberalization within MENA, coupled with an FTA with an industrialized country, could be politically useful as it serves to lock-in the liberalization in each of the countries since reversal will compromise the FTA with the industrialized country.

Fourth, the emerging regional arrangements are distinctive, and in many instances have been labeled as "new" because they have included for the first time ever ambitious liberalization agendas that cover not only trade in goods, but also trade in services, foreign direct investment, intellectual property rights and many other "market access" issues broadly defined. While regional trade liberalization requires the removal of border barriers to promote intra-regional trade, it has been increasingly recognized that the development of regional production systems requires deeper forms of integration of national regulatory systems and policies. Many countries in the MENA region have embraced, mainly on a unilateral basis, a reform strategy that addresses most if not all of these sectors, and their commitment to stay the course appears unrelenting.

The fifth and last point that gives rise to optimism has to do with changed attitudes in the region. MENA countries have accumulated a wealth of information and knowledge, not only in respect of the reasons that have led their integration attempts to falter, but equally importantly, they have assimilated the lessons of experiences of other countries that have successfully integrated. Thus, MENA countries are more aware today than ever before of the need to focus their initiatives on a small, modest core of issues initially, and gradually moving to more ambitious goals as confidence builds up. MENA countries have in addition learned the value of cooperation amongst themselves, and the benefits of good citizenry, be that in their own backyard or increasingly on a global scale.

The above projects hope that new initiatives in the region have the potential of being more influential and successful than earlier attempts. In part, this simply reflects the potential role of the EU in these new initiatives. Still, structural changes and progress in unilateral liberalization reinforce such a conclusion. Nevertheless, a word of caution: like previous attempts at regional integration in the area, they can easily become instruments for trade diversion favoring special interests at the expense of society at large. From this perspective, they may end up having more in common with their forerunners than one would wish.

GATS and Regional Integration Agreements

Should countries in the MENA region decide to further their integration attempt, the experiences of other regions, for example, the EU, NAFTA, and the Australia-New Zealand Closer Economic Relations Agreement (CER) may offer some useful lessons. Six criteria for comparison between regional agreements and the GATS have been used (Hoekman and Sauvé, 1994):[30]

1. the modalities and instruments that are used to liberalize access to service markets,
2. sectoral coverage,
3. disciplines regarding government practices in areas such as subsidization and public procurement,
4. enforcement/dispute settlement procedures,
5. rules of origin, and
6. safeguard provisions.

Whether regional liberalization of services should be viewed as a complement or substitute to multilateral liberalization depends on whether regional agreements effectively lead to significant liberalization and if such arrangements go substantially beyond what is already feasible in the multilateral context. Given the outcome of the GATS, a review of regional trade agreements among OECD countries that cover the services sector suggests that regional and multilateral agreements display a fairly strong degree of complementarity. One important reason for this is the fact that regional agreements appear to have been useful laboratories in which to experiment with ever more sophisticated rules and disciplines covering services, investment and government procurement. There has been a substantial amount of cross-fertilization between the regional agreements and the GATS. The decision to launch the GATS negotiation was heavily influenced by the EU program and the NAFTA. The progress that was made in the multilateral discussions was in part driven by the existence of regional liberalization agreements (Hoekman and Sauvé, 1994).

An important effect of the regional liberalization of services markets is to enhance the competitiveness of firms – whether producers of goods or services – located within the region. The costs of intra-regional exchange are reduced as services providers are induced to specialize and differentiate their products. The main issue then from a policy perspective is what the economic impact of regional liberalization of service markets will be, which in turn depends importantly on the extent of such liberalization.

The consideration of services in the trade policy context has revealed that standard political economy arguments apply as much to services as to goods, and are helpful in understanding why a regional approach to liberalization of service markets has been pursued. There is a need for reciprocal liberalization in order to satisfy political constraints: export interests must balance those groups that oppose the liberalization of domestic markets.

As Hoekman and Sauvé (1994) argue "the non-storability and intangibility of services create incentives to go regional." Because services tend to be non-storable, services transactions often require that the supplier of the service and the consumers interact. Not only will a physical presence often be necessary, but such establishment will be subject to regulatory regimes insofar as governments attempt to offset the quality uncertainty that is associated with the intangible nature of many services. For liberalization to be effective, some harmonization of regulatory regimes and agreement to recognize the standards and regulations of partner countries may well be needed. To the extent that this is feasible, it will be more easily achieved in a bilateral or regional setting.

This raises an important question: does the regulatory environment in which the banking systems operate in the selected countries satisfy the requirements for the liberalization of trade in financial services under the GATS or even under regional arrangements? We summarize these requirements in the context of a liberalized banking system with a competitive structure and an adequate prudential regulation. We provide below a profile of the banking systems in the selected countries. It is worth noting that our efforts are limited by the dearth of information on some of the issues under consideration.

The Arab Banking Systems: Structure, Regulation and Performance

During the last two decades some Arab banks managed to adapt to the changes in the political climate, economic conditions and advances in technology. However, the Arab banking sector remains non-competitive owing to heavy intervention by both governments and influential political groups in the functioning of the Arab central banks and the operations of the banking units. If we use nominal interest rate spread as a proxy for competition in the banking sectors of the selected countries, we find that Arab banking markets do suffer from lack of competition and inefficiency in financial intermediation (Table 3).

Table 3. Nominal Interest Rate Spread in Arab Countries

	1981	1983	1985	1987	1989	1991	1993
Egypt	5.0	4.0	4.0	5.3	6.6	....	....
Bahrain	....	....	....	2.5	....	....	....
Kuwait	2.3	2.3	2.3	2.3	2.3	0.4	1.8
Jordan	....	....	....	....	....	6.75	5.75
Lebanon	....	4.52	4.05	15.36	22.32	21.25	12.97
Tunisia	4.1	4.0	4.28	3.86	....	....	....
Morocco	1.0	0.5	-0.2	0.5	0.5	0.5	....
UK	2.58	-1.34	0.54	1.07	2.49	1.48	2.16
Korea	1.2	2.0	0.0	0.0	1.3	0.0	0.0

Source: IMF, International Financial Statistics Yearbook (1994).

The problems that plague the banking sector in the Arab countries can be attributed to several factors such as:

1. The structure of the banking system in Arab countries which is typically dominated by a few inefficient state-owned banks.
2. Heavy financial repression in the form of government intervention in setting interest rates and allocation of credit, in addition to imposing high required reserves and liquidity ratios.
3. Lack of central bank independence.
4. The prevailing of unfavorable economic conditions such as high inflation rates and vulnerability to external shocks.

Table 4 shows the structure, regulation and performance of the banking systems in the Arab countries. It is clear from the entries in the different cells that the selected countries are not completely ready to face up to the challenges of competition in the international financial market. Financial opening means that Arab banks have to deal with critical issues such as mergers and acquisition, improving the quality of services provided, cost reduction, and so forth. Banks in the Arab countries will find themselves forced to diversify their revenue sources, improve their capital adequacy requirements up to the international standards,[31] and to solve the problems of non-performing loans and excess liquidity.[32] Effective liberalization requires harmonization of regulatory practices among trading partners. Thus, it is clear that to capture the opportunities offered by freeing trade in financial services, Arab countries will need to adapt their regulatory environments and develop supportive physical and human infrastructure.

Concluding Remarks

Although the integration of financial services into the world trading system has been considered one of the most important achievements of the Uruguay Round negotiations, this however made today's trading environment a vastly complicated one for several reasons: first, the financial services sector is the largest and the most sophisticated amongst the sectors on which negotiations are still taking place. Second, liberalizing trade in financial services through the reduction or elimination of barriers to trade is a major undertaking in as far as the majority of LDCs are concerned, and that includes the majority if not all of the Arab countries. Liberalization of financial services requires detailed negotiations of within-border laws and regulations.

Due to lack of data we cannot determine whether the GATS provides significant and substantive liberalization of trade in financial services. However, given the structure, regulation and recent performance of the banking sector in the Arab countries, we argue that they do not meet the prerequisites of successful financial liberalization, and major steps are required to improve their competitiveness. Internal reform of the domestic banking system and external financial liberalization are complementary processes and should be undertaken with the right sequencing, taking into account the initial economic and structural conditions of the financial sector and the economy as a whole.

We argue that allowing foreign banks to enter the domestic market is not enough to weaken the monopolistic structure or to improve the efficiency in financial intermediation as incumbent banks may squeeze out the new entrants or collude with them. The experience of Egypt after approximately two decades of opening its financial market to foreign banks is a case in point.

The progress in negotiations in trade in financial services has not been accompanied by a concomitant improvement regarding the regulatory framework. We argue that the establishment of an appropriate international regulatory framework for trade in banking services has become a necessary condition for a stable and sustainable growth of the international financial market.

Table 4: Structure, Regulation and Performance of the Banking Systems in Selected Arab Countries

Country	Structure	Regulation	Performance and Prospects
Egypt	The banking system consists of 101institutions at the end of 1993. There are 44 commercial banks, including 4 state owned banks which dominate the banking system; 33 business and investment banks including 22 branches of foreign banks and 21 specialized banks; and 3 non-registered banks. Commercial banks account for 81 percent, 90 percent, 75 percent of total assets, deposits and loans respectively.	- In accordance with financial reform measures, that started with freeing interest rates in January 1991, a new law no. 37 of 1992 was promulgated. - This law raised the authorized and paid-up capital to $29 million and $14.5 million respectively. - The law also allowed foreigners to hold shares in banks and permitted foreign banks to deal in domestic currency. According to this law the Central Bank of Egypt (CBE) was granted further regulatory powers. The collapse of BCCI in 1991 made such increase of the powers of the CBF, justifiable. - A deposit insurance scheme was established according to the same law. - All banks were asked to adhere to the Basle standards on risk-weighted capital adequacy.	- The banking structure still suffers from the domination of public sector banks which will continue to be the major players in the banking sectors. - The problem of non-performing loans is still awaiting a solution. The banking system has an excess liquidity problem that reveals inefficiency in the intermediation process. - Foreign banks may find some profit opportunities from the privatization process and the development of the stock market.

Table 4: Continued (1)

Country	Structure	Regulation	Performance and Prospects
Lebanon	The banking system consists of 80 banks. 70 percent of total assets are held by the biggest 15 banks.	- Banque du Liban, which survived the Civil War, regulates the banking system. - The National Assembly may intervene in the central banking operations, for example, in 1991 it refused to pass a law that would have liquidated small banks that cannot meet the minimum capital suggested by Banque du Liban. - 10 percent of local currency deposits must be placed with the Central Bank, interest-free and a further 3 percent must be used for a compulsory purchase of law-rate-treasury bills.	- Before the start of Civil War in 1975 Beirut was the unrivaled banking center of the Middle East. Lebanon after the ending of hostilities in 1991 had the aspirations to regain its former position in the region and to compete with the business centers already established in Bahrain, Dubai and Cairo. - Many banks are under-capitalized because their equity was denominated in Lebanese Lira. However, banks had to meet a capital adequacy ratio of 6 percent in 1993 and 8 percent in 1995 in accordance with the Basle standard.

Table 4: Continued (2)

Country	Structure	Regulation	Performance and Prospects
Jordan	The Jordanian banking system consists of 8 commercial banks, 6 investment banks, 5 branches and 2 representative offices of foreign banks and an Islamic bank, in addition to specialized credit institutions for housing, agriculture and industry. Eight Jordanian banks had 31 branches in the West Bank and Gaza. Several banks have applied for opening and/or re-opening branches after the signing the Jordanian-Palestinian economic cooperation agreement.	- The Central Bank of Jordan (CBJ), regulates the banking system. The main aim of CBJ in the early 1990s was to curb the growth of liquidity using loans to deposits ceilings. - To attract foreign exchange, especially in from workers' remittances, foreign banks are now allowed to offer foreign currency investment portfolios for non-residents. - Interest rates have been liberalized. Foreign currency transfers are free from restrictions since February 1995.	- Four cases of bank failure had disturbed the financial sector in Jordan, in the late 1980s; Petra Bank was unable to provide the required reserves on its foreign currency deposits to the CBJ; the Jordan Gulf Bank suffered a serious liquidity problem; malpractice of the Mashreq Bank forced its closure; the Islamic Investment House was liquidated because of quality problems of its portfolio and divergence from the terms of its license. The four cases were met with firm decisions from the CBJ which restored confidence in the banking system. - Constrained by size of the economy, the Jordanian banking system will remain relatively small. The peace process may not necessarily widen the scope of the banking sector as it has two contradicting effects. Business opportunities may increase in accordance with cooperation agreements but Palestinian entrepreneurs who play a crucial role in the Jordanian financial system may choose to invest in Palestine rather than Jordan.

Table 4: Continued (3)

Country	Structure	Regulation	Performance and Prospects
Bahrain	The financial system in Bahrain is recognized at the international level as an offshore banking center. The offshore market was established as a result of oil euphoria. There are 18 commercial banks including 5 local ones. The two local banks account for 60 percent of local assets. There are also 22 investment banks of which there 6 locally incorporated institutions. The offshore market, which can be divided into locally incorporated and subsidiaries of banks as at the end of 1993. At the peak in 1984 there were 74 offshore banks.	- The Bahrain Monetary Agency (BMA), which replaced the old currency board in 1973, acts as a Central Bank and regulates the commercial, investment and offshore markets. The BMA, for historical reasons, is influenced by the Bank of England, and thus its deposit insurance scheme is modeled on that run by the latter.	- The Bahraini financial system, being based on offshore business, has been vulnerable to international financial changes; for example the National Bank of Bahrain has been negatively affected by the bond market crash of 1994. However, the performance of most of the local banks was sound as they issued healthy dividends. Despite the rise of Dubai as a competing center, it is apparent that Bahrain will continue to be a favored base for banks seeking syndicated lending and advisory business in the Gulf.

Table 4: Continued (4)

Country	Structure	Regulation	Performance and Prospects
The United Arab Emirates	There are 19 locally incorporated commercial banks and 28 branches of foreign banks. Despite the existence of 2 investment banks, in practice it is hard to discriminate between investment and commercial banking in the UAE. In terms of market share, five banks dominate the UAE banking scene.	- The Central Bank of the UAE, which is a federal body, regulates the banking system. - A few incidents have raised serious questions regarding the quality of regulation of the banking system in the UAE, for example, the closure of the BCCI and the failure of Niscorp. The case of the BCCI revealed that the banking system was subject to political influence that had overridden the regulatory framework. -The Central Banks must conform to Basle guidelines.	- It is hard to assess the performance of banks in the UAE as many banks do not operate according to the usual commercial criteria; some banks receive subsidies in a form of cheap deposits from their host Emirates and some of them are over-capitalized.

Table 4: Continued (5)

Country	Structure	Regulation	Performance and Prospects
Saudi Arabia	The Saudi banking system comprises 12 commercial banks, which are owned, wholly, or at least majority, by Saudi interests. There are also state development banks that extend subsidized loans, and so forth, to infrastructure and agriculture. Since 1988 the banking market has been closed to newcomers and no single license for operation was offered. Before 1976 foreign banks were allowed to operate in Saudi Arabia, but after that year they had to be put under majority local ownership through joint ventures.	- The Saudi Arabian Monetary Agency (SAMA), established in 1952, is the Central Bank. Although SAMA is granted considerable power over the banking units sometimes it can be paralyzed from performing its functions due to political pressure and civil groupings. For example one of the major commercial banks did not issue its financial annual accounts for two years, fearing that this would reveal the huge credit granted to influential persons without sufficient collateral. The bank became troubled with nonperforming loans beyond its provision and SAMA was not able force a solution to this problem.	- The banking system grew rapidly during the 1980s and early 1990s but started to shrink afterwards as a reflection of the general economic decline. However, with 15 percent return on average equity in 1993, the Saudi banks appear as the most profitable in the GCC.

Table 4: Continued (6)

Country	Structure	Regulation	Performance and Prospects
Kuwait	With assets of $26.3 billion the Kuwaiti banking system is the third largest in the GCC. In the late 1970s and during 1980s the banking system in Kuwait was comparable to that of Saudi Arabia, but after the Al-Manakh crash the economy was thrown into deep recession that had negative effects on the growth of the banking system. When some signs of recovery started to appear the banking system was hit by the Iraqi invasion. There are 6 commercial banks, 2 specialized banks and an Islamic bank. Foreign banks are not allowed to have branches or even representative offices. All commercial banks are wholly owned by Kuwaiti interests, that is, government or royal family. However, in order to attract foreign expertise, a law was passes in 1994, to allow foreign investors to hold up to 40 percent of local banks.	- All operating banks, except the Kuwait Finance House are regulated by the Central Bank of Kuwait (CBK). The CBK has been effective in applying a standard array of regulatory measures to monitor and control the banking system. Because of resistance of influential bank share holders, the CBK could not enforce the scheme of bank mergers that aimed to strengthen the banking system after the troubles of Al-Manakh financial crisis.	- The heyday of the banking system was before the financial crisis of 1982. Until the implementation of debt settlement scheme (DSS) all banks, except one, were technically insolvent and dependent on CBK subsidies. The DSS replaces bad loan portfolios with government bonds. By implementing the DSS, balance sheets of the banks were cleared out and the introduction of a disclosure standard improved the transparency of these banks. Nevertheless, the reduction of government bonds in bank portfolios is conditional on the government ability to recover the debts it took over from banks, which is doubtful.

Table 4: Continued (7)

Country	Structure	Regulation	Performance and Prospects
Tunisia	The banking system comprises 12 commerial banks, 8 development banks and 8 offshore banks and a merchant bank. There is not any significant problem facing the establishment of branches of foreign banks. The biggest bank in Tunisia is double the size of its nearest rivals in terms of assets.	- The Central Bank of Tunisia (CBT), which is granted some degree of independence, regulates the banking units. - The CBT is competent but there are complaints of its excessive intervention in the banking operations. Despite the adoption of some liberalization measures in 1992, there were more than 100 categories of credit subject to direct control of the CBT.	- The prospects of the Tunisian banking sector are limited by the size of its economy that despite intense efforts to develop remains a marginal one in the region. Hence, it is believed that the Tunisian banking market will continue to be a niche one in the Middle East. - It is argued that the country is 'overbanked' and considering the development of an offshore market in Morocco, the validity of a Tunisian offshore to serve the Mahreb region is questionable.

Table 4: Continued (8)

Country	Structure	Regulation	Performance and Prospects
Morocco	Since the early 1960s the banking system has been divided into three main parts: 2 state owned banks, other commercial banks owned jointly by local and foreign interests and 4 state-owned specialized banks.	- Bank Al-Maghreb, the Central Bank does not control exclusively the banking system or monetary policy. Regulation of credit institutions, control and disciplining, which are normally undertaken by a central bank are divided in Morocco between three separate bodies, which raises the issue of coordination problems. A new law was passed in 1993 to standardize the legal framework and to support deregulation measures undertaken by the government. Although the law covers all credit institutions, the three main development banks are exempted. The Central Bank in 1991 lifted credit ceilings and allowed some freedom for banks to set interest rates. In 1993 banks were asked to adopt the Basle standards.	- The recent creation of an offshore center in Tangier and the privatization of government shares started to bring a significant change in the banking structure.

Source: Based on Cunningham, A. (1995), pp. 27-49; pp. 73-112; 121-135; and pp. 155-171.

Notes

1 See World Bank (1995), pp. 43-55.
2 Ibid.
3 Whalley (1995), pp. 2-3.
4 Moshirian (1994), p. 327.
5 Whalley, op. cit., p. 4.
6 See Safadi and Laird (1996) for a comprehensive analysis of the Uruguay Round Agreements and their impact on developing countries.
7 Article I of the GATS defines trade in services in terms of four modes of supply. The first mode involves the cross-border supply of a service from one jurisdiction to another. The second mode of supply requires the movement of consumers to the jurisdiction of suppliers. The third mode of supply is through commercial presence of supplier in the jurisdiction of consumers. The is the investment mode which caused so much difficulty in the early stages of the services negotiations. Many developing countries argued that commitments on services transactions under this mode of supply were tantamount to a surrogate obligation on FDI, and they expressed unwillingness to ties their investment regimes in this manner. Finally, the fourth mode of supply entails the movement of natural persons from one jurisdiction to another.
8 World Bank, op. cit., p. 55.
9 The regional classification in the table corresponds to that of the GATT Secretariat.
10 On this issue see Appendix (A) in Whalley (1995).
11 Schultz (1993), p. 215.
12 Ibid.
13 See Sapir and Winter (1994), p. 283.
14 Schultz (1993), p. 218.
15 See for example Germidis and Michalet (1984).
16 Schultz (1993), p. 216.
17 The deal was reached on June 29th 1995.
18 Blejer and Sagari (1988), p. 20.
19 Williamson (1993), p. 25.
20 Ibid., Greenaway and Morrissey, op. cit., p. 257, Gibson and Tsakalotos (1994), p. 591, Hanson (1994), p. 337.
21 Greenaway and Morrissey, op. cit., p. 258.
22 Ibid.
23 Edwards (1990), p. 2.
24 Williamson, op. cit., p. 26.
25 Greenaway and Morrissey, op. cit., p. 257-258.
26 Williamson, op. cit., p. 26.
27 This section draws from Safadi (1996).
28 Once, trade policy was about regulating commercial relations between national economies. Now it is being extended beyond countries' borders and into an ever increasing number of areas that have traditionally been considered to belong solely in the domestic policy domain: standards and regulations, investment policy, competition policy, labor policy and environment policy.
29 The potential of North-South agreements to expand Heckscher-Ohlin type of trade (for example, trade based on differences in relative factor endowments) is significant.
30 See Appendix (1) for further details.
31 Arab countries except Saudi Arabia have been classified as high risk countries considering their capital adequacy standards.
32 *Arab Banking and Finance* (1994). pp. 9-10.

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Appendix 1: A Brief Comparison between the GATS, the EU, NAFTA and NAFTA

AGREEMENT CRITERIA	EC-92	NAFTA	CER	GATS
1) Modalities and instruments of liberalization.	Four freedoms: goods, services, capital, labor. Non-discrimination: all modes of supply liberalized. Mutual recognition of diplomas and certification of professional service providers. Harmonization of prudential and safety regulations. Implicit right of non-establishment. No exemption to general nondiscrimination requirements. Common labor market. Accession negotiations.	National treatment, 'reverse'-MFN, freedom of mode of supply, including right of non-establishment (no local presence). No grandfathering. Allows for exemptions to national treatment, MFN and local presence. No disciplines on non-discriminatory QRs., but all such measures to be listed. Ratcheting provision for unilateral liberalization. Abolition of residency requirements for professions. Generic blueprint for use by service providers seeking recognition agreements. Work programs on standards harmonization (land transport and telecoms). Accession clause.	National treatment and market access. Freedom of mode of supply, but right of establishment remains subject to national investment laws. Right of non-establishment. No residency requirements for professionals. Common labor market. MFN for excluded sectors. Encouragement of recognition agreements for licensing and certification requirements. Accession clause.	All modes of supply covered in principle. Transparency, MFN, and dispute settlement as basic general right of non-establishment. Encouragement of recognition agreements. No general disciplines on non-discriminatory QRs., but these prohibited under the market access article unless explicitly reserved.

Appendix 1: Continued (1)

AGREEMENT CRITERIA	EC-92	NAFTA	CER	GATS
2) Sectoral coverage	All services covered. Sector-specific directives and regulations. Common EC policy for transport.	Negative list approach to coverage. Universal coverage, except for air services subject to bilateral air agreements. Annexes on: reservations of existing non-conforming investment and cross-border services measures at federal and state/provincial levels; 'unbound' reservations in sensitive sectors; activities reserved for the state; exceptions to MFN; and existing non-discriminatory QRs. Separate chapters on telecommunications (access to and use of public networks and services); financial services; temporary entry of business people. Timetables for the liberalization of land transport and specially air services.	Negative list approach to coverage. Annexes for exceptions to national treatment and market access obligations. No indefinite exclusions. A number of reserved services were removed from reservation lists in 1992 review of the Agreement.	Positive list of scheduled sectors. Most air transport services excluded via an annex (indefinite). Other annexes deal with telecommunication (access to and use of public networks and services); financial services (complemented by an understanding of commitments on financial services); movement of natural persons.
3) Disciplines on related government policies	State aid subject to restrictions and monitoring. Government procurement of services, including construction, covered.	Government procurement of services and construction covered. Positive list for entity coverage; negative list approach for services coverage. No disciplines on subsidies for services.	Export subsidies for services prohibited. Government procurement of services and other subsidies exempted from national treatment obligation.	No disciplines for Government. procurement or subsidies. MFN obligation for subsidies. Subsidy disciplines to be negotiated in future. Services and construction procedures. under discussion in context of GATT code on Government. procedures.

Appendix 1: Continued (2)

AGREEMENT CRITERIA	EC-92	NAFTA	CER	GATS
4) Enforcement and dispute settlement	EC law has direct effect: supersedes national law. Enforcement by private parties and the EC Commission. Supranational court of justice. No service specific procedures.	Generic procedures apply to all covered areas under the Agreement. Binding dispute settlement available to determine whether relation in response to non-implementation of a panel finding is 'manifestly excessive'. Regime for investor-state arbitration for enforcement of obligations under the investment chapter. Retaliation between goods and services allowed, with the exception of financial services.	Informal and non-binding procedures. Only consultation required.	General procedures under the WTO. Consultation followed by panel. Strict time limits imposed for the various stages of the dispute settlement process. Non-implementation of panel findings may result in authorization of retaliatory measures.
5) Rules of origin	Incorporation in an EC Member Sates and headquarters or principal place of business in the EC.	National or incorporation for investment; substantial business activity within any NAFTA country for cross-border trade in services.	Nationality or residency for natural persons; incorporation for legal persons.	Nationality or residency for natural persons; incorporation under law of a Member State and substantive business operations in a Member; or control - ownership by nationals of a Member. Ownership requires more than 50 percent of assets; control requires the power to direct the actions of the enterprise.

Appendix 1: Continued (3)

AGREEMENT CRITERIA	EC-92	NAFTA	CER	GATS
6) Safeguards	Only one service specific provision relating to the common transport policy. General balance of payments and public health and safety provisions.	No service-specific safeguards, other than periodic review of bus and truck liberalization with scope for modification of phase-in schedule. Emergency protection for goods only. General balance of payments and public health and safety provisions.	Currently no safeguard measures for goods or services. A GATT-type Article XIX safeguard provision applied during the transitional period, which has now expired.	Provides for services-specific measures to safeguard the balance of payments and to protect service industries injured by import competition. However, specific rules on the latter to be negotiated. Also provides for modification of commitments, subject to compensation of affected Members.

Source: Hoekman and Sauvé (1994), Table (4), pp. 45-48.