

**International Trade in Services
in Selected ASEAN Countries:
Telecommunications and Finance**

Ramkishen S. Rajan
Rahul Sen

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Ramkishen S. Rajan
ISEAS Visiting Research Fellow

Rahu Sen
ISEAS Research Associate

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Abstract

This paper outlines the analytical rationale in favour of liberalization of trade in services with particular reference to the key infrastructural sub-sectors of telecommunications and finance and discusses the empirical evidence thereof. The paper goes on to offer an overview of the state of deregulation and the schedule of liberalization of the two service sub-sectors in three middle-income ASEAN countries, viz. Indonesia, Malaysia and Thailand. It compares their GATS commitments in these sectors with those made under a regional agreement (ASEAN Framework Agreement on Services or AFAS). An attempt is also made to synthesize the individual country experiences and extract common themes thereof.

1. Introduction

Service activities have constituted a large and growing share of production, employment, investment and trade. This in turn has led to profound structural changes in many countries, especially in middle and upper income developing ones.¹

Trade in services has conventionally been classified on the basis of the location of the service providers according to the following four-fold typology: (a) Mode 1: *cross-border supply* which are services supplied from one country to another (e.g. international telephony); (b) Mode 2: *consumption abroad* which refers to firms or consumers making use of a service across a national frontier (e.g. tourism and health services/medical patients); (c) Mode 3: *commercial presence* which occurs when a foreign company establishes a subsidiary or branch abroad to provide services in another country (e.g. foreign banks or telecommunication firms setting up operations in a foreign country); and (d) Mode 4: *presence of natural persons* which involves individuals travelling from their own country to supply services in another country (e.g. consultants, design or software engineers, or the temporary transfer abroad of employees of a multinational). In the first kind of transaction, production and consumption are “separated” or “splintered”, while the other modes require the

mobility of factors of production, consumers or both (Bhagwati, 1984 and Sampson and Snape, 1985). Mode 3 appears to be where the most multilateral negotiation activity has taken place thus far. Table 1, while somewhat dated, offers some indication of the global scale of each of the four modes of international service transactions.

Despite the vague statistical description of services, it is noteworthy that international trade in services has outpaced that of merchandise trade over the last decade (Figure 1). By 1999, commercial services trade accounted for nearly a quarter of world trade and an estimated half of global Foreign Direct Investment (FDI) stocks to all regions save Sub-Saharan Africa (World Bank, 2001a). Echoing the view of many an informed observer, Primo Braga (1996) has declared that the “internationalization of services is viewed as being at the core of economic globalization” (p.34). In similar vein the World Bank (2001a) has proclaimed that “(in) virtually every country, the performance of the service sectors can make the difference between rapid and sluggish growth” (p.69). It is in recognition of its rising importance that a multilateral framework for liberalizing trade and investments in the service sector was conceptualized in the form of the General Agreement on Trade in Services (GATS) initiated under the aegis of the World Trade Organization (WTO).²

Hoekman (2000: 39) observes that “the various measures of openness suggest barriers to competition are higher in transportation, finance, and telecommunications. These are also basic ‘backbone’ inputs that are crucial to the ability of enterprises to compete internationally... This suggests negotiating attention should focus on financial services, telecommunications and transport”. Insofar as the key transportation services (air and maritime) have been discussed extensively elsewhere (for instance, see Fink, Mattoo and Neagu, 2000 and World Bank, 2001a, Chapter 4 and references cited within), the focus of this paper is on trade liberalization in telecommunications and financial services.

The next section outlines the analytical rationale in favour of liberalization of trade in services. Particular attention is paid to empirical evidence on the impact of service trade liberalization on output growth. Section 3 offers an overview of the state of deregulation and the schedule of liberalization of the telecommunications and financial service sectors in three middle-income ASEAN (Association of Southeast Asian Nations) countries, viz. Indonesia, Malaysia and Thailand. The service sectors in

these countries constitutes roughly half their respective aggregate output levels. However, the share of commercial services (which includes finance and telecommunication services) in total world trade in services in the three countries has been much lower (Table 2). The low share of services in international trade is, however, somewhat misleading. As noted, trade in services often requires the simultaneous movement of factors of production (labor and capital in the form of FDI). In other words, a number of important modes of supply of services are not considered in the conventional trade statistics.³ In addition, some services such as transportation, insurance, and finance are vital in facilitating the production process and bringing manufactured and agricultural goods to the market. Other types of services are directly embodied in goods but may not explicitly be taken into account (e.g. design, software, repair work and other technical expertise). All in all, therefore, available statistics severely downplay the actual magnitude of international trade in services as many transactions go unrecorded.⁴ Section 4 compares the GATS commitments offered by the ASEAN countries in these two sub-sectors with those made under a regional agreement (ASEAN Framework Agreement on Services or AFAS). The final section offers a few concluding remarks.

2. Benefits From Liberalization of Services Trade

As noted, technical advancements have been a major reason for the growth and increased internationalization of service activities, as have regulatory reforms. The latter involves privatization and market deregulation through the breaking up of monopolies and reducing other “behind the border” measures such convergence in and mutual recognition of standards and certification, protection of intellectual property rights (IPR), opening of government procurement markets, streamlining of customs procedures, development of dispute settlement procedures, rights of establishment of and operation of a commercial presence by foreign firms, limitations on foreign ownership or requirements to enter joint ventures, non-discriminatory access to distribution networks, and the like.

2.1 The Theoretical Case

There have been a handful of theoretical studies on the role of services in the production process and international trade (e.g. Markusen, 1989; also see the survey by Sapir and Winter, 1994). At the risk of generalizing, notwithstanding some theoretical curiosities, the broad conclusion of these studies is that the positive static welfare effects of liberalizing trade in goods extend to services as well. Thus, an appropriately timed and sequenced liberalization of the service sector ought to provide the usual “Harberger Triangle” welfare gains by reducing, if not entirely eliminating, the wedge between domestic and foreign prices as well as permit the “rationalization of service activities along the lines of comparative advantage” (Deardorff, 2001).⁵ A number of developing countries have a comparative advantage and niche export opportunities in certain service activities, particularly professional and business ones (such as computer and office services), tourism, health, construction and transport. Consequently they have a substantial stake in an orderly liberalization of global service markets.

Beyond the direct effects on output and employment, as noted, the service sector is a key input in merchandise and agricultural production and trade. According to the World Bank (2001a: 76) “(a)s countries reduce tariffs and other barriers to trade, effective rates of protection for manufacturing industries may become negative if they are higher than they would be if services markets were competitive”. In addition, a relatively new phenomenon in trade in manufactured goods is “intra-product specialization”, broadly defined as the fragmentation of the process of production of a good into its sub-component parts and processes which in turn are distributed across countries on the basis of comparative advantage. As Arndt (2001: 25) notes, the “basic idea is to think of the region rather than the nation as the production base and to spread component production around the region in accordance with comparative advantage”. Such production fragmentation depends considerably on the reduction in transactions costs (i.e. insurance, transportation and ICT services) and is therefore facilitated by services liberalization (Deardorff, 2001). For instance, effective telecommunications liberalization is usually followed by a significant expansion of networks and a marked decline in prices. The liberalization of the financial service sector ought also to enhance the process of sectoral and intertemporal resource allocation, overall savings, investment and risk sharing. In addition to these direct static gains, as with trade in

goods, there are potential dynamic productivity and growth gains via technology transfer (particularly in cases where services are embodied in FDI), as well as due to the introduction of market competition (i.e. “X-efficiency”). Further welfare gains could accrue to consumers from the availability of broader product variety of specialized producer services as well as enhanced product quality (World Bank, 2001a).

An important caveat should be noted. Unlike trade in merchandise and agricultural goods, it is especially important to ensure that the deregulation of services is handled with care and, in particular, that the domestic regulatory environment is strengthened prior to and during the process of liberalization. The benefits from service liberalization are far from automatic. If deregulation and internationalization takes place prematurely, i.e. in a weak or ineffective regulatory and supervisory environment, there may be severe calamitous consequences on the sector in question as well as disruptions to the overall macroeconomic balance. As it is increasingly recognized, the issue is not one of *whether* to open up and integrate with the global economy in a market-consistent manner, but *when and how* to do so. Nowhere is this adage more pertinent than in the case of the service sector. Having said this, what is meant by “effective regulation” will vary based on the sector under consideration. (Admittedly, it might be difficult to distinguish between regulations that are necessary to minimize possible financial and economic disruptions and those that may have a protectionist goal or effect). For instance, effective regulation in the case of the telecommunications sector refers to pro-competitive regulation, while in the financial service sector it refers to prudential regulation (Mattoo et al., 2001).⁶

2.2 The Empirical Case

A perennial problem in economics — international trade in particular — is the jump from theory to empirics (Srinivasan, 2001). While theory provides a number of potential benefits of a well-timed and sequenced approach to liberalization of trade in services, what do empirical studies tell us about the magnitude of these gains? Notwithstanding the recent “revisionist view” of Rodriguez and Rodrik (1999), the bulk of the empirical literature using cross-country data has found international trade in goods to be growth inducing.⁷ While a number of studies have unearthed a positive

association between trade and growth, most are unable to conclude anything about causality per se. Does openness lead to growth, or does growth lead to openness? This is the focus of an important study by Frankel and Romer (1999). They deal with the potential endogeneity problem of the trade variable by instrumenting it with a set of variables usually used in the estimation of the gravity model for trade flows. While results vary on the basis of the specific data set and equations used, openness in general does have statistically and economically significant effects on growth.

What about the case of services? In view of the acute data problems, it should not be surprising that there is a dearth of empirical studies on the impact of service liberalization on growth. For reasons discussed above, one might expect, a priori, that the liberalization of services trade ought generally to have a relatively more stimulative effect on growth than merchandise trade. This is particularly so since services have hitherto remained relatively more protectionist than manufactured goods which have undergone decades of liberalization of quantitative, tariff and non-tariff barriers worldwide.

Econometric Evidence: Mattoo, Rathindran and Subramaniam (henceforth M-R-S for short) (2001) is a noteworthy econometric study on the impact of liberalization of the financial and telecommunications sectors on overall economic growth. Given the paucity of studies on this issue as well as the influence that it has apparently had on the World Bank (see World Bank, 2001a), it bears summarizing the main elements of the study in some detail.

M-R-S created a set of openness indicators for both the sectors under consideration. In the case of telecommunications, the index ranges from 1 to 9 with higher values signifying greater liberalization. The index is a lexicographic representation of these policy variables, viz. *competition*, *foreign ownership* and *regulation*, with the first element deemed as most important followed by the second. The first two variables indicate the degree of international market competition in the sector. A proxy for regulation is included in recognition of the importance of effective regulation in “ensuring access for rival service suppliers to the networks of incumbents on reasonable terms” (p.11). A country’s telecommunication sector is thus considered to be “fully liberalized” if the index value is 9 (Table 3).

As with the telecommunications sector, the liberalization index for the financial service sector consists of three components. The first two are similar, viz. competition and foreign ownership, but the third is an index for capital controls which was included in recognition of the close nexus between financial sector openness and capital account deregulation (see Bird and Rajan, 2001).⁸ The reason for excluding regulation in this sector as a measure of openness is that it “does not have the same competition promoting role that it does in the telecommunication sector” (Bird and Rajan, 2001:12).⁹ A country’s financial sector is considered to be “fully liberalized” if the index value is 8 (Table 4).

Having developed the indices for services liberalization, M-R-S run a series of cross-country regressions for a sample of 60 countries (37 of which are developing ones) for the period 1990-99. They estimate the following regression specification:

$$G_j = \alpha + \beta X_j + \gamma R_j \quad \text{for } j = 1, \dots, N$$

where G_j is the average annual growth rate of per capita GNP (adjusted for purchasing power parity) between 1990 and 1999 in country j , α is a constant term, X_j is the vector of standard growth controls for country j ¹⁰, R_j is a vector of the openness to trade in services for country j , and N represents the number of countries in our sample.

Considering indices for the telecommunications and financial sectors individually, M-R-S find that both indices entered with the right sign (i.e. positive), with the latter being statistically significant at the 5 percent level and the latter at the 10 percent level. Results are consistent if the sample is limited to developing countries. Thus, there is evidence to suggest that the greater the degree of telecommunications and especially financial sector openness, *ceteris paribus*, the greater will be average output growth. The evidence of the growth-inducing effects of financial sector openness (i.e. the Schumpeterian thesis of banking sector development facilitating economic growth through technological change and capital accumulation) has also been confirmed by a number of other studies (Beck et al., 1998, King and Levine, 1993 and Levine et al., 1998). In the case of telecommunications, Roller and Waveman (2001) have also found a positive linkage between a country’s telecommunications infrastructure and economic growth.

Table 5 reproduces results for the case of “complete liberalization” in both sectors, i.e. interaction of liberalization dummies of both sectors with the variable taking on a value 1 if both sectors are fully liberalized and zero otherwise. As it can be seen, the coefficient is once again statistically significant with a value of 0.015. This suggests that countries that have fully liberalized both their telecommunications and financial service sectors have tended to grow by an average 1.5 percentage points faster than others in the 1990s. The magnitude is even higher when the sample is limited to developing countries.

3. ASEAN Experiences

This section offers an overview of recent developments in the financial and telecommunications services sector in three ASEAN countries (Indonesia, Malaysia and Thailand) with particular emphasis on their liberalization commitments made at the multilateral level (as part of GATS). As it will be apparent, the country overviews preclude a systematic comparison of liberalization strategies and patterns across countries. As such, following the country overviews, an attempt will be made to synthesize and compare the nature of liberalization undertaken in each country. With regard to the financial sector, the focus will be limited to the banking and insurance sectors.¹¹

3.1 Indonesia¹²

The Indonesian authorities have taken steps to deregulate and open up a number of service sectors to foreign investment participation since the 1980s. Thus, infrastructure services (telecommunications, water supply, and electricity) were thrown opened to FDI in 1994-1995, while the banking sector was deregulated in the late 1980s and early 1990s. Under the GATS, Indonesia has made specific liberal commitments in the telecommunications, industrial, transport, tourism and financial service sectors and has upgraded its initial multilateral commitments in telecommunications (1996) and financial services (1997).

3.1.1 Telecommunications Services

With a wide territory comprising 13,600 islands and a large population of about 200 million, Indonesia’s telecommunications market is one of the world’s largest in terms

of potential for further development (only behind China and India in Asia). In 1996, the number of lines in service was about 4 million and the mainline penetration rate was about 2.1 per 100 inhabitants, but the sector experienced rapid growth, with an annual increase of 28 percent in the number of lines installed between 1992-1996.

The formulation of Indonesia's telecommunications policy has been under the purview of the Ministry of Tourism, Posts and Telecommunications (MTPT).¹³ MTPT's powers are broad in scope. It not only regulates competition in the industry but also grants new licenses, sets and controls tariffs for all services and also regulates technical requirements. The Directorate General of Posts and Telecommunications (DGPT) is responsible for the implementation, frequency management and standardization of the telecommunication network.

The development of the telecommunications infrastructure and provision of services was predominantly government-funded and run by state-owned monopolies (PT Telkom in the case of basic local and long-distance telecommunications and PT Telkom Indosat for international services). The Telecommunications Law of 1989 was Indonesia's umbrella telecommunications legislation that provided for partial deregulation and limited participation of private firms in the telecommunication sector. It drew a clear distinction between basic and non-basic services. In the basic segment, private firms were allowed to supply services as long as they cooperate with PT Telkom and PT Indosat by forming joint ventures, joint-operating schemes or some sort of management contracts. Thus, no entity is able to provide basic services in Indonesia without some sort of involvement of either of these two state-owned companies. This proviso does not apply in the case of provision of other services such as mobile telephony, data transmission, paging, Internet services, and satellite systems.

Universal service obligation (USO) is a major policy objective of telecommunication services in Indonesia. Thus, all service providers except PT Indosat are required to reserve a share of their investments to developing infrastructure and services for unserved or underserved areas.¹⁴ MTPT has granted a duopoly to PT Indosat and PT Satelindo for exclusive provision of international telecommunications services until the end of December 2004. The domestic telephone market has been opened up to new telecommunication operators in 1995. MTPT provided licenses to a five-member international consortia (working with PT Telkom) to expand network

facilities and supply telephone services in specified areas outside Jakarta and Surabaya.¹⁵ A second operator for basic international telecommunications services, PT Satelindo, which is a joint-venture company between PT Telkom, PT Indosat, Deutsche Telecom and other Indonesian private partners, was provided a license in 1993.

With regard to the mobile phone market, licenses were issued to seven operators in which PT Telkom, PT Indosat, private Indonesian investors and well-established foreign telecommunications operators are associated in a joint venture. Nearly 30 licenses were also issued to Internet services providers during the same time period. Paging services and data communications and satellite systems market have also been opened to competition.

These deregulation measures in Indonesia's telecommunications policy are reflected in its commitments under the WTO Agreement on Basic Telecommunications that entered into force in February 1998. Under this agreement, Indonesia bound its existing telecommunications regime and also committed itself to review its current policy. Indonesia's new telecommunications law (number 36/1999) came into effect on 18 September 2000. Under this new law, Indonesia will allow entry of new suppliers by 2005 for international telecommunications services, by 2006 for long-distance services, and by 2011 for local fixed line services. As of 1998, foreign equity participation in local companies in most segments of the telecommunications market was limited to 35 percent. As Abrenica and Warren (1999: 8-9) note, the aim of this "partial turnaround in the closed market policy...(was).. a bid to attract foreign investments in telecommunications infrastructure and raise the country's tele-density (which stood at 2.47 in 1997)". With respect to market access, there are no limitations on the cross-border supply and the consumption abroad of local and long-distance telephone services. As noted, with regard to commercial presence, Indonesia requires that foreign presence be in the form of a joint venture, joint operation scheme or management contract (joint venture only for cellular telephony).

3.1.2 Financial Services

Banking: While the Indonesian Ministry of Finance is responsible for the general policy framework governing banks, including the rules and regulations on the conditions of establishment of banks in Indonesia, international negotiations with

respect to market access are carried out jointly with Bank Indonesia (the country's *de facto* central bank), which is responsible for the daily supervision of banks and prudential control. Thus, while the Ministry of Finance has complete jurisdiction over the licensing (or withdrawal of licenses) of banks, the decision is subject to the letters of recommendation of Bank Indonesia.

The banking sector in Indonesia began a process of deregulation in 1988 wherein foreign banks were allowed to operate in the form of joint ventures, with minimum Indonesian equity of 15 percent, or through acquisition of a maximum equity share of 49 percent through an existing listed local bank in the stock market. These joint ventures were granted national treatment in the sense that they could engage in the same commercial operations as locally owned banks. Nonetheless, restrictions continue to be imposed on the number and location of branches, initially set at one per large city, as well as on the presence of natural persons (these limitations were reflected in Indonesia's GATS 1994 and 1995 Schedules). The banking sector in Indonesia witnessed a rapid expansion in the early 1990s; the number of banks approximately doubled while branches tripled. However, in the early 1990s, there were concerns about the soundness and safety of the banking system in Indonesia, with the increasing share of non-performing loans in total lending for state-owned banks. The 1997-98 regional financial crisis hit Indonesia particularly hard, resulting in the virtual decimation of the banking sector. The emphasis has since been on restructuring the sector.

Indonesia improved upon its GATS commitments under the WTO Financial Services Agreement (FSA or the fifth Protocol to the GATS) concluded in December 1997, which also came into force in March 1999. It undertook further supplementary commitments in the context of the IMF programme in January 1998. These new WTO and IMF commitments included: (i) enhance foreign participation in existing joint venture banks and increase by one the number of branches operated by foreign-owned banks and joint-venture banks in Indonesia's main cities;¹⁶ (ii) eliminate the economic needs test that was hitherto applied to the presence of natural persons and remove limitations on national treatment pertaining to capital requirements of foreign joint ventures; (iii) remove restrictions on foreign ownership in listed banks by June 1998 and allow foreign investors to increase (up to 100 percent) its ownership of a listed

local bank and further; and (iv) remove restrictions on branching to allow foreign banks and joint-venture banks to operate nationwide with unlimited number of offices and branches.

Insurance: The Ministry of Finance is responsible for the general policy framework, supervision, regulation and licensing of new companies in the insurance sector in Indonesia. All insurance products are to be supplied through a locally incorporated insurance company that may be either Indonesian or foreign owned, except for products not available in the Indonesian market. Foreign commercial presence in Indonesia in the insurance service sector can take place via a joint venture with an Indonesian firm or through participation in the capital of a listed company. Prior to the FSA, foreign ownership in joint ventures was restricted to 80 percent and to 40 percent in a listed company, and restrictions on intra-corporate movement of personnel and discriminatory capital requirements were in existence. However, under the FSA, Indonesia committed to the removal of ownership limits on foreign insurance companies and binding of up to 100 percent foreign ownership in domestic companies. Indonesia has also committed to promote greater flexibility in the movement of intra-corporate personnel for insurance companies and the removal of discriminatory capital requirements.

3.2 Malaysia¹⁷

Malaysia has attempted to liberalize the service sector in a graduated and progressive manner under the GATS framework. As part of its membership commitments to the WTO, Malaysia has signed and ratified the Fourth and Fifth Protocols of the GATS that encompass basic telecommunications and financial services, respectively. Beyond these, Malaysia's GATS Schedule has remained largely unchanged.¹⁸ Malaysia has *not* made any horizontal commitments covering cross-border supply and consumption abroad.¹⁹ Its commitments to permit commercial presence have generally been limited to joint ventures in which the maximum foreign equity permitted is 15 percent by a single or grouped foreign interest or to an aggregate foreign interest of 30 percent. (though holding of more than 30 foreign equity may be allowed on a case-by-case basis). National treatment provisions are in place for all land and real estate related

transactions with tax incentives and preferences offered to Bumiputras (indigenous Malays).

3.2.1 Telecommunication Services

The telecommunications service sector in Malaysia has been growing rapidly since 1997. Thus, the number of resident and business telephone lines increased from 3.8 to 4.4 million between 1996 and 1999 with a penetration rate (i.e. number of telephones per 100 persons) of over 20 percent in 1999. At the end of 2000, there were about 5.1 million cellular phone subscribers in the country.

The Malaysian government has an ambitious and well-articulated goal of ensuring convergence of telecommunications, broadcasting, and information technology (IT). To fulfil this objective, a new Communication and Multimedia Act (CMA) was passed in 1998 while a Communications and Multimedia Commission (CMC) was established the next year. The Ministry of Energy, Communications and Multimedia is responsible for the formulation of policies as well as long-term planning of the telecommunications sector, while the CMC is responsible for the supervision of the sector, with a view to encourage competition and ensuring orderly and efficient sectoral development. The licensing regime, which is under the purview of the CMA, is based on network and application services rather than telecommunications and broadcasting. The Minister for Energy, Communications has discretion in granting licenses, determining policies and issuing regulations, while the CMC advises the Minister and enforces policies and regulations.

In their efforts to establish Malaysia as a major global centre for communications multimedia information and other knowledge-based services, a Multimedia Super Corridor has been established. The Corridor is 50 kilometres long and 15 kilometres wide stretching from Kuala Lumpur City Centre in the north to the Kuala Lumpur International Airport at Sepang in the south. As of June 2001, there were six network facility providers with equity in four telecommunication companies partly held by foreign investors. The main provider is Telekom Malaysia Berhad with holdings of about 95 percent of the fixed line market. It has a *de facto* monopoly for providing the backbone infrastructure in the Multimedia Super Corridor.

In the cellular mobile communication sector, as of June 2000, there were five companies with eight licensed cellular networks providing services, with the largest company attracting nearly a third of total mobile subscribers. The number of Internet service providers since 1997 has increased from two to seven (five new licenses being issued in 1998). However, the two companies that had licenses earlier are the only Internet service providers in Malaysia offering nationwide coverage. No new licenses have been issued for basic and mobile telephony services since 1997, partly because the authorities regard the current number of providers as adequate. Under the CMA, individual licenses are granted to any entity other than a foreign company, an individual or a sole proprietorship and a partnership. The class license is granted to any persons or entities other than a foreign individual or company. However, an individual license is required for fixed line and mobile service providers. ISP (Internet service provider) services and content providers have been liberalized and now only require a class license.

Foreign equity participation of up to 30 percent is generally allowed in the network facilities provider business, as stated in Malaysia's GATS Schedule; higher participation is only allowed on a case-by-case basis. "Equal Access" to fixed-line services came into effect in January 1999. Under this scheme, subscribers have the right to choose any network to route their long-distance and international calls. Telkom Malaysia has thus far been the sole provider of universal services in Malaysia. Prior to 1999, Telkom Malaysia was subject to the universal service requirement without receiving any contribution from other licensed network operators, but thereafter, all network operators (including Telkom Malaysia) have been required to contribute to the cost of providing universal service.

There have been no discernible amendments to Malaysia's prevailing GATS Schedule of commitments in the telecommunication services, wherein Malaysia guarantees market access and national treatment for specific basic telecommunications services involving up to one-third equity of existing public telecommunications operators. Malaysia has not fully adopted the Telecommunications Reference Paper nor has it made any commitments for future liberalization of the market (Table 6).²⁰ Sector-specific commitments incorporated in Malaysia's GATS Schedule cover value-added services that are usually provided from channels or lines obtained from licensed

network operators. Market access through commercial presence is assured for data and transmission services, mobile data services and telex and telegraph services. Commercial presence is realized through a locally incorporated joint venture or via partial acquisition of an existing licensed value-added services operator.

3.2.2 Financial Services

Banking: All applications to provide any financial services including banking require the in-principle approval of the country's central bank, Bank Negara Malaysia (BNM). The operation of banking institutions is overseen by the Banking and Financial Institutions Act 1989, while the Islamic banks are governed by the Islamic Banking Act 1983. All foreign banks need to be locally incorporated to operate in Malaysia. Their parent banks are allowed to hold 100 percent interest in their Malaysian subsidiaries except for companies involved in insurance, fund management and securities brokerage. Foreign banks can extend loans only in partnership with domestic banks. Foreign banks are not allowed to establish new branches, including off-site ATMs. Although banking has remained the largest sub-sector, non-bank intermediaries have also been increasing their presence in Malaysia's financial sector.

As of June 2001, there were 27 commercial banks (including 2 Islamic banks), 12 finance companies, and 10 merchant banks licensed in Malaysia,²¹ nearly half of which were foreign owned and controlled about a quarter of total assets, gross loans, and deposits in the commercial banking sector.

There are significant restrictions on market access pertaining to commercial presence and hence foreign equity holdings in the financial service sector in Malaysia, depending upon the specific activity involved. Thus, financial companies involved in insurance, fund management, and securities brokerage are allowed up to 51 percent foreign equity and at least 30 percent equity from Bumiputras (indigenous Malays). However, for companies involved in finance/banking and venture capital, Bumiputras must locally hold 70 percent of equity with at least 30 percent equity. 100 percent foreign ownership is permitted for those companies involved in asset management provided that the companies manage only foreign investors' funds, if not only 70 percent of foreign equity is permitted. Similar restrictions apply to companies that are

engaged in offering investment services to the companies other than those within the same group.

Insurance: The insurance industry in Malaysia is regulated by the Insurance Act 1996, and offshore insurance is regulated by the Offshore Insurance Act 1990. As in the case of Banking sector, the BNM is in charge of the overall supervision of the insurance sector. The Labuan Offshore Financial Services Authority supervises offshore insurance activities. The insurance sector in Malaysia comprises life and general insurance, insurance brokers, adjusters, and registered agents. According to the latest available data, out of 63 insurers, 23 were foreign owned (WTO, 2001b). Foreign shares accounted for 72 percent and 36 percent of total life and general premium, respectively. As at December 2000, there were 83 offshore insurance as well as insurance-related companies in Labuan.

Entry of foreign insurers into the Malaysian insurance market is currently allowed through investment in existing insurance companies that are subject to an aggregate foreign shareholding limit of 30 percent. For existing joint venture companies in the insurance business, foreign shareholders that were the original owners of the companies are allowed to own up to 51 percent of the total shares. For the insurance sector as a whole, foreign equity ownership of up to 51 percent is permitted with at least 30 percent of Bumiputra held equity. As of October 2000, 7 new licenses for non-life reinsurance business and 1 license for life reinsurance business were issued to foreign reinsurers since 1995. In July 1999, BNM invited applications for 6 licenses for professional life reinsurance business offered under Malaysia's GATS Schedule. Apart from these regulations, the industry itself practises self-regulation through market agreements, rules and codes issued by the four mandatory associations representing general insurers, life insurers, insurance brokers, and loss adjusters.

3.3 Thailand²²

3.3.1 Telecommunication Services

The Telephone Organization of Thailand (TOT) is Thailand's sole supplier of domestic telephone services and provides services to neighbouring countries, viz. Malaysia, Myanmar and Cambodia. Its monopoly counterpart in most international services, telegraph, telex, and packet-switching services has been the Communications Authority

of Thailand (CAT). The two monopolies are, therefore, in competition for some services. Some of the services in this sector that have been partly privatized and are now provided by private operators include cellular phone market (four operators), domestic Very Small Aperture Terminal or VSAT (five operators), and paging (six operators). A total of 15 operators have thus far received concessions. The authorities have indicated that these concessions provide for revenue-sharing arrangements negotiated on a case-by-case basis with concessionaires. Under current government plans, these concessions are to be converted into joint ventures. There are 15 Internet service providers in Thailand operating under joint ventures and two joint ventures operating domestic high-speed leased circuit services. The CAT and the TOT both have the authority to establish prices, set the level of tariffs, access charges, and accounting rates, although for basic telecommunication services, the prices charged by CAT and TOT must be approved by the Thai Cabinet. Private operators are required to submit their prices to their licensors for approval.

No commitments were made in Thailand's 1994 GATS Schedule for activities like voice telephone services, telex and telegraph services, and facsimile services, indicating existence of a monopoly service provider. Thailand participated in the 1997 WTO negotiations on basic telecommunications services and bound both cross-border supply and consumption abroad of basic telecommunication services, subject to licensing and other requirements in its Schedule on Basic Telecommunications of April 1997. Among these requirements, service suppliers were required to be registered locally and foreign equity and shareholder participation was not allowed to exceed 20 percent. Thailand also undertook to introduce commitments regarding commercial presence in public local, long-distance, and international voice telephone services (as well as telex, telegraph, and fax) on the basis of proposed new communications legislation by 2006.

In 1994, Thailand's GATS Schedule covered database access and on-line information processing services, and five other services.²³ Different limitations have been scheduled for these various value-added services. Thus, cross-border supply was bound within the limits of the public monopoly described above and subject to radio frequency availability. Restrictions on foreign equity participation have ranged from 40 to 49 percent, depending on the activity. No commitments were made regarding the

supply of a number of value-added services in the telecommunication sector, viz. electronic mail, voice mail, electronic data interchange or enhanced facsimile. There was no additional commitment as a result of the 1997 WTO negotiations regarding value-added telecommunication services. Foreign telecommunications suppliers are not currently allowed to establish companies in Thailand. However, they are allowed to own up to 40 percent of the equity of registered Thai companies supplying basic telecommunications services for which concessions have been granted. Hence, current regulations would appear to be more liberal than those reflected in Thailand's WTO commitments.

3.3.2 Financial Services

In the aftermath of the East Asian crisis, the Thai government has been opening up its financial service sector to foreign investment in order to attract foreign capital and expertise, and enhance competition in this sector (Montreevat and Rajan, 2001). Apart from the initial commitments made by Thailand in 1993 under the GATS, new commitments on Financial Services agreed to in July 1995 with respect to insurance, banking and other financial services have been made through the Second Protocol to the GATS (the so-called Interim Agreement) and via the WTO financial services negotiations concluded in December 1997 in its Schedule annexed to the Fifth Protocol. This also included the elimination of the Most Favoured Nation (MFN) exemption of differential treatment of other members on a reciprocal basis.

Banking: The Bank of Thailand (BOT) is responsible for regulation and supervision of the commercial banking sector in Thailand under the Commercial Banking Act of 1962 (last revised in 1992). Since the East Asian crisis, Thailand's banking sector has been undergoing a period of intense consolidation (Rajan, 2001 and Bird and Rajan, 2002). The number of banks was expected to decrease from 15 to 13 at the end of the consolidation process.

With regard to cross-border supply and consumption abroad, there have been no changes in Thailand's market-access commitments in the financial sector save for insurance. These remain unbound with the possible exception of financial advisory services and financial data processing.

With regard to commercial presence, no limitations are placed on representative offices of banks. Thus, 21 foreign banks operated fully licensed branches in Thailand in mid-1999, up from 14 in 1995, while 15 foreign bank branches operated as offshore International Banking Facilities (IBFs) in Thailand under specified terms and conditions. Foreign bank branches are subject to certain operational restrictions. In principle they can operate up to three branches, but in practice, none of the foreign banks have yet been granted approval to open more than one branch. According to the authorities, there has not been any demand for licenses to open additional branches, notably as four local banks have been put up for sale. A limited number of foreign personnel per foreign bank office are allowed and this is governed by a specific set of conditions. Locally incorporated banks in Thailand enjoy a significant advantage over their foreign counterparts, as they are not limited in the number of branches.

Following legislative amendments in 1997, foreign investors are now allowed to hold up to 100 percent of shares in commercial banks, finance, and “credit foncier”²⁴ companies for a period of ten years, and thereby operate locally incorporated banks. Thereafter, foreign investors will not be obliged to divest their holdings but may not purchase additional shares until the proportion of total foreign shareholding falls to within 49 percent. Foreign banks that purchase a majority share in a local bank are allowed to continue operating that bank under the rules pertaining to locally incorporated banks. The amendments of 1997 also maintain the requirement that maximum foreign equity participation should remain limited to up to a quarter of paid-up registered capital, and that the combined shareholding of an individual and related persons should not exceed 5 percent of a bank’s paid-up registered capital, and that at least three fourths of the directors are of Thai nationality. However, the Minister of Finance may relax any of the above conditions for a particular bank if deemed suitable at its discretion. A similar decree was also issued concerning finance companies and credit foncier companies.

Insurance: The Ministry of Commerce in Thailand is the main regulatory body for overseeing the activities of the insurance sector. Thailand undertook a three-stage liberalization of the insurance industry from 1997. In the first stage, 25 percent of foreign equity participation in domestic insurance companies was allowed and approval

granted for setting up 25 new insurance licenses, out of which 12 were in the life-insurance business, and 13 were engaged in non-life insurance business. At the second stage, foreign equity participation is allowed up to 49 percent of registered share capital. In the third stage, foreign equity is allowed beyond the 49 percent limit after appropriate legal institutions are in place and have been in effect for five years.

Foreign insurance companies have played a significant role in the Thai insurance market, accounting for nearly half of total direct premia in the life insurance sector (as of mid 2001). Foreign insurance companies are able to sell life insurance policies to Thai residents, reflecting a high degree of liberalization of this sector. However, there are limitations on national treatment for life insurance services, with life insurance premia being tax deductible up to 10,000 baht only for holders of policies that are issued by locally licensed companies, that may be either domestically or foreign owned. Cross-border supply of non-life insurance services has remained unbound, except for international marine, aviation, and transit, together with all classes of reinsurance in Thailand's insurance service sector. Market access conditions for intermediaries and suppliers of auxiliary services have not changed, viz. a branch of a foreign insurance company cannot conduct the business of insurance brokerage and insurance agent; while foreign commercial presence remains limited to 25 percent of equity.

3.4 Synthesis of Individual Country Experiences

The analysis of the experiences of the three ASEAN countries in liberalizing telecommunication services has suggested that despite a common move to greater telecommunication openness, policy choices towards these goals have varied markedly (Fink, Mattoo and Rathindran, 2001). While the ASEAN countries have been among the first to liberalize the *fixed line* segment, the paths taken have varied.

Tables 7 and 8 summarize the state of *de facto* liberalization as well as specific GATS commitments of the ASEAN countries in the telecommunications services. Malaysia has made commitments in all but two value-added telecom services viz. Electronic Data Interchange (EDI) and On-line Information and/or data processing services. In comparison to these three countries, Thailand is at the other extreme, offering the least number of specific sub-sector commitments for liberalization, with

commitments in only two sectors of value-added telecom services. Indonesia too has been rather cautious in liberalizing value-added telecom services compared to basic services, “partly due to the fact that the state-owned enterprises PT Telkom (sole local and long distance service carrier), PT Indosat and PT Satelindo (exclusive providers of international services) are among the few firms that remain financially viable amidst the floundering political and economic environment.” (Abrenica and Warren, 1999, p.8)

In the case of the *mobile networks*, its pointed growth is more due to the introduction of digital cellular technologies along with reforms in terms of the opening up of mobile service provision to additional operators. Governments appear more willing to open up this segment of telecommunications as there is less political need to protect incumbent operators with state ownership (Fink, Mattoo and Rathindran, 2001). The mobile markets in the region are expected to receive a further impetus from the introduction of third generation (3G) mobile technology launched initially in Japan.

In short, there has been a clear preference for a policy of “managed competition” in many Asian countries including the ones under consideration. Fink, Mattoo and Rathindran (2001) correctly observe that there are relatively larger welfare gains to be obtained from an increase in competition than from a change of ownership. Convincing rationale for not introducing market competition are hard to come by; they may include technical limitations to competition (the scarcity of radio spectrum required for the provision of mobile telecommunications services is a case in point) or the existence of significant economies of scale (due, for instance, to substantial fixed costs of networks). In many cases, governments justify a graduated introduction of the incumbent suppliers by the usual “infant industry” type reasons as well as a means to assist in the “orderly exit” incumbents.

Reviewing the financial service commitments by a number of developing and transition economies, Mattoo (1999:23) has reached the following conclusion, which is just as applicable to the three Asian countries under consideration.

In broad terms, governments have adopted three different approaches to the financial services negotiations, assuming that they participated at all. These are: (i) to bind the *status quo*, which may have been arrived at after liberalization, either unilateral or in the context of the negotiations; (ii) to make binding commitments that represent less than the *status quo*

in policy terms; and (iii) to promise future liberalization, which may or may not have been planned prior to the negotiations. These categories are not necessarily mutually exclusive when the set of a country's commitments is taken as a whole, nor is it always easy to determine the precise category in which a policy position should fall. The distinctions are useful, however, in thinking about the relationship between WTO negotiations and domestic liberalization processes.

Table 9 summarizes the specific GATS commitments by the three ASEAN countries in financial services. As with a number of other countries, these countries have bound their multilateral obligations at less than *status quo*. The binding of commitments below status quo is a reflection of governments' dual objectives of trying to encourage foreign investments into the financial sector while simultaneously avoiding a repeat of the turmoil and instability following the premature and ill-sequenced liberalization prior to the regional crisis of 1997-98, not to mention providing some degree of protection to the incumbent national suppliers from immediate competition. As further evidence of this reluctance to move forward aggressively in its liberalization program, Table 10 summarizes the various grandfathering provisions (which guarantee ownership and branching rights of incumbent firms) undertaken by the Asian countries. As Mattoo (1999: 28) further observes

It is evident that grandfathering was primarily an Asian phenomenon. The grandfathering provisions reflect the relative emphasis in these negotiations on guaranteeing the rights of incumbents. They provide the benefits of security to investors who are already present in the market rather than to *new* investors”.

This said, all the countries, especially Thailand, have continued to take important steps towards the *de facto* relaxation on foreign equity limitations. There appears to be a clear policy preference for promoting foreign equity investments (ownership/divestment) over the promotion of market competition.

With regard to the insurance sector, entry limitations are accompanied by restrictions on foreign equity. There appears to be a relatively greater willingness to undertake more liberal commitments in the banking than the insurance sector (Tables 11 and 12), and there has been a relatively greater willingness on the part of these countries to commit to liberal consumption abroad than to cross-border supply.

4. ASEAN Framework Agreement on Services (AFAS)²⁵

The ASEAN Framework Agreement on Services (AFAS) was signed during the Fifth ASEAN Summit on December 15, 1995. The AFAS was aimed at enhancing co-operation in the service sector among ASEAN members by eliminating intraregional trade restrictions and expanding the scope of liberalization in services beyond those already undertaken under the GATS. In other words, the AFAS is meant to be GATS-plus.²⁶ Under the AFAS, initial negotiations focused on financial services, transport, telecommunications, tourism and professional business services. The initial package of commitments was endorsed during the 29th ASEAN Economic Ministers (AEM) meeting on October 16, 1997 in Kuala Lumpur, Malaysia. A second package of commitments was concluded at the 30th AEM on October 7, 1998 in Makati city, Philippines. A third package of commitments was approved during the 7th ASEAN Transport Ministers meeting in Kuala Lumpur, Malaysia in October 2001.

The remainder of this section compares the regional market access commitments made by the three countries under AFAS to their corresponding GATS commitments in the financial and telecommunication services outlined previously. This allows us to ascertain the extent to which the AFAS commitments are truly “GATS-plus”.

4.1 Indonesia

4.1.1 Telecommunication Services

Indonesia has offered commitments in the same sub-sectors in telecommunications services under AFAS as those committed under GATS, save for value-added services. Foreign equity participation in all these services has been restricted to 40 percent. These have mainly been in local, long-distance and international telephony services under basic telecommunication services and also in domestic mobile and paging services. Similar limitations on market access and national treatment apply as in the case of the GATS schedule in this sector, except that foreign equity participation has been limited to 35 percent under GATS. Thus, the higher level of equity participation under AFAS has been a GATS-plus offer extended by Indonesia to ASEAN members.

4.1.2 Financial Services

Indonesia has not made any specific commitments in this sector under AFAS and has only stated the general conditions for entry in the banking sector. Thus, its AFAS commitments do not cover insurance services at all. Even in the banking sector, no sub-sector specific commitments are detailed under its AFAS schedule. Comparing the general conditions for entry of foreign investors in the banking sector under GATS and AFAS, while it is stated under GATS that all limitations on market access commitments in the banking sector are to be eliminated by 2020 subject to similar moves by other members, the time frame for removing such limitations under AFAS is 2010, advanced nearly by a decade. This, therefore, is a GATS-plus feature.

The second GATS-plus feature in the AFAS schedule of Indonesia's financial services is that branch offices of foreign banks and those involving joint ventures can be opened in three more cities (viz. in Padang, Manado and Amban) under AFAS, compared to those already allowed under GATS (viz. in Jakarta, Surabaya, Semarang, Bandung, Medan, Ujung Pandang, Denpasar and Batam Island).

4.1.3 Summary

All in all, Indonesia has made a few GATS-plus commitments in both the telecommunication and financial sectors under AFAS.

4.2 Malaysia

4.2.1 Telecommunication Services

Malaysia has offered commitments in sub-sectors in telecommunications services that are identical to those offered under GATS, i.e. all categories of services except for electronic data interchange (EDI) and on-line information and/or data processing services (Table 13), with aggregate foreign shareholding restricted to up to 35 percent. Apart from these, similar limitations on market access and national treatment apply as in the case of the GATS schedule in this sector. In the third package of AFAS commitments, Malaysia has restricted aggregate foreign shareholding in Data access and transmission and mobile data services to 30 percent and up to 35 percent for ASEAN nationals. It has also allowed entry of two experts/specialists in the two

sectors for maximum period of two years under mode 4, subject to domestic regulations, which was hitherto unbound in its earlier package of AFAS commitments.

4.2.2 Financial Services

Under the AFAS, Malaysia has offered commitments in the areas of advisory, intermediation and auxiliary financial services, including credit reference and analysis, investment advice on acquisitions, corporate restructuring and strategy, operational headquarter (OHQ) for financial sector, and in life and non-life insurance services (Table 14). However, the schedules indicate that, as in the case of GATS, limitations on market access and on national treatment under AFAS pertain mostly to presence of natural persons (Mode 4) as opposed to commercial presence (Mode 3). Temporary presence of natural persons in these services (excluding OHQ and insurance) has been offered only when supply of services is via commercial presence under AFAS which was kept unbound under GATS. While entry is limited to a maximum period of five years, the number of posts that can be offered to foreign experts are restricted. There have, however, been some GATS-plus offers. One instance of this is, under AFAS, three foreign nationals are permitted to set up representative office for advisory, intermediation and auxiliary financial services, including credit reference and analysis, investment advice on acquisitions, corporate restructuring and strategy.

4.2.3 Summary

Overall, while a few GATS-plus features are apparent for Malaysia's financial services sector in Mode 4, the GATS-plus feature(s) observed under the AFAS commitments made in Malaysia's telecommunication sector pertain to limits on foreign equity shareholding of up to 35 percent in telecom sector (more specifically for ASEAN nationals in some areas) compared to 30 percent under GATS (Mode 3) and to entry of two professionals in certain sub-sectors under Mode 4.

4.3 Thailand

4.3.1 Telecommunication Services

Thailand's commitments under the AFAS schedule covers domestic Very Small Aperture Terminal (VSAT) services (not covered under the GATS Schedule),

telecommunications terminal equipment leasing services, telecommunications consulting services and database access services, with the requirement that cross-border suppliers use the public telecommunications network for VSAT operators. There are no limitations on telecommunications terminal equipment leasing services through commercial presence (Mode 3) as long as foreign equity is below 49 percent. However, VSAT operators are subject to a 40 percent maximum level of foreign equity and shareholder participation through the same mode. Commercial presence in this sector under AFAS is subject to the same limitations on market access and on national treatment as those applying to Thailand's horizontal GATS commitments.²⁷ Commercial presence in Database access services are allowed only for a Thai registered company with foreign equity participation below 49 percent of the registered capital, on the basis of a build-transfer-operate system. There are no commitments under AFAS by Thailand in the other major sub-sectors of telecom services.

4.3.2 Financial Services

Under the AFAS, Thailand has made no commitments in banking and insurance services but it has made commitments in the area of securities brokerage, securities dealing, and underwriting services, as well as in collective investment schemes involving asset management companies. A maximum foreign equity participation up to 100 percent of paid-up capital is allowed in these areas. However, the schedules indicate that there are significant limitations on market access and on national treatment in these areas, mostly those prevailing in its GATS schedule. Notably, market access share is limited to acquisition of existing companies and has been unbound for new licenses.

4.3.3 Summary

Overall, Thailand's AFAS commitments in both these sectors have not really been GATS-plus offers in the sense that far fewer sub-sectors have been committed for liberalization by Thailand under AFAS compared to those under GATS. The only possible GATS-plus feature observed under the AFAS commitments made in the financial services sector pertains to limits on foreign equity shareholding up to 100 percent of paid-up capital, compared to 49 percent under GATS.

5. Concluding Remarks

The paper has outlined the theoretical and empirical rationale for liberalization of trade in services and has attempted to assess the state of liberalization and the policy environment of the financial and telecommunications sub-sectors in three ASEAN countries, viz. Indonesia, Malaysia and Thailand. While the country experiences indicate a general move towards greater deregulation and privatization, a close comparison of actual policies with the offers made by these countries under the GATS schedule reveals that many of the multilateral offers made have been at status quo or below it (i.e. “water” in the liberalization commitments). Similarly, the countries have been very cautious in committing themselves to GATS-plus offers and have made little progress in liberalizing service trade in the two sub-sectors at the regional level. Indeed, Austria and Avila (2001) note that the request-and-offer approach adopted by ASEAN negotiators under AFAS has been rather time consuming and has had negligible impact on services trade among the member countries. The multilateral approach via the GATS appears to have been relatively more effective in promoting trade liberalization in services in the ASEAN region.

This view is strongly supported by Nikomborirak and Stephenson (2001:7-10) who note that

Bolder and more far-reaching commitments have been made in GATS rather than under the AFAS....the liberalizing content of commitments members made in GATS have been often watered down, rather than furthered in AFAS. The lack of progress can be contributed to four key factors namely, the lack of political will and genuine commitment to open up the service market, weaknesses in the negotiation framework, legal restrictions and institutional limitations.

In the final analysis, as with the case of liberalization of trade in goods, liberalization of trade in services could involve fairly painful temporary/short-term adjustment costs that need to be appreciated and appropriately managed. In addition, services liberalization in particular requires that the institutional and regulatory environment be fortified prior to and during the process of liberalization. Deregulation in a weak or ineffective regulatory and supervisory environment could cause severe instability in that sector and the overall economy in view of the important linkages that services have to the rest of the economy. This was made clear by the East Asian crisis

of 1997-98 which was partly due to the premature, i.e. ill-timed and ill-sequenced, financial liberalization.

NOTES

1. As classified by the World Bank according to income, these cover Newly Industrializing Economies (NIEs) in East Asia, Oil producing countries in the Gulf region and Israel. The share of value added of the service sector in national income in such economies increased continuously between 1980-2000 period, accounting for nearly 60 percent of GDP in 2000. The annual growth of the service sector in developing countries was positive over the past two decades and averaged almost 6 percent during the entire period (World Bank, 2001b).
2. See Hoekman (2000), Hoekman and Mattoo (2000) and Mattoo (2001a) for recent discussions on the GATS.
3. The World Bank (2001a) has noted that “(t)he available evidence suggests that commercial presence has been the most dynamic mode of services supply in recent years” (p.72).
4. In recent years, a number of the multilateral institutions have taken significant steps to improve the quality of cross-border services transactions. See, for instance, the UN-ESCAP’s website on this issue: <http://esa.un.org/unsd/tradeserv/> as well as that of the World Bank: http://www1.worldbank.org/wbiep/trade/services_data.htm.
5. Assuming demand elasticity = ϵ and tariff rate or tariff equivalent = t , the size of the welfare loss, in a partial equilibrium analysis, i.e. the Harberger Triangle, is simply $t\epsilon^2/2$. So if the tariff equivalent is ten percent and the elasticity of demand is one, the welfare loss is just half of one percent (of consumer expenditure). Most empirical studies measuring these welfare losses do find them to be about this level (Baldwin, 1992). Does this imply that trade protectionism is not “significantly” harmful? The answer is *no* for at least three reasons. One, Tullock (1967) has noted that even in a static setting, the welfare costs of protectionism may actually be a much larger “Rectangle” once the costs of monopoly power, tariffs, rent-seeking activities or other pre-existing distortions are all taken into account. Two, once again in a static sense, Romer (1994) has argued strongly that the non-rivalry of many goods which enter as inputs (like blueprints) implies that if such goods (characterized by large fixed costs and constant marginal costs) are impeded, there could be potentially large losses to the economy (as much 10-12 percent of GDP). Three, there could be a host of other dynamic gains to be obtained from trade and introduction of competition in terms of scale economies, technological innovations, etc. (Grossman and Helpman, 1991).
6. In fact, concerns about loss of monetary and financial controls led to an insertion of an “Agreement of the Annex on Financial Services” which includes a provision to the effect that member countries are free to take measures for prudential reasons to protect the integrity and stability of the financial system. This clause is generally referred to as the “prudential carve-out” clause.
7. Srinivasan (2001) provides a string critique of the revisionist view. Other recent studies that have found a positive association between openness and trade include Coe et al. (1997), Dollar (1992), Edwards (1993, 1998) and Sachs and Warner (1995). Additional references are cited in Rodriguez and Rodrik (2000).

8. Since no data are available on national policies on competition and foreign ownership, M-R-S infer them from the countries' commitments under the GATS (see section 3). Since some countries (like Brazil) have *de facto* liberal regimes, the authors made appropriate adjustments to the rankings to reflect this.
9. M-R-S do go on to note that "the omission may nevertheless be serious because the quality of banking and prudential regulations is of paramount importance in addressing systemic risk" (p.12).
10. The standard growth controls used by M-R-S include the natural log of per-capita GNP in 1990 (the convergence variable), investment rate (lagged value), schooling ratio (human capital), government consumption to GDP ratio (as a proxy for government size and magnitude of government induced distortions), the inflation rate (as a proxy for macroeconomic imbalances), proxy variables for political and institutional stability, geographical and regional dummies, and an index of tariff and non-tariff barriers.
11. Mattoo (1999:9-10) notes:
"Financial services under the GATS consist of insurance services and banking and other financial services. Insurance services encompass direct insurance (life and non-life), reinsurance and retrocession, insurance intermediation, and auxiliary insurance services (including consultancy, actuarial, risk assessment and claim settlement services). Banking and other financial services are defined under GATS to include acceptance of deposits, lending, financial leasing, payment and money transmission services, guarantees and commitments, trading (in money market instruments, foreign exchange, derivative products, exchange rate and interest rate instruments, transferable securities, and other negotiable instruments and financial assets), participation in issues of securities, money broking, asset management, settlement and clearing services, provision and transfer of financial information (including data processing), and advisory and intermediation services".
12. This section draws on information from WTO (1998a,b, c).
13. The Ministry of Tourism, Posts and Communication was renamed the Ministry of Communications in March 2002 when a new Ministry of Culture and Tourism was established.
14. As part of the joint operation scheme, PT Telkom and its partners are required to allocate 20 percent of their annual investment on installations in unserved or underserved areas regardless of commercial considerations.
15. Each of the five consortia included at least one foreign telecommunications company.
16. According to Indonesia's GATS Schedule, branching is also subject to geographical limitation (limited to eight cities or regions in Indonesia).
17. This section draws on information from WTO (1998a,b and 2001b).
18. The various sectors in which Malaysia has made commitments under the GATS schedule include professional services (such as legal services), communication services, construction and related engineering services, financial services, health related social services, tourism and travel related services, and transport services.
19. Horizontal commitments refer to those commitments that apply to all service sectors in a given mode of service provision.
20. The Telecommunications Reference Paper refers to avoiding anti-competitive practices, manners and processes of managing licensing, the terms on interconnectivity, the right to develop a universal service policy, and such. The importance of a supervisory body independent of any supplier of basic telecommunications services is also emphasized. See Abrencia and Warren (1999) for details.
21. In 1995, there were 37 commercial banks, 40 finance companies, and 12 merchant banks licensed in Malaysia. No new banking licenses have been awarded since 1997 except for offshore banking licenses.
22. This section is based on WTO (1998a,b and 1999).

23. These are sales and consulting services, videotext, teleconference, and domestic leased circuits.
24. Credit foncier companies are essentially non-banking financial intermediaries dealing in immobile properties (Dobson and Jaquet, 1998).
25. This section draws on information from the ASEAN Secretariat (1998 and 2002a and b).
26. This sort of preferential treatment in service trade among regional groupings is permitted under WTO rules, provided that the agreement covers “substantially all” sectors, and eliminates discrimination among members to a substantial extent as well.
27. These are that (i) foreign equity participation should not exceed 49 percent of the registered capital, and (ii) that the number of foreign shareholders should be less than half of total shareholders in the company concerned (ASEAN Secretariat, 2002a).

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About the authors:

Ramkishen S. Rajan is a Senior Lecturer at the School of Economics, University of Adelaide, Australia and Visiting Research Fellow at the Institute of Southeast Asian Studies.

E-mail : ramkishen.rajan@adelaide.edu.au

Rahul Sen is a Research Associate at the Institute of Southeast Asian Studies.

E-mail : rahul@iseas.edu.sg

Table 1
International Transactions in Services by Mode of Supply, 1997

GATS Mode of Supply	Category	Value (\$ Billion)	Cumulative Share (percent)
Mode 1	Commercial services (excl. travel)	890	41.0
Mode 2	Travel	430	19.8
Mode 3	Gross output of foreign affiliates	820	37.8
Mode 4	Compensation of employees	30	1.4
TOTAL	--	2,170	100.0

Note: Modes 1,2 and 4 are derived from balance-of-payments data
Source: Karsenty (2000)

Table 2
Major Statistics of the Service Sector

Country	Average annual growth of service sector		Share of Services Sector Value Added (as % of GDP)		Rank as World exporter of	Rank as World importer of
	1980-90	1900-2000	1990	2000	commercial services	commercial services
	Indonesia	6.5	4.0	41	36	39 (0.3)
Malaysia	4.9	7.2	43	48	26 (0.9)	25 (1.2)
Thailand	7.3	3.7	50	49	28 (1.0)	28 (1.0)

Source: WTO (2001a), and the World Bank (2001b)

Table 3
Methodology for Constructing Telecommunication Index of Openness^a

Rank	Market Structure	Ownership (FDI)	Independent Regulator
9	Competitive	FDI allowed	Yes
8	Competitive	FDI allowed	No
7	Competitive	FDI not allowed	Yes
6	Competitive	FDI not allowed	No
5	Not Competitive	FDI allowed	Yes
4	Not Competitive	FDI allowed	No
3	Not Competitive	FDI not allowed (private)	Yes
2	Not Competitive	FDI not allowed (public)	Yes
1	Not Competitive	FDI not allowed	No

Note: a) Rankings are assigned on a basis of a lexicographic scheme discussed in detail in source
Source: Mattoo, Rathindran and Subramaniam (2001)

Table 4
Methodology for Constructing Financial Index of Openness^a

Rank	Market Structure	Foreign Equity Permitted	Capital Controls (Dailami Index)
8	Competitive	≥ 50%	≥ 1.6
7	Competitive	≥ 50%	< 1.6
6	Competitive	< 50%	≥ 1.6
5	Competitive	< 50%	< 1.6
4	Not Competitive	≥ 50%	≥ 1.6
3	Not Competitive	≥ 50%	< 1.6
2	Not Competitive	< 50%	≥ 1.6
1	Not Competitive	< 50%	< 1.6

Note: a) Rankings are assigned on a basis of a lexicographic scheme discussed in detail in source

Source: Mattoo, Rathindran and Subramaniam (2001)

Table 5
Impact of Full Liberalization of Telecommunication and Financial Services:
Regression Estimates
Dependent variable: Growth of per capital GNP, 1990-99

Independent variable	Whole sample		Only developing Countries	
	(1)	(2)	(3)	(4)
<i>Natural log of initial GNP (1990)</i>	-0.019*** (-2.69)	-0.024*** (-3.49)	-0.018** (-2.28)	-0.022** (-2.49)
<i>Primary education enrollment (1990)</i>	0.052** (2.10)	0.042* (1.92)	0.038 (1.53)	0.035** (1.44)
<i>Lag of investment to GDP ratio (1980-'89 average)</i>	0.166*** (3.75)	0.205*** (3.36)	0.227*** (3.00)	0.306*** (3.11)
<i>Government consumption to GDP ratio (1990-'99 average)</i>	-0.209*** (-3.46)	-0.165*** (-3.04)	-0.261*** (-3.92)	-0.235*** (-3.37)
<i>Average annual inflation rate (1990-'99)</i>	-0.001 (0.73)	-0.002 (-1.56)	-0.0004 (-0.33)	0.001 (-0.87)
<i>Dummy variable for tropical countries</i>	-0.026*** (-4.04)	-0.030*** (-4.33)	-0.031*** (-3.93)	-0.037*** (-4.25)
<i>Dummy for Sub-Saharan Africa</i>		-0.009 (-1.05)		0.005 (0.41)
<i>Dummy for Latin America countries</i>		0.012 (1.44)		0.15 (1.40)
<i>Quality of institutions</i>	-0.0004 (-0.26)	0.002 (0.84)	-0.002 (0.80)	-0.001 (0.31)
<i>Dummy variable for political stability</i>	-0.003 (-0.45)	0.001 (0.08)	-0.003 (-0.39)	0.001 (0.13)
<i>Dummy variable for full liberalization of both sectors</i>	0.015* (2.18)	0.015** (2.21)	0.025** (2.14)	0.028** (2.64)
<i>I.M.F. goods trade restrictiveness index</i>	-0.004*** (-3.70)	-0.004*** (-3.32)	-0.005*** (-3.07)	-0.004*** (-2.49)
<i>Constant</i>	0.170*** (4.17)	0.190*** (4.33)	0.182*** (3.83)	0.185*** (3.32)
<i>R-squared</i>	0.67	0.71	0.76	0.78
<i>Number of observations</i>	59	59	37	37

Note: *, **, *** indicate statistical significance at the 10%, 5% and 1% levels, respectively. The brackets figures indicate t-statistics with Huber-White heteroskedasticity consistent standard errors

Source: Fink, Mattoo and Rathindran (2001)

Table 6
Departures from GATS Telecommunication Reference Paper

Country	Deviation from GATS Reference Paper
Indonesia	<ol style="list-style-type: none"> 1. Independent regulator: No commitment on separation of regulatory authority from suppliers of services. 2. Spectrum allocation: No commitment to ensure non-discrimination in spectrum allocation.
Malaysia	<ol style="list-style-type: none"> 3. Competitive safeguards: No commitment against cross-subsidy. No commitment on timely provision of technical information about essential facilities and commercially relevant information. 4. Interconnection: No commitment to ensure cost based setting of interconnection rates. 5. Licensing criteria: No commitment on time normally required to approve license application. No justification provided for decision to deny license. 6. Spectrum allocation: No commitment on timeliness, transparency and non-discrimination in spectrum allocation.

Note: Based on a comparison of the GATS Reference Paper with individual country schedules of commitments in telecommunications obtained from the WTO

Source: Fink, Mattoo and Rathindran (2001)

Table 7
Actual Policies and WTO Commitments in Telecommunication Services

Country	Local Services	Long Distance	International	Mobile	Maximum FDI	Regulation	Pre-commitment
Indonesia: Actual Policy (mid-2000)	Monopoly, joint ventures in selected areas	Monopoly	Duopoly, resale and callback not permitted	Competition (7 licenses)	39 %	No separate regulator	Under new legislation, exclusivity for expires in 2003 for international and local services, and 2004 for long distance expiry of exclusivity for local services (2011), long distance (2006), international (2005). "Review" admission of new entrants upon expiry.
GATS	Monopoly, joint ventures in selected areas	Monopoly	Duopoly, resale and callback not permitted	Competition (7 licenses), entry only through joint-ventures	39 %	Partial adoption of regulatory reference paper	
Malaysia: Actual policy (early 2000)	Competition	Competition	Competition, resale and callback not permitted	Competition (8 licenses)	49%	Separate regulator established in 1987, Communications and Multimedia Commission formed in 1999	
GATS	Competition, but entry only through acquisition	Competition, but entry only through acquisition	Competition, but entry only through acquisition	Competition, but entry only through acquisition	30%	Partial adoption of regulatory principles	
Thailand: Actual policy (1999)	Monopoly	Monopoly	Monopoly, resale and callback not permitted	Competition (5 licenses)	20%	No separate regulator	Creation of new regulatory agency awaits approval
GATS	Unbound	Unbound	Unbound	Unbound	20%	Unbound	Bind revised policy and regulatory principles in WTO commitment by 2000 conditional upon legislative approval

Note: The WTO commitments refer to market access and additional commitments for the respective market segments. Only few countries imposed restrictions on national treatment

Source: Fink, Mattoo and Rathindran (2001)

Table 8
Summary of Specific GATS Commitments in Telecommunication Services

	a.	b.	c.	d.	e.	f.	g.	h.	i.	j.	k.	l.	m.	n.	01.	02.	03.
Indonesia	X	X	X	X	X			X	X					X	X	X	X
Malaysia	X	X	X	X	X	X	X	X	X	X		X	X		X	X	X
Thailand	X			X	X	X	X			X				X			X
Total	69	63	64	59	47	59	59	55	51	57	48	46	45	43	65	57	46

Key: a. Voice Telephone Services; b. Packet-Switched Data Transmission Services; c. Circuit-Switched Data Transmission Services; d. Telex Services; e. Telegraph Services; f. Facsimile Services; g. Private Leased Circuit Services; h. Electronic Mail; i. Voice Mail; j. On-line Information and Data Base Retrieval; k. Electronic Data Interchange (EDI); l. Enhanced/Value-Added Facsimile Services; m. Code and Protocol Conversion; n. On-line Information and/or data processing; 01. Terrestrial-based mobile; 02. Satellite-based mobile; 03. Other.

Notes: * Entry into force subject to acceptance.
Source: WTO (1998c)

Table 9
Summary of Specific GATS Commitments in Financial Services

Countries	Insurance				Banking			
	Life	Non life	Reinsu- rance	Interme- diation	Deposits	Lending	Trading in Forex	Trading in derivatives
Indonesia	X	X	X	X	X	X	X	
Malaysia	X	X	X	X	X	X	X	X
Thailand	X	X		X	X	X	X	
Total	69	73	78	57	82	83	62	44

Source: WTO (1998b)

Table 10
Grandfather Provisions in GATS Schedules on Banking and Insurance Services

Country	Provision
Foreign equity-related	
Indonesia	<i>Banking and Insurance:</i> Share ownership of foreign services suppliers is bound at the prevailing laws and regulations. The conditions of ownership and the percentage of share ownership stipulated in the respective shareholder establishing the existing individual joint venture shall be respected. No transfer of ownership shall take place without the consent of all parties in the joint venture concerned.
Malaysia	<i>Banking:</i> Entry is limited to equity participation by foreign banks in Malaysian-owned or controlled commercial and merchant banks with aggregate foreign shareholding not to exceed 30 percent, but the thirteen wholly-foreign owned commercial banks are permitted to remain wholly-owned by their existing shareholders.
Legal form-related	
Indonesia	<i>Banking:</i> Existing branches of foreign banks are exempted from the requirement imposed on new entrants to be in the form of locally incorporated joint venture banks.
Malaysia	<i>Insurance:</i> Branching is only permitted for direct insurance companies with aggregate foreign shareholding of less than 50 percent but companies are permitted to maintain their existing network of branches. (See also foreign equity-related provision above).
Thailand	<i>Banking:</i> While the establishment of new branches is subject to discretionary licensing, existing foreign banks which already had the first branch office in Thailand prior to July 1995 will each be permitted to open no more than two additional branches.

Source: Mattoo (2001a)

Table 11
Market Access Commitments in Banking Services

Member	Limits on Cross Border	Limits on Cross abroad	Limitations on commercial presence					
			Legal form	No. of suppliers	Equity	Number of operations (branches)	Value of transactions or Assets	Other
Indonesia	None	None	New: I, joint venture (G of old B)	New: U	Acquisition of existing: 49% (G)	2 B/aux. Office		
Malaysia	Deposits:U	None		New: U	Existing: 30% (G) DLSO	U for B and ATMs of commercial banks		
	Lending ≥ RM25m only with mode 3							
Thailand	U	U	I or B	S: U B: DL	Acquisition of existing: 25% (limits on individual ownership) DL on ≥25%	Existing banks with a B before 1995: 2 additional Bs (G); new Bs: DL		

Notes: Abbreviations used are as follows:

B = branches

S = subsidiaries

h = restrictions in horizontal commitments

I = local restrictions required

None: commitment to impose no restrictions

No text: no restrictions, but reference to some regulations

U: unbound (no commitment)

R: reciprocity condition or MFN exemption

DL: discretionary licensing or economics needs test

(D)LSO: (discretionary) limits on single ownership

G: grandfathering provisions

Source: Mattoo (2001a)

Table 12
Market Access Commitments in Insurance

Member	Limits on Cross Border	Limits on Consumption Abroad	Limits on commercial presence			
			LEGAL FORM	No. of suppliers	Equity	Other
Indonesia	U	DL			100% of listed cos. (G)	
Malaysia	Life: U	I	I	New: U	On incorporation of existing branches and for original owners: 51%; new participation in existing 30% (DLSO)	No branches for foreign 50% (G)
	Non-life: DL					
Thailand	U except for international marine aviation and transit			DL	25%	
	Non-life for ltd class					

Notes: Abbreviations used are as follows:

B= branches

S= subsidiaries

h = restrictions in horizontal commitments

I = local restrictions required

None: commitment to impose no restrictions

No text: no restrictions, but reference to some regulations

U: unbound (no commitment)

R: reciprocity condition or MFN exemption

DL: discretionary licensing or economics needs test

(D)LSO: (discretionary) limits on single ownership

G: grandfathering provisions

Source: Mattoo (2001a)

Table 13
Summary of Specific Commitments in Telecommunications Services under the
ASEAN Framework of Agreement on Services (AFAS)

	Basic Telecommunication Services							Value-Added Services							Other		
	a.	b.	c.	d.	e.	f.	g.	h.	i.	j.	k.	l.	m.	n.	01.	02.	03.
Indonesia	X	X	X	X	X										X	X	X
Malaysia	X	X	X	X	X	X	X	X	X	X		X	X		X	X	X

Key: a. Voice Telephone Services; b. Packet-Switched Data Transmission Services; c. Circuit-Switched Data Transmission Services; d. Telex Services; e. Telegraph Services; f. Facsimile Services; g. Private Leased Circuit Services; h. Electronic Mail; i. Voice Mail; j. On-line Information and Data Base Retrieval; k. Electronic Data Interchange (EDI); l. Enhanced/Value-Added Facsimile Services; m. Code and Protocol Conversion; n. On-line Information and/or data processing; 01. Terrestrial- based mobile; 02. Satellite-based mobile; 03. Others, viz. Paging services.

Note: Thailand's AFAS commitments are only in domestic equipment leasing, consulting, database access and domestic VSAT, which is not directly included in these sub-sectors under the standard WTO classification of Telecommunication Services. Hence, Thailand is not included in this table. It is to be noted that these sub-sectors are listed under the U.N Central Product Classification (CPC), which is different from that under GATS.

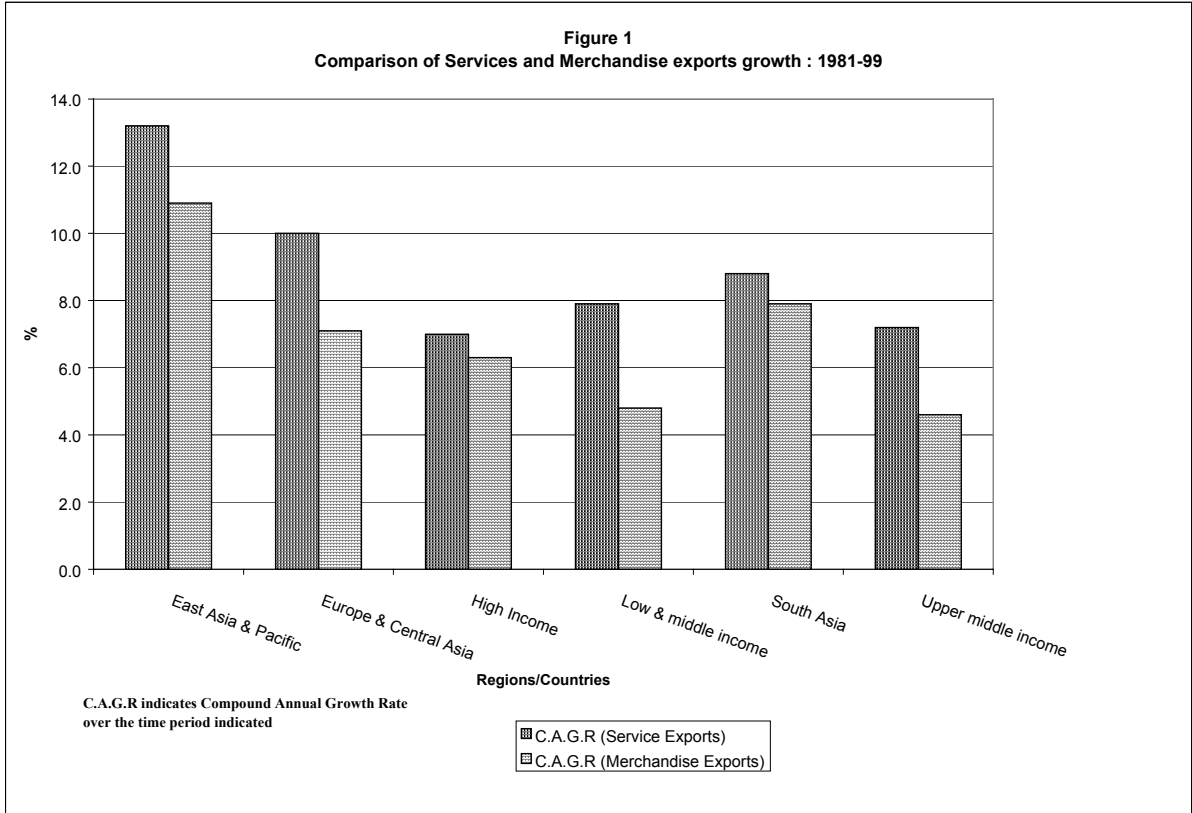
Source: Compiled from ASEAN Secretariat (1998 and 2002a and b)

Table 14
Summary of Specific Commitments in Financial Services under the
ASEAN Framework of Agreement on Services (AFAS)

Countries	Insurance				Banking			
	Life	Non life	Reinsurance	Intermediation	Deposits	Lending	Trading in Foreign Exchange	Trading in derivatives
Malaysia	X	X						
Thailand								

Note: X indicates that commitments have been made for the given sub-sectors by the concerned country, subject to their specific limitations on market access and national treatment, as analyzed earlier. Indonesia has not indicated any specific commitments in financial sector under AFAS, so is not included.

Source: Compiled from ASEAN Secretariat (1998 and 2002a)



Source : Computed from World Bank (2001b)

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