WTO and Nepalese Financial Institutions

Narayan Prasad Kafle
PhD Scholar, Leadership Studies, Kathmandu University, School of Education
Email: nkafle35@gmail.com

ABSTRACT

This article attempts to unveil the possible consequences that have emerged due to Nepal's accession to the World Trade Organization (WTO) agreements and the preparedness to be demonstrated by the Nepalese financial institutions in reference to their efforts of capacity enhancement so as to set up themselves at par with the international standards. Beginning from the agreed General Agreements on Trade and Services (GATS) provisions on Financial Sector Service (FSS), this paper shall attempt to expose the gap between the expected accommodations and the existing realities. The fundamental assumption manifested through this article is the requirement to perform in urgency so as to take the potential benefits of WTO provisions since there is no way out as Nepal has already signed the agreement.

WTO, GATS and Financial Institutions

The General Agreement on Trade in Services (GATS) is among the World Trade Organization's (WTO) most important agreements. The accord, which came into force in January 1995, is the first and only set of multilateral rules covering international trade in services. It has been negotiated by the Governments themselves, and it sets the framework within which firms and individuals can operate. The GATS has two parts: the framework agreement containing the general rules and disciplines; and the national "schedules" which list individual countries' specific commitments on access to their domestic markets by foreign suppliers (WTO 2001).

Nepal officially obtained the WTO membership on 23rd April, 2004 as 147th member. It was highly anticipated that Nepal's membership in such a rules-based trading regime would integrate national economy to the global mainstream and expand trade and market access opportunities, thereby is essential for expanding its trade opportunities, facilitating competition and absorbing knowledge. The attempt of obtaining the WTO membership due to Indo-Nepal trade dispute of 1989 and a passive observant period of the decade of 90s had materialized with high expectations of gaining a new momentum in Nepalese economy.

The realities of globalization, including innovative information and communication technologies, the market economy, new trade agreements, international mobility, and in particular the knowledge society, have been powerful forces of change for many sectors (Knight, 2007).

The World Trade Organization (WTO) deals with the rules of trade between nations at a global or near global level. It is an organization for liberalizing trade and a forum for governments to negotiate trade agreements and to settle trade arguments. It also operates a system of trade rules.

Following a rule based trading regime was supposed to ensure domestic policy stability and enhance institutional capabilities that help increase productivity, foreign direct investment and exposure to new technologies (Bhatta, 2006). Panta (2006) maintains that all branches of economic activity today are fundamentally dependent on access to financial services. In fact, it is the diversified intermediation and risk management services of the financial system which have made possible the development of modern economies. A healthy and stable financial system, underpinned by sound macroeconomic management and prudential regulation, is an essential ingredient for sustained growth. Conversely, macroeconomic instability emanating from weaknesses in the financial sector can undermine the process of development. The continuing globalization of economic activity, and the challenge of attracting productive investments in a competitive international environment, accentuates the need to maintain a healthy and efficient financial sector.

Both Bhatta and Panta (2006) highlight the significance of the presence of robust institutional mechanisms for the sustainable economic growth. And this is this key component that is posing a severe threat and some economists are constantly warning that Nepal may be declared a 'failed state' if the present scenario prevails.

Financial Service Sector (FSS) under GATS

There are twelve major components of GATS and FSS is the seventh point of it. The list presented below states all sectors incorporated within GATS.

i. Business (including professional and computer) services
ii. Communication services
iii. Construction and related engineering services
iv. Distribution services
v. Educational services
vi. Environmental services
vii. Financial (including banking and insurance) services
viii. Health-related and social services
ix. Tourism and Travel-related services
x. Recreational, cultural and sporting services
xi. Transport services
xii. Other services not included elsewhere

Financial sector coverage is further elaborated in the GATS Legal Text as stated below:

Financial services

(a) Insurance and Insurance Related Services
- (i) Direct Insurance
  - Life
  - Non-life
- (ii) Re-insurance and Retrocession
- (iii) Services Auxiliary to Insurance

(b) Banking and other Financial Services

(i) Acceptance of deposits and other repayable funds from the public

(ii) Lending of all types, including, inter-alia, consumer credit, mortgage credit, factoring and financing of commercial transactions

(iii) Financial leasing

(iv) All payment and money transmission services

(v) Guarantees and commitments

(vi) Trading for own account or for account of customers, whether on an exchange, an over-the-counter market or otherwise.

(vii) Participation in issues of all kinds of securities, including under-writing and placement as agent (whether publicly or privately) and provision of service – related to such issues

(viii) Money broking

(ix) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial depository and trust services

(x) Settlement of and clearing services for financial assets, including securities, derivative products, and other negotiable instruments.

(xi) Provision and transfer of financial information, and financial data processing and related software by providers of other financial services.

(xii) Advisory services on all the activities listed above.

A financial service is any service of a financial nature offered by a financial service supplier of a member. Financial services include all insurance and insurance related services, and all banking and other financial services. Opening this section brings both positive and negative impacts on the sector itself and to the whole economy. Hence, opening the FSS, under WTO provision, brings both opportunities and challenges. As some economists call FSS is the 'brain of the economy' and host of others accept it as 'engine of growth'. FSS is important for the economy as a whole since it allows financial transfer and payments. In other words a healthy and stable Financial Service Sector is essential for sustainable economic growth. (Maskay, Bhatt and Panta; 2005). Unhealthy FSS can create the problem in this sector which will harm not only in this sector but as a whole economy and sometimes, even the region (Malakar 2007). Under the Nepalese commitment on WTO, the Nepalese FSS has already opened fully by 2010 only. Under the commitment, the foreign banks are allowed to establish their branches in Nepal for whole sale banking. Opening the sector implies free entry or exit of foreign bank branches into Nepalese financial market. Entry of the foreign bank branches implies the entry of the new technology and latest experiences, by which the whole economic agents can enjoy better services in lower cost. But if once the crisis occurs in FSS then the foreign owned banks do not help to reduce the impact of banking crisis but in some cases it makes the crisis worst (Blejer, 2006).

Internationalization of FSS is open to both problems and prospects. Though no foreign bank or financial institution has entered in the Nepalese soil through this provision but legally the way is paved for them to enter here. Definitely, no foreign financial institution will be here when there is limited market prospects as of today but once the Nepalese economy takes a higher gear and new avenues of investment are open, the presence of such institutions is obvious. The possibility of such institutions is even prosperous in Nepal since the current financial status clearly indicates that Nepal is bound to depend on foreign financial and technical aids for an uncertain period of future. In such a ground reality, it would be prudent that we take necessary initiatives that help up reap the benefits of this unstoppable trend of liberalization.

Basu (2008) in his work paper mentions that there are important, not to mention, controversial, studies to assess the impact of WTO membership on trade benefits enjoyed by countries and its role in providing critical impetus to economic activities. The WTO as a rule-making multilateral world body ought to deliver meaningful benefits. However, given the differential level of economic development and domestic absorption capacity of many of acceding countries, the adjustment needs to be country specific to reduce unwanted costs arising during the process. Similar opinion has been expressed regarding the preparedness of a specific country by Subedi (2007) as well. Hence, the analysis of WTO accession should be broadened to include issues related to a broader economic policies and institutional structures and dimensions.

Pros and Cons of FSS Enactment

Since, Nepalese Financial market just opened fully in 2010 and the financial service sector influence has not been assessed systematically since no direct entry of foreign financial institutions has happened yet. In this context the impact is rather to be anticipated. Internationalization of FSS can bring both positive and negative impacts to this sector and to the whole economy. The following texts shall attempt to analyze some possible positive and negative impacts of the internationalization of FSS. Even though this predicative claim might not be in execution as stated here, it will certainly prove handy in preparing the Nepalese financial institution to be capable to compete in the global standard.

Pros:

Internationalization of FSS allows more stable sources of funds; it can help countries build more robust and efficient financial systems by introducing international practices and standards. It will help to improving the quality, efficiency and breadth of domestic financial institutions as well. Openness helps to increase competitiveness and in turn the economic growth (Malakar, 2007). Some of the positive impacts of opening the FSS can be enlisted as follows:

- Access to international capital market
- Enhanced competition causing the capacity growth
- Increased investment and decreased capital cost
- Access to international financial market
- Improved Balance of Payment (BoP)
- Possibility of emerging as financial center facilitating both India and China

Cons:

Experiences of other countries show that the financial distress is very harmful not for this sector only but the whole economy. In the present context of globalization, the economy is more open hence the financial crisis of an economy transfers more speedily and quickly to other economies, for example, the East Asian Financial Crisis in 1997. The crisis originated from the problem in banking, but most of the east Asian countries (except Singapore) were worst hit by the crisis, hence the positive impact of liberalization of FSS brings many negative impacts as well (Malakar, 2007). Some of the negative impacts are as follows:

- Risk of capital flight through CAC (Capital Account Convertibility)
- Possible decrease of profit and market share of the local banks
- Possible creation of gap between the rural and urban sector
- Emergence of new class groups
- High risk for financial crisis
- Problem of over banking and the fear for monetary autonomy etc

CONCLUSION

Standing at the first quarter of the year 2011, it is really precarious to write about the problems and prospects of Nepalese Financial Institutions due to the enactment of FSS provisions as negotiated under GATS of WTO. The horizon seems wide and open and as indicated by the aforementioned discussions, FSS can prove very much handy if the FIs (Financial Institutions) are well prepared for the forthcoming fierce positive competitions. For this, the role of central bank and the policy directives prepared in this reference matters a lot. The existing dual exchange system and its demerits are to be addressed immediately. The professional growth of the FIs is another area to be observed appropriately so that the political issues have limited impact in their functioning. Moreover, the FIs are to be prepared to accommodate change and even be capable to innovate change through remarkable investment on research and development. The ongoing debate about the policies about the provision of opening the commercial and development banks and the issues related to it are to be settled for forever. The proposed task of merger and acquisition has to be materialized so that the FIs can enhance their coverage, network and reach to the people in every spare of life. The concern for the moment should be to uplift the capacity and be prepared for the service delivery that is of the international standard. In a nutshell, there are four major concerns to be addressed so as to take the maximum benefits from the FSS enactment. Recasting policies and making those of the global standard should be the first concern the regulatory bodies such as Ministry of Finance, Central Bank and the rest. Another concern should be to enhance the technical capabilities and make it absolutely friendly to the ICT based environment and even train the customers for the same. At the policy level the matter of core concern is to take initiative to address the demand side of FSS rather than the supply side and it obviously requires a remarkable investment in research and development and finding the bottom reality. Likewise, enhancing the institutional capacities to that of global standard is undoubtedly the primary condition so as to compete with the possible entry of the FIs of global standard.

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