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FINANCIAL SERVICES AND INTERNATIONAL TRADE – A REVIEW OF LITERATURE

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Abstract

The aim of this paper is to review the literature on 'banking and insurance and international trade. The study presents the literature on services trade, services trade liberalization, trade in financial services, reforms in the banking and insurance sectors, trade in banking services, international trade in insurance services, trade in banking and insurance services and its relationship with economic growth and related aspects. The opening up of financial sector to foreign participation as a part of national financial reforms contributes to international efforts aimed at strengthening the global financial architecture. Finally, we examine the relationship between economic growth and banking and insurance trade performance and measures the impact of banking and insurance trade performance on the economic growth of economies.

Introduction

The study presents the literature on services trade, services trade liberalization, trade in financial services, reforms in the banking and insurance sectors, trade in banking services, international trade in insurance services, trade in banking and insurance services and its relationship with economic growth and related aspects. The opening up of financial sector to foreign participation as a part of national financial reforms contributes to international efforts aimed at strengthening the global financial architecture. At the same time, international frameworks tend to support national programs of financial services liberalization. The most comprehensive of such framework is General Agreement on Trade in Services (GATS) of the World Trade Organization (WTO).

While financial reforms are ongoing in the EU and many other countries, little attention is paid to free trade agreements that continue to liberalize financial services as well as restrict regulatory freedom and controls on capital movements. 'Trade in financial services' does not only mean trans-border movements of financial services (e.g., internet banking with foreign customers) but also the establishment of foreign banks or insurance companies, etc. abroad (i.e., foreign direct investment) and movement of high-level personnel. GATS and FTA have a special clause that allows countries to take Prudential Financial measures for the integrity and stability of the financial system and protect investors and consumers.

The aim of this paper is to present a review of the theoretical and empirical literature dedicated to the international trade in financial services with special reference to banking and insurance services. It is organized as follows. In Section 2, we provide the reforms in financial services, both banking and insurance services. The empirical contributions demonstrating that trade patterns are examined. However, these contributions do not investigate through which channel international trade is affected by external finance. Therefore, in Section 3, we examine the trade in banking services, and we emphasize the

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importance of efficiency of banks. In Section 4, we extend the analysis beyond the banking. We discuss about insurance services – international trade and growth. We examine the relationship between economic growth and banking and insurance trade performance in section 5 It examines how the development determines the economic growth in the long-run and in the short term and measures the impact of banking and insurance trade performance on the economic growth of economies. Section 6 concludes.

Section 1: International Trade in Financial Services

The existing literature on the link between services and growth focuses primarily on the financial sector.

Goldsmith (1969), in the seminal work stressed the role of financial services in channeling investment funds to their most productive uses, thereby promoting growth of output and incomes. Goldsmith uses the ratio of the value of financial intermediary assets to GNP to gauge financial performance and enters it in a regression with economic growth as the dependent variable. He finds a “rough parallelism” between economic growths and financial other growth controls in his regressions. More recently, King and Levine (1993a) postulate that financial services can affect growth through enhanced capital accumulation and/or technical innovation. They find their measures to be significant and the sizes of their coefficients to imply an economically important relationship. They found that the level of financial sector development in 1960 is a significant predictor of economic growth over the later period.

Levine (1997) adopts a functional approach to the link between financial development and growth. He identifies five major functions that financial systems perform which help in minimizing transactions costs and improving the allocation of real resources. However, the author admits that research in this area does not sufficiently account for the role of international trade in financial services. Moreover, the paper is silent on the role of policy.

Francois and Schuknecht (1999) study the growth of per capita real GDP on a measure of the general degree of openness in trade, on certain macroeconomic variables and the concentration ratio for the financial sector. They find a strong positive relationship between growth and financial sector competition. A large number of developed countries such as Canada and many European countries have banking systems characterized by a small number of banks, but still produce competitive outcomes. Goldstein (1999) although the liberalization of controls on capital movements and trade in financial services helps integrate international financial markets, it does not necessarily alter patterns of international capital flows. As financial markets become more integrated, the role of capital flows in restoring market equilibrium through arbitrage might actually diminish.

Tamirisa et al., (2000) studied the trade in financial services is closely linked to capital movements. Establishing a commercial presence in local markets through entry or equity participation requires foreign direct investment. Apostolos Gkoutzinis (2004) in his article reviews the progress achieved in the liberalization of international trade in banking services as part of the General Agreement on Trade in Services (GATS). In particular, it

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examines the existing legally binding commitments and discusses the progress in the negotiations at the Doha Round.

Section 2: Reforms in financial services – banking and insurance services

The regulatory framework for banks known as "Prudential Regulation" in the literature consists of broadly of capital adequacy norms, restrictions on the lines of activities that banks can participate in, restrictions on entry and deposit insurance (Sen & Vaidya, 1997).

Rajan and Zingales (1998) argued that the banking sector liberalization has particularly favorable effects on those sectors that rely relatively heavily on external finance for their investment and growth. Structural reform approaches seek to shield deposits and payments functions of banks from the risks that are generated in the investment banking activities which are linked to volatilities in the financial market Calomiris (1998) and Fisher (1998 & 1999).

Manoj (2007) in his work assessed the banking sector reforms in India. It has been more than 20 years of the start of the economic reform in India and the financial sector reform was one of the important parts of the process. The study listed the major reforms of the Indian baking sector and found out the impacts of these reform and the future prospects. The study confined itself to the impacts of reforms upon credit delivery, share of market of banks, profitability and prudential regulations.

Vyas and J haveri (2008) in their work studied the performance of the Banking Sector in India. They also did a critical review of the performance as well as impact of Banking Sector Reforms in India. The study examined the role and measures initiated by the Reserve Bank in India [RBI] in order to implement the Banking Sector Reforms in India. Radha (2002) critically evaluate the impact of Banking Sector Reforms on the performance of Commercial Banks in India. Schnabl, (2008) they felt that the benefits of financial liberalization must be weighed against the costs of increased financial fragility. They have argued that some degree of financial regulatory reforms is still inevitable and in fact preferable to premature liberalization in developing countries.

Kalpana (2008) presented financial sector reforms in India identified the emerging issues and explored the prospects for further reform. The first part is devoted to a brief background financial sector reforms. The second part is devoted to the institutional aspects of the reform but banking sector will be analyzed in the paper. Issues relating to ownership, competition and regulation in the financial sector are discussed. The third part relating to legal policy framework focuses on monetary policy and credit delivery.

Prasad and Rajan (2008) discuss the deep linkages among different reforms, including broader reforms to monetary and fiscal policies, and recognizing these linkages is essential to achieve real progress. They felt that principles-based regulation will be more conducive to rapidly evolving financial markets and is also more adaptable. Seelanatha & Wikremasinghe (2009) in their study on the financial sector reforms in Sri Lanka and its influence on banking industry found that the depth of the banking industry has improved significantly as a result of the reforms.

FTI Consulting in a paper said that the financial sector faces legislation that is intended to amend existing market structures and business models. The paper critically discussed the different elements of the Volcker, Vickers and Liikanen proposals, analyzed the implied costs and benefits and shed light on elements that will require further work.

Section 3 a: Trade in Banking Services

Grubel (1977) gave the most cited explanation has been the “follow- the –customer” hypothesis ; banks go multinational to better serve the foreign operations of domestic corporate entities. Intuitively if the home country has extensive trade links with a foreign nation, then the demand for a variety of trade-related intermediary services (eg. Provision of documentary credits, foreign exchange credits, insurance etc.,) will typically be high.

Goldberg, & Saunders (1981) in their study showed that rapid growth of foreign banking activity in the United States has led to major changes in the regulation of foreign banks. This paper seeks to determine the factors causing this growth of foreign banks. Goldberg and Saunders (1981), Hultman and McGee (1989) and others have also presented evidence that support this view. Sabi (1988) found no significant relationship between foreign bank participation and size of import – export activity with the country.

Germanidi, (1982) found that the basic motive for the achievement of cross-border banking activities is the redistribution of international fluidity and international capital between the various countries. Vastrup (1983) points out that there is a substantial fixed cost element in credit rating activities; thus banks can lend more cheaply to existing clients than can competitors. It has also been suggested that failure to follow the customer may make the way for others to come in and even encroach on existing domestic business with the parent company.

Neu (1988) in his work on international trade in banking services identified the obstacles in trade in banking services and the issues in the trade in banking services. Walter (1988) suggests that banks may actually be leading their customers. Well-established banks in a country abroad can often provide ‘useful information, contacts, advice and financial services to foreign firms considering entering the foreign market’. Robert Grosse & Lawrence Goldberg (1991) in their work have shown the presence of foreign banks in the United States has grown dramatically in recent years.

Henkel and Levi (1992) studied foreign banking in the USA to examine the choice of form of representation by foreign banks – branches, agencies, representatives or subsidiaries – on the basis of the following country – specific factor: exports to the US; claims against the specific country held by US customers; and the size of the capital market of the bank exporting country.

Swary and Top (1992) concluded that the loss of a comparative advantage by commercial banks as providers of credit to large borrowers, competition from non-bank financial firms, and increased competition from foreign banks have created the impetus for adoption of universal banking. Wengel (1995) investigates which of the theories of international trade best explains trade in international banking in its various forms: branches, subsidiaries and representatives. Strong evidence is found to support the newer economies of scale

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theories and it is proposed that the foreign exchange and capital markets exhibit declining costs to production.

Seth(1996) in his study investigates the lending patterns of US – BASED banks from Japan, Canada, France, Germany, the Netherlands, and the U.K., countries which account for the vast majority of foreign – owned bank activity in the U.S. Simultaneously, they looked at the borrowing patterns of U.S nonbank affiliates of firms from those countries. They found that banks from four of the six countries (Japan, Canada, the Netherlands and the U.K.) allocated a majority of their loans to non-home country borrowers, for some or all of the 1981 -1992 period. That result suggest that "follow the customer" hypothesis may have a more limited applicability than previously supposed.

Maesterrs, Hasan, Lensink and Koetter in their work say that the positive relation between financial development and economic growth seems to have weakened in recent years and when analyzing only developed countries. They suggest that banks' relative ability to intermediate funds cost-efficiently is a quality-based measure of financial development that complements conventional quantity-based measures.

The benefits and costs of foreign bank entry are investigated extensively in the literature. The World Bank (2002) summarizes the benefits as follows.

1) Foreign bank entry increases the efficiency of the domestic banking sector. Increased competition tends to reduce costs and to increase profits (World Bank, 2001; Claessens, Kunt, and Huizinga, 1998).

2) The allocation of credits to the private sector may be improved since it is expected the evaluation and pricing of credit risks to be more sophisticated (Clarke, Cull, and Soledad Martinez Peria, 2001; Barth, Caprio, and Levine, 2001). This may help foster higher growth (Levine, 1996).

3) The presence of foreign banks helps build a domestic banking supervisory and legal framework, and enhance the overall transparency.

4) It is expected foreign banks to provide more stable sources of credit since they may refer to their parents for additional funding and they have easier access to international markets. Thus, domestic financial markets will be less vulnerable to domestic shocks.

5) Foreign banks may reduce the costs associated with recapitalizing and restructuring banks in the post-crisis period.

Claessens, Demirguc-Kunt, and Huizinga (1998) examine the effects of foreign bank entry on the domestic banking sector. They show that in developing countries, foreign banks tend to have greater profits, higher interest margins, and higher tax payments compared to domestic banks. But the opposite is true in developed countries. Another interesting conclusion is that both profitability and overhead expenses of domestic banks fall with foreign bank entry. In this study, we apply their empirical technique to a different data set.

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Demirguc-Kunt, Levine, and Min (1998) show that foreign bank participation lowers the possibility that a country will experience a banking crisis. They indicate that the presence of foreign banks lowers overhead costs and profits of domestic banks. Foreign banks also increase overall economic growth by raising the efficiency of domestic banks.

Hernes and Lensink (1998) in their research work analyse the relationship between foreign bank presence and the performance of the domestic banking sector and takes into account the role of the level of development of the financial sector of the recipient country. They used the bank level data of 982 banks in 48 countries for the period 1990-1996. The results support the hypothesis that financial development does matter.

Demirguc-Kunt and Huizinga (1999) show that foreign banks have generally higher profits and margins compared to domestic banks in developing countries, while the opposite is true in industrial countries. Agenor (2001) is pointed out cost of foreign bank entry. Since foreign investors may not be familiar with the emerging markets, they tend to retreat promptly and massively at the first encounter of difficulty. This may lead to deeper crises in domestic financial markets.

Padwal S.M. (2002) in his paper made an attempt to assess the impact of liberalization on Indian Banking. Padwal came to a conclusion that high cost of branch expansion, growing percentage of credit portfolio to low yielding assets; increasing operating and establishment expenses have adversely affected banks' profitability. He in this paper strongly felt that deregulation in the banking sector is expected to help to widen credit market, enhance saving mobilization and stimulate competition but there is a need to prepare the banking industry to face the consequence of liberalization.

Lensink and Hermes (2003) in their work investigated the short-term effects of foreign bank entry on the behaviour of the domestic banking sector. They hypothesized that these effects are dependent on the level of economic development of the host country. Focarelli, D., Pozzolo, A.F.,(2005) in their paper investigate the patterns of banks foreign investment.

Vassiliadis (2009) is concerned with two different aspects of internationalization. The first aspect refers to the exchange in terms of import and export of banking services and transactions in foreign currency. The second aspect, however, is related to the strategy of banks when internationalizing. Goetz Von Peter (2012) in his paper on ‘after the financial crisis: from international to multinational banking?’ says the financial crisis has led to a reconsideration of banks’ global business models. As a result of post-crisis regulatory reform, the long-term trend toward local banking is likely to accelerate, especially if liquidity regulations are applied locally.

Niepmann (2013) in his paper on banking across borders says that the international linkages between banks play a crucial role in today’s global economy. Existing models explain these links on the basis of portfolio theory, in which banks diversify lending. In the model, banking across borders arises because countries differ in their relative factor endowments and in the efficiency of their banking sectors. Based on these differences, the pattern of foreign bank asset and liability holdings emerges endogenously.

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Section 3 b: Efficiency of Banks:

There are numerous studies on measuring the efficiency of financial institutions.

Charnes, Cooper and Rhodes (1978) developed measures of 'decision making efficiency' with special reference to possible use in evaluating public programs. Their measure is intended to evaluate the accomplishments, or resource conservation possibilities, for every DMU with the resources assigned to it. They have provided a variety of ways of assessing the efficiency of DMU's in public programs in order to improve the planning and control of these activities. They have proposed measure of the efficiency of any DMU is obtained as the maximum of a ratio of weighted outputs to weighted inputs subject to the condition that the similar ratios for every DMU be less than or equal to unity.

Seiford and Thrall (1990) found that mathematical programming procedure used by DEA for efficient frontier estimation is comparatively robust.

Berger and Humphrey (1997) reviewed 130 studies that applied frontier efficiency analysis to financial in 21 countries. They observed that various efficiency measures do not necessarily yield consistent results and suggested some ways to make it consistent. Bhattacharyya et al. (1997) examined the productive efficiency of 70 Indian commercial banks during early stages (1986-1991) prior to liberalization. They used DEA to calculate radial technical efficiency scores.

Resti (1997) analyzes the cost efficiency of 270 Italian banks over the period 1988-1992. He compares the parametric and non-parametric efficiency scores and finds that econometric and linear programming results do not differ substantially. He reports higher efficiency scores between 81% and 92% for SFA as opposed to DEA scores between 60% and 78%.

The Bauer et al. (1998) study is among all the most significant, given the application of four approaches SFA, DEA, Thick Frontier Analysis (TFA) and Distribution Free Analysis (DFA) on a data set of 683 US banks over the period 1977-1988. They concluded that there is no single correct approach to specify an efficient frontier. Instead, both measures seem to react to varying degrees to particularities of the data.

Jackson and Fethi (2000) study on Turkish banks found that the profitable banks are more likely to operate at higher levels of technical efficiency.

Yang, Ma, Koike (2000) in their work point out the defect of the first DEA model CCR (Charnes, Cooper and Rhodes, 1978) in measuring the efficiencies of the production system with k independent subsystems and propose a new model YMK (Yang, Ma and Koike) by improving CCR model. It is concluded that the overall efficiency (YMK) of each DMU has a great deal to do with the efficiencies of its subsystems under CCR model

Das et al. (2005) analyzed the cost, revenue and profit efficiency of Indian banks for 1997-2003 using DEA. The study observes that Performance Evaluation of Banks in India – A Shannon-DEA Approach results of input-oriented, output-oriented and cost efficiency measures are similar, but the results in respect of revenue and profit efficiencies differ sharply during this period. They found that the bank's size, ownership, listed in stock

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exchange had a positive impact on the profit efficiency and to some extent revenue efficiency.

Hermann, Leipig, Todter (2006) investigate the consistency of efficiency scores derived with two competing frontier methods in the financial economics literature: Stochastic Frontier and Data Envelopment Analysis. Sufian (2007) has employed the DEA method to investigate the effects of mergers and acquisitions on the efficiency of Malaysian banks. DEA has become increasingly popular in measuring efficiency in different national banking institutes

Soleimani-damaneh and Zarepisheh (2009) observed that existing super-efficiencybased ranking methods in the DEA literature (Adler et al., 2002; Andersen and Petersen, 1993) has a desirable feature of differentiating between some of the efficient DMUs that have identical efficiency scores equal to one in the basic DEA models. Soleimani-damaneh and Zarepisheh (2009) proposed combining of efficiency scores of various DEA models using Shannon’s entropy method to provide a more balance ranking of DMU.

Mohd Tahir (2009) examined whether the domestic and foreign banks are drawn from the same environment by performing a series of parametric and non-parametric tests. Ray and Das (2010) studied the cost and profit efficiency of Indian banks using DEA during the post reforms period and observed that public sector banks are more efficient compared to private sector banks Also, there is a strong evidence of ownership explaining the efficiency differentials of the banks.

Kaur and Kaur (2010) examined the impact of mergers on the cost efficiency of Indian commercial banks using DEA. They opined that the stronger banks should not merge with the weaker banks, as the weaker banks will have adverse effect upon the asset quality of the stronger banks.

Dwivedi and Charyulu (2011) seek to determine the impact of various market and regulatory initiatives on efficiency improvements of Indian banks. Das and Kumhakar (2012) studied the productivity and efficiency of Indian banks using hedonic aggregator function and observed that efficiency of public sector banks surpassed the efficiency of private sector banks during the post reform period 1996-2005.

Anastasios D. Varias and Stella Sofianopoulou (2012) in their study evaluate the efficiency of the biggest commercial banks that operated in Greece at the financial year 2009. Hoque and Reyhan (2012) analysed twenty four different banks in Bangladesh. Data Envelopment Analysis is mainly of two types – constant returns to scale and variable returns to scale.

Jayaraman and Srinivasan (2014) in their study evaluate the performance of the banks in India using cost, revenue and profit models of DEA and come out with a comprehensive efficiency index for banks. The study observes that Shannon-DEA approach provides a comprehensive efficiency index for banks and a reasonable way of ranking.

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Section 4: Insurance Services: International trade and Growth

There is a growing empirical literature seeking to assess the relationship between macroeconomic performance of the insurance sector and economic growth, which contributes to increase the international trade among countries. Insurance sector is a central element of the trade and development matrix and is considered as one of the key pillars of the financial services.

A sound national insurance sector represents an essential feature of a proper economic system, contributing to economic growth and fostering high employment (UNCTAD, 1964). As both, an infrastructural and commercial service, a well-functioning insurance sector plays a crucial role in economic development not just at a macro-economic level but also in terms of the activities of individuals and businesses (UNCTAD, 2007). From an infrastructural perspective, it promotes financial and social stability, which mobilizes, and channel savings, supports trade, commerce and entrepreneurial activity and improves the quality of the lives of individuals (Puri 2007).

Liberalization and privatization helps bring substantial financial strength, technological and industry know how. At the same time, good risk management and asset liability management skills are required especially in the context of developing countries (Puri 2007). Venkatesh (2013) in his study concluded that Indian insurance sector is having increasing growth rate. Chen, Lee, Chang, Feng in their study showed that a country with a well-developed financial system does not necessarily enhance the positive effects of the development of the life insurance market on economic growth.

Arkell (2011) explained that these initiatives involve restrictions to the opportunities for abroad-based insurers, which would affect their potential benefit. The study of Sinha et al (2012) identified the per capita number of agents and the per capita number of insurance offices (both are supply driven), as two other influencing factors, apart from per capita GDP, which explained together large section of data appropriately.

There are several studies [Carter and Dickinson (1992), Enz (2000), Zheng et al (2008), Sastry (2011), Sinha et al (2012), Kamiya (2012) etc.], which have attempted to examine the nature of inter-relationship between the insurance penetration and the percapita GDP. These studies have revealed that a positive relationship holds between insurance penetration and per capita GDP. Insurance penetration normally increases with the increase in the per capita GDP. The relationship between the two could be linear or non-linear (curvilinear). The studies of Carter and Dickinson (1992) and Enz (2000) indicated that the relationship between the insurance penetration and per capita GDP can be explained with an S-curve (a non-linear form).

Section 5: Relationship between Economic growth and Banking and Insurance performance

Goldsmith (1969) was the first to show empirically the existence of a positive relationship between financial development and economic growth. According to the Goldsmith's (1969) work, the evolution of domestic financial markets leads to a high level of capital

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accumulation efficiency, and the positive correlation between financial development and growth is mainly due to the efficient use of capital stock.

Hicks (1969) also noticed that financial institutions might facilitate growth. Though he focused on capital formation. The task of financial institutions is to enhance the liquidity of long-term investments so that more investment is expected in the high-return projects. Adams, Andersson and Lander mark in their study found that the development of insurance fosters demand for banking services but only in times of economic growth. McKinnon (1973) and Shaw (1973) demonstrate the importance of financial liberalization in promoting savings and investment, and admit the significance of financial development in promoting economic growth through high capital productivity.

King and Levine (1993), studied a sample of 70 countries. The results show an empirical link between financial development indicators and growth. Hermes (1994) argues and financial liberalization theory and the new growth theories basically assume that financial development leads to economic growth. Murinde and Eng (1994) and Luintel and Khan (1999) argue that a number of growth models show a two-way relationship between financial development and economic growth.

Rajan and Zingales (1996) analyzed the correlation between the performance and the growth of firms and the financial market developments, while Demirguç-Kunt and Maksimovic (1996) argued that the firms accessing developed stock markets are characterized by high growth rates.

According to Hicks the industrial revolution in England was mainly caused by the capital market improvements that moderated liquidity risk (Levine, 1997).

Levine (1997), after reviewing many studies on the relationship between financial development and economic growth for individual or broad cross-country level concluded that the functioning of financial markets is important for economic growth. According to the survey results provided by Levine, countries with larger banks and more active stock markets grow faster.

Accordingly, Levine and Zevros (1998) reach the conclusion that financial development is an accurate indicator of economic growthWard and Zurbruegg (2000) examined the relationship between GDP and insurance growth. It was found that insurance premium was Granger Cause of GDP in some countries but for some countries it was not true.

Koivu (2002) find that the efficiency of the banking sector accelerates economic growth in the transition economies. Drakos (2002) examined also the relation between financial sector and economic development in 21 transition economies and showed that imperfect competition in banking sectors lowers economic growth and deepen business cycles. Calderon and Liu (2003) studied a large sample of 109 developing and industrial countries and found that financial development leads to economic growth in all countries.

Hou, et al. (2012) investigated the impact of financial institutions and GDP in 12 Euro-countries. Two major conclusions were found: first it was from cross-country evidences that life insurance penetration and banking development do not have any significant

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impact on GDP. Secondly, the life insurance and banking development are significant predictors of GDP.

Eatzaz and Malik (2009) analyses the role of financial sector development in economic growth, their studies reported that domestic credit to private sector is instrumental in increasing per worker output and hence promoting economic growth in the long run.

Keeping in view India's growing integration with global financial markets, external-sector vulnerabilities have an increasingly large impact on India through the trade and capital account channels. It is therefore important that the development of an efficient and healthy financial market should also be accompanied by an effective regulatory mechanism that keeps track of external vulnerabilities.

Conclusion:

Financial sector reforms all over the world have been driven by two apparently contradictory forces. The first is a thrust towards liberalization, which seeks to reduce if not eliminate several direct controls over banks and other financial market participants. The second is a thrust in favour of stronger regulation of the financial sector. In the global policy context, the liberalization of financial services trade is closely linked to the reforms of the institutions architecture underlying the international financial system.

All branches of economic activity today are fundamentally dependent on access to financial services. A healthy and stable financial system, accompanied by sound macroeconomic management and prudential regulation, is an essential ingredient for sustained growth. Conversely, macroeconomic instability arising from weaknesses in the financial sector can undermine the process of development.

The recent financial crisis has highlighted again that there can be risks associated with cross-border banking and foreign banks presence. These developments have led to an increased demand among policy makers and interest among academics for more analyses of the benefits and risks of foreign bank presence to help guide regulatory reforms. The important aspect at this point of time is that regulation must become tighter, and the supervision must become more controlled.

The study identifies low level of insurance penetration and density levels vis-à-vis advanced and emerging economies. It has also shown the correlation between the insurance penetration and economic development. The increased penetration with the opening up of the section in 2000 gives a clear indication that the private and foreign players have an ability to enhance the size, structure and participation in the insurance market worldwide. Structural reforms are crucial in three areas for building an efficient and stable financial sector. Trade liberalization in the financial services sector can play a supportive role in relation to these structural reforms, through pre-commitment to market opening.

The reforms in the Indian Banking sector and the recommendations made by the respective committees helped the industry to remain abreast of the international practices. With regard to globalization, there is an opposing view that along with of looking

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outwards, Indian banks should look inwards through financial deepening. In this context, it needs to be noted that looking outwards for global presence and looking inwards for deeper financial penetration are not mutually exclusive. This opportunity for larger Indian banks which are looking for growth and looking outwards for global presence is initiated and made possible by the reforms in the banking and insurance sector in India.

With the lessons learnt from the crisis, many countries have been reviewing their banking structures post crisis. It is important to review the banking structure in the Indian context also with a view to enabling the banking sector to cater to the needs of a growing and globalizing economy as well as furthering financial inclusion.

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