

EPFSF Briefing: EU Opportunities in China and India

Summary: *The European Union is not only striving to establish an internal market for financial services among the EU-25 Member States, it is equally pursuing growth perspectives beyond its borders and two of the most important emerging markets are undoubtedly China and India, both leading members of the World Trade Organisation (WTO).*

The recent extension of international dialogues with China and India is fully supported by industry. As these bilaterals develop further the emphasis should go beyond seeking market access gains through international trade policy it should focus more on a broader level of co-operation.

Introduction

China is a key economic and trading partner for the EU. China has been a member of WTO since December 2001. Its dynamic growth and available workforce has enabled China to become a major player in the world economy, the fourth largest by exchange rate (but the second largest in the world after the United States when GDP is measured by purchasing power parity at US\$8,158 trillion in 2005. Chinese economic development is among the fastest in the world, with an average annual GDP rate in excess of 9% for the past 25 years. In 2004 the enlarged European Union became China's biggest trading partner and China is now the EU's second largest trading partner just behind the US.

The accession negotiations to the WTO have provided a useful and welcome roadmap for China to commence to open its financial services sector. However, a range of restrictions on the ability of EU financial services providers to access the Chinese market persist (such as caps on foreign equity capital, absence of national treatment on conditions of licensing and authorisation, limited regulatory transparency, etc.).

The Chinese government faces clear economic and social challenges particularly in the areas of promoting balanced regional development, financial education, building social security system and saving for retirement. The EU has recognised that in addition to international trade policy measures there is an opportunity to share best practice regarding the development of internationally competitive capital markets to promote growth and balanced development in China. This should accelerate not only the growth of China's domestic capital market but also the removal of the current restrictions for foreign financial institutions.

The relationship between the EU and India took root in 1963, when India was amongst the first developing countries to establish diplomatic relations with the then European Economic Community. Since then, India, a member of the SAARC (the South Asian Association for Regional Cooperation) and the EU have developed a close relationship that covers key areas such as political relations, trade and investment and economic and development cooperation. Today, India's diverse economy is the second fastest growing major economy in the world, with an estimated GDP growth rate of 8.4% at the end of the first quarter of 2005–2006. When measured in USD exchange-rate terms, it is the 12th largest in the world, with a GDP of \$785.47 billion in 2005, as calculated by the World Bank (but is the fourth largest in the world as measured by purchasing power parity (PPP), with a GDP of US \$3.63 trillion). Although India has a well developed legal and regulatory system and an excellent skill base with which to develop financial services, historically foreign participants have encountered restrictions such as equity caps and restrictive conditions, economic needs tests and discriminatory authorisation and operating conditions compared to domestic companies. Policy development and reforms have only recently appreciated the positive role that can be played by enabling improved market access by foreign financial services players, including firms based within the EU. Moreover, India is looking at steps that can be taken to introduce capital account convertibility on a prudent basis. Thus, while market opening is occurring, and better treatment is now permitted than is bound under current WTO commitments, EU-based firms would benefit from the security of more liberal bindings under the WTO. India's development too would benefit greatly from a reduced cost of capital, better risk management and the deployment of more diversified and innovative financial products, including the mobilisation of finance for badly needed infrastructure projects.

Multilateral relations – the WTO

An important plank to the EU's external economic relations' policy consists of the multilateral framework for progressive liberalization of trade provided by the World Trade Organisation (WTO).

The WTO's General Agreement on Trade and Services (GATS) entered into force in January 1995 as a result of the Uruguay Round negotiations. The agreement was created to extend the multilateral trading system to services, in the same way the General Agreement on Tariffs and Trade (GATT) provides such a system for the trade in goods. A major objective of the Doha Development Round of WTO/GATS negotiations was to achieve further significant steps on liberalisation of services trade, including financial services. In this context, the global financial services industry has put forward specific detailed proposals for further liberalisation of financial services. However, difficulties over agriculture and goods contributed over this summer to the suspension of the Doha Round.

Europe's financial services providers have always believed and argued that trade liberalization through the WTO is a "win-win" situation for both developing and developed country markets. The significant economic benefits have been underscored by extensive research by academic researchers and by international institutions such as the World Bank and the WTO Secretariat. Indeed, given that services account for over 70% of the EU economy, these economic benefits far outweigh the economic value of EU interests at stake in the politically sensitive agriculture and goods negotiations. Because of their size and economic importance, multilateral agreements involving China and India will be crucial to realising these benefits. The EU thus has a vital interest in an early resuscitation of the Doha Round and in ensuring that a very high priority is attached by the EU negotiators to achieving specific and concrete commitments as proposed by industry in each of the financial services sub-sectors, securities, banking and insurance.

Bilateral Relations – International Regulatory Dialogue

Although significant benefits accrue from multilateral trade liberalization, there remains an important role for bilateral discussions of economic, investment regulatory and trade matters, particularly given the current status of the Doha Round.

This includes dialogue between supervisors and regulators, especially in an area such as financial services, which is heavily regulated for prudential purposes and which is undergoing continued reform in both China and India. In order that financial services liberalisation can deliver its wider development benefits, active and specifically focussed bilateral dialogues with important countries such as China and India can help ensure that regulatory "density" and inappropriate regulation justified on prudential grounds does not inhibit effective market access by EU-based firms. Moreover, exchanges of experience on best practice methods of safeguarding the stability of the financial system, of ensuring investor protection, and of implementing accounting and corporate governance standards can create better understanding on how best to reconcile prudential goals with a dynamic and growing capital markets. Such dialogues can also help lay the groundwork for subsequent negotiation within the WTO of binding commitments that will secure liberalisation of financial services markets.

Regulatory dialogues with countries that harbour important financial markets is helpful and sometimes essential to the task of avoiding or minimising conflicting, duplicating or discriminatory rulemaking for European financial services providers active in these markets.

From a financial services point of view certain policy areas also need to be addressed in bilateral regulatory dialogues, such as questions of financial stability/capital, corporate governance issues, financial crime, securities and investment markets/capital markets, accounting/auditing, global standards in financial markets, data privacy, etc... Obviously the nature of the problems will require a different emphasis between advanced and emerging financial markets respectively, and each would require a different approach in the regulatory dialogue.

The problems arising in advanced financial markets like the US, Japan, Switzerland or Canada mainly stem from the absence of mutual recognition of essentially equivalent regulatory frameworks. As a result, operating in these jurisdictions is more burdensome for European than for domestic operators.

While these issues also play a role in emerging markets, the more important source of problems for subsidiaries and branches of European financial services providers in markets such as China and India generally arise from discriminatory treatment. As the financial regulatory authorities of emerging market countries tend to justify their discriminatory rules for foreign operators by citing prudential reasons, regulatory dialogue with such countries could help to achieve improvements for European financial services providers and avoid new discriminatory rules from the outset by addressing the prudential motivation of the host-country regulator and providing, where necessary and helpful, assistance for a build-up of regulatory and supervisory capacities and know-how in order to replace discriminatory regulation with more appropriate rules.

Of course, these bilateral regulatory dialogues must take due account of and support multilateral regulatory standards that are developed by international bodies such as the Basel Committee on Banking Supervision, the International Organization of Security Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS) and the International Accounting Standards Board.

The EU, following the development of the FSAP legislative programme, is particularly well placed to initiate a programme of bilateral dialogue on financial services especially with China, India and other key emerging markets in order to explain the objectives of EU policy and to outline the evolution of its system of financial regulation. The Commission, the Council and the Parliament should be fully engaged in the process and the Commission should ensure active ongoing consultation with the financial services industry, especially before and after each bilateral session. Beyond this, all efforts by the EU to develop regular and substantive dialogue - through the facilitation of more working level staff exchanges, sponsorship of academic research and facilitation of regulatory roundtables – would promote the sharing of best practice between jurisdictions and be to the mutual benefit of all participants.

Bilateral Relations - Parliamentary exchanges

Building on the exchange of experiences and fostering the better understanding of each other's legislative and regulatory environment and motivations is a very important contribution to this process and the regular meeting by the European Parliament's Delegations to meet fellow law-makers in China and India is an essential part of working towards closer relations and increasing trade between ever-more important trade partners. Moreover, a six monthly exchange devoted specifically to financial services issues would promote financial liberalisation and inform EU discussions at a multilateral level, thereby increasing Europe's understanding of and influence in these important markets.

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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