Who benefits from banks' cross-border competition

SUERF Conference on Cross Border Financial Services: Europe's Cinderella?
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Robert Koopman
Chief Economist and Director of Economic Research and Statistics Division, WTO
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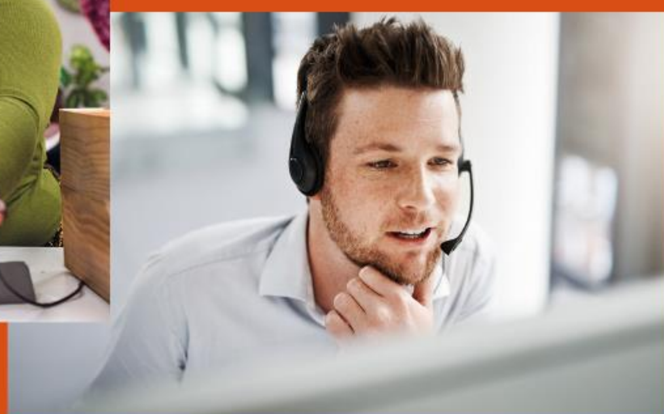
Who benefits?

- Exporting country, importing country.
  - Competition effects
  - Variety effects
  - Innovation/learning effects
  - Scale effects
- Financial services are an integral contributor to other services sectors, but also manufacturing sectors.
- Gains also require effective, coherent, and consistent regulatory environments.
- This presentation mainly about what we know about cross border financial services flows and the global evolution of those flows and global rules– from our World Trade Report 2019 released in early October.

World Trade Organization



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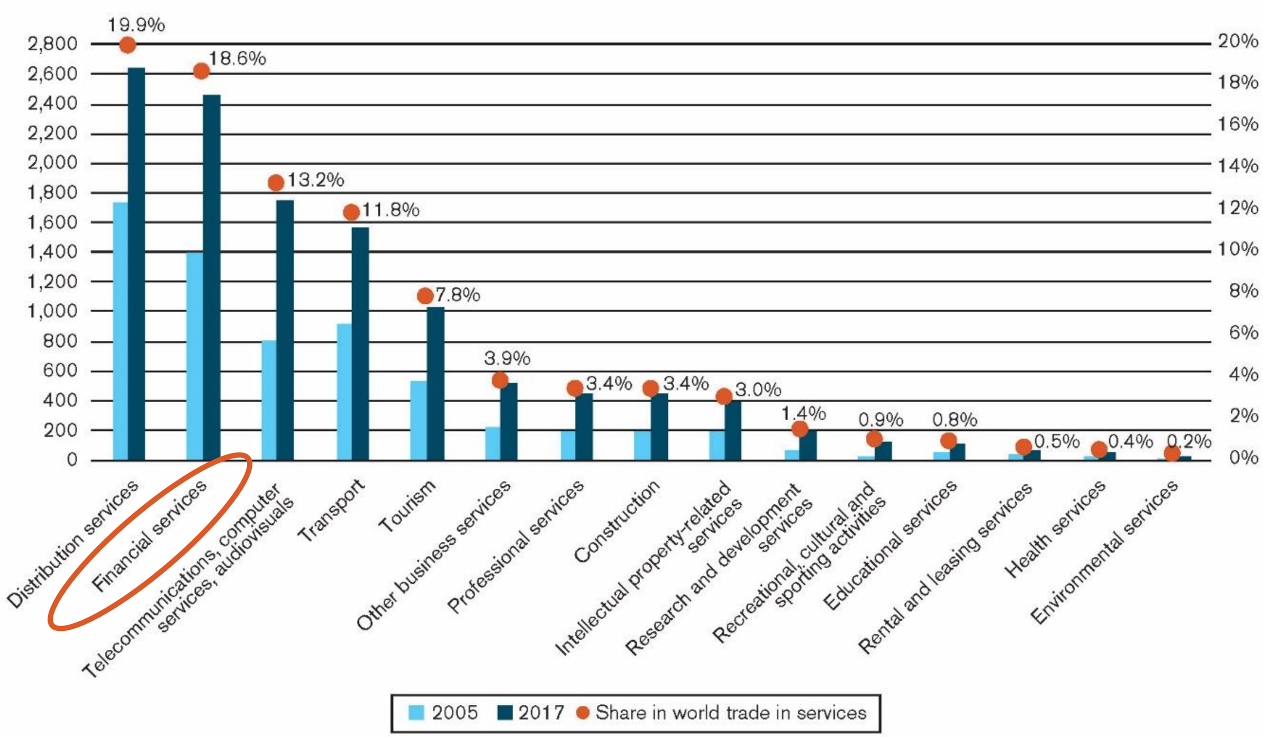
The future of services trade

Financial services are the second largest service sector traded globally

Figure B.2: Distribution and financial services are the most traded services[3]
World trade in commercial services by sector, 2005 and 2017



Source: WTO estimates (2019).

Note: World trade is calculated as the average of world exports and world imports.

- Global trade in financial services was worth US$ 2,463 billion in 2017
- That is 18.6 per cent of total services trade.

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Commercial presence is the dominant mode of supply

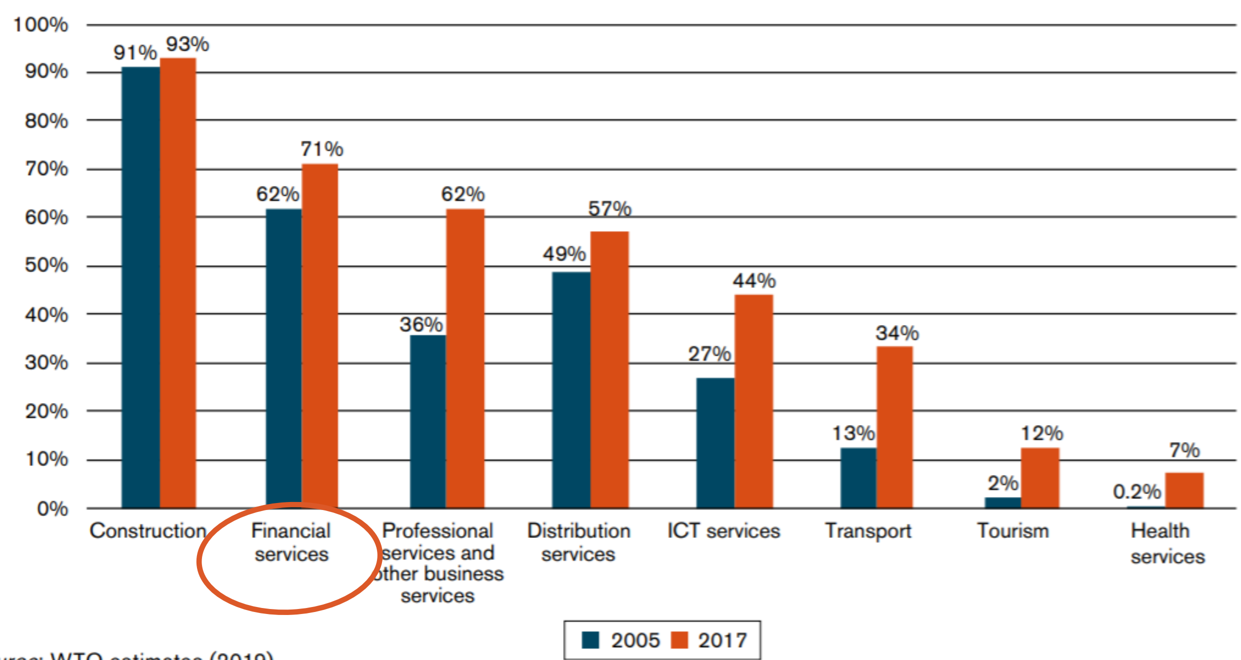
- World trade in financial services takes place predominantly by means of the establishment of a commercial presence in other countries (mode 3).

- In 2017, around 77 per cent of financial services, or some US$ 1,941 billion, were traded worldwide through foreign affiliates.

This is the case also for the main developing exporters

Figure B.12: For the top five developing economies, commercial presence is the dominant mode for exporting services

Five leading developing economies' exports through foreign-controlled affiliates abroad (commercial presence) in selected services sectors, 2005 and 2017



Source: WTO estimates (2019).

- China, Singapore, Korea, Hong Kong, China and India are the largest developing exporters of services
- 71% of their financial services exports were through foreign presence in 2017

But digitalization is reshaping the business model

- Increased digitalization, e-banking and mobile banking are reshaping business models for the finance sector.

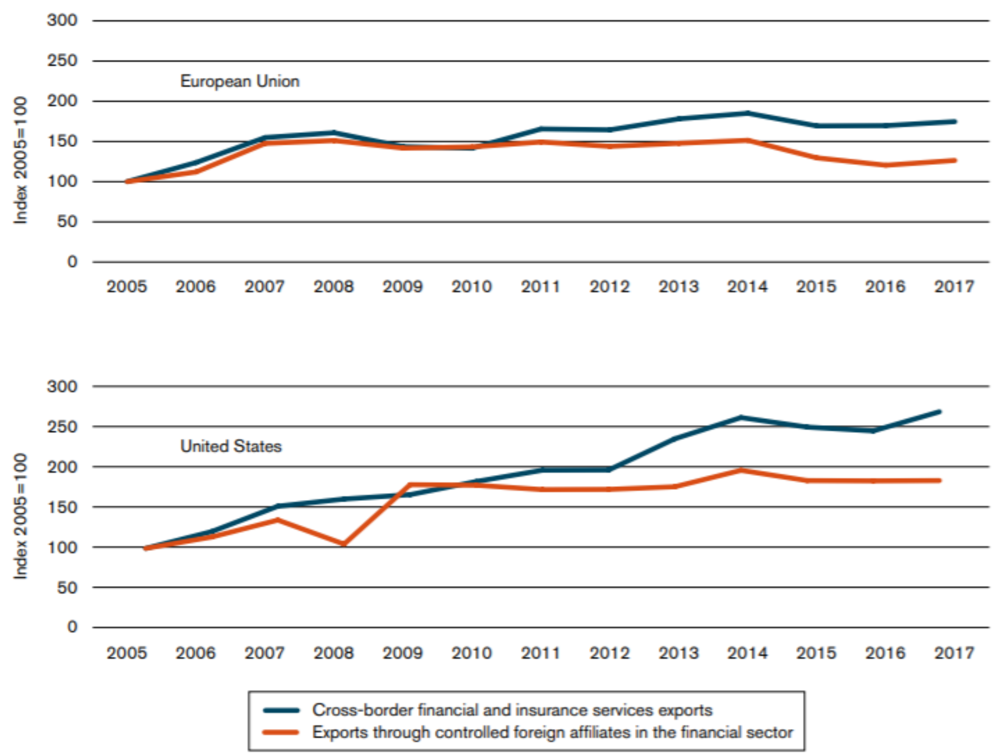
- Although banks and other financial services institutions maintain affiliates abroad for operations, they are offering an increasing number of services online, from credit card transactions to finance management.

- Insurance companies are making it possible to underwrite and submit claims online. These are only a fraction of the online cross-border services that digitalization is expected to bring to the industry in the near future.

Cross-border supply of financial services is gaining importance

Figure B.3: EU and US cross-border financial and insurance services exports are growing faster than exports through foreign-controlled affiliates

EU and US cross-border exports of financial and insurance services and exports through controlled affiliates abroad (mode 3), 2005-17



Source: WTO estimates (2019).

Note: The European Union is calculated as the sum of the 28 EU member states and includes intra-EU trade.

- The share of financial services exports through foreign presence is declining in the EU and the US.
- In 2017, the share of financial services exported by EU-controlled affiliates was 6 percentage points lower than in 2005.
- The United States' financial services exports through cross-border transactions almost tripled compared with 2005, reaching US$ 109.6 billion.

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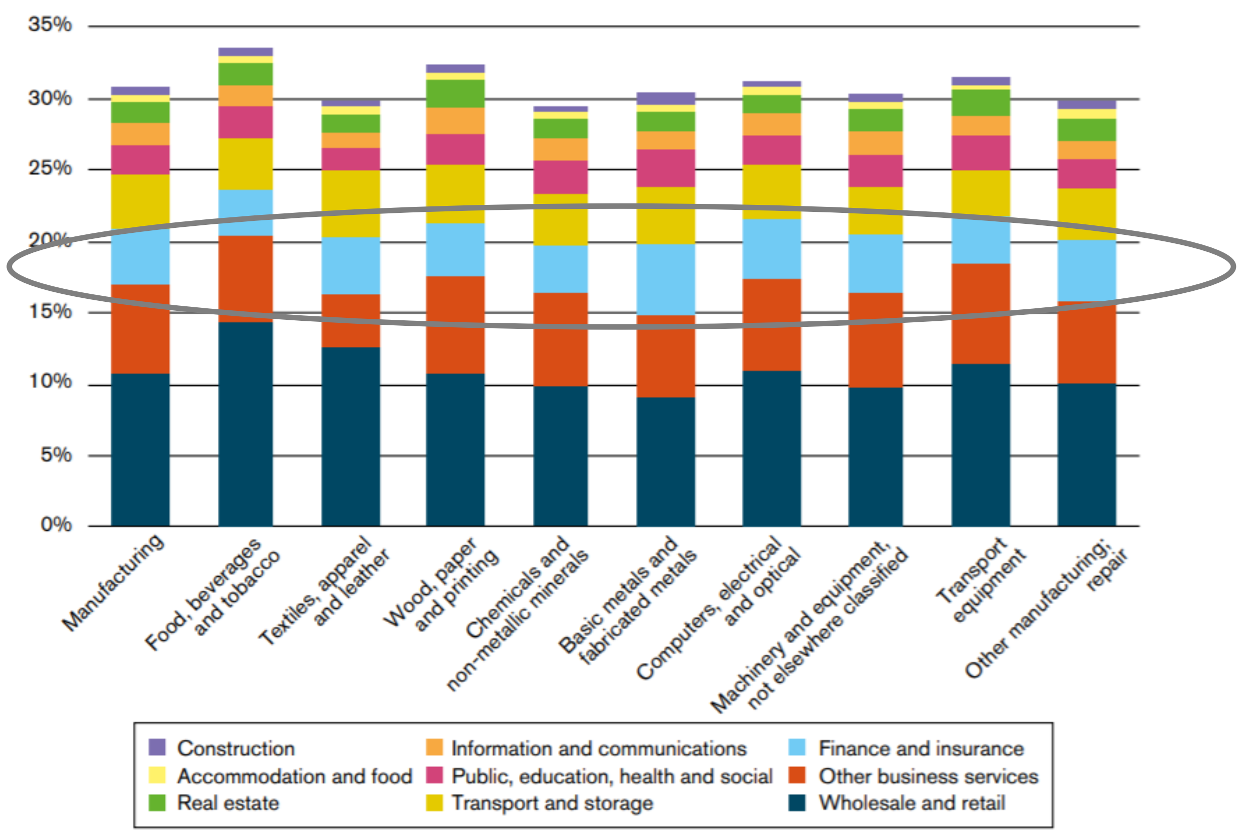
Financial services are important inputs into manufacturing exports …

Figure B.25. Services have similar relative importance for exports in different manufacturing sectors
Services value-added in exports of manufacturing industries, 2015



Source: OECD TiVA database (2018).

… which makes them critical for the functioning of the entire economy …

- The financial or capital market is responsible for allocating an economy's savings to their most productive uses and also for allocating investment risk to those willing to bear it.

- If this allocative function fares poorly because of an underdeveloped financial sector, it can starve productive firms of much-needed capital, while channelling resources to firms with poor prospects.

- The state and performance of financial services has thus an enormous influence on productivity across the entire swath of a modern economy.

… and sustainable development

- Many Sustainable Development Goals and their associated targets mention financial services.

- SDG 1 ("End poverty in all its forms everywhere") identifies better "access to [...] financial services, including microfinance" as a specific target.

- Access to financial services is mentioned as a means to
  - "End hunger, achieve food security and improved nutrition and promote sustainable agriculture" (SDG 2);
  - "Ensure healthy lives and promote well-being for all at all ages" (SDG 3);
  - "Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all" (SDG 8);
  - "Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation" (SDG 9).

Trade in financial services can potentially improve their quality and efficiency …

- The entry of foreign banks is associated with greater efficiency in the domestic banking system (Claessens et al., 2001)

- Greater openness of the financial sector can boost economic growth especially in developing countries (Eschenbach and Francois, 2002; Mattoo et al., 2006)

- The benefits from greater openness hinge on a minimum regulatory and institutional quality that can ensure the effective functioning of the financial sector (El Khoury and Savvides, 2006)

… leading to more competitive production

- Imported financial services can partly compensate for a weak domestic financial services sector, improving productivity in the manufacturing sector (Liu et al., 2018).

- Gains from a sound financial infrastructure are more pronounced for firms that are further from the industry-level technological frontier, notably in developing countries (Bas and Causa, 2013)

Case study: Financial services in Kenya (1)

- Kenya has expanded its financial sector, boosted trade in financial services, and become a regional leader and hub for financial services.

- Foreign bank participation, coupled with sound regulation, has been an important driving factor.

- At the end of 2017, Kenya’s banking sector comprised 42 commercial banks, of which 15 were fully foreign-owned and accounted for 30.1 per cent of total banking assets (WTO, 2019).

- Kenya’s banks and financial institutions have pursued vigorous expansion over the last years, with 9 banks having subsidiaries operating in other East African Community (EAC) countries.

Case study: Financial services in Kenya (2)

As a result:

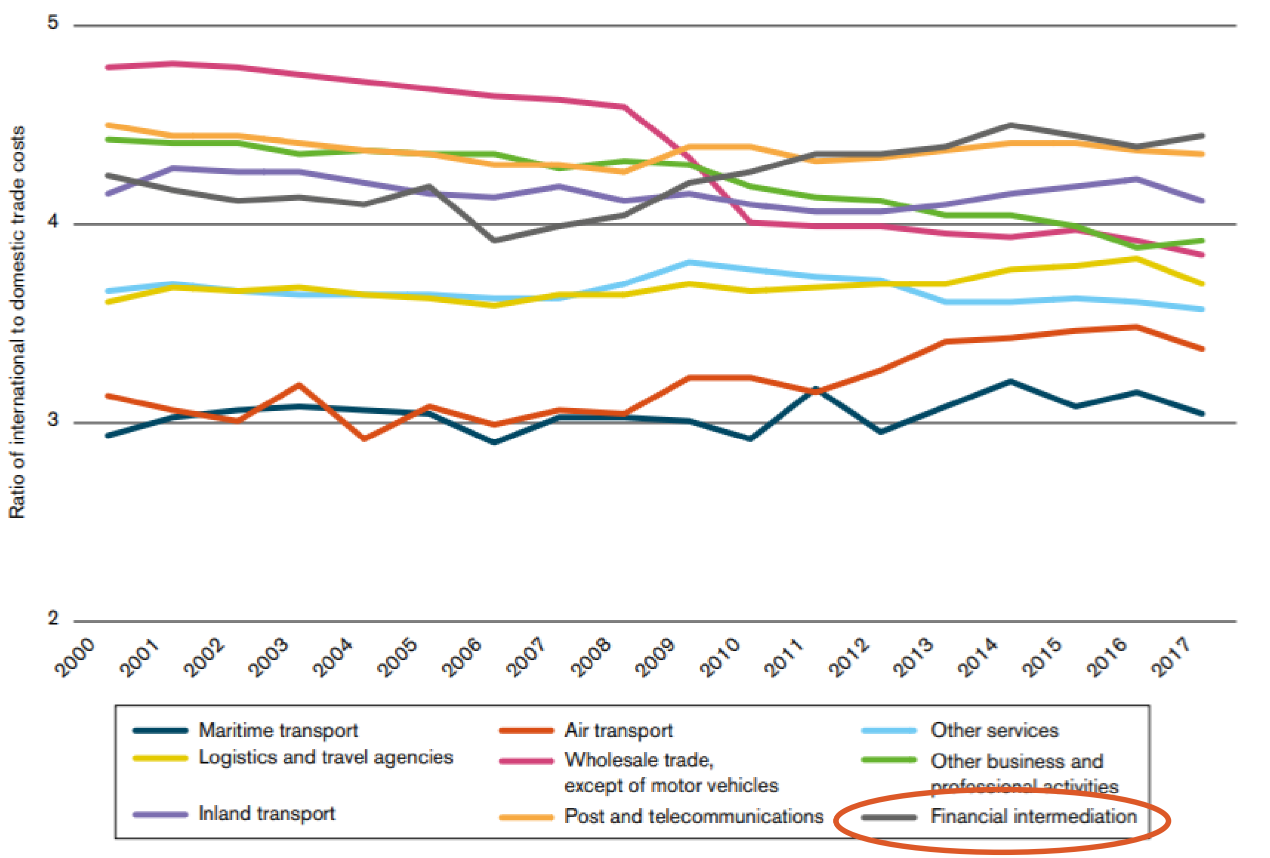
- Financial services have become an important part of the economy
  - the sector now accounts for 2.8 per cent of Kenya's total formal employment
  - and 4.6 per cent of total services exports (Hoekman and te Velde, 2017).

- This transformation has allowed Kenya to generate high-skilled and high-wage jobs in the financial sector.

- Kenya has also succeeded in improving financial inclusion through the expansion of the mobile banking sector.

The cost of trading financial services across borders has been increasing

Figure D.3: Services sectors with low trade costs
Trade costs in services by sector, 2000-17



Source: WTO estimates.

Note: The results are based on data for 43 economies. See Appendix D.1 for data sources and an explanation of the estimation methodology. The value of trade costs represents the ratio of international to domestic trade costs. "Other services" include community, environmental, cultural and personal services.

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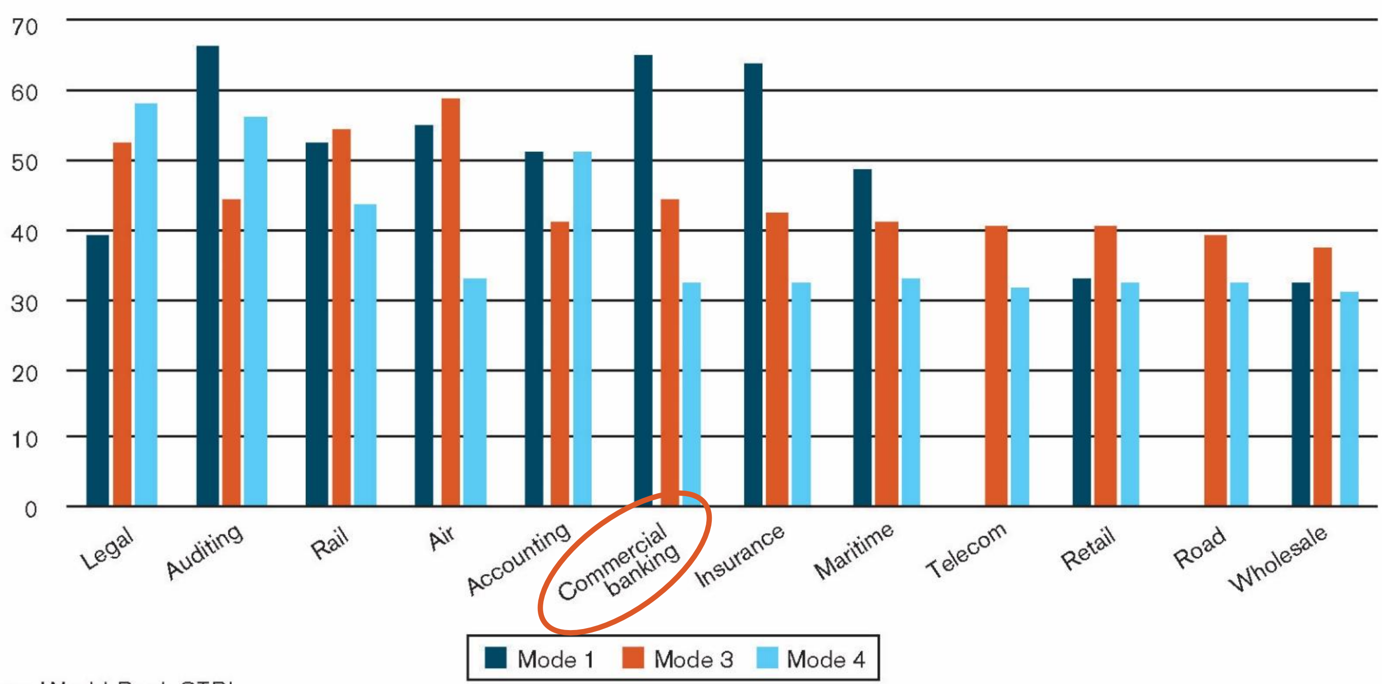
Commercial banking has one of the highest trade restrictions index on cross-border supply

Figure D.8: Services trade restrictions vary by mode of supply

Services Trade Restrictions Index by sector and mode of supply, 2016



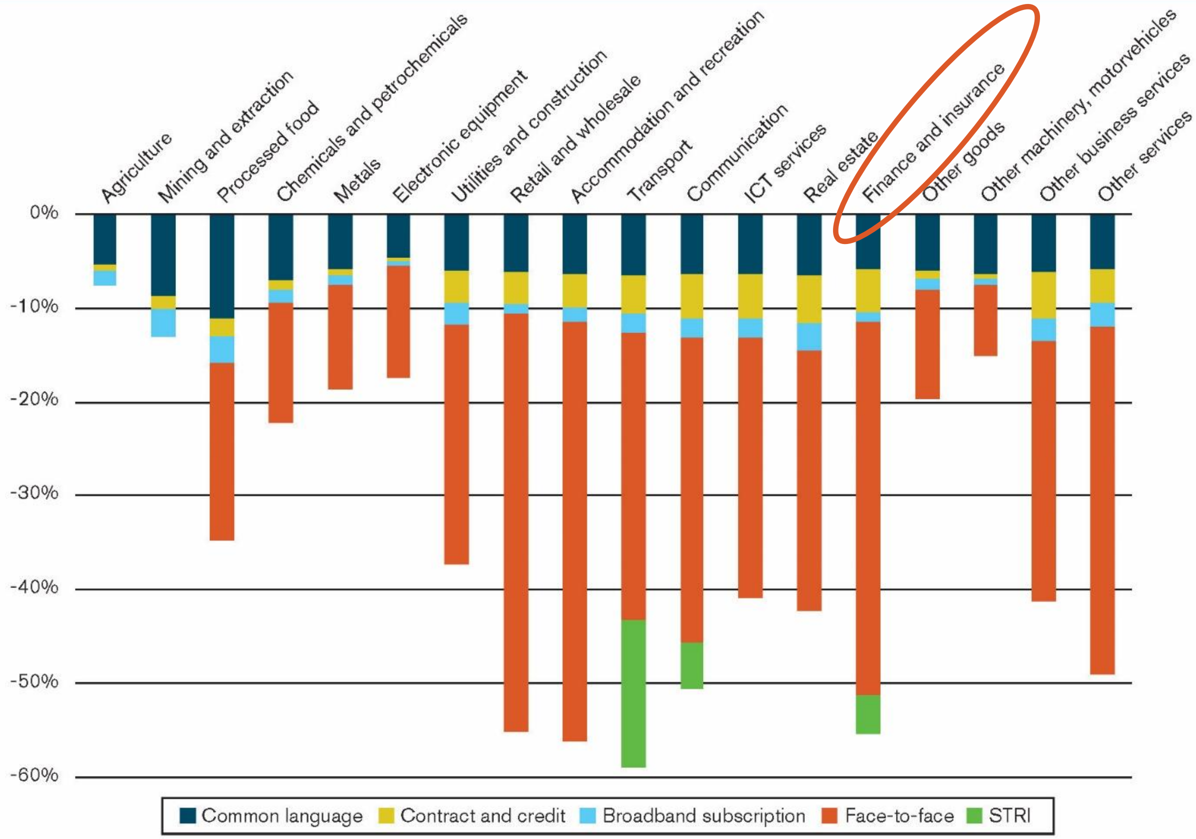
Source: World Bank STRI.

Note: The World Bank STRI ranges from 0 to 100. The STRI for mode 1 is not computed for the following sub-sectors: road transport, telecommunication, maritime cargo-handling, storage and warehousing, legal host country advisory and representation services. In other words, there is no mode 1 STRI for those subsectors.

Reductions in the cost of face-to-face communication are projected to greatly decrease the cost of trading financial services

Figure D.33: New technologies are projected to reduce trade costs in different services sectors

Ad valorem equivalent trade cost reductions 2018-40 – different trends (sector averages)



Source: WTO calculations based on various methodologies as described in the text.

Notes: Figure D.33 displays the contribution of different variables to the reduction in trade costs in the different scenarios. Common language, credit and contract, and broadband subscription measure the reduction in trade costs because of a reduced impact of the absence of a common language, poor credit and contract environment, and a low number broadband subscriptions, respectively. Face-to-face measures the reduction in trade costs, because of a reduced importance of face-to-face contact for trade costs. STRI measures the reduction in trade costs because of an improvement in services trade regulation. The methodology is described in the text. Note that percentage reductions are not additive. The corresponding numbers are in Appendix Table D.6

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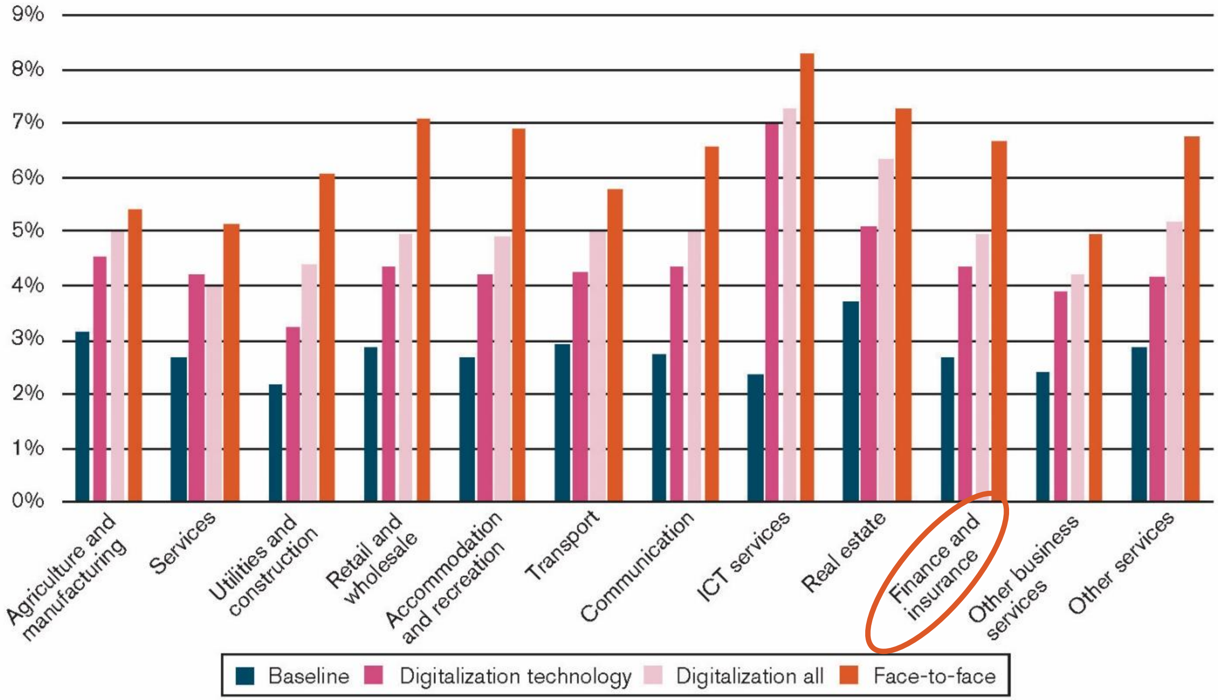
Under such scenario, financial services are projected to be among the fastest growing sectors

Figure D.35: Projected trade growth is highest in ICT services

Annual real trade growth in different services sectors, 2018-40



Source: Simulations with WTO Global Trade Model.

Notes: The figure displays the average yearly real trade growth from 2018 until 2040 under the different scenarios in the different sectors. "Agriculture and manufacturing" and "Services" are calculated based on trade-weighted averages. The digitalization scenario has been split into two in this figure. The "digitalization technology" scenario contains additional productivity growth and a more intensive use of ICT services in production. The "digitalization all" scenario adds reductions in trade costs associated with digitalization, such as an extension of broadband coverage. The face-to-face scenario, cumulative to the digitalization scenario, includes trade cost reductions because of the reduced importance of face-to-face interaction.

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International co-operation in financial services

- The WTO negotiations on financial services in the late 1990s is one services example of how plurilateral negotiations dedicated to a particular sector or topic can succeed, be integrated into an existing agreement (the GATS) and be applied on an MFN basis.

- The negotiations were first concluded at the end of July 1995. While many members had improved their previous commitments, the results were still considered unsatisfactory.
  - 66 members had made commitments on financial services by the entry into force of the WTO, of which 29 were improved during the 1995 negotiations

- Negotiations were successfully concluded in December 1997. The improved commitments entered into forced on 1 March 1999.
  - 89 members had made commitments on financial services

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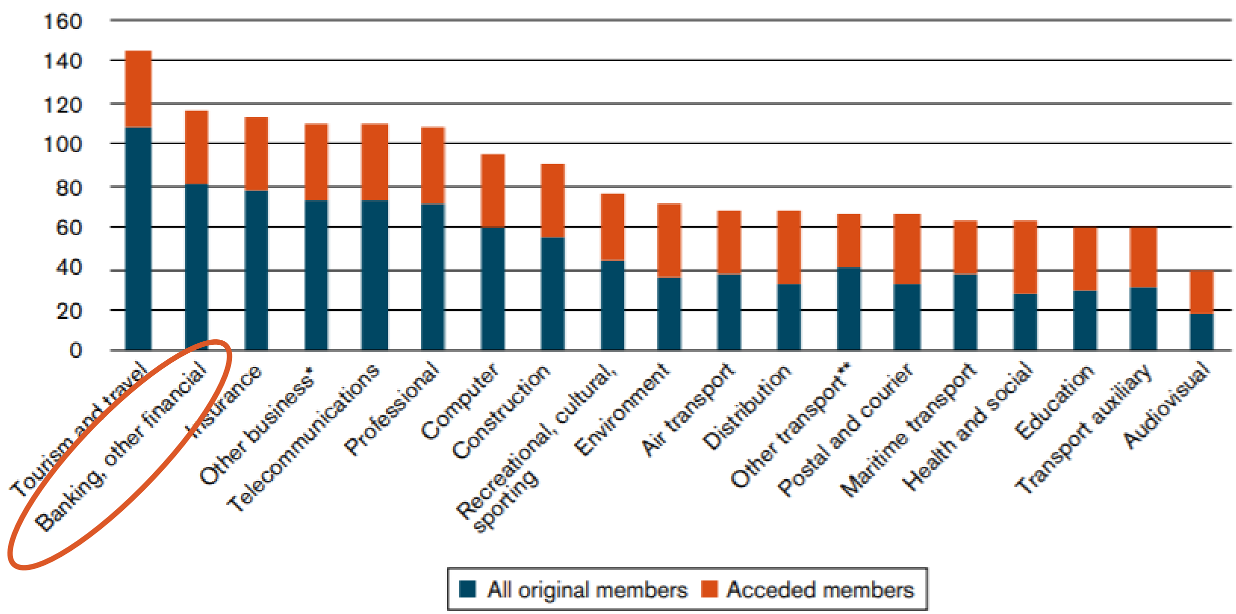
Financial services have a relatively high level of commitments in GATS

Figure E.4: GATS commitments vary by sector
Number of members with specific commitments, acceded members and other members by sector



Source: WTO Secretariat, May 2019.

Note: European Communities (12), which is used given that a number of the EU (25) members acceded to the WTO after 1995, are considered as one.

* Business services other than professional and computer and related services.

** Transport other than maritime, air, and auxiliary services to all modes of transport.

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Regulatory cooperation in the financial sector: Fintech (1)

- Technology-enabled innovation in financial services (so-called **Fintech**) has grown rapidly in the past decade, allowing for the emergence of such services as mobile payments and peer-to-peer lending.
- Fintech presents many challenges due to regulators' limited technological expertise which makes it difficult to assess innovative business models and practices, and their impact.
- An increasing number of regulators are responding to such challenges by introducing innovative regulatory approaches, including so-called **innovation offices** and **regulatory sandboxes**

Regulatory cooperation in the financial sector: Fintech (2)

- **Innovation offices** are often the first approach to improve regulator-innovator dialogue and are a good first option for resource-constrained regulators in emerging and developing economies, since they are easier to implement and operate than other regulatory initiatives.
  - More than 30 jurisdictions around the world are currently operating this type of office.

- Innovation offices may also facilitate international cooperation on regulatory matters through bilateral cooperation agreements.
  - The UK Financial Conduct Authority (FCA)'s Innovate as established in 2014 and has signed cooperation agreements with counterparts in Australia, Canada, China, Hong Kong (China), Japan, the Republic of Korea, Singapore and the United States. These agreements promote information-sharing on emerging trends in financial innovation between authorities and facilitate referrals of innovators from one market to another, thus reducing regulatory barriers to entry in foreign markets

Regulatory cooperation in the financial sector: Fintech (3)

- A **regulatory sandbox** is a formal programme that allows live and time-bound testing of innovations (e.g. new financial products, technologies, business models) with actual customers, subject to regulators' oversight.
  - The first regulatory sandbox became operational in 2016 in the United Kingdom. At the beginning of 2019, there were almost 30 jurisdictions actively implementing them.

- The sandbox concept is being explored to promote cross-border regulatory cooperation and enable innovators to gain economies of scale more rapidly on a regional or global basis.
  - Two initiatives for multi-jurisdictional sandboxes are currently under way: the Global Financial Innovation Network (GFIN), proposed in 2018 by the UK FCA, together with 11 financial regulators around the world, and the API Exchange (APIX), launched by the Association of Southeast Asian Nations (ASEAN) Financial Innovation Network (AFIN) (UNSGSA and CCAF, 2019).

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