SPEECH/06/314

Charlie McCreevy

European Commissioner for Internal Market and Services

Financial Markets and Globalisation

China-Europe International Business School

Shangai, 18 May 2006

Ladies and Gentlemen,

It is really an honour and a pleasure to address such a distinguished audience in the prestigious China Europe International Business School.

Since its establishment more than 10 years ago, this school has been a symbol of the dynamism and depth of cooperation between the European Union and China. But it is much more than a symbol. Thanks to the quality of its faculty and its students, the CEIBS is now recognised worldwide as one of the leading international business schools, ranking alongside the world's most renowned institutions – some of which were established more than a century ago. And, indeed in education, as in the economy, competition is now increasingly global.

To be recognised as a top-flight business school, it must attract the best students and the most talented professors from all over the world. It must generate ideas, knowledge and know-how that will spread across the globe and shape tomorrow's economic successes. Being a local reference point, or the source of national pride, is no longer sufficient. With the new rules of the game, winners and losers are picked on the world stage. This is also true for financial markets.

The global interdependency of financial markets

Globalisation cannot be categorised as a purely economic process. It also brings about changes in our way of life, our cultures, our perceptions of others and our environment. But it is undeniably in the economic sphere, and singularly in the financial sector, where changes have been the most profound and impressive.

I will not drown you in numbers, but it is a fact that global trade and investment flows have never been so large. The structural trend for the years ahead is not a declining one. On the contrary, in the foreseeable future, we can expect ever intensifying economic intertwining between the different global players.

This has sweeping consequences for the global financial system, as financial markets are the backbone of the economy. The impressive growth of international trade is resulting in strong financial linkages, creating an unprecedented interdependence between the financial sectors of the major global economies.

Opportunities and risks

Unlike some in Europe, I do not see globalisation as a threat. On the contrary, I am profoundly convinced that there are huge emerging opportunities, just waiting to be seized. I have only been in China for a few days now, but I can already feel the energy of its booming economy while it emerges on the global stage.

Those who condemn globalisation should not forget that European countries, and thus businesses and consumers in Europe, also greatly benefit from globalisation and international trade. Just look at the origin of the profits of the largest European companies.

But, despite these new opportunities, over the last few months we have witnessed a surge of protectionist rhetoric across the globe. Those who have followed the debate in Europe will know where I stand: protectionism is not my cup of tea. On the contrary, I believe companies should be able to expand when they see prospects for successful business. And my job is to make sure they can do so within Europe, even if I have to take Member States to the European Court of Justice to enforce the rules.

This is not only my job, but also my political responsibility towards European citizens. We all know that protectionism is hardly ever driven by sound economic reasoning, but rather panders to short term political objectives. I do not deny that, on very rare occasions, there might exist legitimate strategic interests to protect. But, in most cases, the protection of the general good is a thin excuse used to justify the protection of national vested interests. The citizens are often the losers, with hampered competition and a sluggish economy not able to create growth and jobs.

It would be easy to blame globalisation for all our problems. But, frankly speaking, it does not hold up to a detailed and objective analysis. I am not an ideologue, but a pragmatic policymaker. I can see that trade is a 2-way street. When competition is fair and unbiased, it benefits both sides. We should not forget this, while tough negotiations are ongoing within the WTO in Geneva. The EU has always promoted an ambitious agenda, notably in services. Our partners should now move very quickly if we are to meet the deadline of the Doha round.

At the same time, I am not naïve. New opportunities rarely come without new risks. In the financial sector, this was clearly demonstrated a few years ago, when a series of corporate scandals of a global magnitude unravelled. All major marketplaces were hit, and are still dealing with the aftermath, notably in restoring investor confidence. Because of the interplay between financial markets, a serious crisis in one market is also a threat for the stability of the other markets. All the major financial marketplaces therefore have a common interest in having the highest regulatory and supervisory standards.

Openness and fair competition as the right way forward

In this reshaped environment, all global players are faced with this strategic challenge: how to seize the opportunities within reach while fending off risks. Unfortunately, there are no “quick-fix” solutions. In many cases, wide-ranging structural reforms need to be implemented to create the regulatory framework for an efficient, competitive and attractive financial sector.

Any policymaker knows that structural reforms sometimes give rise to short-term difficulties. But only good policymakers know that the transition costs of carefully prepared and wisely implemented structural reforms are more than offset by the long-term benefits of a vibrant and growing economy and the increased social welfare it produces. Experienced and wise policymakers know that indefinitely delaying necessary reforms can only lead to a catastrophe, whether this come in the form of lasting economic underperformance or a more sudden crisis situation.

In Europe, our main challenge has been to integrate financial markets in order to create a dynamic and safe internal market for financial services, serving 450 million citizens in 25 Member States, with more joining in the near future. The preparation of the introduction of the euro in 1999 revealed the state of fragmentation of the European financial sector. This needed to be tackled with great political determination.

That is exactly what the EU did by implementing the Financial Services Action Plan (FSAP). This ambitious plan was aimed at completely revamping the European financial regulatory and supervisory framework within a 5-year timeframe. Despite the impressive number of measures it contained, the FSAP was implemented in full and on time. Building on this success, the Commission adopted last December its Financial Services Policy for the next five years. This policy reaffirms the political objective of building the best financial framework in the world by consolidating dynamically towards an integrated, open, inclusive, competitive and economically efficient EU financial market.

The EU's political choices rely on a two-tiered vision. Firstly, as I said, competition in today's market is global. Investors in search of higher returns will channel their money towards efficient and safe markets, wherever they may be. Issuers looking for easier and cheaper access to finance will raise money on the most liquid and transparent markets, regardless of location. Financial marketplaces can no longer exist in isolation, cut off from the rest of the world. Closed markets will see their liquidity slowly – but surely – being siphoned off towards the more open ones. That is why Europe has made the resolute choice of a fully open market. It is not a sign of weakness. On the contrary, openness reinforces the strength of the European financial marketplace, by attracting capital flows and foreign financial services providers.

This brings me to the second element of our vision. Competition among financial services providers must be encouraged. It increases efficiency, fosters innovation and enables consumers to benefit from more efficient markets and better products. It should of course take place on a level playing field. Unfortunately, the argument of a level playing field is often perversely used to discourage, impede, or even block, foreign competitors from entering domestic markets. In Europe, the rules are clear and non-discriminatory, including towards third country operators. As is the case with operators based in the EU, they can benefit from free movement of capital, as enshrined in the EU treaty. Once they have established a subsidiary in the EU, they enjoy easier access to all EU markets through the passport mechanism.

Today, we are already seeing the benefits of our policy, with buoyant and sound markets and a healthy financial sector. By consolidating the progress made so far, additional benefits are within reach and will strengthen further the competitiveness of the EU financial sector on the global stage.

The need for regulatory cooperation

Over the last few days, I have had the opportunity to meet and discuss with many of the key policymakers and economic actors in the Chinese financial sector. From what I have seen, the strategic issues facing China today are no less challenging than those that we are addressing in Europe. Although there may be some differences in our respective challenges, I believe that there is a great deal of common ground in how we are to tackle them. We can, and should, learn from each other's experience to see what works and what does not.

Increased cooperation between regulators worldwide is not only necessary: it is inevitable. Because markets are so deeply connected one to another, actions that a regulator in one market takes will surely have consequences on the others. Such spillover effects need to be anticipated as much as possible, in order to avoid unintended, adverse effects. Again, the choice is not really between doing something or doing nothing, but rather between being smart by solving problems *ex ante* or having to constantly put out fires that could have been avoided.

In the recent years, we had to learn how to take this external dimension into account in our policy making process – sometimes in crisis situations. In the light of the corporate scandals I mentioned earlier, each jurisdiction engaged in a review of its rules on financial information, with the objective of strengthening controls and closing loopholes, in order to avoid any new fraud of this nature. But the events which provoked this reaction precisely evidenced that an uncoordinated addition of domestic response would not be sufficient, or might even be counterproductive.

Policymakers do not simply have an obligation of means – piling up costly compliance requirements – but an obligation of results. In a globalised financial marketplace, this obligation can be only met through increased cooperation. Regulators must build mutual understanding. Exchange information. Imagine new work-sharing methods, which take into account the specificities of the local markets.

The challenges for regulators

I believe we have travelled a long way in a short period of time. This allows us to move away from the heat of instantaneous problem-solving and to set up a more upstream, pro-active agenda for regulatory cooperation. Broadly speaking, I see three main challenges for regulators.

Firstly, as global interdependency is growing, inefficiencies and frictions are inevitably appearing. Companies are raising capital internationally. Investors are diversifying their risks across borders. Financial institutions are serving their customers globally. But these economic actors are often confronted with many unnecessary hurdles: redundant requirements, double checking, regulatory spillover… The role of the regulators is to work together to safely remove those sources of inefficiency. For instance, when a bank is subject to rigorous prudential oversight in its home country, with stringent capital rules, I do not see the need for adding layers and layers of excessive capital requirements.

The role of regulators is also to adapt the regulatory framework to innovation and structural changes. The challenge is to make sure that outdated rules will not stifle innovation, while ensuring that investor confidence and financial stability are protected. In this respect, regulators of the major financial markets have to take the lead and play a role in promoting the highest standards on the global stage.

Finally, regulators must also address the emerging risks, by protecting markets from instability, fraud and financial crises. One could say that the principle of the weakest link applies to global financial markets. That is why we need global standards in the area of banking supervision, accounting, auditing, and money laundering. A "race to the bottom" will only benefit fraudsters and criminals, who will not hesitate in exploiting any possibility of dangerous regulatory arbitrage.

Conclusion

Ladies and Gentlemen, let me conclude.

Much has already been said on the recent evolution of global financial markets. Today, I have tried to look further ahead and sketch what the consequences of those changes are for global financial players. Globalisation reinforces the case for openness and fair competition. In my view, those will be the two yardsticks in judging who the winners and the losers will be in the years to come. Protectionism will undoubtedly be on the losers' side. The winners will be found amongst those who will be courageous enough to embrace new opportunities and implement the necessary reforms.

Adapting the financial regulatory framework to the new economic environment is a common challenge for regulators, in China, in Europe and elsewhere. This is by no means an easy task. However, with that objective in mind, we have to cooperate as much as possible. That is our only route to success. The discussions I have had in Beijing and here in Shanghai have given me the confidence that authorities in both the EU and China are up to this challenge. We will deliver what companies and citizens can legitimately expect from us.

Thank you for your attention.