Living in a Global Economy: Implications for the Liberalisation of Financial Markets and Services

by

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Introduction

Ladies and gentlemen, good afternoon. I would like to firstly thank the organisers for inviting me to speak at this panel discussion. It is my privilege to be here with you today on the occasion of the Malaysian Finance Association's Second Annual Symposium. The timing of the Symposium is interesting in that it comes at a time when we can safely say that the Asian crisis is behind us and that, with a couple of exceptions, the outlook for this region is generally favourable. So we are looking at strategies for growth rather than for rehabilitation. One of the most difficult issues that we have to grapple with in planning for growth, I think, is in the area of financial liberalisation.

Let me begin by outlining what I would classify as the three Ws of Financial Liberalisation.

The 3Ws of Financial Liberalisation: What, Why and Who

The first "W". What is financial liberalisation? The topic is one that has been rather heatedly debated in local circles for quite a while and has been, I think, the focus of quite a fair amount of media exposure and academic interest. Coming from the capital market regulatory agency, it is inevitable that we have seen and heard strong arguments on this subject from a wide range of sources with whom we have frequent contact: from industry leaders, government, our regulatees and the general public. Even within Malaysia, there are widely disparate views on what is the best approach towards financial liberalisation. For some, only total liberalisation-which I would define here as the freeing up of financial services, ownership and the employment market to foreign competition-will suffice; for others, only total protectionism makes sense.

Living in a global economy. To make sense of the debate, we need to look at what the primary impetus for financial liberalisation is. I think that the overriding reason given for pursuing liberalisation strategies has been, and continues to be, the increasing pressure to be more competitive in a rapidly changing world-a process often referred to by the unfortunately over-used term "globalisation".

To define globalisation of financial markets as the increasing integration of global society and economies is almost trite. The process of globalisation, while not new in itself, has become an integral issue in the development of financial markets world wide because of the growing tendency for enterprises to operate across national borders, and the extensive advances made particularly in communication technologies.

I will not be discussing all the detailed issues driving the globalisation process at this session; that would probably take us into the night to finish! I think the general issues are probably familiar to most of you as well. They relate to how the Internet and technology are revolutionising the face of capital markets; how increasing competition for business is intensifying the rate of mergers and alliances between exchanges and financial institutions world-wide; and how greater levels of education and awareness are spawning a new breed of sophisticated investors and investment professionals. All of these factors have contributed to the phenomenal growth of global markets and capital flows over the past decade.

The second "W". Why are these developments relevant to Malaysian capital markets? Naturally, this increase in capacity has heightened pressures on national securities markets to accelerate efforts to stay ahead of the curve, and not get left behind. The pursuit of liberalisation policies has been conventionally seen to be the best way to extract value from globalisation. The competitiveness of the financial services industry typically relies on two main features: efficiency and cost. Where liberalisation can increase efficiency and decrease costs, there will be significant implications for the competitiveness and attractiveness of conducting business in the Malaysian capital market.

No homogeneous approach to liberalisation. That said, though, I very much doubt if there is any one-size-fits-all approach towards liberalisation that can be regarded as universally optimal for all financial markets. In the post-war period, the US, Europe and Japan (and some other parts of East Asia) each embarked upon their own specific programmes of market liberalisation. Each has been successful in its own way, given that all three are regarded as among the most highly advanced economies in the world. However, their approaches are markedly different. Japan, for instance, has been deregulating its domestic financial sector for the past few years, but is still considered relatively closed to foreign financial service providers. On the other hand, banking in the US is often criticised by market participants as over-regulated, yet US financial service markets are relatively open to foreign financial service providers.

For all the talk about the benefits of greater liberalisation, World Bank estimates indicate that only 25% of service sectors in industrialised countries are currently subject to full international competition.1 So clearly even advanced economies have reservations towards simply opening their markets for services and exposing them to unconstrained external competition.

The right approach, I think, is to allow each country to approach liberalisation in its own way and to adopt a process that seems best suited to its own circumstances. This is all the more relevant as we move towards a knowledge-based economy, where the potential for monopolisation is perhaps even greater than in a production-based economic system. In the so-called "New Economy", the need to further elevate the breadth and depth of financial services offered within Malaysia grows even more critical. We have to harness new technology and knowledge where possible to make the quantum leap to engage in meaningful competition with more developed markets.

The third "W". However, while I am all for reaping the benefits that greater foreign access to our markets will bring, there are several critical questions we must continue to ask ourselves. Most importantly, what will be the benefit of greater financial liberalisation when weighed up against the costs of greater foreign access? Having touched on what the financial liberalisation process is, and why international markets are increasingly facing pressure to liberalise their financial markets, this leads us to the question of: "Who?" Who are the main winners and losers, if you will excuse the term, of greater financial liberalisation?

Local markets and institutions may lose from premature liberalisation. To assume that greater liberalisation per se will automatically lead to an efficient and robust market would be, frankly, a little naïve. Premature and improperly sequenced liberalisation can open up markets to greater instability and the potential loss of investor confidence if there are insufficient safeguards to manage large and sudden reversals of capital flows: a scenario many of us are unfortunately all too familiar with from the experience of recent years.

Furthermore, free market capitalism is fine in theory but, for all this talk about levelling the playing field, we have to recognise that there is an inherent tension between the objective of liberalisation and the reality of liberalisation. Liberalisation does not automatically translate into the enlargement of the economic pie, which is then shared equitably among all participants. Multi-national financial service providers-such as those arising from the recent spate of international mega-mergers between major financial institutions-wield superior economic power and wider distribution networks in comparison with their counterparts in most developing countries. Domestic businesses in rapidly liberalised sectors can easily be overwhelmed by the sudden intensification of competition from stronger foreign market participants, unless there are adequate preparatory measures beforehand. This is exacerbated when the liberalisation process does not actively target the effective transferral of improved technology and skills to local players.

But is not liberalising at all a viable choice?

So, while views broadcasting the evils of quick liberalisation may be unpopular in some circles, they have very real merit. But I would say that-while liberalisation is but one response to globalisation-the choice of simply maintaining the status quo is not a choice at all. Doing nothing will simply consign us to the backwater of the global marketplace.

Argentina's stock market is one case in point. Heightened global competition and domestic under-development have, in recent years, seen a drastic migration of business away from the Argentine bolsa. Issuers have complained of the stock exchange's sluggishness in adapting to the needs of Argentine companies. Consequently, limited domestic capacity has basically driven firms to other markets instead to raise money. Dwindling investment choices mean that Argentine stocks are gradually disappearing from the radar screens of fund managers invested in Latin American securities, and this has in turn led to many local firms looking to other alternatives, including delisting from the Buenos Aires Stock Exchange and moving to foreign exchanges. These developments have raised very valid concerns over the future of the Argentine equity market as large stocks disappear.

Mitigating the pain of change.

Similarly, the challenges we in the Malaysian financial sector face today will force us to adapt our practices and thinking in order to survive and grow. The only way we can mitigate the pain of change is to prepare ourselves appropriately for the challenges that it creates.

One driver for greater financial liberalisation that is often cited is the way the Internet has totally transformed traditional methods of access to global markets. The Net virtually opens up new markets and opportunities for both retail and institutional market participants, causing transactions to become increasingly independent of geographical and regulatory barriers. The popularity of web-based trading such as e-Trade and Island in the US testifies to the vast potential coverage of online trading. To a certain extent, this is already being explored on the local front. Many brokers, not only in developed markets but also some on local shores, already allow order transmittal services via the Internet.

The shift in the trading paradigm calls for a renewed perspective on the fundamental role of market intermediaries. Technology and increasing liberalisation have also intensified the pressure on brokers, investment houses and other market intermediaries to adapt so as not to lose out on business or, at the extreme, become redundant. For instance, some brokers have developed their own private networks to serve their customers. Some are rationalising their operations to cut costs and focus their efforts on value-added areas.

Exchanges and clearing houses, too, are not exempt from having to keep up with the pace of change. We have seen exchanges such as Nasdaq becoming increasingly engaged in cross-border competition and alliances to not only attract company listings globally, but also to broaden trading access and penetrate a wider pool of investors. Even closer down south, we have seen the newly-established Singapore Exchange engaging in active alliance negotiations with the likes of the Australian Stock Exchange and the National Stock Exchange of India.

That said, the composition of investors itself is changing. Larger ageing populations means that there will be increasing demand for the efficient deployment of savings and pension funds invested in the capital market. The advent of a more investment-savvy generation of investors and fund managers, should lead to further pressure on brokers and investment banks to provide cost-efficient and value-added services.

Liberalisation can arguably accelerate local residents' access to a broader and most cost-efficient range of products and services catered to their individual needs. It should also provide the necessary impetus for the local financial industry to develop its own backyard in line with international standards of practice, so that Malaysian financial institutions will not be found lagging in this respect.

For instance, measures were taken late last year requiring all stockbroking firms to comply with new rules Capital Adequacy Requirements. These changes were significant in that they not only provided a proactive alert mechanism for stockbroking companies to better quantify, manage and address the risks of their businesses, but also set the standard for the overall risk control framework for stockbroking companies on par with international best practices.

These challenges are not unique to the Malaysian market. It is natural that the structure of markets and firms should adapt as the industry searches for cost-efficiencies and competitive advantages. Although eventual liberalisation is inevitable if we want to realise the ideal of developing a world-class financial services sector for Malaysia, a pragmatic approach is needed to ensure that domestic residents and markets are not disadvantaged or encumbered by a hasty liberalisation process.

Pragmatic sequencing of the liberalisation process.

Having said that, there are a number of sequencing issues-many of which are already being carried out now-that can facilitate the liberalisation process. A gradual deregulation of the domestic financial industry, as a first step, will compel domestic market participants to engage in much higher levels of competition among each other than they have hitherto been subject to. This stage of the process may also include the comprehensive rationalisation of key sectors to ensure that the players we do have are those that have the critical mass to compete effectively in the increasingly competitive marketplace.

There should also be an objective assessment of the costs and benefits of allowing freer capital flows to and from the domestic financial system. In addition, we need to develop a pool of skilled human resources-a fact which, I think, is often not emphasised enough-through both ongoing education and the effective transferral of skills from qualified international professionals. For all this talk about greater competition and efficiency arising from liberalisation, there will be serious negative implications if we do not have the requisite safeguards, or capacity, in the Malaysian financial services industry equipped to deal with the challenges of such competition. We have to be careful that domestic firms and industries are not totally squeezed out by our unequivocal embrace of globalisation.

As we are mindful of this fact, the SC has endeavoured to foster this gradual increase in competition, including the recent lowering of trading fees and the staggered deregulation of fixed brokerage commissions to fully negotiable rates by 1 July 2001, subject to a cap of 0.70%. The SC is also in the midst of developing a framework for the implementation of e-commerce in the capital market, which will be incorporated into the Capital Market Masterplan currently being developed by the SC. This framework will include recommendations to facilitate more efficient processing of trades, electronic information dissemination, as well as prudential safeguards to ensure that investor protection is not compromised.

Shared responsibility for the management of the liberalisation process.

While we on the regulator's side have ongoing efforts to address these issues, gearing our financial sector for greater foreign competition is really a partnership effort between the public and private sectors. There needs to be co-ordinated efforts by both the public and private sectors to keep pace with changes so as to support robust, competitive markets without abandoning needed safeguards. Any sensible approach towards liberalisation must bear in mind, but clearly identify the milestones for each stage of progressive liberalisation, and closely evaluate the need for further opening up of market access to meet longer-term success factors. These issues will be addressed further in the Capital Market Masterplan, including the sequencing and extent of liberalisation needed within and across markets and industries in order to arrive at the targeted strategic positioning of the Malaysian capital market within the next ten years.

Conclusion

Let me say, in conclusion, that I do not doubt that in the years to come, capital market participants will inevitably face increasingly difficult issues. But the whole point about financial liberalisation is about making financial services and products more efficient and less costly to the end-users. The main plus side of well-managed financial liberalisation, I believe, is that not only will we end up with stronger institutions, but consumers will be offered wider choices and more efficient financial services and resources in the long run. I would not by any means suggest that this process is simple. However, the short-term hurdles in meeting these challenges will, hopefully, be eclipsed by the longer-term development of the Malaysian financial services industry.

Thank you very much.