

# Mumbai as an International Financial Centre

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# International financial services (IFS)

An example:

- A South African railway project comes to Mumbai to do a bond issue
- It faces a sophisticated primary market with a plethora of global and local investors
- This leads up to a liquid secondary market - a full ecosystem with information, research, speculation, derivatives
- It is able to choose any major global currency to issue in.

When this happens, India reaps 'export revenues'.

# The South African railway project has choices!

- It can go to Singapore, London or New York.
- For Indian financial services to interest a global customer, India has to match global quality and global prices.
- This is like any other situation where the challenge of exporting is faced:
  - Export orientation requires achieving global standards of quality and price;
  - Domestic consumers are best served when Indian producers are export-quality.

# What are IFS?

Fund raising	Fund management
Secondary market trading	Risk management (derivatives + insurance)
Knowledge services (databases, research, training)	Support services (law, accounting, taxation)

At an IFC, all six aspects are uncompromisingly *international*: Global customers, global firms, all currencies, global employees.

# The four big questions

- Why should India try to have an IFC?
- Is achieving an IFC feasible for India?
- Can we diagnose what holds us back?
- How can we solve these problems?

## Part I

Why should India try to have an IFC?

# Indian purchase of IFS

- GDP and cross-border flows are growing rapidly
- IFS demand rides on cross-border flows
- HPEC estimate: IFS purchases were \$13 billion in 2005
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- HPEC estimate: IFS purchases were \$13 billion in 2005
- In 2015, HPEC estimates these will rise to \$50 billion – \$70 billion.
- There is no case for protectionism: Buyers should have access to the best service providers.
- But shouldn't India try to sell to this natural market?
- India has done well when high skill labour is required.
- English, mathematics, IT, finance: all fields where India has tremendous human talent.
- Reverse protectionism: “Import of steel is permitted but domestic production of steel is inhibited by policy”.

# The most important reason

- Finance intermediates savings into investment
- A better financial sector is more effective in converting a given investment rate into a higher GDP growth.
- E.g. - remarkable ICORs of US and UK are partly about the strength of their financial systems.
- An ideal tool in the task of accelerating GDP growth.
- What is the best way to ensure that Indian consumers get world class televisions? By having local firms produce to export quality, by being open to trade and FDI.
- What is the best way to ensure that the Indian economy is well served by a world class financial sector? By having local firms produce to export quality, by being open to trade and FDI.

## Part II

Is achieving an IFC feasible for India?

# Six strengths

Hinterland advantage – fast growing GDP, even faster growth of cross-border flows	Human capital – English, risk-taking and trading, IT and mathematics, Indians in global financial firms
Location	Democracy, freedom of speech, rule of law
Mindshare	Strong securities markets - Rank 3 and 5 in the world.

## Part III

Can we diagnose what holds us back?

## Two areas with problems

**Urban economics** Achieving an IFC requires attracting the best and brightest - people who could choose to live anywhere in the world. Mumbai needs to become a world class city in terms of life, work and play, in order to attract these key individuals.

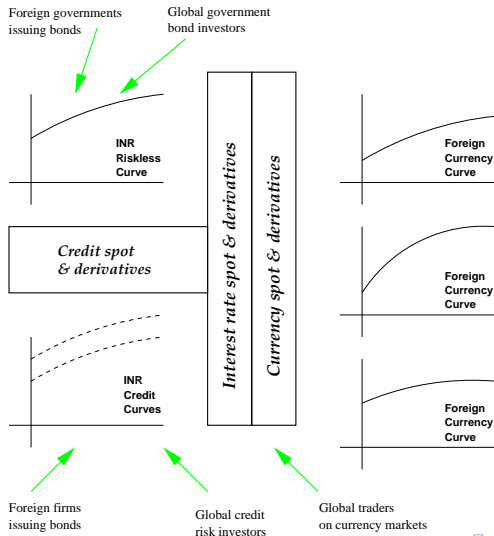
A failure to do this will relegate India to second-tier low-value support functions, which are akin to BPO.

**Financial sector and macroeconomic policy** India needs to match world standards in financial sector policy so as to enable IFS production, which in turn, requires modernisation of macro policy.

# Weaknesses of Indian finance – a strategic view

- 'Missing' markets for debt, currency and derivatives
- Inadequacies of institutional investors: size, sophistication, flexibility,

# The Bond-Currency-Derivatives (BCD) Nexus



# Why?

Why is the BCD Nexus missing? Why are the institutional investors inadequate?

- Poor levels of competition
- Compartmentalisation of the financial system
- Barriers to innovation

These three areas of work constitute a pragmatic assessment of where the maximal progress can be obtained in achieving an IFC.

## Part IV

How can we solve these problems?

# 1. Macro policy

As a new player in the IFS game, macro stability in India will be judged *more* stringently than is the case with incumbents.

## Fiscal

- Measure the debt/GDP of the consolidated government fully
- Improve transparency and reporting
- Bring down the consolidated debt/GDP to levels like 50–65%

## Monetary

- Independence + Accountability
- Transparency: The market must know the monetary policy regime
- Must have no conflicts of interest
- Inflation targeting is the ‘gold standard’; it would give global investors confidence in the INR.

## 2. New approaches on public debt financing

- Avoid 'original sin' by avoiding foreign currency exposures such as MIB
- Issuance of INR denominated bonds is safe
- Fully open up INR denominated bonds to global fixed income investors
- Build a stable community of global fixed income investors through inflation targeting, a declining debt/GDP ratio, and fiscal transparency + disclosure.

### 3. Creation of BCD Nexus

- Launch currency spot trading on exchange with a 'market lot' of Rs.10 million, accessible to all financial firms in the first stage.
- Launch INR cash settled currency derivatives on exchange, accessible to all.
- Solve the policy difficulties holding back the interest rate futures.
- SEBI as the regulator of all organised financial trading: exchange / OTC, spot / derivatives, currency/bonds.

## 4. Financial market integration

- Place all organised financial trading under SEBI regulation, spanning currencies, equities, sovereign and corporate bonds, and commodities.
- 'Holding company' structure, where a financial firm owns many subsidiaries which are banks / mutual funds / etc.
- Create a new 'wholesale asset management' business, and remove all impediments to outsourcing of fund management by banks, insurance companies, pension funds, mutual funds, etc.
- Shift from regulation of entities to regulation of domains. IRDA would regulate insurance products, not all activities of insurance companies.

## 5. Principles-based regulation

- Shift from prescriptive rules-based regulation to principles-based regulation.
- A new 'Financial Services Modernisation Act' which brings a new approach to bear on financial law.
- Creation of IFSAT which hears appeals against all financial regulators by all financial firms.

## 6. Capital account convertibility

HPEC recommends convertibility in 18-24 months.

## 7. Taxation of IFS and financial transactions

- HPEC does not propose a tax haven or even 'encouraging' exports by using fiscal subsidies.
- HPEC only emphasises core principles of sound tax policy:  
You cannot export taxes  
Taxes on turnover (i.e. excises) are bad taxes.
- HPEC reiterates proposal of FRBM Task Force of introduction of GST.
- Finance should be integrated into GST, with zero rating of exports.
- Simultaneously remove all central and state turnover taxes including STT, stamp duties, etc.

## 8. Competition and innovation

A series of efforts need to be undertaken immediately to step up competition and create an innovation-friendly framework:

- Remove barriers against private domestic corporations from starting financial firms;
- Remove barriers against foreign financial firms from operating in India;
- Restrict demands for reciprocity only to domestic financial services;
- Progressively reduce public ownership of financial firms;
- Removing barriers to M&A.

## 9. Performance of the legal system

Embark on considerable improvements so as to resolve disputes, adjudicate settlements, and enforce complex financial contracts in realtime.

## 10. IFS support service infrastructure

Open up to foreign firms in law, accounting, taxation, management consulting, IT services, etc.

- 1 Elementary, glaring deficiencies of Mumbai's urban infrastructure need to be solved on a war footing.
- 2 Project Mumbai as a cosmopolitan metropolis that attracts migrants from all over India and the world. Make it a more expatriate-friendly city.
- 3 Lifestyle facilities up to world class.
- 4 Municipal and state governance, personal security, law enforcement need to come up to world class.

# This slideshow was a highly oversimplified treatment

- A more nuanced treatment, with the full logic of the argument, and details on policy proposals is in the report – published by Sage India.
- Additional materials are accessed from the Ministry of Finance website at the URL <http://finmin.nic.in/mifc.html>

## In summary

Can India do for finance what was done for manufacturing?

- In the early 1990s, it was impossible to think of large scale exports of manufacturing or software from India. The Indian real sector was trapped in a morass of inefficiency, lack of competition, poor technology, etc.
- Today, India earns \$250 billion a year by selling goods and services. *Nobody* in 1991 thought this was possible in 16 years.
- How was this done?
  - Removing barriers to competition;
  - Removing trade barriers;
  - Removing barriers to FDI;
  - Telecom reforms;
  - Building enabling infrastructure such as highways and ports.
- The same story must now be repeated in finance.

Thank you.