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Opening up New Trade Routes for Financial Services: Canada's Priorities

Canada is well-positioned to take advantage of more open global trade and investment in financial services. It should focus its trade negotiating efforts on certain promising markets in this respect, starting with the TPP countries and China, as well as other key countries in the Americas and Asia. Canada's financial services sector could gain from even modest liberalization, a realistic goal.

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THE STUDY IN BRIEF

The importance of services to Canada's economy is often lost in the discussion of how Canada can take advantage of trade agreements such as the Trans-Pacific Partnership. In this *Commentary*, we look to close this gap with respect to the vital financial services sector.

In order to determine the countries that Canada should target as realistic priorities in trade negotiations – with a focus on financial services – we ranked markets from the viewpoint of both economic attractiveness and the feasibility of concluding negotiations.

We find that Canada's first priority, which exploits Canada's advantages in financial services, should be to ratify the TPP, as many of the countries ranked high on our list are involved in this agreement. Next, Canada should respond to China's still outstanding offer to negotiate a trade agreement. In addition, we should build on our existing agreements and reinvigorate negotiations with Latin America, as well as with India, and engage with ASEAN nations such as Indonesia, the Philippines and Thailand. While not an exhaustive list, successful liberalization of financial services in these markets would bring significant gains to the Canadian financial sector and economy as a whole.

This conclusion is supported by our empirical analysis of three liberalization scenarios – one the TPP as recently signed; second, a Canada-China comprehensive trade agreement that assumes, however, only minimal direct liberalization of financial services; and last an exercise in liberalizing only financial services with some key markets. From this wide range of scenarios, we find gains for Canada's financial services sector to liberalizing trade. These gains come from the overall positive impact on economic growth of trade agreements, from any actual reduction to barriers affecting financial services, assumed to be fairly modest in all cases, and from the reduction of uncertainty that results from the "binding" of these barriers at levels much lower than what countries are allowed to impose under World Trade Organization rules.

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Financial services figure prominently in recent major trade and investment agreements involving Canada, such as the Comprehensive Economic and Trade Agreement (CETA) with the European Union and the Trans-Pacific Partnership (TPP).

This is good news for Canada, since financial services represent a source of strength for the Canadian economy. Should Canada seek to open financial services trade with other countries? And if so, which ones? And is there evidence that we will gain from doing so?

In seeking to answer these questions, we build a ranking system to assess the potential for the removal of barriers on the ability of Canadian financial services firms to either deliver services directly across borders or deliver them by investing and operating in those markets. By barriers, we mean domestic rules that prevent or make it more difficult for a foreign firm than a domestic one to access or operate in the domestic market. We then evaluate selected trade liberalization scenarios in order to shed light on the effects on the Canadian financial services sector of removing barriers to trade.

We find that, from the point of view of financial services trade liberalization, Canada already has fairly open trade with a number of important markets, and has signed agreements with others that have yet to be implemented. However, a focus on other important markets, notably China and other markets still emerging in Asia and Latin America, is also needed. We also find that

one of the key benefits of trade and investment agreements for the financial services sector, apart from the overall positive impact on economic growth of boosting business for the sector overall and from any actual reduction to barriers affecting financial services themselves, is the reduction of uncertainty that results from the “binding” of these barriers at levels much lower than what countries are allowed to impose under World Trade Organization (WTO) rules.

BACKGROUND: FINANCIAL SERVICES, ECONOMIC GROWTH AND TRADE BARRIERS

To begin, we should provide some background on the importance of competitive financial services for economic growth, Canada’s current trade and investment performance in the sector, and on the relative competitive position of Canadian financial services in the global context.

The financial services sector consists of entities that engage in financial intermediation – the key function of which is to channel funds from borrowers to lenders – and those that fulfil other financial needs, such as those for insurance, asset

management and pensions, or that facilitate payments between third parties.¹ Financial services are essential to economic growth. They facilitate both the flow of savings to their most productive uses and the transfer of risk to economic agents best able to bear it, while meeting the liquidity and intertemporal preferences of diverse economic agents (Dodge 2015). Indeed, along with transportation and communications services, financial services are often dubbed “infrastructure services,” by virtue of their contribution to productivity and growth in other sectors of the economy. For example, many goods and services that we take for granted, such as transportation itself, would not be as efficiently delivered – if at all – without insurance services (see, for example, Arkell 2011).

More generally, there is a strong correlation between the availability of financial services and economic development and performance,² although this is not to say that every expansion of financial services in an economy is conducive to growth *per se*.³ In the specific Canadian context, the financial sector is one of the few in which the market share of large firms is comparable to that in the United States. This is significant, as the smaller size of the typical Canadian business accounts for

virtually all of the productivity difference between the two countries (Baldwin et al. 2014).

Therefore, the availability and competitiveness of financial services should rank high on the list of economic priorities for Canada and other developed and developing countries alike.

In the global competition for financial services, however, the reality is often quite different, with governments imposing a plethora of discriminatory barriers to trade and foreign investment in the sector, seeking to protect and promote their own financial services industry by sheltering it from foreign competition or by providing domestic firms with privileges not available to foreign competitors. Examples of such barriers include the prohibition of foreign subsidiaries and/or foreign branches, but there are potentially dozens of other such discriminatory practices, as recorded for example in the Organisation for Economic Co-operation and Development’s (OECD’s) index of financial services restrictions (Rouzet et al. 2014).⁴

Often, these policies are self-defeating, in that they weaken the sector and the economy overall if they go against the grain of a country’s comparative advantages (Lin 2012), including by allowing governments to influence where the financial system directs funds. In many countries, state-

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- 1 Some of these services – notably, payments between third parties – increasingly are offered by technology platforms operated by non-financial institutions. According to the Centre for International Finance and Regulation, there are now more “mobile money” agencies, permitting customers using mobile phones to make a variety of traditional banking operations, than there are bank branches in at least 28 countries (CIFR 2014, 29).
 - 2 See, for example, Thiel (2001) and Dabla-Norris, Ho, and Kyobe (2013), who find significant benefits of banking liberalization for middle-income countries.
 - 3 See Cechetti and Kharroubi (2015) for specific cases when financial sector growth ends up disproportionately benefiting high-collateral/low-productivity projects.
 - 4 In this paper, the impact of removing barriers is estimated through the use of aggregate indexes representing the overall level of trade and investment barriers, respectively, in individual markets. For the complete list of possible barriers and how they are aggregated by country, see either the OECD Services Trade Restrictiveness Index Regulatory Database, <http://qdd.oecd.org/subject.aspx?Subject=063bee63-475f-427c-8b50-c19bffa7392d#>, or the World Bank’s Services Trade Restrictions Database, <http://iresearch.worldbank.org/servicetrade/>.

owned financial institutions play a major part in the financial services landscape, another way that government intervention can stifle crossborder competition.⁵

These discriminatory barriers are not the same as differences in prudential financial regulations that are found between countries. Although the latter may result in a more fragmented and less efficient global marketplace than necessary, and hence in a reduction of the potential benefits of competition across borders, trade agreements universally recognize the need for governments to be able to enforce their own prudential regulations given the risks that disruption or failures in the financial sector, and even of individual systematically important entities within it, may cause to entire economies. Any harmonization of those rules is typically primarily a matter for cooperation among the regulators of each jurisdiction. Most trade agreements that cover financial services thus contain a “prudential carve-out” (see [online Appendix A](#)).⁶

Nevertheless, countries that seek to promote access for their financial firms across borders have an interest in ensuring that policies taken in the name of prudence do not arbitrarily restrict market access or give a country’s regulator the ability to discriminate in favour of domestic firms. In other words, an interface is needed, such as the Financial Services Committee established between the three NAFTA governments to exchange information. As with NAFTA, this interface should also be the arbiter of disputes, such as claims by investors against governments that involve prudential

measures. The interpretation of prudential measures in the context of international trade and investment agreements is expected to be an increasingly lively topic in international negotiations.⁷ Indeed, Appendix A also describes a current case before the WTO involving, for the first time in that forum, a challenge to a country’s interpretation of the prudential carve-out.

CANADA’S FOREIGN TRADE AND INVESTMENT IN FINANCIAL SERVICES IN A GLOBAL CONTEXT

The provision of services to customers can differ in fundamental ways from the provision of goods. In turn, this affects how we conceive of the liberalization of services relative to that of goods (Copeland and Mattoo 2004). Specifically, there are aspects of trade in services that do not always apply to trade in goods: the need for continuing personal interaction with customers, for example, or the fact that, as indicated above in the discussion on prudential rules, regulators will want oversight of the way a service is delivered or to ensure the integrity and soundness of the provider of the service. These aspects often require at least some local presence on the part of the firm providing the service.

Thus, banking, insurance and other financial services can be provided to non-residents in two main ways. One is through the direct provision (or purchase) of services across borders, akin to traditional trade flows, except that financial flows are “invisible.” In trade parlance, this is defined as

5 Government intervention can be a significant source of potential inefficiencies. See Levy Yeyati, Micco, and Panizza (2004); Lin (2012).

6 Having said this, issues such as the independence of regulators from possible political interference do figure on the list of potential trade and investment restrictions that the indexes we use in this study consider problematic and subject to potential removal through negotiations.

7 See, for instance, Australia (2015, 160).

“Mode 1” delivery of services across borders. The other main way is through the establishment or acquisition by entities domiciled in one country of subsidiaries in another country that provide services to foreigners in their own country, known as “Mode 3.”

Looking at Mode 1, the WTO estimates that, notwithstanding existing barriers, global trade in insurance and pension services, expressed in US dollars, grew at a 7.9 percent annualized clip between 2005 and 2014, while other financial services increased at a 7.5 percent rate. This growth occurred despite absolute declines in 2009 and 2010.

Canada ranks in the middle of the pack of major exporters of financial services when looked at in absolute terms (Figure 1). It is below a few Asian and European powerhouses, as well as the United States. Canada ranks somewhat lower in terms of financial services exports as a percentage of gross domestic product (GDP) (Figure 2). But trend-wise, Canada has substantially partaken of the recent strong growth in financial services trade, with its share of world insurance and pension services exports growing from 0.18 to 0.29 percent of the world total during that period, and its share of world exports of other financial services growing from 0.79 percent to 1.35 percent.

Indeed, Canada has become a net exporter of banking and related services (as it has of commercial services generally) since 2010, whereas traditionally it had been a net importer. Recently, as Figure 3 indicates, Canada has also experienced a boom in its net exports of non-bank, non-insurance financial services, such as asset management services. The same is not true of insurance services, however, in which Canada continues to import more than it exports, a gap that has widened steadily since 1993. This gap is driven by the non-

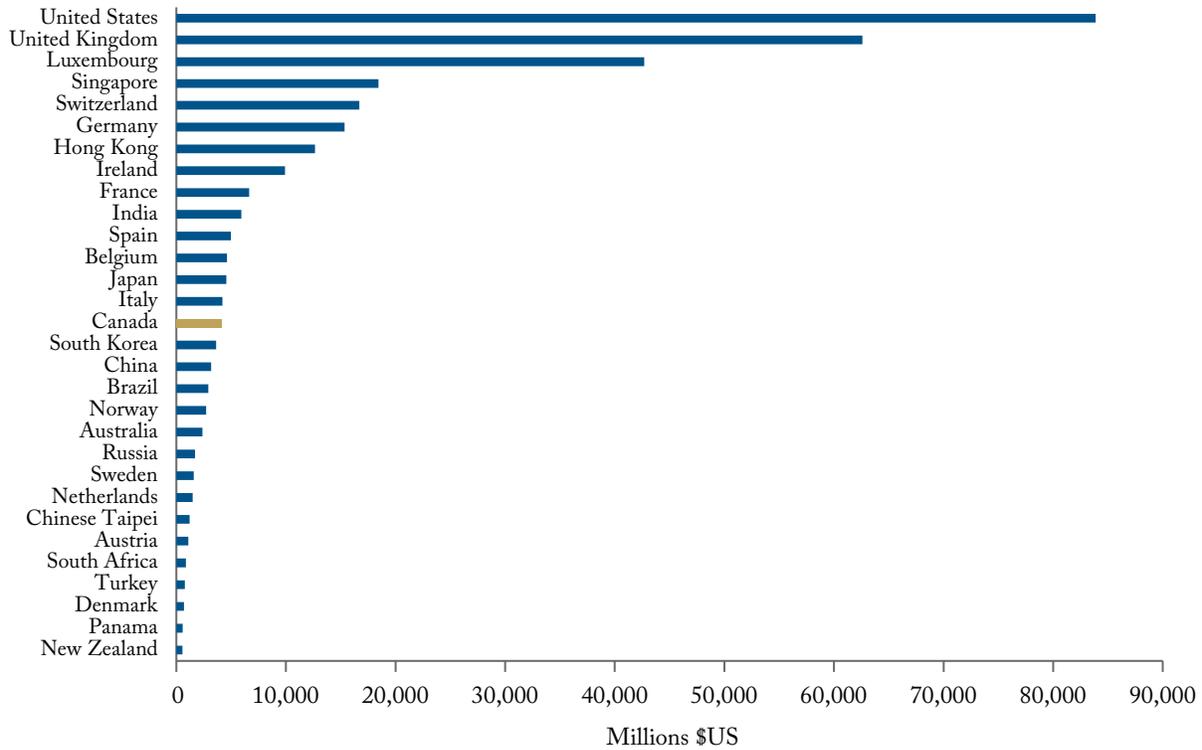
life, or property and casualty insurance, portion of the insurance industry, where in 2014 only 2.1 percent of the approximately C\$46.6 billion in net written premiums realized by Canadian companies were earned outside Canada, and of those, only half were Canadian-owned companies – the rest were foreign-owned companies that may be booking global premiums to Canadian branches.⁸

Turning to Mode 3, Figure 4 indicates that Canadian-based providers of financial services are among the top foreign investors in the financial sector in absolute terms, ranking only behind the United States, the United Kingdom, France and Switzerland. As a share of GDP, however, Canada not only falls substantially below these same economies; it is also surpassed as a foreign investor by other European players as well as by Singapore and Hong Kong (Figure 5). Nine of the 11 countries that outrank Canada in terms of outward investment stock as a share of GDP (Mode 3) also outrank it on financial services exports as a share of GDP (Mode 1). In sum, Canada ranks among the important financial services traders and foreign investors.

Investment abroad is clearly an important strategy for many financial services firms. On this point, affiliates abroad contribute to output and employment in their host markets. But they also contribute to earnings, and thus national income, in their home economy. Domestically based firms that engage in this strategy typically do so because it is essential to maintain their global competitiveness – without which even their domestic operations would be at greater risk of being weakened. In such cases, the ability to trade or invest across borders is complementary to a domestic growth strategy, not a substitute for it. Geographically, the majority of the sales (53 percent) and employees (58 percent) of Canadian-majority-owned banks abroad are in the

8 Data from MSA Research Inc.

Figure 1: Exports of Financial Services – Selected Countries, 2013



Source: International Trade Centre.

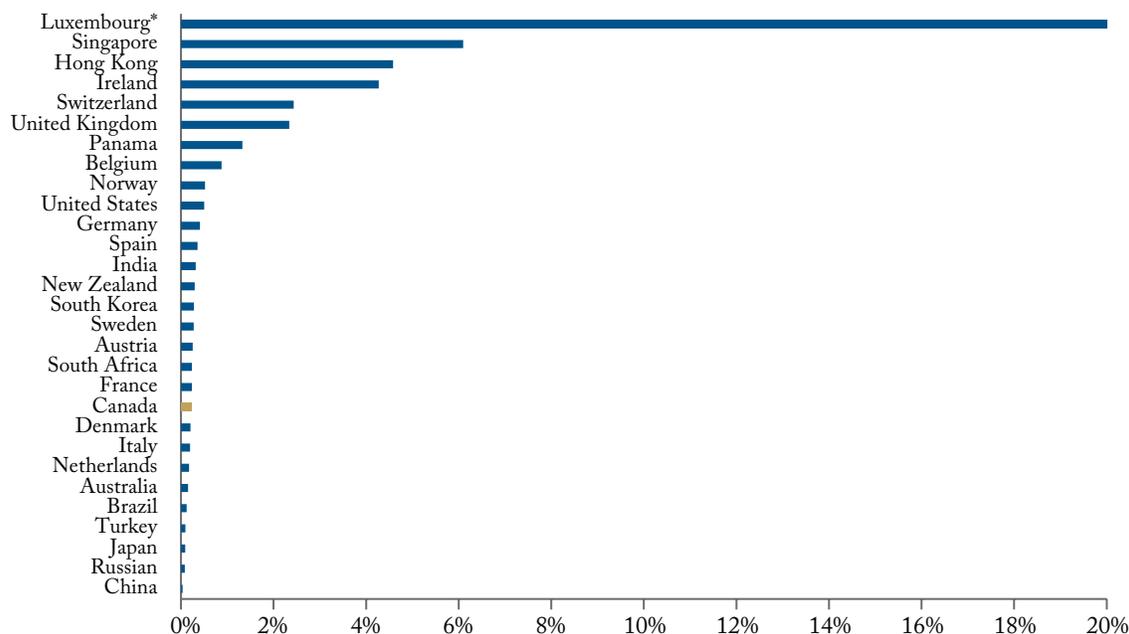
United States, while the majority-owned foreign subsidiaries of Canadian insurance companies are more geographically diversified.⁹

Importantly, and in line with what we observe from trade statistics, Canadian financial institutions maintained their global presence through the turmoil of the global financial crisis, which saw

a decline in importance of some traditional competitors and the emergence of strong competitors in the Asia-Pacific region. This can be illustrated by the change in the share of the total market value of publicly traded financial services firms in the Forbes “Global 2000” ranking, by country of headquarters, between 2006 and 2015

9 The concepts of foreign direct investment (FDI) and foreign affiliates statistics discussed here are closely related, but they represent slightly different things. Notably, FDI data used in the international comparison figure are at book value and include ownership shares deemed controlling, even if below 50 percent, whereas foreign affiliate data represent current sales of majority-owned affiliates.

Figure 2: Exports of Financial Services as a percentage of Gross Domestic Product – Selected Countries, 2013



Note: * Luxembourg actual percentage – 71 percent.

Source: International Trade Centre.

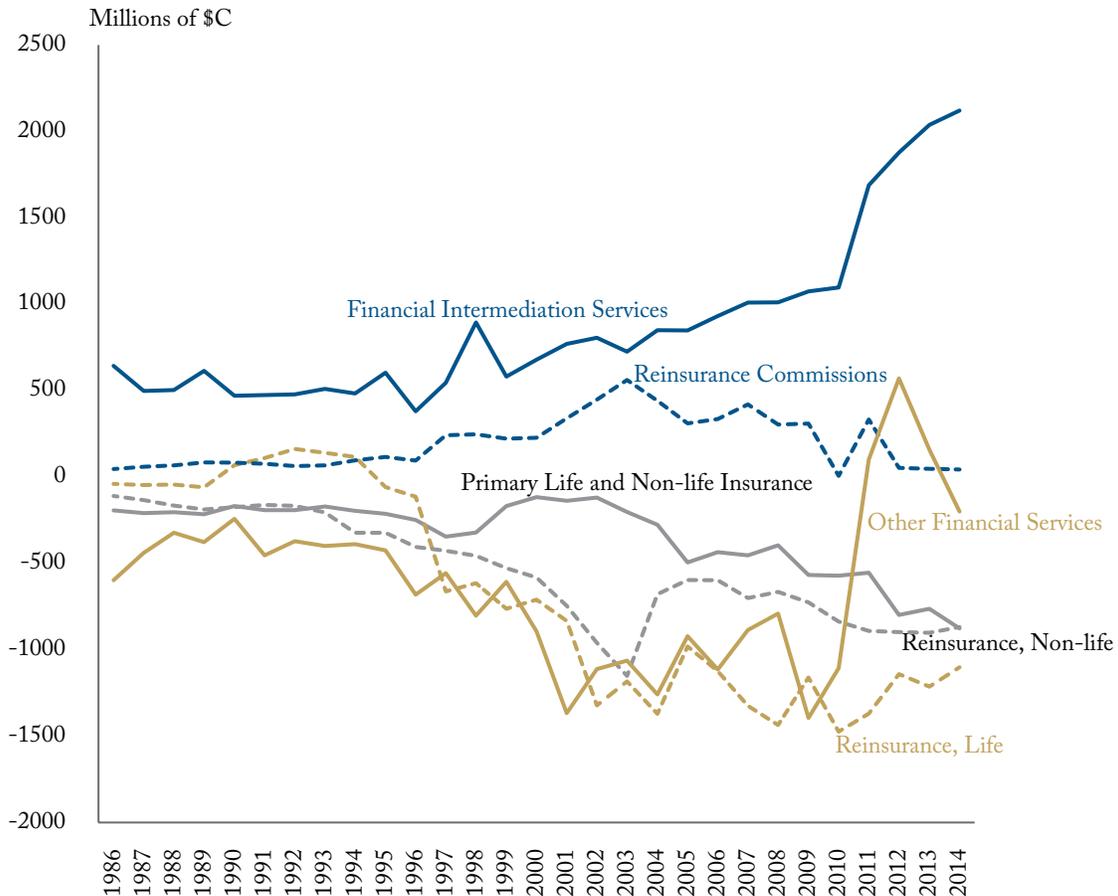
(Figure 6). The figure shows that Canadian publicly traded financial institutions¹⁰ have held up well amid the rise of China, in particular, and of some more modestly rising players (such as India), while European, US and Japanese counterparts have faltered.

The practically flat share of total market capitalization of Canadian financial institutions as a

whole, however, masks a difference between a small rise in the share of Canadian banks among the 311 banks and a decline in the share of Canadian insurers among the 109 insurers in the Global 2000 compared to 2006. Still, Canadian institutions represent 4.5 percent of the market value of banks and 4.7 percent of the market value of insurance

10 In Canada, unlike in a number of countries, there are no government-owned retail banks, but cooperatives account for about 7 percent of banking assets, according to the Credit Union Central of Canada and the federal Department of Finance. Arguably, ATB Financial (a provincial Crown corporation) offers retail-like financial products and services and federal Crown corporations such as Farm Credit Canada, Export Development Canada and the Business Development Bank of Canada offer financial services to niche business markets.

Figure 3: Finance and Insurance Services Trade Balances, Canada



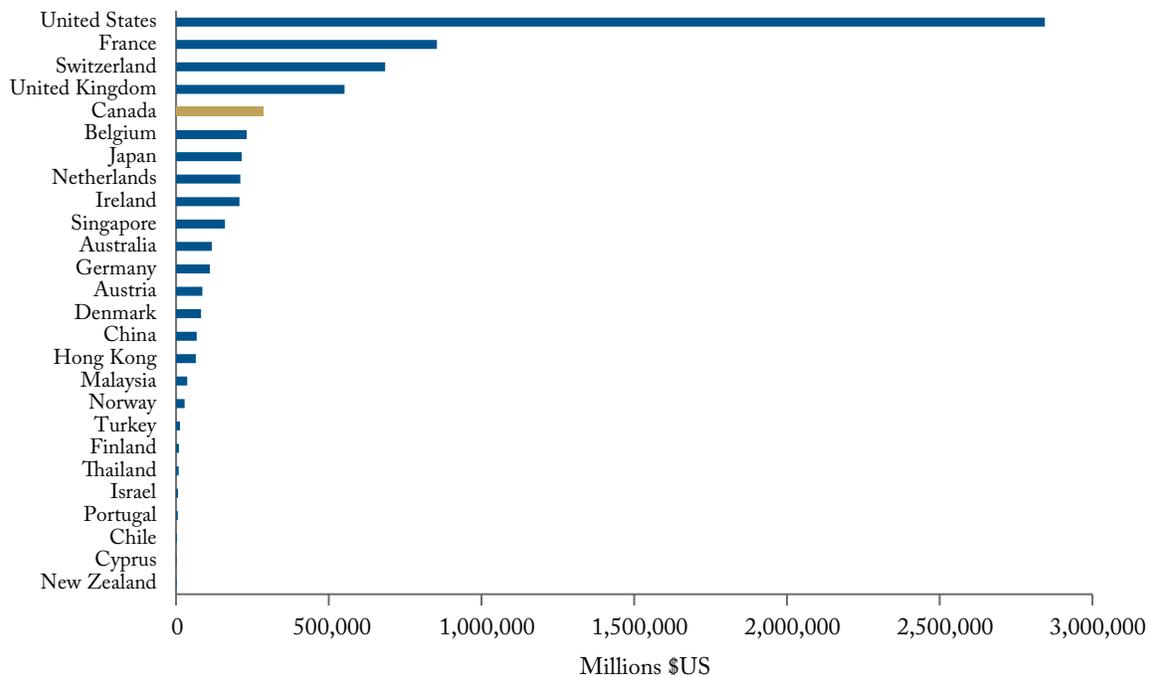
Source: Statistics Canada, CANSIM Table 376-0033, accessed November 27, 2015.

companies in the Global 2000. These shares are above Canada’s share of world GDP, suggesting that Canada – a country whose traditional advantage has been in natural resources – is also punching above its weight in both banking and insurance.

From an international trade and investment policy perspective, we note that the top Australian financial institutions have, by the market value measure used in Figure 6, expanded somewhat faster than their Canadian counterparts since before the global crisis. Although many factors are

responsible for this result, we note that Australian banks are both located closer to high economic growth areas in the Asia-Pacific than are Canadian institutions and that Australia has concluded more trade agreements – which span services as well as goods – than Canada has with countries in this region. This, at the very least, points to some potential effects of international trade and investment policy on a country’s financial services sector, which we explore in greater detail below.

Figure 4: Outward Stock of Foreign Direct Investment, Financial Services Sector – Selected Countries



Note: Data are for the most recent available year for each country, ranging from 2010 to 2012.
Source: International Trade Centre.

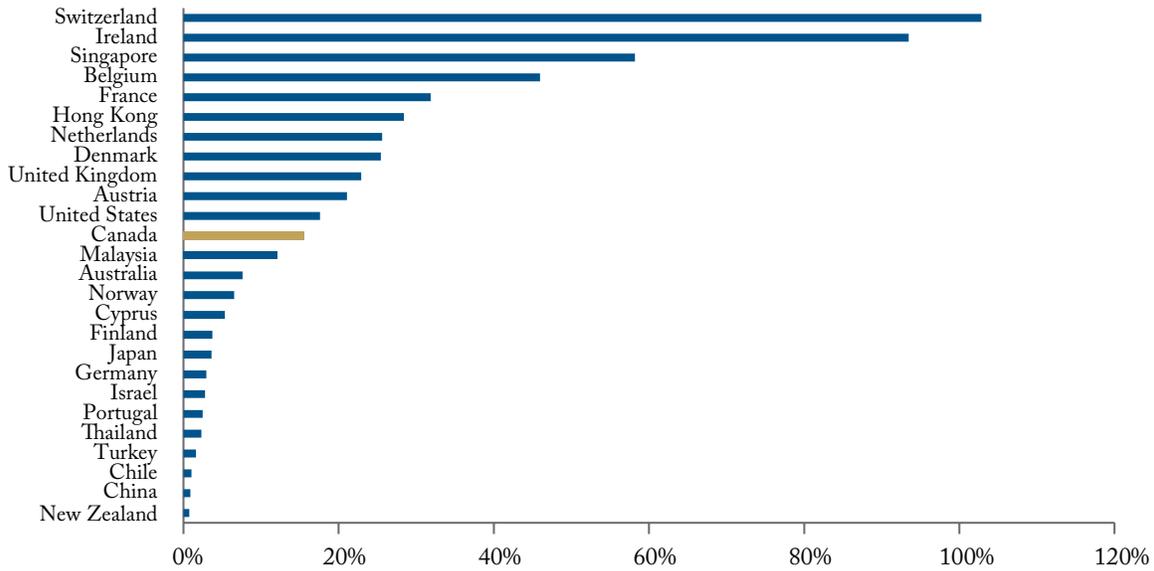
COMPETITIVE POSITION OF CANADIAN FINANCIAL SERVICES

In attempting to evaluate the effect of a Canadian push for the liberalization of financial services trade and investment, we need to summarize Canada's relative strengths and weaknesses in that sector. We begin with Figure 7, which describes major financial centres in terms of two characteristics: the type of services they provide, ranging from niche to full service, and the geographical range of their operations, from local to international. Toronto, Canada's primary financial services centre, with over 30 percent of all financial services employment in the country (Sutherland 2014), ranks quite high as a full-service centre – one that provides deep capital markets and a full suite of financial services

and expertise. As Figure 7 shows, however, a few other centres enjoy greater global reach. In the set of countries directly to the right of the “bubble” containing Toronto, we see represented some dynamic Asian countries whose financial sectors have expanded quickly in recent years, including Singapore, Hong Kong and China. At the far end, we have the two major global players: the United States and the United Kingdom.

An important advantage of financial centres that appear as more important global players than Canada's is that they operate in much larger markets. This is due to the size of their domestic economies (for example, the United States, Japan, and China/Hong Kong), or to the fact that they operate in large economies that often are governed by some commonly agreed rules of the game (such

Figure 5: Outward Stock of Foreign Direct Investment as a percentage of Gross Domestic Product, Financial Services Sector – Selected Countries



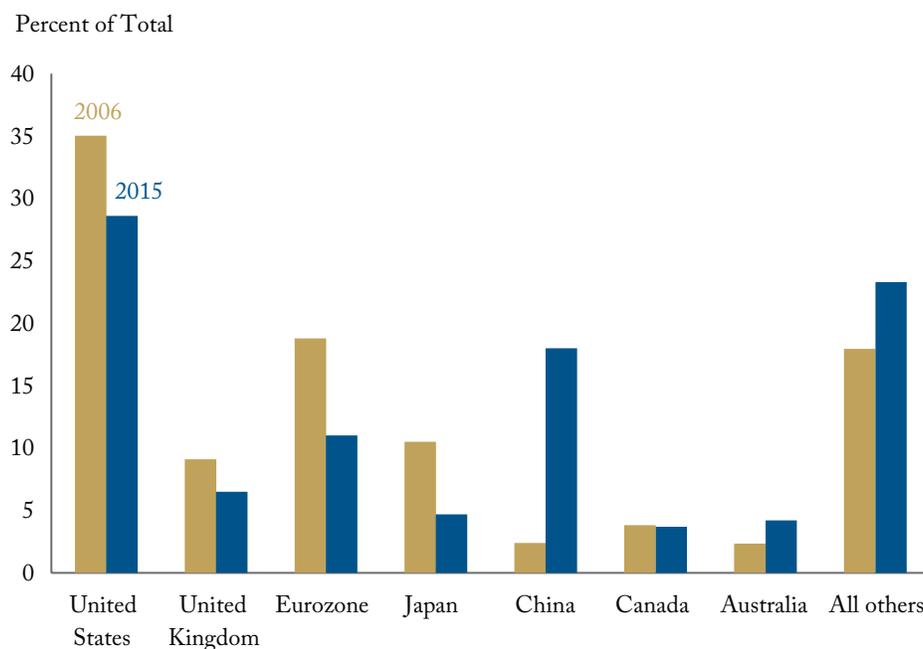
Note: Data are for the most recent available year for each country, ranging from 2010 to 2012.
 Source: International Trade Centre.

as the United Kingdom through the European Union) – which is not the case bilaterally between Canada and the United States, for example – or to their extensive array of agreements with economies that, for the most part, are not as competitive in these types of services as they are (such as the case of Singapore). Although the North American Free Trade Agreement (NAFTA) does cover financial services,¹¹ at the end of the day there is no attempt at NAFTA-wide regulatory convergence that would facilitate trade and investment in such

services among the three signatories, other than through multilateral regulatory cooperation bodies. Another significant advantage for the United Kingdom and other European countries is their location in terms of time zones. At the beginning of their work day, Asian markets are still open, while toward the end, US and Canadian markets, including Toronto’s, are just starting their activities. Nevertheless, Canada has important compensating advantages, particularly the soundness of Canada’s regulatory regime (The CityUK 2014). Canada also

11 See Sauvé and González-Hermosillo (1993) for a detailed description.

Figure 6: Forbes Global 2000 Market Value of Financial Services Firms, by Country of Headquarters



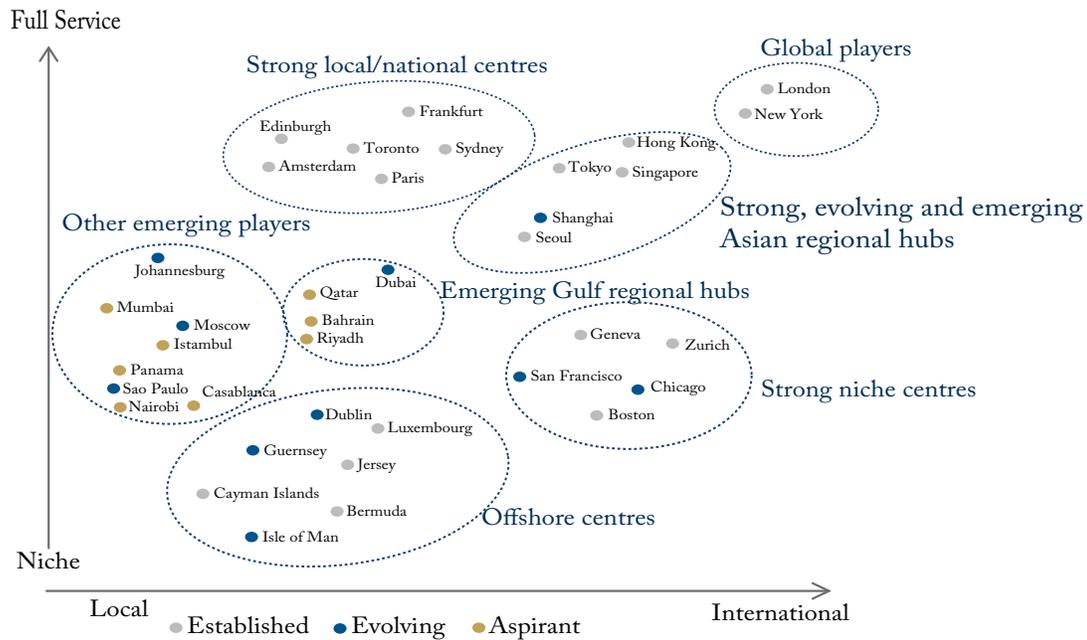
Source: Forbes Global 2000, and authors' calculations.

has a competitive corporate income tax regime: KPMG (2014) ranks Canada as having the lowest corporate tax burden on profits, after deductions and incentives, among its NAFTA peers and large European and Asian-Pacific countries.

As Table 1 indicates, Canada ranks as a world leader on many indicators pertaining to the health of the financial services industry (World Economic Forum 2014). It ranks at the top of the list in the soundness of its banks and in the top 10 in the availability of financial services, financial market development, the affordability of financial services, and the regulation of securities exchanges. These results are correlated with the findings by the International Monetary Fund (IMF) on why the Canadian financial system was successful in avoiding the depths of the financial crisis, and why

it has continued to be strong in the slow growth years since (IMF 2014). Specifically, the IMF study found that a key contributor of this success is Canada's financial regulatory infrastructure made up of the Office of the Superintendent of Financial Institutions, the Bank of Canada, the federal Department of Finance, the Canada Deposit Insurance Corporation and the Financial Consumer Agency of Canada. Canada is unique in that supervisory information is shared among all these institutions, which helps set effective federal policies. These institutions also emphasize accountability on the part of boards of directors and management. In short, Canada has a strong brand based on a comparatively well-run financial sector, including a solid risk-management framework at the institutions themselves. Areas for improvement

Figure 7: Canada's Financial Centre, Comparison with the Rest of the World



Source: The CityUK based on City, Oliver Wyman and Z-Yen.

include the availability of venture capital and ease of access to loans. A low venture capital ranking is not a new concern in Canada: Hurwitz and Marett (2007) argue that Canada's crossborder tax scheme when nonresidents sell shares of private corporations is much harder to deal with than their US and UK counterparts. This type of treatment ends up restricting the amount of foreign capital coming from institutional investors and private equity firms. Venture capital investment is making a comeback in Canada, but much of it comes from government-backed investors (Canada 2014).

In today's increasingly integrated trade world, the availability of inputs, whether imported or not, is a key component of an industry's competitiveness. The availability of skilled personnel able to work across borders is an important aspect of

global services competitiveness (Australia 2015) emphasizing the complementarity of movement of skilled personnel across borders ("Mode 4") to other modes of liberalization discussed here. And most countries that host top financial centres are not only important sources of outward trade and FDI, but also of inward flows and stocks. Figure 8 shows that Canada does not rank among the highest jurisdictions in terms of FDI inflows. And, as Figure 9 shows, it also ranks relatively low in terms of foreign bank assets as a percentage of total bank assets. However, that Canada's lower ranking on the presence of foreign competitors in its domestic market, at least with respect to banking, does not seem to have impeded the competitiveness and competition of that sector (Allen and Engert 2007).

Table 1: Financial Sector Characteristics – Canada and Selected Countries

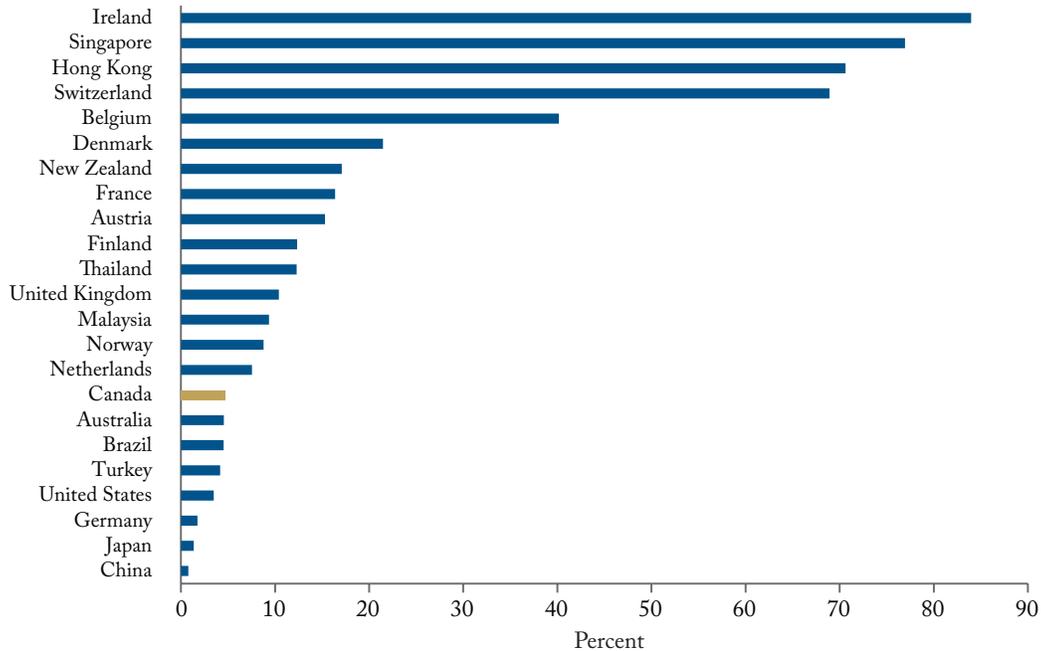
	Soundness of Banks	Availability of Financial Services	Financial Market Development	Affordability of Financial Services	Regulation of Securities Exchanges	Financing through Local Equity Markets	Venture Capital Availability	Ease of Access to Loans
Canada	1	5	4	8	6	11	20	18
Australia	3	19	7	24	10	14	40	39
Singapore	5	8	2	7	3	8	3	4
Hong Kong	7	3	3	4	4	2	9	5
Switzerland	20	1	10	1	12	10	18	28
Japan	28	26	19	28	11	12	21	19
United States	39	4	5	10	24	5	5	14
France	40	29	29	27	23	18	29	17
Germany	46	18	18	14	26	17	25	35
Netherlands	60	11	31	17	18	22	24	49
United Kingdom	63	7	16	19	21	7	14	82
China	78	61	54	48	52	44	16	21
India	100	81	53	71	69	45	13	29
South Korea	113	99	87	89	78	47	86	119

Source: World Economic Forum (2015)

One useful measure of Canada's global competitive position in financial services is the country's "revealed comparative advantage" in that sector, compared to that of key competitors or potential markets (see Table 2). These readings combine banking, insurance and other financial services and are from the OECD's "trade in value-added" database for 2011. Thus, for example, they exclude financial services that might simply transit through a country without contributing much to value added there (thereby reducing the comparative advantage reading of, for example, offshore centres relative to what a comparative advantage reading based only on gross flows would

show). But they do include the value of domestic financial services embedded in other exported products. Although revealed comparative advantage is not a direct measure of competitiveness, it does indicate how successful countries are by sector in the international marketplace, relative both to competitors and to all other sectors of their economy. A reading above 1 for a country in a particular sector indicates the country has a comparative advantage in that sector; a reading below 1 indicates that it is at a comparative disadvantage in that sector. These readings help us to define a potentially useful trade liberalization strategy for Canada in financial services, by

Figure 8: Inward Stock of Foreign Direct Investment as a percentage of Gross Domestic Product, Financial Services Sector – Selected Countries



Note: Data are for the most recent available year for each country, ranging from 2010 to 2012.
 Source: International Trade Centre.

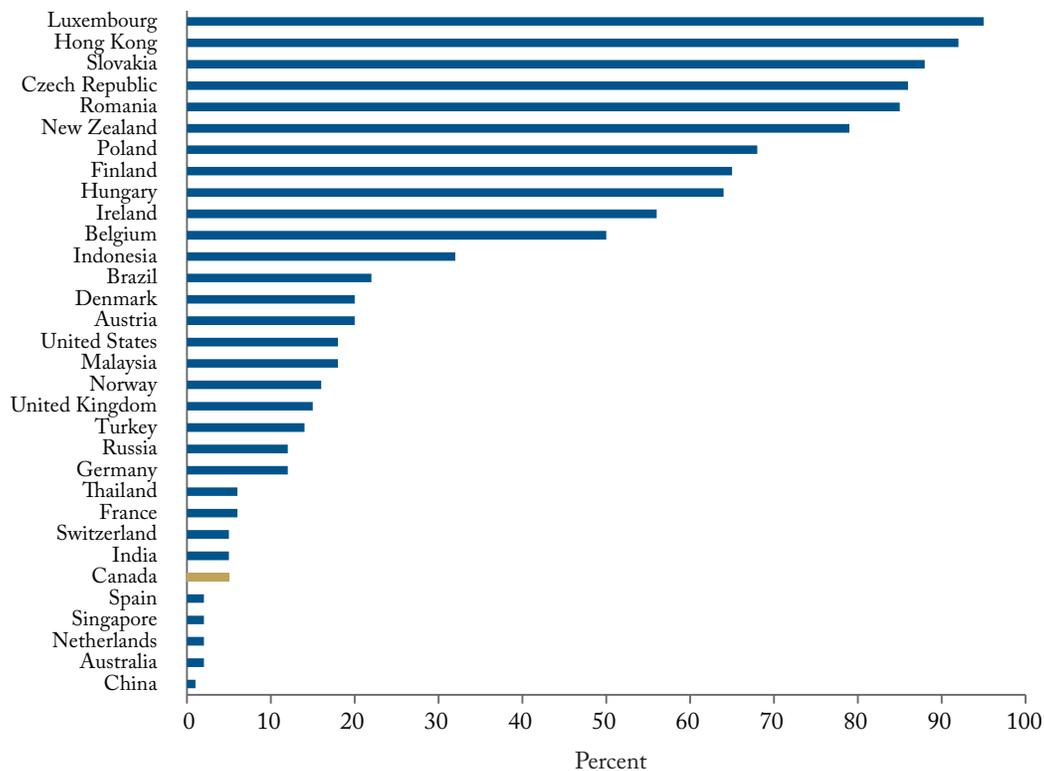
identifying countries that are not very competitive yet remain relatively closed to foreign trade and investments in that sector. To the extent that they are significant markets, they should be prioritized accordingly.¹²

At the same time, Canada could pursue a more cooperative, two-way trade strategy with countries that have developed some comparative advantages

in the financial services sector, particularly lower-income countries such as India. Canada as a high-income country has a comparative advantage in high-value-added services that could complement India's lower-value-added but still competitive (relative to India's other exports) international services offerings. Finally, the lower readings for countries such as Japan, Germany and Australia

12 By using comparative advantage calculated with trade in value-added statistics as an overall gauge of which country is comparatively "strong" or "weak" in financial services overall, we implicitly assume that a country's strength or weakness in crossborder trade parallels its strength or weakness as a crossborder investor – in other words, that a country with a relative disadvantage in financial services trade will also in general find it difficult to compete as a global crossborder investor, and vice-versa. This makes sense if we think of the two readings of strengths – as trader and as investor – as positively correlated.

Figure 9: Percentage of Foreign Bank Assets among Total Bank Assets – Selected Countries, 2009



Source: Claessens and van Horen (2014).

suggest there are select high-income economies with which Canada could advantageously pursue financial services liberalization (as Canada is doing with Japan and Australia in the TPP and with Germany in the Comprehensive Economic and Trade Agreement (CETA)).

Overall, Canada has a strong résumé when it comes to its financial sector. One challenge it faces on the global stage is whether it can turn the widely praised strength of its regulatory system into a direct advantage in trade and investment, rather than indirectly via reputational effects and, presumably, good reception in capital markets for Canadian-based financial institutions. At the end of the day, Canada is a smaller jurisdiction than those in which many top international competitors

are playing, so it must rely on cooperation with other jurisdictions and on investment agreements to enable the optimal exploitation of its competitive advantages in the broader marketplace.

CANADA'S PRIORITY MARKETS FOR TRADE AND INVESTMENT IN FINANCIAL SERVICES

As we have seen, there are good reasons to think that Canada's financial services sector would benefit from more open trade and investment in general and from more liberal financial services regimes in a number of countries. Where, from that perspective, should Canadian negotiators focus their energy to obtain the highest reward.

Table 2: Revealed Comparative Advantage in Financial Services Trade – Selected Countries, 2011

	Comparative Disadvantage	Neither Large Advantage or Disadvantage	Comparative Advantage
Higher-income Countries	Chinese Taipei (0.83)	Canada (1.01)	Luxembourg (5.64)
	Australia (0.71)	Denmark (1.03)	Hong Kong (3.43)
	Germany (0.67)	Italy (1.03)	Switzerland (3.41)
	Japan (0.53)	France (0.99)	Singapore (2.56)
			United Kingdom (2.39)
		Israel (1.85)	
		United States (1.39)	
Middle and Lower-income Countries	Brazil (0.78)*		
	China (0.77)*		
	Turkey (0.71)		
	Philippines (0.69)*		
	Russia (0.68)*		
	Tunisia (0.64)*		
	Poland (0.53)	Thailand (1.04)*	
	Chile (0.53)*	Malaysia (1.03)	
	Cambodia (0.43)	India (1.02)*	South Africa (1.24)*
	Vietnam (0.40)*	South Korea (0.99)	
	Indonesia (0.34)*		
	Mexico (0.29)*		
	Colombia (0.28)*		
	Argentina (0.28)*		
Saudi Arabia (0.11)*			

Note: The revealed comparative advantage index was computed using each country's domestic financial intermediation value added that is embodied in foreign final demand. A reading above 1 indicates that a country is successful against competitors in that sector in the international marketplace, relative to other goods and services it exports. Countries with high barriers to financial services trade and investment according to World Bank and/or OECD indexes of services trade restrictiveness are indicated by an asterisk.

Source: Authors' calculations from OECD Trade in Value Added dataset, June 2015.

Our rankings attempt to capture indicators that help to answer the following two questions: (i) in which economy would the international liberalization of financial services trade and investment likely to have the most beneficial impact on Canada, and (ii) how likely is it that Canada could successfully negotiate financial services liberalization with those countries?

To answer the first question, we rank countries according to five criteria that speak to the potential for beneficial liberalization – not just for Canada, but also, ultimately, for the partner country that would liberalize its financial services sector. Our

methodology is as follows. First, we rank them according to the average of three indicators of existing barriers in foreign markets: how they rank on the World Bank and (where available) the OECD trade restrictiveness index for financial services, and also the extent to which the banking sector is dominated by majority state-owned entities – a growth-hindering barrier. Our first criterion therefore represents barriers faced by foreign entrants. Second, we rank countries using our second criterion, an indicator of banking intensity in the form of bank deposits to GDP, and our third criterion, an average of the amounts of life

and non-life insurance premiums per capita. We then average rankings for these criteria. Countries that are more open and are relatively well served in terms of banking or insurance get a low ranking – in other words, they are not as attractive candidates for liberalization as countries that are closed and underserved. We then normalize this average ranking by a factor representing the inverse of a country's revealed comparative advantage (RCA) in financial services, our fourth criterion. We do this normalization in order to moderate the potentially large swings in ranking that would come from using the raw RCA numbers. The assumptions here are that countries with low comparative advantage in this sector would benefit most from moving away from “comparative-advantage-defying” policies (Lin 2012) that protect the sector, and that Canada's relatively more competitive financial services industry would be well placed to help them do so. Finally, we multiply this score by a projection of the absolute GDP increase (in US dollars) for that country over the next seven years, our fifth criterion. The straightforward idea is that, all things being equal, liberalization in a market in which Canadian firms can parlay their advantages and that is likely to experience more growth is more valuable than liberalization in a similar market that is likely to experience slower growth.

The rankings we obtain using this formula indicate market attractiveness in general – not necessarily where Canada could hope to meet with particular success in opening these markets through negotiations. Therefore, our next order of business is to rank these same economies using indicators that might be good proxies for Canada's chances of success in negotiations. To do this, we rank economies by three indicators, with low numbers

implying a good chance of success for Canada and high numbers the opposite, and produce an average ranking for each economy. The first indicator is the GDP coverage of their existing trade agreements that cover at least some services. The idea is that countries that are less averse to negotiating services liberalization in principle need to be prioritized, both because of a greater likelihood of success and because by definition they already tend to give better access to Canada's competitors than to Canada, unless Canada already has an agreement with them guaranteeing similar access. The second indicator is the importance to these countries of their merchandise trade with Canada, the simple assumption being that the more Canada is on their radar, the more likely they will be open to engaging with Canada on broader negotiations. The third indicator is the number of workers from these countries that are in Canada through the temporary worker program and the international mobility program, which includes other types of visas, such as visas for skilled and business travelers – which might indicate a complementarity of skills between that country and Canada.

Our final negotiating priority list, presented in Table 3A, was compiled using an equally weighted average of the “general attractiveness” and the more Canadian-specific “feasibility” ranking.¹³ Note that we did not remove from the ranking countries with which Canada already has trade agreements or has concluded negotiations to liberalize trade and investment, preferring instead to just highlight what those countries are. This is so as to give us an indication of access already gained – while not losing sight of the importance of these markets, since in many cases further progress could be accomplished.¹⁴

13 Tables 3B and 3C provide a sensitivity analysis of the rankings using different weights between “attractiveness” and “feasibility.”

14 Clearly, other indicators of attractiveness and feasibility could have been used, such as bilateral FDI stocks or the existence of tax or air agreements between Canada and partner countries.

Canada's Market Priorities

As it looks for partners with which to expand its financial services trade footprint, Canada has more than the bilateral route as a possible avenue. Canada could, of course, push to deepen the General Agreement on Trade in Services (GATS) – which currently provides for more or less partial liberalization depending on countries' schedule of commitments (Páez 2008). Canada could also seek to join any plurilateral or regional negotiation – involving only some GATS signatories – as with the examples of the yet-to-be-completed Trade in Services Agreement (TiSA) and the recently completed TPP, which seek to open the door to new market opportunities in services in general and to financial services in particular. In selecting the geographically broad talks to join, however, Canadian policymakers should keep in mind the individual markets they seek to access as a matter of priority, as indicated by our rankings. In drawing the implications of individual country rankings for Canadian trade policy priorities, we will keep in mind such country groupings which it might be more efficient for Canada to join than seeking to liberalize on a bilateral basis, given Canada's limited capacity to negotiate many agreements at once.

Based on these rankings, then, what would an ambitious outcome – one that would encompass many of the desired results while being well within the realm of possibility – look like for Canada? In

our view, such a scenario would include five priority components, plus a few “desirables”:¹⁵

1. The presence of the United States and Mexico at the top of the list reminds us that, even though Canada has an existing trade agreement with these partners, which include a “Most-Favored-Nation” (MFN) clause automatically extending to Canada concessions they may extend to third parties on financial services *per se*, it is extremely important to stay current with whatever other concessions they offer to other partners or get from them, in areas that may relate to financial services, such as movement of goods and people, and opportunities to invest or access procurement markets, that may not have been subject to MFN in the NAFTA. Altogether, eight of the top 20 countries on the list are countries with which Canada has just completed the TPP negotiations, including two (Chile and Peru) with which Canada already has a trade agreement and four (Australia, Japan, Malaysia and Vietnam) with which it does not. And two other important markets for Canada are touted as likely eventually to join the TPP: South Korea, with which Canada already has a trade agreement, and the Philippines. Therefore, job one, from the point of view of better exploiting Canada's relative advantages in financial services is to ratify the TPP.
2. Respond to China's offer of trade negotiations. China can be a difficult market due to competition from state-subsidized firms and

¹⁵ These would be in addition to CETA, which will soon undergo a complex ratification process in Europe and encompass three of the top 20 markets on our list. Although CETA might not be as immediately important as some other potential agreements on our priority list, it is potentially very important in reducing uncertainty about this access and as a gateway to new members that the European Union might attract (such as Turkey). At the same time, a number of EU members are very competitive in financial services, by the standards used in this paper, such that while the agreement certainly opens new opportunities for Canadian financial services firms in the EU, EU providers of financial services will also likely increase their business in Canada as a result, which will benefit Canadian consumers. Thus, most of the net gains from the CETA for Canadian financial services institutions are likely to emerge from the overall beneficial impact of the agreement on Canadians' incomes.

Table 3A: Canada's Trade Agreement Priority Countries – Equal Weighting for Feasibility and Attractiveness

	Rank – Feasibility	Rank – Attractiveness	Overall Priority Rank		Rank – Feasibility	Rank – Attractiveness	Overall Priority Rank
<i>United States</i>	2	2	1	Russia	71	5	30
<i>Mexico</i>	1	8	2	Morocco	33	44	33
China	15	1	3	Switzerland	25	52	33
<i>Korea</i>	3	16	4	<i>Honduras</i>	9	69	35
<i>Chile</i>	4	21	5	Argentina	67	12	36
Vietnam	14	13	6	Sweden	43	37	37
Philippines	6	22	7	Nicaragua	7	74	38
Indonesia	33	4	8	Czech Republic	44	39	39
Japan	19	19	9	Finland	36	48	40
United Kingdom	13	26	10	New Zealand	28	57	41
<i>Peru</i>	5	35	11	Turkey	76	9	41
India	38	3	12	Algeria	58	28	43
Thailand	10	31	12	South Africa	64	23	44
Australia	31	14	14	Nigeria	78	10	45
Germany	26	20	15	Spain	45	43	45
France	32	15	16	Hungary	38	51	47
<i>Colombia</i>	30	18	17	Chinese Taipei	37	53	48
Norway	21	32	18	Romania	54	36	48
Malaysia	20	34	19	Trinidad & Tobago	17	73	48
Guatemala	10	45	20	Austria	45	46	51
Italy	29	27	21	Egypt	69	25	52
Pakistan	47	11	22	Sri Lanka	62	33	53
Poland	35	24	23	Hong Kong	22	76	54
Netherlands	22	38	24	Kazakhstan	70	29	55
Bangladesh	50	17	25	Portugal	40	59	55
Saudi Arabia	60	7	25	Singapore	24	75	55
Brazil	65	6	27	Lithuania	41	60	58
Cambodia	15	56	27	Denmark	48	54	59
Dominican Republic	10	61	27				
Belgium	18	58	30				
Costa Rica	8	68	30				

Table 3A: Continued

	Rank – Feasibility	Rank – Attractiveness	Overall Priority Rank
Slovakia	53	49	59
Ethiopia	73	30	61
Greece	63	41	62
Iceland	27	77	62
Israel	57	50	64
Estonia	42	70	65
Ireland	49	63	65
Tanzania	72	40	65
Kenya	74	42	68
Uruguay	61	55	68
<i>Panama</i>	<i>51</i>	<i>67</i>	<i>70</i>
Slovenia	55	66	71
Paraguay	75	47	72
Tunisia	59	65	73
Bulgaria	55	71	74
Luxembourg	52	79	75
Mozambique	68	64	76
Latvia	66	72	77
Senegal	77	62	78
Mauritius	79	78	79

Note: Ranking methodology for feasibility and attractiveness explained in the text. Countries with which Canada already has a trade agreement are in *Italic*.

a current significant slowdown in economic growth. And non-economic considerations such as security issues often come prominently into play when contemplating greater opening vis-à-vis that country. Nevertheless, Canada should not leave much longer on the table what we understand to be China's offer to negotiate a comprehensive trade agreement. The bilateral Canada-China Foreign Investment Protection and Promotion Agreement, which came into effect last year, is a major step in the relationship, putting Canadian firms on par with their competitors there that already benefit from the protection afforded by such agreements. However, many of Canada's competitors, including Australia, Israel and the United Kingdom, have been much more effective in cementing their economic relationship with China through formal agreements and/or participation in important Chinese-led economic initiatives such as the Asian Infrastructure Investment Bank.

3. What is striking is the presence near the top of all four countries – Mexico, Peru, Colombia and Chile – that are currently negotiating under the aegis of the Latin American trade bloc known as the Pacific Alliance. Although Canada has a bilateral free trade agreement with all four, it should clearly seek to join the group in order to benefit from any deeper trade liberalization among this important economic grouping for Canada.
4. Completing trade negotiations with India also ranks fairly high on the list of priorities. Although these negotiations have been hampered, from a Canadian perspective, by the issue of Indian firms bringing workers to Canada temporarily to provide services to Canadian firms in the information technology sector, our rankings clearly suggest that Canada's reservations need to be weighed against the opportunities that such a deal would present, including giving Canadian firms better access to the Indian financial services market.

Table 3B: Canada's Trade Agreement Priority Countries – 75 percent Feasibility Weighting

	Rank – Feasibility	Rank – Attractiveness	Overall – Priority Rank		Rank – Feasibility	Rank – Attractiveness	Overall – Priority Rank
<i>United States</i>	2	2	1	Poland	35	24	31
<i>Mexico</i>	1	8	2	New Zealand	28	57	32
<i>Korea</i>	3	16	3	Hong Kong	22	76	33
<i>Chile</i>	4	21	4	Morocco	33	44	34
Philippines	6	22	5	Singapore	24	75	35
China	15	1	6	Pakistan	47	11	36
<i>Peru</i>	5	35	7	Finland	36	48	37
Vietnam	14	13	8	Iceland	27	77	38
Thailand	10	31	9	Chinese Taipei	37	53	39
United Kingdom	13	26	10	Hungary	38	51	40
Guatemala	10	45	11	Sweden	43	37	41
Japan	19	19	12	Bangladesh	50	17	42
Dominican Republic	10	61	13	Czech Republic	44	39	43
Costa Rica	8	68	14	Spain	45	43	44
Malaysia	20	34	15	Portugal	40	59	45
Nicaragua	7	74	16	Austria	45	46	46
Norway	21	32	16	Lithuania	41	60	47
<i>Honduras</i>	9	69	18	Saudi Arabia	60	7	48
Germany	26	20	19	Estonia	42	70	49
Cambodia	15	56	20	Denmark	48	54	50
Indonesia	33	4	21	Romania	54	36	50
Netherlands	22	38	22	Brazil	65	6	52
Australia	31	14	23	Algeria	58	28	53
<i>Colombia</i>	30	18	24	Slovakia	53	49	54
France	32	15	25	Ireland	49	63	55
Belgium	18	58	26	Argentina	67	12	56
Italy	29	27	27	South Africa	64	23	57
India	38	3	28	Russia	71	5	58
Trinidad & Tobago	17	73	29				
Switzerland	25	52	30				

Table 3B: Continued

	Rank – Feasibility	Rank – Attractiveness	Overall – Priority Rank
Sri Lanka	62	33	59
<i>Panama</i>	<i>51</i>	<i>67</i>	<i>60</i>
Israel	57	50	61
Greece	63	41	62
Slovenia	55	66	63
Egypt	69	25	64
Luxembourg	52	79	65
Bulgaria	55	71	66
Turkey	76	9	67
Uruguay	61	55	68
Kazakhstan	70	29	69
Tunisia	59	65	70
Nigeria	78	10	71
Ethiopia	73	30	72
Tanzania	72	40	73
Kenya	74	42	74
Mozambique	68	64	75
Latvia	66	72	76
Paraguay	75	47	77
Senegal	77	62	78
Mauritius	79	78	79

Note: Ranking methodology for feasibility and attractiveness explained in the text. Countries with which Canada already has a trade agreement are in *italic*.

- Three economies on our top 20 list – Indonesia, the Philippines and Thailand – are members of the Association of Southeast Asian Nations (ASEAN), but are not involved in other trade-liberalizing negotiations to which Canada is currently a party. Canada should quickly seek an agreement with this group, at least on par with what ASEAN members have signed, collectively and individually, with Australia and New Zealand. This, combined with a revival of bilateral talks with Japan, could also be a reasonable plan should TPP ratification hit a snag. In parallel, Canada should continue to work with the members of Asia-Pacific Economic Cooperation on relevant taxation matters and to implement a “passport” system for certain financial services regulated by individual countries.

Readers might be surprised that the proposed TiSA is not on our list. The agreement would indeed open up trade between Canada and other economies in the middle tier on our list – such as Norway, Pakistan, Switzerland and Taiwan. Furthermore, Canada certainly could aspire through this agreement to deepen liberalization across a range of services sectors. However, it would also similarly widen and deepen global markets for many of Canada’s already successful competitors in financial services, including the United States and Singapore (which are also in the TPP), the United Kingdom, Hong Kong and Switzerland. The impact of this agreement on Canada’s overall financial services sector specifically therefore might be muted.

Readers might also note that some potentially very attractive markets – such as Brazil, Russia and Saudi Arabia – did not make it onto our list of top priorities. The reason behind this evaluation is that these countries have shown less openness than others to negotiate agreements that liberalize trade and investment in services with any partner, let alone Canada. This does not mean they are not potentially important partners, but the indicators we use suggest only a low potential for progress on trade in services with them.

Table 3C: Canada's Trade Agreement Priority Countries – 75 percent Attractiveness Weighting

	Rank – Feasibility	Rank – Attractiveness	Overall – Priority Rank		Rank – Feasibility	Rank – Attractiveness	Overall – Priority Rank
<i>United States</i>	2	2	1	Algeria	58	28	32
China	15	1	2	Egypt	69	25	33
<i>Mexico</i>	1	8	3	Guatemala	10	45	34
Indonesia	33	4	4	Sweden	43	37	35
India	38	3	5	Kazakhstan	70	29	36
<i>Korea</i>	3	16	6	Czech Republic	44	39	37
Vietnam	14	13	7	Sri Lanka	62	33	37
<i>Chile</i>	4	21	8	Romania	54	36	39
Philippines	6	22	9	Ethiopia	73	30	40
Australia	31	14	10	Morocco	33	44	41
Japan	19	19	11	Spain	45	43	42
France	32	15	12	Finland	36	48	43
Pakistan	47	11	13	Switzerland	25	52	44
Saudi Arabia	60	7	14	Austria	45	46	45
Brazil	65	6	15	Cambodia	15	56	45
<i>Colombia</i>	30	18	16	Greece	63	41	47
Germany	26	20	17	Hungary	38	51	48
Russia	71	5	17	Belgium	18	58	49
United Kingdom	13	26	19	Tanzania	72	40	49
Bangladesh	50	17	20	Dominican Republic	10	61	51
Argentina	67	12	21	Chinese Taipei	37	53	52
Thailand	10	31	21	New Zealand	28	57	53
Turkey	76	9	21	Kenya	74	42	54
Poland	35	24	24	Slovakia	53	49	54
Nigeria	78	10	25	Israel	57	50	56
Italy	29	27	26	Denmark	48	54	57
<i>Peru</i>	5	35	26	Costa Rica	8	68	58
Norway	21	32	28	<i>Honduras</i>	9	69	59
Malaysia	20	34	29				
South Africa	64	23	30				
Netherlands	22	38	31				

Table 3C: Continued

	Rank – Feasibility	Rank – Attractiveness	Overall – Priority Rank
Paraguay	75	47	59
Portugal	40	59	61
Lithuania	41	60	62
Uruguay	61	55	63
Nicaragua	7	74	64
Trinidad & Tobago	17	73	65
Ireland	49	63	66
Singapore	24	75	67
Hong Kong	22	76	68
Estonia	42	70	69
<i>Panama</i>	<i>51</i>	<i>67</i>	<i>69</i>
Slovenia	55	66	71
Tunisia	59	65	72
Iceland	27	77	73
Mozambique	68	64	74
Senegal	77	62	75
Bulgaria	55	71	76
Latvia	66	72	77
Luxembourg	52	79	78
Mauritius	79	78	79

Note: Ranking methodology for feasibility and attractiveness explained in the text. Countries with which Canada already has a trade agreement are in *italic*.

In another region, the Caribbean, Canada might get more liberalization mileage for the time being by completing its trade negotiations with CARICOM, which were launched eight years ago, and especially with the Dominican Republic, which is a fairly promising market, ranking twenty-seventh on our list. And in Africa, Canada could seek to make more serious inroads in that fast-growing market by negotiating with the few countries on the continent that both have signed agreements with others that include services liberalization – namely, Morocco, Kenya and Tanzania – and are at a competitive disadvantage. We did not consider countries that constitute potentially attractive markets but appear to be just emerging from economic isolation – in particular, Cuba and Iran.

QUANTITATIVE ESTIMATES

With this complete list of priority countries in mind, we turn now to the modelling that will allow us to generate quantitative results to assess the effects of liberalization of the financial services sector.

The removal of trade and investment barriers in financial services is typically not negotiated in isolation, but as part of a comprehensive agreement covering goods, most services, investment and many other issues. Each agreement is different in terms of its level of ambition and timing, and its effects also vary given the differing areas of strengths of Canada's FTA partners. As well, each trade agreement generates some preferential gain at the expense of countries that are not party to the agreement, but subsequent agreements involving those other parties claw away those preferential gains. Thus, for example, as suggested above, the sum of Canada's gains from a series of bilateral services agreements with TiSA parties would be substantially greater than the gains from the TiSA itself, since the preferential gains at the expense of other TiSA parties in each individual agreement

would be netted out in the comprehensive agreement.

The Model: What Restrictions Are We Looking At?

Estimating the effects of services trade liberalization is particularly challenging (see online Appendix B). Furthermore, modern trade agreements, such as CETA, tend to remove existing legal barriers to Mode 1 trade and Mode 3 investment in services only incrementally, if at all, especially in advanced economies. Where services are concerned, the most important result of these agreements is instead the significant reduction in uncertainty about access to and treatment in foreign markets subject to the agreement – through the “binding” of existing restrictions at their current level or lower.¹⁶ Recognizing this fact, our model explicitly takes into account such reduced uncertainty about access and treatment (again, see online Appendix B for details). As well, the model allows for a supply response on the part of labour and capital, in the form of incipient wage and rate of return changes in response to trade and investment liberalization.

Despite these two “real-life” features of the model, the results we obtain give only a partial illustration of the likely impact of freer trade and investment in services between Canada and other markets. For example, the model cannot take into

account the likely important and positive effects over time of adopting a “negative list” approach to liberalization – where parties explicitly list what sector or measure is to be excluded from a general liberalizing framework, but include everything else, including new types of services that might emerge in the future and thus would automatically fall under the more liberal trade rules. This approach is followed in CETA, the TPP and the Korea-US Free Trade Agreement (KORUS), for example. Nor do we consider here the adoption of complementary measures to facilitate the movement of skilled and professional workers, or of intra-company transferees in general, across borders (liberalization of Mode 4) that are often included in modern trade agreements and can have an important impact on a firm’s ability to provide services across borders (Bloomfield et al. 2015).

At the same time, other realistic features of our model make it far less likely than other approaches to exaggerate the potential impact of more open trade in services. These other approaches assume percentage cuts to estimated nontariff barriers to trade in services or investment on the basis that the barriers are “actionable” and that the agreement is a high-quality one.¹⁷ But in these other approaches, the specific texts in trade agreements that deliver these results are not mapped to the results; thus, how the trade agreement reduces nontariff barriers remains a “black box.” By contrast, under

16 These binding commitments help explain why *ex-post* gravity models have trouble identifying the specific elements that take advantage of the additional trade that arises from FTAs, as they routinely find that more trade is generated than explained by *ex-ante* modelling, which does not take these bindings into consideration. Indeed, it is reasonably well established in theory that uncertainty affects firm behaviour (see, for example, Dixit and Pindyck 1994), and that reductions in uncertainty about market access stimulate engagement through trade and investment (see, for example, Handley and Limão 2012).

17 For example, a study by Petri, Plummer, and Zhai (2012) on a possible China-US FTA posits across-the-board cuts for services and investment restrictions of 40 percent. Since the estimated nontariff barriers to trade in services and investment tend to be high, such deep cuts would generate large gains that tend to dominate the outcome. Similarly, Francois et al. (2013), in a study of the proposed Transatlantic Trade and Partnership agreement between the United States and the European Union, assume 50 percent of the services barriers are actionable and, in an ambitious scenario, cut these by 50 percent (that is, 25 percent of the total estimated actionable barriers).

our approach, there is deep structure behind the estimated liberalization impacts,¹⁸ based on texts as negotiated, or likely to be negotiated, as opposed to more stylized and aspirational scenarios favoured by some other authors.

Below, we present the result of three such realistic illustrative simulations of the impact on Canada's financial services sector of liberalization with different markets. The first illustrates some of the impact of the TPP on Canada's financial services trade. The second illustrates the impact of a prospective comprehensive Canada-China agreement, assuming it would be based on the recently concluded Australia-China agreement (which seemed to us to represent an evidently feasible outcome for Canada – though not the most ambitious one possible with China, by any stretch). The third simulation is somewhat different in that it estimates the impact only of financial services liberalization – based on the state-of-the-art financial services chapter of the KORUS – simultaneously with 12 disparate markets that feature on our list, including many highly desirable ones and others that are participating in the TiSA talks. We use the KORUS as a template because of its value as a concrete precedent other countries negotiating with Canada might reasonably aspire to rise to, although again, it is not the most ambitious agreement that Canada could possibly reach with these markets. This eclectic approach allows us to discuss different facets of trade liberalization pertaining to financial services with different types of trading partners.

The specific restrictions against foreign investors addressed in the KORUS financial services chapter, and therefore what we used as template for our third modelling exercise, are listed in Table 4.

Additional details on the extent of the reduction in barriers that a KORUS-like agreement would imply with all the countries participating in the TPP, TiSA and the Pacific Alliance, plus India, Brazil and China, can be found in online Appendix C. The tables there show that much of the change of a KORUS-like agreement with these countries, where financial services are concerned, would come from the binding of restrictions at a lower level than currently found in the GATS, and hence they would come from greater certainty for financial services firms that barriers would not be imposed above these levels, rather than from the removal of current legal barriers *per se*.

Summary of Simulation Results

TPP

The expected results of the TPP for Canada's financial services sector are summarized in Table 5. Since the TPP is an agreement which includes both advanced and emerging economies, a number of which are home to highly competitive providers of financial services, it will generate some competition in the domestic market in addition to opening new doors for Canadian providers of financial services. However, Canada is already fairly open to competition from providers of services from the largest TPP economy, the United States, notably through the NAFTA. Thus, as Table 5 indicates, the TPP is expected on net to generate higher exports than imports of financial services for Canada. Specifically, annual sales of financial services for Canada will have increased by US\$429.7 million (in 2011 US dollars) over the baseline scenario in 2018, increasing to US\$615.2 million by 2035. In

18 See Ciuriak, Dadkhah, and Xiao (2014) for a comparison of the difference between cuts based on assumed percentage reductions and those based on the analysis of a text as negotiated.

Table 4: Mapping the Model FTA against Specific FDI Restrictions it Addresses

KORUS Model	Restrictive Measures
Article 13.4: Market Access for Financial Institutions	<ul style="list-style-type: none"> Quotas or economic needs tests are applied in the allocation of licences Joint ventures required Limits on the number of branches Limits on the number of ATMs per bank Some financial products are reserved for statutory monopolies
Article 13.8: Senior Management And Boards Of Directors	<ul style="list-style-type: none"> Board of directors: majority must be nationals Board of directors: majority must be residents Board of directors: at least one must be national Manager must be national
Article 13.13: Payment And Clearing Systems	<ul style="list-style-type: none"> Non-discriminatory access to wholesale payment systems Non-discriminatory access to retail payment systems
Article 13.11: Transparency	<ul style="list-style-type: none"> Regulations are communicated to the public prior to entry into force There is a maximum time allowed to the regulator for decisions on applications
Article 13.2: National Treatment	<ul style="list-style-type: none"> Non-discriminatory access to retail payment systems

Source: Authors' compilation.

contrast, the increase in imports over the baseline scenario is significantly lower, sitting at US\$48.3 in 2018, and US\$219.1 in 2035.

What explains these results? The TPP agreement provides a significant upgrade in certainty levels surrounding services trade and FDI. The binding of market access for services has been markedly improved for all countries, including for the United States.

Given new of certainty afforded by the TPP, Canada should benefit from more secure access to markets where it already holds a decisive competitive hand in financial services. Furthermore, although TPP certainly opens new opportunities for Canada's financial services firms, an additional positive impact of the agreement for the financial

services sector will come from the overall gains it will generate for the Canadian economy.

A Canada-China FTA

Despite China's paucity of past commitments in bilateral FTAs to liberalization beyond its WTO commitments, a subtle change appears to be underway, beginning with the Australia-China FTA signed in June 2015. That agreement includes commitments to financial services that, while marginal, represent a change from past agreements for China. In banking, for example, China has agreed to lower the time Australian banks must wait to engage in local currency business from the previous three years to one year. In insurance, China

Table 5: TPP Trade and Investment Impacts, Financial Services Sector, Canada

	2018	2020	2025	2030	2035	2018	2020	2025	2030	2035
	<i>USD Millions at 2011 Prices</i>					<i>Change in Percent</i>				
Imports of Financial Services										
Change in Cross-border Imports	48.3	50.3	50.1	50.8	51.2	0.62	0.64	0.60	0.59	0.57
Change in FAS	0.0	70.5	105.1	139.2	167.9	0.00	0.29	0.41	0.51	0.58
Total	48.3	120.8	155.1	190.0	219.1					
Exports of Financial Services										
Change in Cross-border Imports	429.7	442.0	476.5	509.1	539.1	6.44	6.48	6.64	6.78	6.89
Change in FAS*	0.0	35.0	60.1	67.6	76.1	0.00	0.12	0.20	0.22	0.24
Total	429.7	476.9	536.7	576.7	615.2					

*pro-rated Canada share

Note: These estimates represent the real annual impact on the financial sector of TPP at different points out to the year 2035. These estimates are preliminary and subject to revision.

has committed to giving Australian insurance providers access to its third-party liability motor vehicle insurance industry, with no restrictions on form of establishment or equity.

A possible Canada-China FTA can be assessed on a preliminary basis by using the framework of the Australia-China FTA. Despite the moves toward liberalization in that agreement, they are marginal compared to complete openness. Thus, in our model, we do not liberalize the Chinese financial services sector, preferring to take a more conservative approach by assessing how the comprehensive nature of an agreement and the subsequent opening up of other industries might affect financial services.

As Table 6 indicates, a similar story emerges for Canada in a Canada-China agreement as it did

with the TPP. Specifically, total sales would increase by approximately US\$459 million (in 2011 US dollars), or by 0.21 percent of total current sales for the entire sector. This increase would be driven by domestic sales increases of US\$499 million. Bilateral exports with China would increase, exports to third markets would fall somewhat, as resources get diverted to Chinese trade, but, similar to the TPP results, the comprehensive nature of such an agreement would engender a net gain in annual sales.

Other Markets

We have also analysed possible liberalization scenarios with other markets, including high-priority markets in which Canada should focus

Table 6: Change in Shipments and Exports by Canadian Financial Services Sector, Canada-China Agreement

	Domestic Shipments	Bilateral Exports	Total Exports	Total Shipments	Bilateral Exports	Total Shipments
	<i>US\$ million at 2011 prices</i>			<i>percent</i>		
Financial Services	499	13	-40	459	0.10	0.21

Note: These estimates represent the real annual impact on the financial sector of a comprehensive bilateral trade agreement with China, similar to the one it signed with Australia in 2015, out to the year 2030. The term shipments is synonymous with revenues.

its efforts on the trade liberalization front. These include the six countries with which Canada does not have an FTA and rank among the top 10 attractive markets: Brazil, China, India, Indonesia, Russia and Turkey. In our list of high-priority markets, we also include some other economies with which Canada does not have an FTA and which are part of the TiSA negotiations: Taiwan, Hong Kong, Mauritius, and Pakistan. Here, contrary to the exercise with the TPP and China, we focused on financial services liberalization only – without the supporting impact of more comprehensive liberalization. We aggregated the model and applied the financial services liberalizing shocks to these countries as a group. These shocks would not be amplified by the income effects from other parts of agreements with these countries (which would depend on the level of ambition of those other parts of the negotiations) nor would the effects be covered up by the resource reallocation effects that take place when the whole economy is liberalized at once, as in our TPP and Canada-China scenarios. The results, broken down this time between banking and insurance services, show that even without the support of comprehensive liberalization, financial services liberalization on its own is likely to be beneficial.

CONCLUSION

We believe there is value in thinking about the issue of services and investment liberalization in quantitative terms. We note, however, that large uncertainties still exist in quantifying barriers to, and the effects of, liberalization. The difficulty in producing accurate quantitative estimates include the fact that trade flows are poorly measured, in part because multinational services providers are able to book service contracts where they want, and the teams putting them together are likely spread around the world. Furthermore, barriers to services trade can be difficult to quantify, and how trade adjusts to changes in these barriers is still a work in progress. Accordingly, our quantitative estimates should be treated with due caution and considered in the light of qualitative assessments, economic theory and intuition – factors that can sometimes be more easily captured in the type of ranking of priority markets that we also developed in this study.

Despite these challenges, we have been able to generate some important results. We have calculated the effects FTAs would have in reducing uncertainty in the financial services sector from the difference between the lower trade and investment restrictions allowed under the new agreement, and the higher ones allowed under the

Table 7: Change in Shipments and Exports by Canadian Financial Services Sector, Some Priority Markets

	Domestic Shipments	Bilateral Exports	Total Exports	Total Shipments	Bilateral Exports	Total Shipments
	<i>US\$ million at 2011 prices</i>			<i>percent</i>		
Banking Services	46.05	307.70	301.23	347.27	69.99	0.25
Insurance Services	22.04	270.60	244.99	267.03	23.87	0.66

Note: These estimates represent what would have been the impact on the financial sector in 2015 of a series of bilateral trade agreements liberalizing only trade and investment in financial services between Canada and a number of priority economies, as defined in this paper, and only to the level of financial services liberalisation in the KORUS agreement, assuming such bilateral agreements had all simultaneously been in force during the period 2011-2015. The economies in this simulation are: Brazil, China, India, Indonesia, Russia, Turkey, countries negotiating the Trade in Services Agreement with which Canada does not already have a free trade agreement (namely Chinese Taipei, Hong Kong, Mauritius, and Pakistan as well as Paraguay and Uruguay). The term shipments is synonymous with revenues. Another set of results using a lower ad valorem equivalent measure of barriers in banking and insurance than the one in this simulation is available from the authors upon request.

GATS. Furthermore, we have created a ranking of trade partners based on an aggregation of factors representing both the likely positive impact on and the feasibility for Canada of concluding agreements that would benefit trade and investment in financial services.

We find that the first order of business from the viewpoint of exploiting Canada's relative advantages in financial services should be to ratify the TPP, as many of the countries high on our priority list are involved in this agreement. China, too, is a key market, despite the many challenges associated with negotiating a trade deal with that country. It is also important to continue negotiations with high-priority markets in Latin America, further discussions with India, despite earlier setbacks, and spend energy on ASEAN nations such as Indonesia, the Philippines and Thailand. This is by no means an exhaustive list, but successful liberalization of financial services in these markets would bring significant gains to the Canadian

financial sector and economy as a whole.

This conclusion is supported by our empirical analysis of three liberalization scenarios – one the TPP as recently signed; the other a Canada-China trade agreement that assumes, however, only minimal formal liberalization of financial services; and the third an exercise in liberalizing financial services only with some key markets, including China. As designed, these exercises provide a very cautious view of the extent of possible liberalization – they are based on templates of existing agreements, that Canada could realistically aspire to, but are far from fully liberalizing trade. In one case, the scenario assumes full liberalization of financial services, but not of other, complementary sectors, which the first two simulations show are important sources of gains for financial services. In spite of this, we find in all cases gains for Canada's financial services sector from these liberalization scenarios. These gains come from the overall positive impact on economic growth of trade agreements boosting

business for the financial services sector overall, from actual, though often modest, reduction to barriers affecting financial services themselves, and from the reduction of uncertainty that results from the “binding” of these barriers at levels much lower than what countries are allowed to impose under WTO rules.

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