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CRS Report for Congress

Fair Trade in Financial Services: Legislation and the GATT

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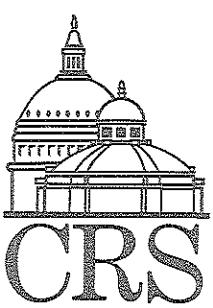
March 10, 1994



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FAIR TRADE IN FINANCIAL SERVICES: LEGISLATION AND THE GATT

SUMMARY

As many countries enjoy growing financial economies, American banking and securities firms feel excluded from them. Asian countries are perceived as being especially discriminatory against U.S. financiers. Conversely, foreign financiers face few barriers against entry into the United States. Their share of U.S. finance has reached very significant amounts — especially that of Japan in U.S. commercial banking. Both pressures have induced consideration of legislation that could require reciprocity for foreign direct investment in financial companies in America, intended to open up corresponding nations' financial markets. The proposed legislation also reflects final collapse of multilateral negotiations in the General Agreement on Tariffs and Trade seeking to open up financial services in many nations to U.S. providers. It would apply sanctions against such countries similar to those opening up government securities markets abroad, but might result in some retaliation.

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POLICY ISSUES

Foreign interaction with American finance has aroused concern. Some observers claim that foreign financiers can enter U.S. markets of their choice, allegedly practice predatory pricing, and capture market shares of finance in much the same way that imports penetrated the automobile and electronics industries. Conversely, numerous emerging or newly privatized economies are believed to offer favorable opportunities for lending and securities activities. Many of these places impede direct American financial competition. U.S. bankers feel that the home countries of many of their competitors — especially Japan — are discriminating against U.S. banks. In the securities field, the U.S. market is entirely open to foreign entry, although mutual fund managers and other securities entities believe that many foreign markets are closed to U.S. firms. Counterarguments include the U.S. tradition of free financial entry, and that any new foreign entrants make lending and investing activities increase in volume and decrease in price in America.

NATIONAL TREATMENT OR RECIPROCITY?

U.S. policy of unconditional "national treatment" — treating foreign financial firms essentially the same as domestic ones — appears to be almost unique. It was legislated in the International Banking Act of 1978[1] for banks. It is viewed as existing under the many securities laws, which are silent as to international concerns. More specifically, the Senate Report on this Act declared that for national treatment:

> . . . Under this principle, a foreign bank operating in a particular nation should be accorded operating privileges which provide such banks with the opportunity for competitive equality with their host country domestic counterparts.[2]

The more common treatment in the world of finance is reciprocity, which:

> . . . as it is conventionally applied to trade in financial services implies that a country discriminates in its treatment of foreign firms by

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[1] P.L. 95–369.

[2] Senate Report No. 95–1073, reprinted in *U.S. Code Congressional and Administrative News*, 1978, v. 3. p. 1438.

affording each of them exactly the same treatment the country's own firms receive in its home country. Reciprocity is therefore analogous to retaliation in trade policy.[3]

Even within America, a handful of States require reciprocity for their banks to locate in a given foreign home country as a condition of allowing foreign banks to open a branch under State authority. (Fourteen States that allow foreign bank branching have no such requirement.)[4]

Foreign banks and securities firms may not behave much differently from domestic ones in our economy. Indeed, some have found that unconditional entry of foreign firms into the U.S. markets results in lower interest rates or greater credit and investment flows to U.S. parties — regardless of the countries of origin of the lenders.[5] Investment of Japan's surplus dollars back into the United States through financial activities in the 1980s is often cited as an example.[6] Historically, foreign banking and capital financing activities were vital to the development of this Nation for its first century.[7]

COUNTRY TREATMENT OF U.S. FINANCIAL FIRMS

Congress has received a series of Treasury Department reports beginning in 1979 on the extent of national treatment for our financial institutions by other nations. They have shown that despite general world–wide "deregulation" of financial industries — across and within borders — many countries still restrict U.S. financial operations. Countries with attractive financial markets

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[3] Walter, Ingo. *Global Competition in Financial Services: Market Structure, Protection, and Trade Liberalization*. Cambridge, Mass., Ballinger, 1988. p. 150.

[4] Conference of State Bank Supervisors. *A Profile of State–Chartered Banking*. Washington, 1992. p. 228–230. Data are as of December 31, 1991.

[5] Analyses include Meinster, David R., and Elyas Elyasiani. The Performance of Foreign Owned, Minority Owned, and Holding Company Owned Banks in the U.S. *Journal of Banking and Finance*, June 1988. p. 293–313; and, Institute of International Bankers. *Banking in a Global Economy: Economic Benefits to the United States from the Activities of International Banks*. New York, 1993. 77 p.

[6] See U.S. Library of Congress. Congressional Research Service. *Foreign Direct Investment in the U.S.: Japan as Number One*. Report No. 93–704 E, by James K. Jackson. Washington, 1993. 6 p.

[7] Jackson, James K., and William D. Jackson. Foreign Ownership of U.S. Assets. In: U.S. Library of Congress. Congressional Research Service. *Foreign Direct Investment: Effects on the United States*. Report No. 89–504 E, coordinated by James K. Jackson. Washington, 1989. p. 18–30; and, Jackson, William D. Foreign Investment in United States Banking. *Ibid*., p. 93.

that have been cited as not offering access or competitive equality for U.S. financial businesses include Brazil, Indonesia, Korea, Philippines, and Taiwan, in addition to Japan. More than twenty countries of the Organisation for Economic Co–operation and Development have formal restrictions against foreign–based financial service providers.[8] (Many of them do not apply the restrictions against American firms in practice.) The Treasury Department specifically intends to negotiate to win full business rights for U.S. financial services providers in China (especially) as well as Argentina, Brazil, Hungary, and Turkey.[9]

On the other hand, Canada, Mexico, and the countries in the European Union will provide access to U.S. financial firms on terms that are perceived as generally favorable by the American providers. Their financial economies were accessed by specific negotiations leading to bilateral agreements. European agreements include the Second Banking Directive — which includes some securities activities — and the UCITS Directive covering "unit trusts," which are parts of the "EC92" program of multi–country commercial deregulation.[10] The more recent North American Free Trade Agreement[11] was built upon the earlier Canada–U.S. Free Trade Agreement.[12]

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[8] Statement of Lawrence H. Summers in U.S. Congress. House. Committee on Banking, Finance and Urban Affairs. Subcommittee on International Development, Finance, Trade and Monetary Policy. *Fair Trade in Financial Services*. Hearing. Washington, U.S. Govt. Print. Off., 1994. p. 31–32. (Serial No. 103–96). (Hereinafter cited as *Fair Trade Hearing*.)

[9] Bacon, Kenneth H. Bentsen Unveils Effort to Open Capital Markets. *Wall Street Journal*, January 19, 1994. p. A2.

[10] U.S. Library of Congress. Congressional Research Service. *Banking in "Europe 1992."* Report No. 89–456 E, by William Jackson. Washington, 1989. 14 p; and, *Banking in the European Community*. Report No. 89–670 E, by William Jackson. Washington, 1989. 16 p. Now known as the European Union, the twelve countries covered by the "European Community" Directives are: Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, and United Kingdom. The standard is actually "reciprocal national treatment" which was viewed as favorable liberalization for U.S.–financial entrants for the mid–1990s.

[11] U.S. Library of Congress. Congressional Research Service. *Banking and Finance in the North American Free Trade Agreement*. Report No. 93–560 E, by William Jackson. Washington, 1993. 6 p.

[12] Jackson, William. Banking and Securities Industries. In: U.S. Library of Congress. Congressional Research Service. *The Effect of the Canada–U.S. Free Trade Agreement on U.S. Industries*. Report No. 88–506 E, coordinated by Arlene Wilson and Carl E. Behrens. Washington, 1988. p. 64–66.

RELATIVE MARKET SHARES

A comparison of market shares by country can be computed for banking; market shares for securities activities are not quantifiable. This approximation does not account for demand conditions — the attractiveness of each national market for financing activities. Neither does it consider each country's balance–of–payments position that would lead to cross–border investment in finance. It is thus not necessarily a supply restriction measure. It appears in table 1 (below) for the most recently available U.S. data.

TABLE 1. Top Countries in U.S. Banking, Mid–1992

Country of Parent	(1) Number of Banks	(2) Asset Market Share
Japan	55	12%
France	15	2
Canada	6	2
United Kingdom	10	1
Italy	13	1
Switzerland	7	1
Netherlands	3	1
Germany	14	1
Hong Kong	9	1

Source: (1) Foreign Banks in the United States. *American Banker*, April 19, 1993. p. 6A; (2) Computed by CRS from *Ibid.*

U.S. banking institutions appear much less important in most other countries' finances, in contrast. The most recently available (late–1980s) market shares of U.S. banking organizations in major countries are shown in table 2 (on the next page). In that table, only the Philippines, Singapore, and United Kingdom markets show a U.S. bank presence anywhere near the 10 percent share that the Japanese had within our economy in 1988, approximately the time frame of table 2. At that time Canadian, British, Italian, French, Hong Kong, and Swiss bankers each had around one percent of U.S. banking assets.[13] This "problem" of foreign banking in America has become focused largely on the disparity in market shares and regulation between the United States and Japan; it could become largely self–correcting as Japanese banks contract their operations world–wide and in America.[14]

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[13] Jackson, Foreign Investment in United States Banking, p. 94.

[14] Zimmerman, Gary C. Difficult Times for Japanese Agencies and Branches. *Federal Reserve Bank of San Francisco Weekly Letter*, October 22, 1993. p. 1–2.

CONGRESSIONAL REACTION

The Financial Reports Act of 1988[15] requires that the Treasury Department continue to examine and report to Congress on competition and regulation in financial services direct investment across borders. The Department continues its reports of this nature, as first mandated in the International Banking Act of 1978.

TABLE 2. Shares of U.S. Banks in Country Banking Markets, Late 1980s

Country	Number of U.S. Banks	Percentage (generally of assets)
Argentina	10	7%
Australia	4	4
Brazil	4	7
Canada	20	3
Finland	1	a
France	15	Not Specified
India	3	a
Indonesia	5	2
Italy	38	a
Japan	18	a
Korea	14	2
Mexico	1	a
Norway	3	a
Philippines	4	9
Singapore	5	13[b]
Sweden	2	a
Taiwan	12	2
Thailand	5	a
Turkey	4	a
United Kingdom	67	10
Venezuela	1	a
West Germany	23	1

[a] Less than one percent.

[b] U.S. institutions with a full or restricted license ("domestic" operations).

Source: Computed by CRS from U.S. Department of the Treasury. *National Treatment Study: Report to Congress on Foreign Treatment of U.S. Financial Institutions*. Washington, 1990. Various pages.

[15] Sections 3601–3604 of P.L. 100–418, the Omnibus Trade and Competitiveness Act of 1988.

Commencing 1987, both the House and the Senate had separately approved Fair Trade in Financial Services language, including measures attached to Defense Production Act reauthorization.[16] The Senate passed the legislation three times; the House once. Then lacking firm Administration and industry support, at seemingly the last minute no such measures became legislated.[17]

Following scandals involving prominent foreign banks in America, the Foreign Bank Supervision Enhancement Act of 1991[18] was enacted. It requires much scrutiny of foreign banks' operations and regulation abroad as a condition of allowing their entry into America. It applies greater regulatory oversight to State–chartered banking institutions owned by foreign parties than is required for domestic ones. It has indeed made entry of foreign bankers into America much more difficult.[19]

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[16] Congressional interest in this kind of legislation has been documented in, among other places: U.S. Congress. House. Committee on Banking, Finance, and Urban Affairs. *Regulation of Foreign Banks*. Hearing. Washington, 1991. 165 p. (Serial No. 102–41); Subcommittee on Financial Institutions Supervision, Regulation and Insurance. *Oversight Hearing on Foreign Competition in the Banking Industry*. Washington, U.S. Govt. Print. Off., 1990. 271 p. (Serial No. 101–123); *National Treatment in Policy and Practice in the United States and Abroad*. Hearing. Washington, U.S. Govt. Print. Off., 1990. 44 p.; Task Force on International Competitiveness of U.S. Financial Institutions. *Competitiveness of U.S. Insurance Companies, Financial Service System and Nonbank Financial Firms*. Hearing. Washington, U.S. Govt. Print. Off., 1990. 218 p. (Serial No. 101–155); *Problems Confronting U.S. Banks Attempting to Implement Global Strategy*. Hearing. Washington, U.S. Govt. Print. Off., 1990. 55 p. (Serial No. 101–116); *Report*. Washington, U.S. Govt. Print. Off., 1991. p. 97–128. (Committee Print 101–7); Subcommittee on International Development, Finance, Trade and Monetary Policy. *Fair Trade in Financial Services Legislation*. Hearing. Washington, U.S. Govt. Print. Off., 1992. Part 1, 511 p. Part 2, 285 p. (Serial No. 102–85); Subcommittee on Economic Stabilization. *Fair Trade in Financial Services*. Hearing. Washington, U.S. Govt. Print. Off., 1991. 218 p. (Serial No. 102–25); Senate. Committee on Banking, Housing, and Urban Affairs. *Fair Trade in Financial Services Act of 1990: Report to Accompany S. 2028*. Washington, U.S. Govt. Print. Off., 1990. 40 p. (Senate Report No. 101–367); and, *The Fair Trade in Financial Services Act of 1990*. Hearing. Washington, U.S. Govt. Print. Off., 1990. 112 p. (Senate Hearing 101–870).

[17] Statement of John R. Price in *Fair Trade Hearing*, p. 49; and, Hilsby, Ashby G. Proposed Law Might Pry Open Foreign Financial Markets. *American Banker*, December 30, 1993. p. 16.

[18] Sections 210–215 of P.L. 102–242, the Federal Deposit Insurance Corporation Improvement Act of 1991.

[19] Kraus, James R. Foreign Banks Face Hurdles. *American Banker*, April 19, 1992. p. 2A; Bellanger, Serge. Stormy Weather: The FBSEA's Impact on
(continued...)

GATT

In continuing multilateral negotiations during the prolonged Uruguay Round of the General Agreement on Tariffs and Trade (GATT) covering services, the United States maintained that America need not open its borders to institutions from countries with closed financial markets. It offered most–favored–nation rights in finance only to countries offering full access to U.S. providers. Asian countries would not be eligible until their internal markets were to be opened. At the same time Brazil, Egypt, India, and other Third World countries feared that multinational (U.S. and European) financial services companies would swamp their internal providers, thereby blocking any final agreement for this sector.[20]

The final 1993 GATT document did not contain any financial services provisions in its multi–industry trade liberalization package. It did allow a two–year window period – 1994 until 1996 – in which new rules might be negotiated to cover international financial services. U.S. financial industries were particularly disappointed that GATT did not open up Japanese and Korean markets to them.[21]

OUTLOOK

Re–introduction of Fair Trade in Financial Services legislation in 1993 was intended, in part, to stimulate negotiations by other countries to open their financial markets in GATT.[22] Following the final collapse of GATT talks covering financial firms, the Senate Banking Committee reported an amended

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[19](...continued)
Foreign Banks. *The Bankers Magazine*, November 1992. p. 25–31; Misback, Ann E. The Foreign Bank Supervision Enhancement Act of 1991. *Federal Reserve Bulletin*, January 1993. p. 1–10; and, Cairns, John B. FBSEA: Still Grimm in the Second Year. *The Bankers Magazine*, November 1993. p. 8–14.

[20] Jackson, William. The International Banking and Related Financial Market. In: U.S. Library of Congress. Congressional Research Service. *Uruguay Round of Negotiations and Its Impact on the U.S. Service Sector*. Report No. 91–233 E, coordinated by Gwenell L. Bass. Washington, 1991. p. 10–11; and, U.S., EC Differ on Financial Services Approach in GATT Trade in Services Talks. *BNA's Banking Report*, October 25, 1993. p. 647.

[21] Harbrecht, Douglas. GATT: It's Yesterday's Agreement. *Business Week*, December 27, 1993. p. 36.

[22] Key Law Makers in House, Senate Introduce Identical Fair Trade Bills. *BNA's Banking Report*, October 18, 1993. p. 604; and, *Fair Trade Hearing*, p. 1–58.

version of S. 1527.[23] In 1994 the measure became attached to community development banking legislation which became approved by the entire Senate. The House Banking Committee has also approved the companion H.R. 3248. This currently considered Fair Trade in Financial Services measure now carries Administration and financial industry support.

The legislative proposal is patterned broadly after the Primary Dealers Act of 1988,[24] which addressed U.S. access to underwriting government securities abroad. (That Act, unlike the currently considered measure, named Japan specifically). The new measure would authorize retaliation against countries that discriminate against U.S. financial institutions. It is more forceful than the corresponding "discussions" with other countries suggested in the Financial Reports Act of 1988. Under this new approach, the Secretary of the Treasury could recommend that U.S. financial regulators disallow entry by foreign financial entities whose home countries do not provide competitive equality to U.S. banking or securities firms, respectively. The Treasury could also initiate negotiations with the financial foreign countries, leading toward having them accord national treatment to U.S. banking and securities companies.

The Fair Trade in Financial Services measure's reciprocity tactics are the consequence of perceived disparities under current unconditional national treatment. The Primary Dealers Act has been viewed as successful through its stronger approach. Policymakers favoring the new measure believe that the Treasury Department needs more authority than now backs up its bilateral negotiations for open financial service markets.[25]

The measure's sanctions are not automatic, however. They would cover only expansion or new entry by foreign financiers. Such denials might work only against countries whose financiers seek U.S. entry. The countries could refuse to negotiate. Perceptions could also arise that the United States might be waging a kind of financial trade war against friendly countries. Possibilities of foreign retaliation could arise, in this view.[26] And as was noted before, the United States may limit access to foreign banking firms based in countries that do not open their doors to American financial firms under the Foreign Bank Supervision Enhancement Act now, and to securities firms as well as banks under the GATT framework after January 1996.

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[23] U.S. Congress. Senate. Committee on Banking, Housing, and Urban Affairs. *The Fair Trade in Financial Services Act of 1993 — S. 1527.* Hearing. Washington, U.S. Govt. Print. Off., 1994. 87 p.

[24] Section 3501 of P.L. 100–418, the Omnibus Trade and Competitiveness Act of 1988.

[25] See footnote 22 above.

[26] Statement of John P. LaWare in *Fair Trade Hearing*, p. 9–11, 42–43.