Increasing Efficiency and Economic Growth Through Trade in Financial Services

Statement of
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on behalf of the
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Introduction

I am pleased to be with you today to discuss the banking industry's views on increasing efficiency and economic growth through trade in financial services. I am testifying today as the president of BAFT—the Bankers' Association for Finance and Trade—an organization founded in 1921. Today BAFT is an affiliate of the American Bankers Association and its membership includes most of the major American banks that are active in international banking and also many of the major international banks chartered outside of this country.

My employer, JPMorgan Chase & Co., is one of the largest U.S. financial services institutions. Many of our clients engage in business activities around the world and we provide them with a wide range of retail and commercial banking, securities, asset management, and other investment banking products and services on a global basis. Our commitment to lowering international trade barriers reflects our clients' interests as well as our own.

Importance of International Business Activities

Although only a few of the largest U.S. banks operate on a truly global scale, international business activities are an important part of the business of many U.S. banks, both large and small. As one of the global banks, JPMorgan Chase in 2004 earned more than 30% of its total revenues in international activities—transactions that involve customers located outside of the United States. We have operations in more than 50 countries. The importance of our international business is reflected in our international council, an advisory board with 26 members from the U.S. and 16 other nations.

Similar statistics can be cited for other global U.S. banking organizations. Citigroup is on the ground in more than 100 countries and territories, ranging from Argentina to Zambia. In 2004 Citigroup earned 53% of its income outside of North America. Bank of America has offices in 35 countries, supporting clients in 150 countries. In 2004, 5.7% of Bank of America's assets were attributable to non-U.S. business, as was 5.6% of its total revenue. Another major U.S. bank, Wachovia, has 40 international offices.

Other U.S. banks participate in international business through trade finance and correspondent banking. For example, Wells Fargo is a partner in a joint venture called Wells Fargo HSBC Trade Bank, a U.S. national bank dedicated exclusively to international trade, and Comerica has more than 1,400 correspondent banks worldwide.

Whatever their international business activities might comprise, BAFT members support the reduction of international trade barriers. To the extent those barriers impede the flow of goods and services across national borders, they limit the commercial activity and economic growth that U.S. banks finance. To the extent they impede U.S. banks' ability to conduct business across borders and within foreign markets, those barriers directly limit the banks' growth and profitability. Reduction of international trade barriers will benefit American banks *and* their customers of all sizes and kinds. Today many more American businesses, including small and medium-sized companies, are establishing operations overseas and require local banking services. In many cases, it is advantageous for them to be able to do business with the local office of an American bank. Reduction of trade barriers also will help to address our country's worrisome trade deficit, which is at an all-time high (currently running at an annual rate of $706 billion). The U.S. generally is an open market and we will be the beneficiaries of a reduction in international trade barriers as markets in other countries become more open to us. This is particularly true with respect to banking and other financial services where the U.S. enjoys competitive advantages; it is a trade sector that has shown the capacity for substantial growth and it will grow even faster when trade impediments are removed.

Restrictions Faced by U.S. Banks in Foreign Markets

U.S. banks maintain representative offices, branches, and subsidiaries, and conduct diverse business activities, in many foreign markets around the world. In fact, until the adoption of the Gramm-Leach-Bliley Act in 1999, U.S. banking organizations were permitted to engage in a much broader range of financial activities outside of the U.S. than they were permitted to conduct at home. One of my firm's predecessor banks, JPMorgan, first developed its securities underwriting and dealing capability (and related operational services such as custody and cash management) in Europe and the U.K. because at the time it was not permitted to conduct those activities within the U.S. Notwithstanding the scope of their international business, however, U.S. banks continue to encounter a wide range of restrictions on their presence and business activity in foreign markets.

China provides a good example. This is a country that has experienced tremendous growth since 1978 when Chinese political leaders began the transition to a market-oriented system. The gross domestic product of China has quadrupled since 1978 and by 2004 China was the second-largest economy in the world. This clearly is a desirable market with huge potential for financial services firms from the U.S. and elsewhere.

In connection with its accession to the WTO in December 2001, China made a large number of commitments to open its markets to foreign participants, including banks, and it has made impressive progress. Foreign banks were allowed immediately to engage in foreign (*i.e.*, non-Chinese) currency operations throughout China. Last December, China began to phase-in Chinese-currency operations for foreign banks (based on location) and the country has committed to eliminate geographical restrictions and customer limitations on foreign banks by the end of 2006. Despite these important steps, however, U.S. and other non-Chinese banks continue to face obstacles in Chinese markets.

These include China's restrictive limits on foreign investment in Chinese banks. A single non-Chinese investor may not own more than 20% of the equity in a Chinese bank, and total foreign investment in a single Chinese bank is limited to 25%. Although foreign banks are permitted to operate through branches, they are subject to capital requirements that are applied on a branch-by-branch basis and exceed the capital requirements imposed on local banks. The branch licensing process also is slow and, among other things, requires a foreign bank to have a representative office in the same province for at least two years before obtaining a branch license. Representative offices are limited to representing only the head office of the bank, but not the business activities of its branches, subsidiaries, or affiliates.

The regulatory system in China is another impediment for U.S. and other non-Chinese banks. A study of foreign banks in China, published by PricewaterhouseCoopers in September 2005, found that new regulations are the most important issue they face and that the regulatory environment is regarded as the most difficult aspect of doing business there. Criticisms expressed by the foreign banks included: interpretation of regulations varies from place to place, regulations are not well thought-out and applied in an arbitrary and ad hoc manner, and the overall nature of the legal framework is rudimentary.

We don’t wish to single out China as being a uniquely difficult place for U.S. banks to do business, particularly in light of the significant progress they have made and which we believe they fully intend to continue to make in the future (though we should continue to closely monitor their progress in meeting their commitments). U.S. banks face difficult challenges in many WTO-member countries. For example, a review of various countries’ limits on foreign banks undertaken by the Coalition of Service Industries in February 2003 noted that in India foreign banks’ share of total system-wide banking assets was limited to 15%; foreign banks were subject to higher taxes than domestic banks; and foreign banks were subject to more restrictive capital requirements than domestic banks. Foreign banks are permitted to operate in India through branches and wholly owned subsidiaries, but their investments in non-distressed private-sector Indian banks generally are limited to less than a controlling interest (foreign banks that acquire troubled institutions may be able to acquire control). Foreign investment in India's public-sector banks, which dominate the banking market, is even more limited. Although India plans to allow greater foreign investment in private banks, that will not occur until 2009.

In Indonesia, a 1988 deregulation package partially opened banking to foreign investment. In 1998 Indonesia exceeded its WTO commitments by allowing foreign banks to own up to 99% of the equity in local banks. But in 2003, CSI noted that Indonesia was not granting licenses for new branches or subsidiaries of foreign banks. In the Philippines, foreign banks may control no more than 30% of the country's total banking assets; there is a moratorium on licenses for new banks and there are discriminatory limits on foreign banks opening new branches. The United States Trade Representative's 2005 Report on Foreign Trade Barriers noted that rural banking in the Philippines is totally closed to foreigners.

In Thailand, foreign banks are permitted to open only one branch and an off-site ATM is classified as a branch. Foreign investment in Thai banks is capped at 25% of total equity. (We hope these issues will be addressed in the free trade agreement the U.S. and Thailand are negotiating and hope to conclude in early 2006.) Korea permits foreign banks to operate through subsidiaries or branches, but imposes branch lending limits on the basis of branch capital. USTR's 2005 Report concluded that, "All banks in Korea continue to suffer from a non-transparent regulatory system and must seek approval before introducing new products and services—an area where foreign banks are most competitive."

Similar restrictions and limitations can be found in many other countries. I've chosen the ones I've mentioned because they are found in some of the biggest and most interesting foreign markets for U.S. and other banks. China and India, as the world's fastest growing economies, are particularly significant and obtaining trade barrier reductions in their markets are high priorities for many American banks.

I also want to mention several limitations imposed on foreign banks in Russia, which is not yet a WTO member. (The Russian Federation is in the process of negotiating with current WTO members regarding the market-opening concessions it is willing to make in order to gain accession to the WTO.) Russia prohibits foreign banks from operating through branches. Non-Russian banks are permitted to operate only through subsidiaries—my bank has a Russian subsidiary, as does Citi—and the Russian Central Bank has the authority to impose a limit on foreign bank subsidiaries' share of the total charter capital of Russian banks.

U.S. banks hope that the WTO's Doha Round of trade negotiations will lead to a significant reduction in trade barriers generally, as well as in the restrictions imposed specifically on foreign banks by many WTO-member countries. But multilateral negotiations are not the only avenue for reducing trade barriers. We also support our country's bilateral negotiation of free trade agreements and we hope these efforts will continue. Our banks will benefit from gaining greater access to foreign markets in whatever manner it is achieved. Local consumers and businesses in other countries also will benefit from the competition, management expertise, skills transfer, new operating methods, innovative products and services, and standards of conduct that U.S. and other foreign banks can bring to their markets. In addition, particularly in developing countries, the presence of highly rated international banks generates greater confidence in the banking system and encourages local citizens to open accounts and become integrated into the economy. Increasing deposits in the banking system adds liquidity and stability to the local economy and makes funds more available for local business. The benefits of opening local markets to foreign competition extend to all levels of the economy.

Characteristics of Open and Competitive Markets

Open and competitive markets share certain fundamental characteristics: national treatment; unrestricted market access, including freedom to choose a suitable business structure; and transparency. We believe that countries participating in the Doha Round should have these characteristics as a goal for their own financial services markets and that their offers and revised offers to reduce trade barriers should strive to achieve that goal. BAFT plans to evaluate the Doha Round's progress with respect to banking services on a country-by-country basis using these characteristics as a benchmark. We also believe that countries like Russia that wish to become WTO members should make concessions that are consistent with these fundamental characteristics.

National treatment is achieved when domestic and foreign firms have the same opportunities to compete and are subject to the same rules governing their activities in the local market, without regard to the location of their charter or home office or that of a parent or affiliate. Of course, different rules can and should apply to firms that are situated differently, but only with respect to relevant factors such as business activities and type of organization; the differentiating factor should *not* be nationality.

Unrestricted market access means that domestic and foreign firms should have the same ability to offer their products and services in all segments of a particular market. This includes government procurement. Government entities should not prefer local firms solely because of their nationality. It also means that domestic and foreign firms should have the ability to serve their customers in whatever manner they determine to be best suited to their business needs: by establishing a business entity locally (and having the choice whether to operate through a subsidiary or a branch), by using a local business entity with support services coming from outside the country, by providing products and services across borders without a local establishment, and by providing products and services to customers who cross borders to obtain them. The choice should be governed by the requirements of the business and the needs of its customers, and not by dictates based on nationality or borders. Unrestricted market access requires that employees have the ability to travel across borders freely for business purposes, and that businesses have the ability to move employees into and out of local markets based on business need (referred to as business travel facilitation). Unrestricted market access also means that countries should not impose economic needs tests as a barrier to market entry—the market itself is a much better and impartial judge of economic need.

Transparency is a particularly high priority for banks and other financial firms because their businesses are highly regulated. Banks spend an enormous amount of time and money determining how they can conduct business in the various jurisdictions in which they operate and keeping abreast of changes in the regulatory rules in each of those jurisdictions. Transparency means that the laws, regulations, and other rules governing banking activities in a particular country should be written, compiled in an intelligible manner, and accessible to the banks that must comply with them. Both domestic and foreign banks should be given advance notice of proposed new rules and regulations or changes in existing ones, with reasonable opportunity to comment. They should have advance notice before new rules and regulations go into effect and should be given sufficient time to study, understand, and comply. Transparency means that laws, regulations, and rules should be applied in a consistent and uniform manner among institutions, whether domestic or foreign, and from place to place within a particular country.

Transparency also is needed with respect to licenses and the licensing process. The requirements for granting a license should be specific and objective, and they should be written and accessible to the banks and individual bank employees that need licenses for particular activities. Decisions on license applications should be made promptly and reasons should be given if license applications are denied. Full transparency also requires that an appeal process be available for disappointed license applicants.

Conclusion

We believe that U.S. banks can realize significant benefits from a general reduction in global trade barriers and, thus, they have much to gain in the WTO’s Doha Round of trade negotiations. We are concerned, however, about the slow progress being made in the Doha Round. Of the 148 WTO members, only 93 (including each of the EU countries as a separate entity) had made initial offers covering financial services as of mid-October 2005 (initial offers were due on March 31, 2003) and only 52 had submitted revised offers (which were due May 31, 2005). Although BAFT has not yet evaluated individual countries' offers, the overall quality of the initial and revised offers generally is regarded to be unsatisfactory, as reported by the WTO's Trade Negotiations Committee (TNC) Chairman (and WTO Director-General) Supachai Panitchpakdi in July. In fact, some countries' offers do not even go so far as to commit to trade barrier reductions that equal what the countries permit in actual practice today. The TNC Chairman's July report included comments from various participants that described countries' financial services offers similarly.

The success of the Doha Round is important and we urge all of the participating countries to redouble their efforts and make aggressive reductions in their trade barriers. It is in their own best interest to do so. The U.S., as the world's largest and strongest economy, should take the lead and set an example for others to follow. We have done so in our proposal to reduce agricultural subsidies and should do so across the board, including in particular with regard to business travel facilitation.

BAFT greatly appreciates the efforts of the U.S. Treasury Department and USTR in promoting financial services liberalization within the WTO negotiations. I would like to emphasize that securing broad services liberalization—and specifically significant financial services liberalization—is essential to an agreement being one we can support.