"INTERNATIONAL TRADE IN BANKING"

by

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Comments welcome.

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SUMMARY

In this paper, I develop an economic analysis to guide the legal framework governing international trade in banking services. This is timely as, following up on the GATT Uruguay Round concluded in April 1994, further negotiations on the liberalization of the financial services sector will begin in 1995. Close attention is paid to the ability of the *national treatment* principle to deal with banking, to *reciprocity* clauses, and to the eventual need for an additional harmonization of national regulations. The six main conclusions of the paper are as follows :

• A sensible discussion of the legal framework governing international trade in banking services must start with an understanding of the potential market failures leading to public interventions and regulations. The economics literature has identified three potential sources of market failure calling for public interventions : Imperfect information, bank runs and the related fear of systemic crisis, and implicit subsidies which can distort international trade. Each of these demands its own regulatory and supervisory responses.

• As long as national authorities are responsible for the stability of their own financial markets, I support fully the recent recommendations of the Basle committee on banking supervision and of the General Agreement on Trade in Services which allocate to national authorities the prudential supervision of firms operating in their own markets. In practice, this implies often a collaboration between the home and host country supervisors.

• As far as the protection of investors is concerned, it is for each country to choose the level of protection for the 'uninformed' investor. Moreover, I recommend that insured bank deposits be made 'first order' claim. This would reinforce private incentives for bank

monitoring, since uninsured deposits, being second order claims, would have more at risk in the event of a bank failure.

• As domestic regulators will be responsible for controlling the ownership of banks (public or private), the degree of market power in their domestic market, and the public bailing out policies, countries must ensure that banks do not exploit domestic rents to subsidize their international activities. Moreover, in this context of fair trade, harmonization of national banking regulations is only necessary in the case of an identified public subsidy which confers a competitive advantage.

• European banking integration presents a useful case of advanced integration from which standing issues can be identified. In particular, taxation of income on capital is rapidly becoming a major issue. The economic benefits expected from integration of banking markets should not be reversed by tax inefficiencies. Substantial work remains to be done to prevent inefficient competitive moves to reduce taxation of income on capital.

• Finally, as concerns national treatment and reciprocity, I argue that, although the national treatment principle governing international trade seems adequate on many aspects, there can be cases where differences between domestic and foreign regulations limit *de facto* entry in banking markets. Since entry (direct investment) is essential to deliver many financial services, it would seem that negotiations on reciprocity are warranted in those cases where entry is restricted *de facto* by differences among national regulations.

Progress in information technology and financial innovations have led the substantial growth and globalization of the financial services industry. At the insistence of the United States, and despite strong opposition from developing countries, financial services have been included in the Uruguay Round of the GATT negotiation. As concerns trade in services, the Round concluded in Marrakesh in April 1994 recognizes the obligation to give equal access to all trading partners (*Most Favored Nation* treatment). However, financial services are excluded from the agreement because the commitment by some countries to liberalize their financial markets were deemed inadequate. Further negotiations to liberalize the financial services sector are scheduled to start in July 1995. More success for financial market integration has been observed at regional levels. The European Commission has finalized the framework governing the provision of financial services in the European Community, while Canada, Mexico and the United States have adopted the North-American Free Trade Agreement (NAFTA). Barriers to trade in financial services are unique, because they originate not so much from tariffs or quotas as in manufacturing, but from quite disparate sets of national prudential and macroeconomic regulations which have been developed over time. Any agreement on trade in financial services raises immediately the policy issues of prudential regulation and supervision, the allocation of responsibilities among national supervisors, and the eventual need for further harmonization of regulations.

The objective of the paper is to develop an economic analysis to guide the legal framework governing international trade in banking services. The ultimate objective of most trade negotiations has been the adoption of the national treatment principle, according to

which foreign and domestic firms operating in one particular country are subject to similar rules. A main purpose of the paper is to pay close attention to the ability of national treatment to deal with banking, to the eventual need for reciprocity clauses, and to an additional harmonization of national regulations[1]. The paper shall not address negotiation tactics, such as the right for countries to exempt from the obligation to give equal access to all trading partners (*Most Favoured Nation* treatment) when a particular partner does not grant effective market access[2].

The paper is structured as follows. In the first part, I document the growth of trade in international financial services. In the second part, I review the literature on the potential market failures in banking services, the eventual need for public interventions, and the implications for the design of a legal framework governing international trade in banking services. I summarize next the experience of the European Community with the integration of twelve banking markets. It provides a unique example of advanced financial integration from which standing issues can be identified. Finally, I discuss the ability of the national treatment principle to deal with trade in financial services, the issue of reciprocity, and the potential existence of non-discriminatory barriers in financial services. The six main conclusions of the paper are as follows :

• A sensible discussion of the legal framework governing international trade in banking

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[1]The literature on international trade in financial services includes among others Dale (1984), Herring (1993), Herring and Litan (1993), Hultman (1992), Key (1993), Key and Scott (1992), Pecchioli (1987), and Walter (1985, 1988).

[2]As an example, the proposed American Fair Trade in Financial Services Act is designed to give U.S. negotiators more leverage to obtain equality of competitive opportunity for U.S. financial firms operating in foreign markets.

services must start with an understanding of the potential market failures leading to public interventions and regulations. The economics literature has identified three potential sources of market failure calling for public interventions : Imperfect information, bank runs and the related fear of systemic crisis, and implicit subsidies which can distort international trade. Each of these demands its own regulatory and supervisory responses.

• As long as national authorities are responsible for the stability of their own markets, I support fully the recent recommendation of the Basle committee on banking supervision and of the General Agreement on Trade in Services (GATS) which allocate to national authorities the prudential supervision of firms operating in their own markets. In practice, this implies often collaboration between the home and host country supervisors.

• As far as the protection of investors is concerned, it will be for each country to choose the level of protection for the 'uninformed' investor. Moreover, I recommend that insured bank deposits be made 'first order' claim. This would reinforce private incentives for bank monitoring, since uninsured deposits, being second order claims, would have more at risk in the event of a bank failure.

• As domestic regulators will be responsible for controlling the ownership of banks (public or private), the degree of market power in their domestic market, and the public policies for bailing out, countries must ensure that banks do not exploit domestic rents to subsidize their international activities. Moreover, in this context of fair trade, harmonization of banking regulations is only necessary in the case of an identified public subsidy which confers a competitive advantage.

• European banking integration presents a useful case of advanced integration from which standing issues can be identified. In particular, taxation of income on capital becomes increasingly difficult. The economic benefits expected from integration of banking markets

should not be reversed by tax inefficiencies. Substantial work remains to be done to prevent inefficient competitive moves to reduce taxation of income on capital.

• Finally, as concerns national treatment and reciprocity, I argue that, although the national treatment principle governing international trade seems adequate on many aspects, there can be cases where differences between domestic and foreign regulations limit *de facto* entry in banking markets. Since entry (direct investment) is essential to deliver many financial services, it would seem that negotiations on reciprocity are warranted in those cases where entry is restricted *de facto* by differences among national regulations.

SECTION ONE : INTERNATIONAL BANKING, SOME STATISTICS

To illustrate the growth and relative importance of the financial services sector, I first provide some data on the share of labor force employed in financial services in various countries, and on the shares of financial services in exports or imports.

Insert Tables One and Two.

As is documented in Table One, the share of labor force occupied in banking, insurance or real estate has grown substantially over the last ten years, reaching more than ten percent of the labor force in the United Kingdom, the United States, and Switzerland. Over the last ten years, the share of labor force occupied in financial services has grown on average by forty percent.

Table Two reports the results of a recent study by the OECD (1993) on the relative importance of financial services in international trade. The figures which refer to the share

of fees and commissions in trade (excluding interest revenues) show sharp differences across countries, with France and the United States leading with shares of 5.7 % and 4.7 % of goods and services export linked to commissions and fees.

International trade in financial services can be described not only by commissions and fees received from (paid to) non-residents, but also by the magnitude of cross-border interbank claims. This is documented in Table Three.

Insert Tables Three, Four and Five

Between 1983 and 1991, the international interbank claims within the BIS reporting area grew at a compounded annual average rate of 16 %. The evolution of cross-border interbank activity vis-à-vis Japan differed considerably from that between other centers. Between 1983 and 1991, interbank business involving Japan expanded at an annual average rate of 31.4 %, whereas business between other centers expanded at a rate of 10 %. Reflecting the above developments, the nationality distribution of banks'exposures in the international market changed rapidly in the course of the 1980s. As documented in Table Four, Japanese banks but also continental European ones saw a very large increase between 1983 and 1991. Among the factors contributing to this growth was the lifting of foreign exchange controls (notably in France, Italy and Sweden), the prospects for the European internal market, and the growth in Japanese foreign trade and direct investment.

As concerns the relative position of individual banks documented in Table Five, and consistent with the above developments, the Japanese banks have taken a leading position, at least as far as asset size is concerned. At the end of 1992, eight of the ten largest banks in the world were Japanese ; none were Americans. This last observation reflects in part the appreciation of the yen and the increasing use of off-balance sheet transactions by American institutions. In this respect, and as is documented in Tables Six and Seven, it is

remarkable to observe that more than fifty percent of open positions on the option or financial futures markets involve foreign institutions both in Chicago (CME-IMM) and in Paris (MATIF).

Insert Tables Six and Seven.

If these figures are indicative of growth in the financial sector and globalization, they should not hide the fact that in several markets, particularly in commercial banking, the penetration of foreign institutions is rather modest. Table Eight documents the markets share of foreign institutions on the market of various countries. One does observe wide variation with 'open' markets in the United Kingdom and the United States, and fairly 'closed' market in Germany and Japan. The case of Japan is discussed in more details as it casts some doubt on whether national treatment is sufficient to deliver effective market access.

Insert Table Eight.

The Case of Japan

The lack of foreign penetration in traditional commercial banking activities (lending and deposit-taking) in Japan has raised a concern, especially in view of the Japanese penetration in foreign markets. For instance, Zimmerman (1989) reports that twenty five percent of bank assets in California are controlled by Japanese interests. This asymmetric penetration of foreign banking markets is puzzling because Japan has adopted the national treatment principle, meaning that foreign institutions operating in Japan face *de jure* the same regulations as domestic firms. This state of affairs has led trade negotiators of other countries to call for effective market access (*de facto* national treatment). A tentative explanation of the lack of foreign penetration in Japan follows.

According to Benston (1990), the determinants of bank competitiveness in foreign markets arise from four main factors : comparative operating cost or innovation rate advantage, public subsidy, lower cost of capital, and services to home customers. Evidence on the overall operating cost efficiency of Japanese banks is reported in Benston (1990) and Hawawini and Skill (1992), but it is unclear whether this productivity is due to the particular structure of Japan (very high population density which allows fewer branches and the systematic use of ATMs), and whether this cost advantage can be exported abroad. The second source of competitive strength, public subsidy, could come from a privileged access at subsidized rates to the discount window of the Bank of Japan. However, as is pointed out by Benston (1990), discount window funding by Japanese banks represents a very small fraction of deposit funding. In my opinion, it is doubtful whether the first two factors of international competitiveness -operating efficiency and discount window funding- could be the main determinants of Japanese banks' expansion.

The next factor of international competitiveness is the low cost funding base of Japanese banks. It has been attributed to four separate sources : regulated home-based retail deposits, lower cost of subordinated debt, lower cost of equity capital, and lower equity to risk-assets ratio. The benefits arising from regulated home-based retail deposits, from *de facto* publicly insured subordinated debt, and from a relatively low equity to asset ratio have been well documented[3]. But it should be pointed out that these sources of lower funding cost are not specific to Japan. In most countries around the world, domestic banks have enjoyed a similar lower cost advantage which did not create the asymmetry of market

[3]Evidence on the lower cost of subordinated debt is reported in Zimmer and McAuley (1991). Scott and Iwahara (1994) argue that systematic public bailing out allows Japanese banks to operate with a lower equity requirement than their American counterparts. Packer (1994) documents the public support in facilitating the sale of bad loans to special vehicles.

penetration. For instance, public bail out has been systematic in many countries, as the recent cases of Scandinavia, Spain, France or Venezuela demonstrate. The fourth source of low funding cost seems very specific to Japan : the cost of equity capital. Studies by Zimmer-McAuley (1991) and Abuaf-Carmody (1990) point out to a lower cost of equity which allows Japanese banks to bid very aggressively for loans.

Empirical evidence on various sources of lower funding cost has been demonstrated, but this factor alone is unlikely to be the main determinant of the competitiveness of Japanese banks. Indeed, since many European banks have enjoyed quite similar benefits, it would have to be shown that Japanese banks are using this lower funding cost to subsidize foreign activities or to fend off foreign competition at a higher degree that European firms. Moreover, this argument cannot explain the empirical evidence of the relative performance of Japanese and American firms in third countries, such as the United Kingdom. As is reported by the Federal Reserve Bank of New York (1991), American banks had a 8.1 % market share of all commercial loans in the United Kingdom in 1989, while Japanese banks had a market share of 7.8 %. These data being inconsistent with the 'low funding cost' argument, it would appear that other factors must explain the asymmetry of market penetration observed in some countries.

The last source of competitive advantage -servicing home-based customers- seems to be one of the main determinant. Two studies by Zimmerman (1989) and Hultman-McGee (1989) point out to the importance of trade and foreign direct investment to explain the growth of Japanese lending in the United States. Japanese banks do accompany national companies abroad. As to the low market share of foreign banks observed in Japan (and curiously in Germany), it can be explained by the very close relationship between Japanese banks and their customers in the financial group structures (keiretsu).

As far as the future strength of Japanese banking is concerned, one wonders whether most of these sources of competitive advantage are not fading away. The retail deposit market is increasingly deregulated ; the collapse of the stock market has created an equity shortage ; and maybe most importantly, large Japanese firms seems to rely increasingly on bond financing in place of bank loan[4], facilitating possibly the entry of foreign underwriters.

The importance of the financial services sector and the rapid growth of international trade in banking services raise the need for a satisfactory international regulatory and supervisory framework. In the next section, I develop an economic analysis of international banking regulations.

SECTION TWO : THE ECONOMICS OF BANKING REGULATIONS

Banking is a highly regulated industry in all countries. The regulatory framework includes regulations on entry (the 'fit and proper' criterion), on the scope of permissible activities (banks'powers), and on rules of conduct of business (regulation on capital, on large exposure...). Regulations are applied to national and foreign suppliers of banking services. To assess the economic logic of national banking regulations, and the specific issues raised by a fast growing trade in banking services, one must first review the economics on the potential market failures which explain the need for banking regulations : Imperfect (asymmetric) information which could prevent the proper

[4]Hoshi, Kashyap and Scharfstein (1993).

functioning of unregulated private markets, the potential for bank runs and the related fear of systemic crises, and implicit subsidies which create distortions in international trade.

Imperfect (Asymmetric) Information and Investor Protection

The analysis which follows is rooted in imperfect information in banking markets, and the potential need to protect consumers of financial services.

The first and most important case of asymmetric information concerns the imperfect knowledge about the solvency of a banking firm. Depositors find it costly to evaluate the solvency of their bank. Additional sources of asymmetric information concern the potentially fraudulent character of management, the nature of the legal contract (for instance, the exact nature of a loan covenant), and problems related to conflicts of interest between different departments in a bank. For instance, an M&A advisor should not inform a fund manager about the likelihood of a transaction, otherwise the fund manager will purchase securities of the 'target' firm, the price of shares will increase, making the acquisition more expensive.

The economics literature[5] recognizes that the inability of consumers to properly evaluate the quality of a product can create a market failure. This literature distinguishes three types goods : search goods, whose quality is apparent before purchase, experience goods, whose quality is apparent after consumption, and 'trust' goods, whose quality is not always apparent even after consumption. An inefficiency may arise because the quality of a service is not valued properly by the market and reflected into higher prices so that there is insufficient incentives for firms to produce quality. Regulation (such as minimal

[5]see Kay-Vickers (1986)

qualifications in the legal or medical professions) is a way to ensure a minimum level of quality. In the context of banking, quality refers in part to the degree of solvency of an institution. When depositors are uninformed, there are fewer incentives to limit the riskiness of the assets of a financial institution or its degree of financial leverage (deposit to equity ratio). Indeed, finance theory[6] has shown that, whenever depositors are not properly informed, shareholders of banks do benefit from an increase in risk. With perfect information, depositors would react by requesting an interest rate increase to offset the transfer going to shareholders. With imperfect (asymmetric) information, this would be difficult, raising a well identified and documented moral hazard problem[7]. However, the potential existence of imperfect information per se does not yet justify public intervention. It has to be shown that private mechanisms cannot succeed.

The solutions to the imperfect information problem are threefold : Information disclosure, reputation to protect the long term value of the franchise, and the supply of risk-free deposits.

Regulation on information disclosure will reduce the degree of information asymmetry. However, it has been argued that the evaluation of bank risks is a costly activity which could create a 'free rider' problem. Individually, each customer may prefer not to engage in information search and analysis on the assumption that other investors will do it. In such a situation, the provision of private information could be too low. I do not share this view. Indeed, since information once produced is available to investors at a very

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[6]Merton (1977).The underlying intuition is that an increase in risk (variance of asset return) allows the shareholders of a firm to reap potentially large gains, while limiting the downside risk to zero because of the limited liability characteristic of shares.

[7]See the application of moral hazard to the American S&L crisis by L. White (1992).

low transfer cost, the evaluation of banks should not be undertaken by each depositor but could be delegated to a public agency or a private rating firm. The cost of information gathering by the individual investor would be small.

A second solution to the asymmetric information problem is that firms have commercial incentives to protect their reputation. Firms who care for the value of their franchise and long run profits have strong incentives to build internal control systems to reduce risks and fraud. However, a tradeoff will always exist between (potentially high) short term fraudulous profit and the benefits of long term reputation.

A third solution to information asymmetry is to create risk-free deposits. Since small account holders may find the cost of interpreting the rating high and/or since they care about risk free deposits only, two alternatives could be developed. The first is to have deposit insurance. This could be organized publicly or by the industry which guarantee the quality of the services offered. Peer monitoring or industry self-regulation prevent deviant behavior. The second mechanism is to create risk free institutions, that is intermediaries investing all deposits in risk free securities (the so-called 'narrow bank' proposal). Depositors would have the choice between institutions offering a higher but risky return and those providing quasi-risk free deposits. It would appear that the evaluation of risks is not inherently more difficult in banking than in other industries. A main difference is that it is quite likely that a large fraction of depositors care for risk free deposits, but these could be provided by the markets.

This analysis has shown that the information problem can be solved privately on the market in several ways : information disclosure, reputation, and insurance. However,

whenever there is evidence that the market cannot discriminate among firms[8], then there is a case for the government to regulate entry and ensure a minimal quality, as is done for instance in the medical and legal professions. The argument is that regulation is necessary to maintain a minimum desired level of quality. In this context, a question arises as to whether this should be done privately or quasi-privately as in Great Britain with the self-regulatory organizations (SROs), or whether it should be public. The benefits of flexibility and industry expertise provided by private self-regulation have to be balanced against the risk of capture by the SROs whose members have an obvious incentive to limit entry and competition. As there is currently no empirical evidence in favor of one system or another, I suggest letting the national regulatory structures compete[9].

The possibility of competitive deregulation raises immediately the question of the need to harmonize regulations at the international level. The answer is again related to imperfect information. Competition among national regulators or private clubs is desirable whenever the parties can evaluate the quality of regulatory systems. For instance, competition among regulators in Tokyo, Paris, Frankfurt, London and New York will shape the developments of local stock exchanges and the outcomes will be optimal if participants can discriminate among different regulatory systems. Harmonization of rules to ensure minimal quality would be necessary only if the market cannot discriminate. This suggests that the degree of international harmonization could vary for different activities and classes of investors, the 'informed' and the 'non-informed'. An alternative to the harmonization of

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[8]Evidence is a strong word. In most cases, there is a social-political belief of the need to protect investors.

[9]An additional argument to let the national regulatory structures compete, is that the 'general equilibrium' costs of regulation are not fully understood. With the exception of a paper by Santomero-Watson (1977), most scholars have used partial equilibrium models to analyze the effects of regulations.

prudential regulations is to grant some supervisory powers to the host state, whenever it is felt that investors are not adequately protected by foreign regulation or supervision[10]. But these cases should be limited. Indeed, one has to be extremely careful to avoid permanent regulatory interference which can create the 'raison d'etre' of public intervention. For instance, the creation of a safe and publicly insured deposits market reduces the incentives for information gathering and the creation of risk free funds. A *laissez-faire* policy should not imply that there is no ground for public intervention to compensate the unlucky or imprudent investors. The argument is that transitory transfer policies should be used in these cases rather than direct and permanent interference with the functioning of private markets.

The economics literature identifies a first market failure rooted in imperfect information. it is legitimate for countries to design prudential regulations to protect the 'uninformed' investors.

Bank Runs and Systemic Risks

The second market failure is the potential for bank runs and systemic crisis. Banks are special because the financial contract that emerges -illiquid loans funded by short-term deposits- creates a potential market failure and a need for public intervention. The financial contract creates the risk that depositors run to withdraw their funds. A run can be triggered

[10]For instance, European countries can regulate foreign firms for reason of 'public interest'.

by a bad news about the value of bank assets or by any unexplained fear[11]. In both cases, there may be a loss since illiquid assets will be sold at a discount. Moreover, a bank failure could eventually trigger a signal on the solvency of other banks, leading to a systemic crisis. Here, a distinction should be drawn between 'domino' effect and systemic crisis.

A 'domino' effect exists if the failure of one bank would directly endanger the solvency of other banks. However, this risk is substantially reduced today since banks are systematically measuring and controlling their counterparty exposure through, for instance, netting arrangements. A pure case of systemic run could occur if, lacking information, there is a run by depositors on all banks.

This market failure explains banking regulations and the establishment of safety nets to guarantee the stability of banking markets. They have taken the form of deposit insurance, lender of last resort interventions, and public bail outs. As is shown in Table Nine, deposit insurance funds are unlikely to contribute much to reducing systemic risk because they cover small deposits only. Runs are likely to be initiated by large firms or financial institutions. Therefore, lender of last resort interventions by central banks or public bail out remain the most likely tools to avoid bank runs and systemic crisis.

Insert Table Nine

Safety nets with deposit insurance or lender of last resort create raise three issues at the international level. They concern a fair level playing international field when deposits are subject to different insurance coverage, to the potential liability of the insurer, and to the well-identified moral hazard problem.

Firstly, since national deposit insurance coverage differs from counties to countries,

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[11]Calomiris and Gorton (1991) argue that most of the bank runs are created by a decrease in value of bank assets.

they can be destabilizing if investors start to chase the best coverage.

Secondly, since most deposits insurance systems currently in place cover the deposits of domestic and foreign banks operating locally, and since lender of last resort will be concerned primarily with their domestic markets and banks operating domestically[12], it is legitimate that the insurers keep some supervisory power on all institutions (branches and subsidiaries) operating domestically. That is, host country regulation could apply to limit the risks taken by financial institutions and the exposure of the domestic central bank in cases of bailing out[13]. The problem is well illustrated by the January 1992 winding up order made for Bank of Credit and Commerce International, a bank chartered in Luxembourg with significant activities in Great Britain. It automatically created a liability for the British Deposit Protection Board. A first alternative to host country control is to harmonize completely the solvency standards of different countries, but experience has shown that it would be very difficult to reach an agreement on harmonization of regulations and supervisory practices. Moreover, I do not believe that centralized regulation is necessary, or even desirable. Competition between national regulators should produce efficient standards and prevent regulatory capture by the regulatees as has happened so often in banking in the last sixty years. It thus seems reasonable to let domestic supervisors keep some host supervisory powers on international banks (subsidiaries and branches) having substantial funding at risk in their own country. In the context of international trade in banking services, this view is consistent with the General Agreement on Trade in

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[12]It is well known that the Bank of Italy did not intervene to prevent the collapse of the Luxembourg-based Banco Ambrosiano Holding, because it created little disturbance on the Italian financial markets.

[13]Bailing out would occur if the failure of a branch of a foreign bank leads to a run on domestic banks.

Services[14], i.e. the right for local authorities to enforce prudential solvency standards on both local and foreign firms offering services. This view is fully in line with the American Foreign Bank Supervision Enhancement Act of 1991 (Misback, 1993), and the ruling of the Basle Committee on Banking supervision[15] accepting host country control for international solvency rules.

The third problem is that deposit insurance contributes further to reduce private incentives for monitoring the solvency of banks. As I have discussed earlier, the creation of risk free deposits could be organized by the market (the 'narrow bank' proposal), or alternatively, it would be preferable to make insured deposits 'first order' claim. The uninsured deposits bearing larger losses in case of bank failure would have additional incentives to monitor the solvency of financial institutions.

The analysis of the second type of market failure, bank runs and systemic crises, leads to the following conclusion. Since domestic central banks will be primarily concerned with the stability of their domestic markets, they should have the right to control the solvency of banks (subsidiaries and branches) operating in their domestic market. Since in many cases, the solvency would depend on the solvency of an entire group, I recommend joint supervision by the home and host country authorities.

Fair trade

The third policy issue, besides investor protection and bank runs, is the fair level

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[14]General Agreement on Trade in Services (1994).

[15]Financial Times (1992).

playing field. Two issues will be distinguished. The first relates to the implicit guarantee given by central banks. The second refers to the possibility of cross-border subsidization.

Public safety nets or deposit insurance systems can provide an implicit subsidy that can alter competition. For instance, deposit financing can reduce the cost of funding loans, not only because of the tax-deductibility of interest payments, but also because of the implicit guarantee given by the lender of last resort[16]. To foster stability and create a level playing field, the Basle Committee of Banking Supervision has enforced minimal capital requirement[17]. From the point of view of competition, the harmonization of prudential regulations is warranted when the objective is to create a level playing field. But harmonization should only be limited to that objective. For instance, the current effort to harmonize the regulation on interest rate risk and foreign exchange exposures do not appear desirable because they do not provide clear competitive advantage to banks[18]. The reason is that the existence of large and liquid derivative markets allow the hedging of these risks at relatively low cost in most countries. Quite often, the identification of a regulatory subsidy will be difficult. For instance, do links between banks and industrial groups provide a competitive advantage which is subsidized by the central bank who takes a greater risk ? There is no case for harmonization as long as the existence of a subsidy yielding a competitive advantage can not be demonstrated. Such a case was clear in the context of loan funding and capital adequacy. It is much debatable in the context of the links between

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[16]Technically, deposit insurance creates a subsidy in the only case where the insurance premium is below its fair price.

[17]According to Scott and Iwahara (1994), differences in bailing out and accounting policies (such as provisioning of bad debt) reduces substantially the efficiency of these agreements.

[18]Dermine, 1993.

banks and industrial groups.

The second issue discussed earlier is the possibility that oligopolistic home markets could generate rents used to subsidize foreign activities. The issue arises because of the fear that some countries could allow concentration on their domestic banking markets. This is fairly evident in the European Community in which the competition policies in the Netherlands and the United Kingdom differ substantially. The British Office of Fair Trading prevents excessive concentration on the domestic market, while the Dutch authorities have allowed the creation of a few national champions. For instance, in 1993, the British bank Lloyds withdrew its bid on Midland Bank by fear that the bid would be stopped by the merger authorities ; while in the Netherlands, domestic mergers have reduced the number of market players to three : ABN-AMRO, ING-Bank, and Rabobank.

Three potential sources of market failure calling for public intervention and harmonization have been discussed : **Imperfect information, bank runs, and fair trade.** As Key and Scott (1992) have emphasized, these are quite different sources of market failure, demanding each a specific regulatory response. As concerns imperfect information, I have been argued that in many cases a market for private information will be developed so that regulations should apply to very specific activities and classes of investors.

As sovereign countries will wish to protect the stability of their domestic banking markets, it seems reasonable that they keep some supervisory powers on financial institutions operating domestically.

As concerns fair trade, one must ensure that public or private subsidies are not used to subsidize international banking services.

In the next section, I present an advanced case of financial market integration, the

single European market. It is special because countries accept to abandon part of their sovereignty.

SECTION THREE : The EC APPROACH TO INTERNATIONAL INTEGRATION

While most international agreement have used the national treatment principle, which ensures the equal treatment of all firms operating in one country, the European Commission has used a different method of integration : single banking license, home country control with mutual recognition, and very minimal immediate harmonization of national regulations[19]. All credit institutions authorized in an EC country will be able to establish branches or supply cross-border financial services in the other countries without further authorization, provided the bank is authorized to provide such services in the home state. These services include :

- Acceptance of deposits and other repayable funds from the public.
- Lending (including consumer credit, mortgage credit, factoring, with or without recourse, financing of commercial transactions (including forfeiting)).
- Financial leasing.
- Money transmission services.

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[19]These principles are incorporated in the Second Banking Directive (Directive 89/646/EEC).The principles of home country regulation and mutual recognition have been inspired by the famous 1987 case Cassis de Dijon (EC Commission vs Germany, 205/84, ECR 3755). In this case, the European court of justice found that Germany could not prohibit the import of liqueur that was lawfully produced and sold in France solely because the alcoholic label was too low for it to be deemed liqueur under German law.

- Issuing and administering means of payments (e.g. credit cards, travellers'cheques and bankers'drafts).
- Guarantees and commitments.
- Trading for own account or for account of customers in :
  - (a) money market instruments (cheques, bills, CDs etc);
  - (b) foreign exchange;
  - (c) financial futures and options;
  - (d) foreign exchange and interest rate derivative instruments;
  - (e) transferable securities.
- Participation in securities issues and the provision of services related to such issues.
- Advice to undertakings on capital structure, industrial strategy and related questions, and advice and services relating to mergers and the purchase of undertakings.
- Money broking.
- Portfolio management and advice.
- Safekeeping and administration of securities.
- Credit reference services.
- Safe custody services.

The banking model adopted by the EC is the universal banking model. It permits banks to undertake investment banking activities and leaves it to national regulators to control financial conglomerates, the ownership structure of banks, and their relationship with industry. For instance, it is known that the Bank of England does not favor the ownership of banks by industrial groups, while this is allowed in France or Belgium.

The Second Banking Directive calls for home country control on solvency. This extends to the bank itself, its foreign and national subsidiaries which have to be consolidated for supervisory purposes, and its foreign branches. As concerns the latter, the host state retains the right to regulate a foreign bank's activities in the host state to the extent only that such

regulation is necessary for the protection of the 'public interest'. Thus the manner in which a bank markets its services and deals with customers can be regulated by the host state. The host state may also intervene in those matters which have been expressively reserved to it, notably liquidity, monetary policy and advertising.

To address a need for a minimal harmonization of regulations, the Second Banking Directive calls for an initial capital of at least ECU 5 Million, harmonized capital adequacy standards and large exposure rules, supervisory control of banks' permanent participation in the non-financial sector.

A supportive piece of legislation is the 1988 Directive on Liberalization of Capital Flows. However, that directive contains a safeguard clause authorizing Member States to take necessary measures in the event of balance of payments problems[20].

The December 1991 Maastricht Treaty on Economic and Monetary Union has confirmed the Single Market programme. Although the primary objective of the European System of Central Banks shall be to maintain price stability, there are explicit references to regulation and supervision.

"The European System of Central Banks (ESCB) shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system ... The national Central Banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the European Central Bank ... The ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States in the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system ... The ECB may fulfill specific tasks

[20]The June 1988 capital directive (Article 3) provides for the temporary implementation of capital controls. In the case of large speculative movements, the Commission after consultation with the Committee of Central Banks Governors can authorize capital controls. In very urgent cases, a country can implement them, but must notify the Commission. After consultation with the committee of central banks governors, authorization to pursue capital controls can be given for a period not exceeding six months.

concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings".

Although the exact rules governing the functioning of the new system have yet to be worked out, the Treaty is explicit on the principle of decentralization and allocation of regulatory and supervisory powers to national central banks. It is only in very special circumstances and with unanimity in the European Council that the European Central Bank will be allowed to regulate or supervise financial institutions. On October 12, 1993 the last obstacle to ratification was lifted with a ruling by the German Constitutional Court, and the Maastricht Treaty has officially been in effect since November 1, 1993.

Finally, it should be recognized that the single banking market go beyond the twelve members of the European Union. On May 13 1992, the countries of the European Free Trade Association (EFTA)[21], with the exception of Switzerland, joined the European Economic Area (EEA). As concerns banking, it implies that the EEA countries accept the European banking legislation regarding single banking license, home country control, mutual recognition, and acceptance of the common regulations.

The integration of European banking markets has raised three set of issues, related to an efficient deposit insurance systems, reciprocity with non EC-countries, and taxation of capital income.

[21]EFTA includes Austria, Finland, Iceland, Liechtenstein, Norway, Sweden, and Switzerland.

Deposit insurance in an integrated market

Following the collapse of Bank of Credit and Commerce International, the European Commission has worked to revise the deposit insurance systems to ensure an adequate degree of accountability. As discussed earlier, a solution to deposit insurance in international banking is to allocate supervisory powers to the institution in charge of insuring the deposits. A draft directive on Deposit Guarantee Schemes has been accepted by the Council of Ministers in September 1993. It provides for mandatory insurance for all EC financial institutions. The coverage per depositor is a minimum of ECU 20,000 (15,000 until 1999), with a franchise of maximum 10 %. To ensure accountability, the principle of home country would apply, that is the insurance system of the parent bank would cover the deposits collected by domestic and foreign branches. This is the principle, against which two very important exceptions stand. In the case, where the home coverage is too large vis-à-vis the host coverage (f.i. a French bank operating in Belgium), the coverage of foreign branches cannot exceed that of the host country to prevent 'unfair' competition. In the case where the home coverage is lower than that of the host country, the foreign branch will have the right to obtain supplementary insurance from the host state. Finally, for the branches of non-EC banks, the host country will decide whether they must or not join an insurance system, with the provision that depositors will be informed about the magnitude of the coverage.

Reciprocity clause

The issue of reciprocity has received considerable attention in non-member countries. Two concerns have to be distinguished : The denial of national treatment, and effective market access comparable to that which the Community grants to third countries. Article 9(4) of the Second Banking Directive deals with the situation where there is discrimination against Community financial institutions, compared with their domestic counterparts in a third country. In this case, the directive provides for the initiation of discussion with the option to suspend new banking licenses for institutions from the third country. In the second case -comparable access- Article 9(3) provides for negotiation with the country without the suspension of the right of establishment. A recent report on the Treatment of European Financial Institutions in Third Countries has been published by the Commission[22]. Although it recognizes the existence of discriminatory treatment in some countries, the Commission recommends negotiating in the framework of the new World Trade Organization. Moreover, the report makes no reference to a temporary suspension of authorization.

Taxation of capital income

To enhance the attractiveness of their home market, various countries have reduced the taxation of income on capital, at least relative to the taxation of labor income. From a fiscal policy perspective, it would seem that the creation of an integrated financial market should not affect the relative taxation of labor and capital income. Obviously, this will not be the case as long as there is no harmonization of taxation, or sharing of information by

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[22]European Commission, 1992.

tax authorities. Table 10 reports the amount of liabilities of national banks vis-à-vis non-bank non-residents.

Insert Table Ten.

Even acknowledging the expertise of some banking centers, it would appear that the volume of deposits housed in a few small countries is abnormally large. Proposals for a common withholding tax on interest revenue have been rejected so far by Luxembourg and the United Kingdom with the argument that the euro-market would be transferred to a non-EC country. An alternative proposal, that would suffer a similar concern, would be to lift bank secrecy. That is, the fiscal authority of one Member State would have the right to obtain information about bank deposits in another EC country. An alternative is to modify substantially the tax structure, focusing tax revenue on labor and corporate income, while reducing substantially taxes raised on capital income.

The case of the European Community is fairly illustrative of the problems raised by integration of banking markets. The first observation is that decentralized deposit insurance systems create issues of fair trade and supervision. The second is that international banking integration can conflict with fiscal policy

SECTION FOUR : RECIPROCITY and NON-DISCRIMINATORY BARRIERS

The international negotiation on trade liberalization aims at the national treatment principle, according to which there will be no discrimination between domestic and foreign firms in the application of regulatory and supervisory rules in a particular country. Some countries, in particular the United States and Europe, are not satisfied with the principle and have asked for reciprocity, according to which powers given to foreign banks operating in their own countries should also be given to banks operating in foreign countries. The economic issue with respect to reciprocity is to see whether non-discriminatory regulations fully compatible with national treatment could raise *de facto* barriers to trade in banking services[23].

In this section, I first present some large differences in regulatory regimes, and analyze next whether these non-discriminatory barriers could affect trade in banking. The scope of permissible activities is analyzed first. Restrictions on corporate controls follow.

Scope of permissible activities

Table Eleven provides information on the regulatory regimes governing the involvement of banks in the insurance sector. Regulatory differences are large, with on one side a liberal Great Britain, and on the other side the United States and Japan separating banking from insurance. As is evident from market developments in Europe, this issue is

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[23]see Key (1993).

non-trivial since European banks have acquired very rapidly more than fifty percent of the life insurance market in just a few years.

Insert Tables Eleven and Twelve.

In a similar manner, the regulations of banks activities in the securities markets are well known to vary considerably, with on one hand European banks enjoying a large freedom with the universal banking model, and on the other hand American and Japanese banks being very strictly regulated by the Glass Steagall Act and Article 65. However, these regulations are increasingly being challenged.

Following the 1929 crisis, the 1933 Glass-Steagall Act had separated commercial banks from securities activities. However, in the last twenty years, the Federal Reserve has progressively widened the range of securities-related activities open to some bank holding companies. While limited in size, underwriting of commercial paper, corporate bonds and even recently equities has been allowed for those banks presenting safety, but these activities have to be housed in separate subsidiary. As concerns restrictions on foreign activities of American banks, the policy has been not to undermine the competitiveness of US subsidiaries which have been allowed to operate in foreign securities markets (Dale, 1992).

After World War II, the United States imposed on Japan the main features of Glass-Steagall. Article 65 of Japan's Securities and Exchange Law of 1948 states that banks may not engage in securities activities. Very recently, as documented in Table Twelve, three banks have been allowed to exercise very limited securities activities.

The economic issue raised by substantial differences in regulatory environment is whether the more liberal countries are well founded in demanding reciprocity. At first sight, it would seem that countries should be free to choose their regulatory regimes, and that

competition between financial centers will lead to an optimal state (Walter, 1992). If indeed economies of scale and scope do exist, European banks should benefit from a liberal environment, and it would be for American or Japanese banks to pressure their home regulators to free the system. Moreover, if the European system allows banks to subsidize their insurance activities because of the free implicit guarantee given by their central banks, it should be again for the American or Japanese firms to complaint about unfairness in trade. Therefore, it would appear at first that the demand for reciprocity is not very well founded. However, I argue that the arguments just proposed are incomplete, and that there could be specific situations in which reciprocity and the need for further harmonization of regulations could be warranted. These situations arise when entry in a market is restricted *de facto* by differences in regulations. The example of 'bancassurance' is such a case. If as seems to be the case, European banks adopt the 'bancassurance' model for competitive reason, they would be restricted to compete in the Japan and the United States because they would have to choose between banking and insurance activities. This situation is illustrated by ING, the Dutch financial services group, which was given a grace period to decide between banking and insurance[24]. As in the financial services industry, restriction on entry and direct investment cannot be substituted by trade in services (physical presence is necessary in most financial services), a barrier on entry becomes *de facto* a barrier on trade. The case of 'bancassurance' can be deemed very special, but there are other far more restrictive regulations on entry, all linked to corporate control which prevents the purchase of local institutions.

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[24] In 1994, the ING group decided to return its banking license to U.S. authorities.

Corporate Control

Some countries limit effectively the entry of foreign shareholders in limiting the percentage ownership. Table Thirteen illustrates a few cases. Recently, the Italian authorities have imposed a three percent voting power limit in the privatization of a large public institution. It would appear that, since entry and direct presence in a country is vital to deliver financial services, it would be reasonable to harmonize those regulations which limit *de facto* entry.

Insert Table Thirteen.

CONCLUSION

The banking literature has identified three main sources of potential market failure calling for public intervention : Asymmetric information and the protection of investors, stability of financial markets, and fair trade.

- The first source of market failure is the traditional need to protect investors. I have argued that domestic regulation of solvency is only warranted in those cases where investors cannot evaluate the quality of a product. Similarly, international harmonization of regulations is necessary if the market participants cannot discriminate among different regulatory structures. It is my view that information disclosure, competition between public or private regulators and the creation of risk free funds will be satisfactory in most

situations. In any case, different products and classes of consumers will require different regulatory treatment. To foster incentives for bank monitoring, I suggest that insured deposits be made 'first order' claim. Uninsured deposits, being second order claims, would have additional incentives for monitoring since they would have more to loose in the event of bank failure.

• A second reason for public intervention is the need to foster the stability of financial markets. As long as national authorities are responsible for the stability of their own markets, they should keep supervisory responsibilities on all firms affecting their markets, and collaborative host and home country supervision seems warranted.

• The third potential market failure concerns fair trade. As domestic regulators will be responsible for controlling the ownership of banks (public or private), the degree of market power in their domestic market, and public bail outs, countries must ensure that banks do not exploit domestic rents to subsidize their international activities. Moreover, in this context of fair trade, harmonization of banking regulations is only necessary in the case of an identified public subsidy which confers a competitive advantage.

• European banking integration presents a useful case of advanced integration from which standing issues can be identified. Taxation of income on capital becomes increasingly an issue. The benefits expected from integration of banking markets should not be reversed by tax inefficiencies. Substantial work remains to be done to prevent inefficient competitive moves to reduce taxation of income on capital.

• Finally, as concerns national treatment and reciprocity, I argue that, although the national treatment principle governing international trade seems adequate on many aspects, there can be cases where differences between domestic and foreign regulations limit *de facto* entry in banking markets. Since entry (direct investment) is essential to deliver many financial

services, it would seem that negotiation on reciprocity are warranted in those cases where entry is restricted by differences among national regulations.

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Table One : Percentage of Labour Force in Banking, Insurance or Real Estate (%).

	1980	1989
Belgium	6.2	8.6
France	7.5	9.6
Germany	NA	7.9
Switzerland	NA	10.5
United Kingdom	8.2	12.7
United States	8.4	11.3
Japan	5.7	7.8

NA : Not available
Source : 0ECD (1991)

Table Two : Trade in Financial Services
(in percentage of Exports (Imports) of Goods and Services)

	1988	1991
Belgium		
Exports	1.17	2.60
Imports	0.74	1.70
France		
Exports	1.50	5.7
Imports	1.70	6.3
Germany		
Exports	0.74	0.96
Imports	0.12	0.33
Switzerland		
Exports	3.00	3.80
Imports	NA	NA
United Kingdom		
Exports	2.40	3.20
Imports	0.09	0.20
Unites States		
Exports	3.80	4.70
Imports	1.70	2.30
Japan		
Exports	NA	NA
Imports	NA	NA

NA : Not available

The data include commissions and fees received or paid related to the following transactions : Foreign exchange, international payments, management of cash balances, factoring, operations in securities, asset management, fiduciary funds, guarantees and endorsements, financial leasing, counselling on takeovers or mergers, participation in barter arrangements.

Source : OECD (1993).

Table Three : The Interbank market within the BIS Reporting Area (Billion of US $)

	1983	1991
Cross-border interbank claims	1194.8	4155.3
of which :		
.between Japan and other BIS inside-area countries	162.3	1458.8
.between the United States and BIS other inside-area countries except Japan	393.1	816.0
.between European countries	341.7	1387.5
.other inside area	297.7	493.0
Local foreign currency interbank claims	285.7	588.6
Total international interbank claims	1480.5	4744.0

Source : BIS (1992)

BIS inside-area countries include : Group of Ten, Luxembourg, Austria, Denmark, Finland, Ireland, Norway, Spain, the Bahamas, Bahrain, Cayman Island, Hong Kong, the Netherlands Antilles, Singapore and branches of US banks in Panama.

Table Four : International Bank Assets by Nationality of Banks (US $ billion)

	1983	1991
Belgium	38.2	135.1
France	191.4	565.4
Germany	144.5	640.4
Switzerland	79.9	408.9
United Kingdom	178.8	282.1
United States	605.5	650.7
Japan	456.9	1935.1

Source : BIS (1992)

Table Five : International Bank Scoreboard
(US $ billion, end of 1992)

	Assets	Market value of Equity
Dai-Ichi Kangyo (J)	456.5	57.7
Fuji Bank (J)	454.7	60.8
Sumitomo Bank (J)	448.9	65.9
Sanwa Bank (J)	445.9	61.2
Sakura Bank (J)	437.9	49.5
Mitsubishi Bank (J)	424.3	73.6
Norinchukin Bank (J)	368.5	NT
Credit Lyonnais (F)	352.0	4.4
IBJ (J)	336.2	63.2
Deutsche Bank (G)	302.0	19.7
Credit Agricole (F)	299.2	NT
Banque Nationale de Paris (F)	284.8	NT
LTCB (J)	271.7	22.3
Tokai Bank (J)	270.6	24.2
HSBC (UK)	258.0	23.8
Société Générale (F)	257.9	8.9
ABN-AMRO (N)	253.5	8.1
Asahi Bank (J)	233.2	26.9
Barclays (UK)	222.8	11.5
Bank of Tokyo (J)	221.0	26.5

NT : Non-traded
Source : Business Week, 1993

Table Six : Nationality Distribution of Open Positions in the Euro-dollar Futures and Options Contracts Traded on the Chicago CME-IMM Exchange (US $ billion, end of 1991).

	Euro-dollar Futures		Options on Euro-dollar Future			
			Call		Put	
Nationality of banks	Purchase	Sales	Purchase	Sale	Purchase	Sale
USA	153.3	104.3	40.0	24.4	57.7	39.9
Japan	93.1	97.3	37.3	28.2	13.7	82.5
France	21.3	23.4	6.1	2.4	4.4	4.8
UK	18.7	30.5	6.9	14.0	8.9	19.6
Canada	6.5	3.4	2.1	2.2	1.4	0.8
Switzerland	..	..	17.3	15.7	19.1	14.2
Other banks	73.6	84.1	8.6	9.5	17.0	25.3
Total identified banks	366.5	343.0	118.3	96.4	122.2	187.1
Others*	656.7	680.2	139.7	161.6	238.7	173.8
Grand total	1023.2		258.0		360.9	

*Positions of non-banks or banks below the reporting cut-off point.
Source BIS, 1992.

Table Seven : Open Positions in Futures and Options Contracts Traded on the MATIF (US $ billion, end 1991)

Contract type	Total face value of open positions	Distributions of open positions (average of long plus short)		
		Banks		Other
		French	non-French	
Futures				
CAC-40	1.8	0.2	0.7	0.9
Notional French government bond	11.2	3.7	3.4	4.1
PIBOR	47.0	14.2	16.1	16.8
Options				
Notional French government bond (call plus put)	24.7	10.8	3.1	10.8
PIBOR (call plus put)	96.3	46.8	16.1	33.4

Source : BIS (1992)

Table Eight : Market Share of Foreign Institutions (% of total assets)

	1986	1989
Germany	4.0	4.4
Belgium	46	47
France	10.9	13.0
Italy	2.45	2.9
UK	62.2	59.1
Japan	2.7	2.0
USA	17.9	21.4

Source : Federal Reserve Bank of New York (1991), Goldberg (1992), Swary-Topf (1992).

Table Nine : Deposit Insurance Systems in Selected Countries

Country	Coverage (Domestic Currency)	Coverage (US $)
Belgium	BEF 500,000	14,650
Denmark	DKR 250,000	39,320
France	FF 400,000	72,660
Germany	30% of equity per deposit	
Ireland	£IRL 10,000	14,960
Italy	Lit 1 billion (100% for first 200 mil. and 75% for next 800)	650,000 (100% for first 130,000 and 75 % for next 520,000)
Luxembourg	FLUX 500,000	14,650
Netherlands	DG 40,000	22,800
Spain	Pta 1,500,000	11,800
United Kingdom	75% of deposits (ceiling of £15,000)	75% of deposits (ceiling of 23,400)
Japan	Yen 10,000,000	96,900
United States	$ 100,000	100,000

Table Ten : External Position of Banks vis-à-vis the Non-bank Sector (US $ billion)

	1989	1992
Austria	10.9	8.9
Belgium	27.1	41.1
Luxembourg	77.2	121.6
Denmark	4.1	4.1
Finland	3.5	1.0
France	32.1	49.1
Germany	39.2	73.3
Ireland	4.4	4.9
Italy	9.1	9.2
Netherlands	31.9	42.2
Norway	1.4	1.3
Spain	20.4	29.3
Sweden	9.5	9.2
Switzerland	178.4	208.7
United Kingdom	266.4	313.7
Caribbean Centers	204.5	231.1
Japan	13.5	17.7
USA	90.6	73.4

Source : BIS (1993). These statistics could understimate the external position of banks to the extent that fiduciary deposits are not included.

Table Eleven : Permissible Activities in Insurance

Member Countries	Direct Production by a bank of an insurance product	Direct distribution by a bank of an insurance product	Creation of an insurance subsidiary by a bank	Shareholding of a bank in an insurance company	Financial group in which a bank or an insurance is a company of the group
Australia	F	A	SL	L	A
Belgium	F	A	SL	SL	A
Canada	F	L	F	SL	A
Denmark	F	A	A	A	L
France	F	A	L	L	A
Germany	F	A	A	A	A
Ireland	E	A	A	A	A
Italy	F	A	A	A	A
Japan	F	F	F	SL	SL
Netherlands	F	A	L	L	A
New Zealand	NA	NA	NA	NA	NA
Portugal	F	L	A	A	A
Spain	F	L	A	A	A
Sweden	F	A	L	L	L
Switzerland	F	A	A	A	L
United Kingdom	F	A	A	A	A
United States	E	L	SL	SL	SL

A :Allowed ; E : Exceptional ; F : Forbidden ; L : Limited ; SL : Strictly limited.
NA : Not available
Source : OECD (1993)

Table Twelve : Permissible Activities of Banks in Securities in Japan

	Primary Market	Secondary Market
Straight bonds	Yes	Yes
Convertible bonds	Yes	No
Warrant bonds	Yes	No
Stocks	No	No
Stock index	No	No

Source : Financial Times, July 26, 1993

Table Thirteen : Restrictions on Ownership of Banks

Country	Restrictions on Individual Foreign Ownership
Australia	< 10 %
Brazil	< 50 %
Canada	< 25 %
Italy	< 3 %
Japan	No
Korea	< 10 %
Malaysia	< 20 %
Mexico	< 30 % of voting rights
Singapore	< 5 %

Source : European Commission (1992).