



Global Banking

by Christian Weller, Center for Popular Economics

Once a hometown business, banking is now a global affair. Since the early 1980s, bankers—working together with national policymakers and officials at such international financial institutions (IFIs) as the World Bank and the International Monetary Fund (IMF)—have largely succeeded in deregulating the global banking system. As local, domestic, and international barriers to private banking have tumbled, cross-border banking has spread dramatically, and major banks in the world's wealthy nations have established branches throughout the globe. Although this globalization of private banking has increased the availability of loans to governments and businesses and improved the quality of banking services for some customers, its overall impact has been negative, both at home and abroad.

The global reach of private banking has two major dimensions: cross-border lending and direct investment in the financial services sector of other nations. Cross-border lending occurs when a U.S. institution like BankAmerica lends dollars to the Mexican government or to a company in Mexico. Direct investment occurs when a U.S. bank like Citibank establishes a subsidiary in a foreign country. Banks that have subsidiaries in other countries are called multinational banks (MNBs).

The largest U.S. banks do both: lend internationally and have an array of subsidiaries active in the financial services sector of many foreign countries.

In the last two decades both types of global banking have expanded, although the rise in multinational banking has been more dramatic. In mid-1997, U.S. banks had a foreign loan portfolio of \$131 billion, whereas the assets of the branches and subsidiaries of U.S. banks totaled \$511 billion. U.S. banks, which account for about 15% of all cross-border lending, are aggressive MNBs. Citibank, for example, is one of the

world's largest banks, with operations in more than 90 countries.

The rise in international bank lending and the worldwide expansion of MNBs have given some borrowers better access to credit. But the spread of global banking

has contributed to the financial instability of many nations and led to the disruption of domestic credit markets. Short-term, international lending favors speculative investments over those that increase long-term productivity. This sets the stage for speculative booms followed by economic crashes. The direct entry of MNBs into foreign financial markets—particularly those of low income countries (LICs)—often triggers a drop in the lending levels of domestic banks. Small and medium-sized enterprises, consumers, and farmers are generally the first to lose access to affordable financing, while transnational corporations and domestic blue-chip companies are the least affected. Reduced access to credit means that firms cannot undertake all their investment projects, thus stifling economic growth.

The negative effects of global financial deregulation are not limited to LICs, however. To repay their international debt, countries with troubled economies often focus on increasing their exports and attracting foreign investors. Workers in the U.S. experience low-wage competition as imports increase and U.S. companies close domestic factories to set up shop abroad. Furthermore, to prevent financial crises from spreading, the IMF and lender governments orchestrate financial bailouts that are underwritten by the taxpayers of both the LICs and the wealthier countries like the United States.

Although the risks and problems associated with deregulated financial flows are increasingly evident, several multilateral institutions—including the IMF, the World Trade Organization (WTO), and the Organization for Economic Cooperation and Development (OECD)—are currently negotiating new agreements that would open more markets to MNBs on an even broader scale than previous regional agreements, such as the North American Free Trade Agreement (NAFTA) and the Asia Pacific Economic Cooperation (APEC) forum. The explicit purpose of the proposed rules is to create legal, political, and economic frameworks that would make it virtually impossible for governments to impose controls on international capital. For example, the IMF intends to amend its articles so that member countries would be required to obtain permission from the IMF to introduce capital controls; the WTO is negotiating a new agreement called the General Agreement on Trade in Services (GATS) to liberalize service sectors, including banking; and the OECD is negotiating a Multilateral Agreement on Investment (MAI), which would substantially increase the rights of international lenders and multinational banks.

Key Points

- International banking activities frequently result in financial instability and serious economic downturns as financial markets become more open and deregulated.
- Competition from multinational banks has reduced the availability of credit to small- and medium-sized enterprises, to low- and middle-income consumers, and to farmers.
- While economies experience financial instabilities and declining credit, governments are losing the means to protect their domestic markets.

Most of the problems associated with the expansion of global banking—both cross-border lending and investments in foreign financial sectors—are tied to the risks of moneylending. The usual risks involved in private lending are magnified in global financial markets, both because it is more difficult for international lenders to liquidate collateral across borders and because multilateral banks generally have less familiarity with the economic and political dynamics of foreign nations. To reduce risks, cross-border lenders and MNBs usually focus on short-term loans. Banks that lend internationally generally limit their clientele to governments, other large banks, and major corporations. Similarly, most MNB branches and subsidiaries serve transnational corporations and domestic blue-chip companies.

No longer limited to domestic banks, most prime bank customers switch to more savvy and better-equipped MNBs. Coca-Cola Poland, for instance, is likely to do all its banking with the Citibank branch in Warsaw rather than with locally owned Bank Przemislowo Handlowy. The loss of prime transnational and large domestic corporate customers spells the end of a steady income stream for most domestic banks. As a consequence, domestic banks often reduce their lending activities. For example, while the number of MNBs in Hungary rose from 9 to 20 between 1989 and 1994, real loans in the country declined by nearly 50%. This credit slump primarily affected small businesses, low- and middle-income consumers, farmers, and others considered to be high-risk borrowers.

Because most international bank loans are short-term, they amplify financial booms and busts. For instance, most international loans to Korean banks (\$78 billion out of \$89 billion as of June 1997) had a maturity of less than one year. This flow of international loans is often channeled into speculative ventures (such as the purchasing of Russian bonds) that promise high, short-term yields. Loans from foreign banks have also frequently been granted to corporations associated with domestic banks that borrow internationally. In Korea such international loans flowed into the coffers of the industrial conglomerates known as the *chaebol*.

In Thailand and Malaysia the injection of foreign loans sparked construction booms, resulting in some of the world's tallest office buildings. The initial flow of profits from speculation and from the networks of crony capitalists snowballed as domestic investors tried to cash in on real estate booms and speculative bubbles. But as soon as some international lenders began withdrawing their short-term funds, others quickly followed their lead—resulting in the financial meltdown that spread

throughout Asia. This financial bust was especially serious because money flowed out of the affected countries rather than being invested in other domestic projects.

National policymakers and IMF officials are aware of many of the problems associated with global banking. But the preferred solutions usually aggravate rather than solve these problems. Instead of more regulation of global banking, the U.S. government has advocated reduced controls on financial flows and financial services, arguing that as MNBs become more familiar with host economies they will expand lending to previously underserved sectors. Even in the wake of financial crises and the associated withdrawal of international bank loans, the U.S. government maintains that the liberalization of financial flows and financial services must be part of the solution. In keeping with its orthodox approach, Washington also prescribes fiscal and monetary austerity measures to restore confidence in the economy and to reattract lenders.

The actual behavior of global banking, however, points to the flawed logic of such policy prescriptions. International banks are attracted by an expanding economy regardless of its degree of openness. And MNBs recognize that it is harder for borrowers to repay loans in countries that have implemented fiscal and monetary austerity measures. MNBs in Poland admit that in the foreseeable future they will not expand their lending to borrowers who ask for less than \$100,000 per loan—a rather high minimum, considering that Poland's per capita income is about one-eighth of that in the United States.

Existing problems associated with global banking may expand due to the proposed Multilateral Agreement on Investment, the WTO's proposed GATS agreement, and the IMF's proposal to alter Article VI of its charter—all of which make it more difficult for countries to regulate international lending and the liberalization of financial services. By codifying the elimination of capital controls, the proposed measures would severely limit the potential of governments to shield themselves from the negative consequences of global banking.

Key Problems

- MNBs seek to reduce risks of cross-border lending by offering mostly short-term loans, thereby amplifying financial booms and busts.
 - As prime bank customers switch to MNBs, domestic banks are weakened and forced to reduce their lending activities.
 - New international agreements being negotiated by the IMF, OECD, and WTO will exacerbate these problems by opening more markets for MNBs and making it harder for governments to impose capital controls.
-

Foreign Policy in Focus is a joint project of the Interhemispheric Resource Center (IRC) and the Institute for Policy Studies (IPS). The project depends on sales and subscription income, individual donors, and grants from The John D. and Catherine T. MacArthur Foundation, General Service Foundation, and various church organizations. *In Focus* internships are available.

Editors

Martha Honey (IPS)
Tom Barry (IRC)

Production

Grant Moser

Communications Director

Erik Leaver (IRC)

Orders and subscription information:

Mail: PO Box 4506
Albuquerque, New Mexico 87196-4506
Phone: (505) 842-8288
Fax: (505) 246-1601
Email: resourcectr@igc.apc.org

Editorial inquiries and information:

IRC Editor	IPS Editor
Phone: (505) 388-0208	Phone: (202) 234-9382/3 ext. 232
Fax: (505) 388-0619	Fax: (202) 387-7915
Email: resourcectr@igc.apc.org	Email: ipsps@igc.apc.org

Website: <http://www.foreignpolicy-infocus.org>

When considering the general problems associated with international financial flows and the particular problems associated with global banking, policymakers and advocacy groups should focus on the need for increased regulation. New regulatory policies should be designed to minimize the problems associated with the expansion of global banking while retaining the benefits associated with increased global financial integration, such as better access to the quantities of capital, hard currency, and technological improvements offered by MNBs.

As a result of the recent Asian financial crisis, there is broad recognition that financial flows need to be regulated, both to protect individual economies such as Thailand's and to stabilize the international financial system itself. Yet, if current negotiations at the IMF, the OECD, and the WTO are successful, it will become much harder to implement either unilateral or multilateral policies regulating financial flows and financial service providers.

U.S. policymakers and concerned citizens should work to revise the proposed agreements to ensure that global

Key Recommendations

- The current negotiations for new multinational agreements at the IMF, the OECD, and the WTO need to allow governments the option to introduce different forms of capital controls.
- Governments should require minimum time lengths for international loans and should reduce the volume of speculative international transactions through international transaction taxes.
- Governments should require MNBs to lend to certain less profitable but socially important economic sectors and to offer technological and financial assistance to domestic banking systems.

banking serves the interests of national and international economic development. A fundamental condition, then, would be that individual governments retain the right to introduce capital controls designed to protect their economies from the negative impacts of international and multinational banking.

Multinational banks can be an asset to national development because of their vital international connections and their technical capacities. But MNBs are generally reluctant to lend to some sectors, such as small businesses, low-income consumers, and farmers. Thus international financial policy should allow for national regulations—

sometimes known as performance requirements—that require MNBs to lend a fixed portion of their assets to exactly these sectors.

Since MNB operations are generally highly profitable, especially in those countries recognized as emerging markets, performance requirements would make only a small dent in the high profit ratios of MNBs and would therefore not deter these banks from investing. Take the case of Citibank's investment in the financial services sector of Poland. In 1994, Citibank enjoyed an 11% income-to-assets ratio in Poland, which was about eight times as profitable as the bank's total worldwide

operations. If Poland were to set guidelines that required lending to certain sectors, it is unlikely that Citibank would shut down operations in this country since its profit margin is so high. Yet under new rules set forth by the IMF and in the proposals for GATS and MAI, such lending guidelines would be prohibited (or rendered too expensive to implement) because they are considered to be restraints on international capital flows. The U.S. should support another country's right to enact performance requirements.

Not only do many countries need performance requirements, they also need special assistance to ensure that their financial services sectors remain healthy and stable. The U.S. should support international financial rules that allow countries to require MNBs wishing to enter their financial services market to offer technological or financial assistance. In this way, a government can help ensure that its national financial sector is stable and able to compete technologically. Again, under the new proposed international rules, technical assistance requirements would constitute performance requirements. As such, they would violate the so-called national treatment rule, which demands that foreign investors be treated just like domestic ones.

International bank loans create greater financial booms and busts than purely domestic activities due to: 1) the speed with which loans can be extended to and recalled from borrowers in developing economies, and 2) the sheer volume of these international loans. To reduce the speed with which loans can be recalled and extended, governments should institute so-called speed bumps like Chile's one-year-minimum-stay requirement on foreign capital.

Controlling the volume of international bank loans in order to curb speculative ventures can only be achieved by multilateral agreements. One option would be to introduce a transaction tax on international bank loans. The objective would be a tax level that would reward long-term investments and punish short-term speculation. Although speed bumps would most likely be considered performance requirements under the proposed international agreements, transaction taxes would not necessarily constitute a violation. If foreign transaction taxes were instituted unilaterally, funds would simply shift from one country to another. Such a measure must be implemented on a multilateral basis. Policymakers and advocacy groups should oppose current proposals to eliminate restrictions on controls of capital flows, while at the same time they should join together to formulate agreements that would institute multilateral transaction taxes.

Christian Weller (cpe@acad.umass.edu) is a staff economist at the Center for Popular Economics in Amherst, MA.

Comments on the *In Focus* briefs are found in *The Progressive Response*, the project's weekly electronic forum. To subscribe, send email to newusfp-manager@zianet.com with the message: "join newusfp."

Sources for More Information

Organizations

Economic Policy Institute
1660 L Street NW
Washington, DC 20009
Voice: (202) 775-8810
Fax: (202) 775-0819
Email: epi@epinet.org
Contact: Robert Scott

The Ecumenical Coalition for Economic Justice
402-77 Charles Street West
Toronto ON M5S 1K5
Canada
Voice: (416) 921-4615
Fax: (416) 922-1419
Email: gatfly@web.net
Contact: John Dillon

European Network on Debt and Development (EURODAD)
Rue Dejoncker 46
B-1060 Brussels
Belgium
Voice: 32-2-543-9060
Fax: 32-2-544-0559
Contact: Ted van Hees

Friends of the Earth
1025 Vermont Avenue NW
Washington, DC 20005
Voice: (202) 783-7400
Fax: (202) 783-0444
Email: foe@foe.org
Website: <http://www.foe.org>
Contact: Michelle Chang

**New School for Social Research
Center for Policy Analysis**
80 Fifth Avenue, 5th Floor
New York, NY 10011-8002
Voice: (212) 229-5901
Fax: (212) 229-5903
Email: cepa@newschool.edu
Website: <http://www.newschool.edu/cepa>

Publications

Board of Governors, *Geographical Distribution of Assets and Liabilities of Major Foreign Branches and Subsidiaries of U.S. Banks*, Statistical Release E.11, December 12, 1997 (Washington, DC: Federal Reserve System).

John Dillon, *Turning the Tide: Confronting the Money Traders*, (Ottawa, ON: Canadian Centre for Policy Alternatives, 1997).

Gerald Epstein, Julie Graham, and Jessica Nembhard, eds., *Creating a New World Economy: Forces of Change and Plans for Action* (Philadelphia: Temple University Press, 1993).

Ethan B. Kapstein, *Governing the Global Economy: International Finance and the State* (Cambridge, MA: Harvard University Press, 1994).

Alex C. Michalos, *Good Taxes: The Case for Taxing Foreign Currency Exchange and Other Financial Transactions* (Dundurn Press, 1997).

Maurice A. Odle, *Multinational Banks and Underdevelopment* (New York: Pergamon Press, 1981).

Testimony of United Steel Workers Association President George Becker before the U.S. House of Representatives Banking and Financial Services Committee, *East Asia Economic Conditions*, February 3, 1998.

Mahbub Ul Haq, Inge Kaul, and Isabelle Grunberg, *The Tobin Tax: Coping with Financial Volatility* (New York: Oxford University Press, 1996).

Christian Weller, "How International Finance Facilitates the Movement of Global Capital", forthcoming in *Socialist Review*, 1998.

World Wide Web

Institute for Banking and Money at the University of Goettingen, FRG
http://www.gwdg.de/~ifbg/bank_2.html

Bank for International Settlements
<http://www.bis.org>

International Monetary Fund
<http://www.imf.org>

Board of Governors of the Federal Reserve System
<http://www.bog.frb.fed.us/releases/>

Back Issues of *Foreign Policy In Focus*

(\$2.50 each, postpaid. Bulk orders: \$12 for 10 copies of the same issue.)

Afghanistan	Congo/Zaire	Iran	Overseas Drug Control
Africa Economic Policy	Costs of NATO Expansion	Iraq	Overseas Rural Development
Africa Overview	Dangers of NATO Expansion	Islamic Movements	Panama
Africa Peace and Security	Defense Conversion	Israel	Peacekeeping and the UN
Albania	Export Import Bank	Japan	Peru
APEC	Export Promotion Programs	Korea	Restructuring Transitional States
Arms Sales to Latin America	Foreign Agricultural Policy	Macedonia	Russia
Arms Trade	Foreign Economic Aid	Mexico	Somalia
Asian Financial Crisis	Former Yugoslavia	Middle East Oil	South Africa
Asia/Pacific Overview	Free Trade Area of Americas	Military Modernization	U.S. Policy in Middle East
Asia/Pacific Security	Haiti	Military Strategy	Structural Adjustment
Burma	Human Rights	Military Training in L.A.	Sudan
Burundi	Indochina	Multilateral Agreement on Investment	Taxing Overseas Investments
Cambodia	Indonesia	Multilateral Debt	Trade and Environment
Central America Security	Intelligence Apparatus	NAFTA	Trade and Labor
Chemical/Biological Weapons	Int'l Financial Institutions	Nicaragua	USIA
Child Labor	IMF Bailouts	Nigeria	U.S.-U.N. Relations
China	International Trade	North Korea	Warfare vs Welfare
CIA, Drugs, and Crack	Investment/Competitiveness	Nuclear Nonproliferation	World Trade Organization
Colombia	Investment Funds	OPIC	

To subscribe to *Foreign Policy In Focus*, or to order back issues, contact the IRC at:

PO Box 4506 ♦ Albuquerque, NM ♦ 87196-4506

Phone: (505) 842-8288 ♦ Fax: (505) 246-1601 ♦ Email: resourcectr@igc.apc.org ♦ Website: <http://www.foreignpolicy-infocus.org>