The United States and the Coming Global Financial Services Market

Prepared Remarks Of
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Last week as international bankers grappled with the implications of what Federal Reserve Board Chairman Alan Greenspan has termed the new "high-tech" world of global finance, Americans were trying to come to terms with projected changes in the country's financial services sector as a result of merger mania in the marketplace.

What is increasingly clear is that a new age of global economics and financial organization has dawned and it is imperative that the implications of the changes underway be understood and, to the degree possible, prudentially shaped to serve the public good.

In this regard it is increasingly clear that the Asian financial contagion is not the kind of problem from which an economy even as large as ours is immune. While the U.S. economy is vibrant today, GDP growth is likely to be reduced and our trade deficit increased this year. Negative ramifications on the American economy could continue into following years if Asian economies and currencies are not stabilized.

In this context, the Pacific coastal states are likely to be hurt disproportionately, as over 40% of the nation's $177 billion in exports to Asia originated from the West Coast in 1996.

Asian markets are also key to the health of Midwestern agriculture. Overall, U.S. agricultural exports to Asia account for 40% of our agricultural exports, totaling some $23 billion. In recent months forecasts of U.S. agricultural exports to Asia have been lowered by five to 10 percent as the depreciation in Asian currencies has raised the cost of importing U.S. goods.

Without IMF stabilization programs and concomitant trade and investment reforms designed to help stabilize Asian economies, agricultural sales would be battered further. Like manufactured goods, food sales are a function of capacity to pay, as well as need.

Accordingly, I believe it is in America's national interest for Congress to promptly approve both the $3.5 billion New Arrangements to Borrow (NAB) and the $14.5 billion quota increase for the IMF. At issue is not only the stability of the international financial system and the ability of the IMF to respond to future crises, but the broader question of whether the U.S. intends to be an engaged leader in global economic policy and multilateral diplomacy in general.

While most critiques of the IMF have elements of merit, the problem is that alternative policy options may be more expensive and less effective. The
challenge is to establish a policy that neither ignores economic problems such as those which have arisen in Asia nor exclusively Americanizes their solution. In this context, the IMF advances a prudential and relatively inexpensive approach to international problem solving.

The IMF, after all, involves burdensharing – with over 80% of its total resources coming from other countries – and the capacity to influence the shape of the economic infrastructure in countries to which credit is extended.

Many people have used the term "bail out" in discussing IMF-led programs. But bail out indicates that someone is getting something for nothing. This is wrong on two fronts. First, the IMF is a lending, not an aid-granting institution. Second, no government or international institution has the individual capacity to resolve the crisis in Asia. Likewise, there is no single solution. It will take the cooperation of governments, banks, commercial businesses, and, most of all, ordinary citizens to solve this problem.

Since 1968 Congress and the Executive Branch have agreed that transactions with the IMF related to U.S. credit-line arrangements or the U.S. quota subscription are treated as exchanges of monetary assets that do not affect the budget. When the U.S. provides resources to the IMF, it receives a liquid, interest-bearing claim on the IMF backed by the Fund’s substantial reserves, which include almost $40 billion in gold. While there is an element of risk in any lending arrangement, to date no country has ever defaulted on an IMF loan. The U.S. claim is thus like a deposit in a AAA-rated bank, on which the U.S. is paid interest and which it can withdraw on short notice.

By bolstering the financial resources of the IMF, Congress will put in place an insurance policy ensuring that a quick response to the crisis is possible if it deepens or widens further. Conversely, failure to support the IMF would leave the U.S. and world economy vulnerable to additional financial shocks in Asia or elsewhere. It would be seen abroad as a repudiation of current American leadership and of the long-standing American commitment to expanding global trade. Indeed, failure to support the IMF would send destabilizing shock waves through the international financial system, with dangerous knock-on effects for broader U.S. security and political interests.

For all of the world’s problems, and perhaps because of some of them, this is a time of opportunity for the United States in Asia. If America offers leadership, our ties and influence in the region could be strengthened for decades to come. On the other hand, if we turn a cold shoulder in this time of crisis, the
consequences for American political leadership and commercial activities in the region will be profoundly negative for a long time to come.

There are lessons for all developing countries to be found in the current Asian crisis. There are also lessons for the United States.

A review of regional economies indicates that those countries with prudential and transparent financial regulation have done well and those without have found public treasuries jeopardized. In addition, the chaebols of Korea, the keiretsus of Japan and cartels of Indonesia provide lessons not dissimilar from those in Western Europe where public treasuries have been stretched when banks have overextended themselves with commercial investments. Those who actively advocate financial modernization legislation in the U.S. Congress which mixes banking and commerce might want to take a hard look at the kinds of conflicts of interest endemic to systems that have allowed such mixing.

For the same reason that U.S. manufacturers may be competitively disadvantaged by weakening currencies in Asia, U.S. financial services providers are in a strengthened position to expand their market share in the region. This will particularly be the case if America’s financial services firms are provided the flexibility of their foreign counterparts and allowed to vigorously market a spectrum of banking, securities and insurance products.

Passage of financial modernization legislation would allow United States banks, securities firms and insurance companies to be in a position to consolidate our global leadership in finance. U.S. firms would not have to charter separate businesses abroad, thus avoiding job creation outside the U.S., to get around our decades old laws which restrain competitiveness.

As for the mergers announced in the last few weeks, it is clear that the big are getting bigger from the top down. But from the bottom up, locally-controlled institutions – credit unions as well as community banks – are doing better on a same store basis.

Indeed, the greatest secret in American banking today is that when community banks merge with regional or national banks, the market share for locally-controlled competitors, including newly chartered institutions, has generally increased. There is a great deal of vibrancy in banking today with institutions stressing personal service doing particularly well.

Two decades ago community banks were severely apprehensive about projected trends toward multi-state holding companies. Today, as the inevitable consolidation is increasingly becoming reality, they aspire to little more than that
their principal competitor sells out to institutions headquartered away from their downtown.

In response to the trend toward bigness, more than 300 new banks have been chartered in the last two years and most of them are growing faster than larger institutions, providing increased competition in the financial services sector.

The other noteworthy aspect of recent mergers is that regulators have construed current laws in ways not fully contemplated by legislators to the competitive advantage of larger, established institutions. Thus, the Federal Reserve Board’s Section 20 decisions in the securities field, the Comptroller of the Currency’s decisions on insurance, and the pending Citigroup proposal – which intertwines banking, securities and insurance – represents a market-driven, regulator-shaped change in the competitive landscape.

The only way to level the competitive playing field -- particularly for small banks, insurance agents and regional securities firms -- is through legislation empowering all financial services providers, as proposed in H.R. 10.

What has not been well understood is that not only is H.R. 10 the most pro-competitive financial services bill Congress has considered in modern times, it represents the only way community-based institutions can be provided a credible opportunity to compete against larger institutions which are increasingly being granted competitively advantageous powers by regulators.

The Committee will hold a public hearing next week on the recently announced mega-mergers in part because of questions about whether management and regulators are equipped to prudently administer and supervise institutions of such dimensions. In addition we will explore the issue of the competitiveness of smaller banks and financial services firms with these newly created financial conglomerates.

Each of the recent merger announcements needs to be looked at on an individual basis as well as on an industry basis. For instance, the Citicorp-Travelers merger involves the integration of a money center commercial bank with a major insurance and securities firm; the Bank of America-NationsBank merger involves the creation of a national coast-to-coast retail bank based upon a union of two dominant regional banks; the First Chicago NBD-BancOne merger involves a major consolidation within a particular region; the Washington Mutual merger with Great Western and Home Savings involves the creation of the largest S&L in the country, with a West Coast emphasis, the deposits of which account for over 11 percent of the taxpayer-backed savings association deposit insurance fund; the Household-Beneficial merger involves a consolidation of two of the largest consumer finance companies in the country.
It is understandable that there is increasing public concern about concentration of resources attendant in the recently announced mergers, as well as those currently subject to private discussion. Unlike its European and Asian counterparts, the American public has been skeptical about allowing the financial services marketplace to be monopolized by a handful of large institutions. I share this skepticism. America’s financial services industry is the most competitive, transparent, vibrant and efficient one in the world because of a pro-market, pro-competition business philosophy.

However, the following perspectives should be considered when reviewing any proposed mergers:

First, from an international perspective, it is interesting to note that the world’s largest economy has only a handful of banks in the top twenty when ranked by size. For instance, in 1993, there was only one U.S. bank that ranked in the top twenty based on asset size, Citicorp. Even with the economic shocks to Asia and the phenomenal economic boom in the U.S. since 1993, American banks still only account for 4 of the top twenty spots, with the newly proposed bank holding company, Citigroup vaulting to the top of the list.

Ironically, U.S. banks overseas compete at a severe disadvantage. They are in head to head competition with European and Asian banks which can offer a larger range of financial products to international corporations and customers. U.S. banks which want to provide comparable financial services have been forced to charter specialized subsidiaries overseas. For instance, J.P. Morgan. Prevented by U.S. law to affiliate with an insurance company in the U.S. has chartered one in Ireland.

Domestically, U.S. insurance companies are facing greater competition from foreign insurance companies which have a broader financial services base in their home countries to build from. H.R. 10, by repealing federal restrictions on banks affiliating with securities firms and insurance companies would allow U.S. financial firms to expand their operations in the U.S., thereby providing more jobs here at home.

Second, it is important to remember that there are a number of safeguards contained in present law to ensure against overconcentration. For instance, the Federal Reserve and Justice Department are required to do anti-trust reviews of banks mergers. If a merger is found to harm competition, the proposed merger cannot take place (as was the case recently when the Federal Reserve turned down an application to merge two banks in Marshalltown, Iowa) or the merged entity must divest branches and deposits (as was the case in the recent
Nationsbank-Barnett merger).

In addition, federal law contains a specific cap on the percentage of deposits that an interstate bank can hold. Under the 1994 law, which repealed the restrictions on interstate banking and branching, federal regulators are prohibited from allowing banks to merge if the resulting organization has more than 10 percent of the nation’s bank deposits or 30 percent of a state’s deposit base. The 1994 interstate banking law also prohibits interstate banks from establishing deposit production offices, whereby a large bank simply siphons off the deposits of a community or state without providing loans. A provision expanding the prohibition on deposit production offices to diversified financial services companies is included in H.R. 10.

The most important safeguard, though, is the Bank Holding Company Act restriction on commercial entities buying banks and bank holding companies engaging in commercial activities. Thus, while American banks are getting bigger, the conglomeration of resources caused by a mixing of banking and commerce, a la Japan’s keiretsus, cannot occur. However, on this issue two warnings must be made.

First, with regard to financial services modernization legislation, there are those in Congress who would like to repeal these banking-commerce restrictions. As noted above, I am opposed to such a repeal and would question how it is in the public interest to allow Mobil to buy Citigroup or vice versa. Second, I am supportive of efforts to close the unitary thrift holding company loophole, which allows commercial enterprises to control thrifts. While thrifts do have modest limitations on their lending authorities, they are becoming increasingly like banks and therefore should be subject to the same restrictions on commercial activities that banks operate under. The latest version of H.R. 10, with the exception of grandfathered institutions, closes down this loophole.

Changes in the financial services industry must foremost be evaluated from the perspective of what is best for consumers and the overall economy. The critical question is whether these consolidations bring more products to more consumers at lower costs or whether they fuel anti-competitive forces.

Technological developments, overcapacity in the industry, and other market forces are reshaping America’s financial services industry. These developments have unique implications that should be reviewed separately, as well as within the context of the general trends occurring in the financial services marketplace.

The good news is that our financial services industry has never been stronger or more competitive. The bad is that globalization of finance holds dangers, as well as promise. The key is to proceed forthrightly, but with a degree of caution and
recognition that the public interest is definitively intertwined with the health of the financial community. A strong economy is impossible to achieve and maintain without a vibrant, competitive financial services industry.

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