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Aspects of international financial services

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Abstract

The purpose of this paper is to discuss the issues related to international financial services, particularly foreign direct investment in banking. The paper discusses the challenges of measuring incomes generated from the activities of multinational banks, including their international lending and direct investment in host countries. The paper highlights the complementary role of FDI and trade in financial services and discusses investment in banking services. The patterns of FDI in banking in Eastern European countries, Latin America and East Asia are also analysed with a focus on the costs and benefits of FDI in banking in the emerging countries.

JEL classification: G15; G25

Keywords: Financial services; FDI in banking; Emerging countries

1. Introduction

The Asian currency crisis prompted various people and agencies to call for a New International Financial Architecture (NIFA) as a way of ensuring more global financial stability. Indeed, the IMF referred to global financial stability as a global public good. In other words, all nations will have significant interest in ensuring that the global financial system is sound, as financial instability causes significant financial and other costs to most nations and people. For instance, the Mexican crisis in 1994–1995, the Asian currency crisis in 1996–1997, the Russian currency crisis 1999

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and Argentina's crisis in 2002 have inflicted significant financial costs to both these nations and other nations. As part of the NIFA and other measures taken by the IMF and the World Bank towards global stability of financial systems, there have been calls for more transparency and accountability of financial institutions around the world and the way their operations are supervised both at national and possibly at international levels. At the same time, with the process of globalization, there is a greater need to ensure that national regulators and financial supervisors are more vigilant and more accountable for the way local financial institutions operate. A number of sound international standards, including the International Association of Insurance Supervisors and the Basel Committee on Banking Supervision, are designed to improve the international standards of financial institutions and financial markets. It is also noteworthy that, gradually, developing countries are adopting the Basel Core Principles and the implementation of Basel II.

At the same time, as the process of globalization is accelerating, more and more countries are adopting sound macroeconomic policy, including a low inflation policy, as it is recognized that low inflation is one of the prerequisites of sound financial stability. Another factor that contributes to global financial stability and effective financial institutions are effective legal system infrastructure. The study by Beck and Levine (2002) link economic growth to a sound financial services industry. Similarly, the study by La Porta et al. (2002) shows that private ownership of banks is more conducive to economic growth.

One of the factors that could reduce global financial instability is more financial market integration between developed and developing countries. As part of this process, integration of banking systems is one of the elements of global financial market integration. To this end, one could note that the process of globalization has increased the presence of foreign banks in emerging countries to the extent that from 1990 when we had a virtually insignificant level of FDI in many developing countries, we now have a significant proportion of banks, for instance, in some of the Eastern European countries, owned by foreign banks. Latin America is also experiencing the presence of a large number of foreign banks. Despite some challenges, such as sharing of responsibility for crisis management or issues related to cross border tax rules, overall the increase in FDI in banking has been contributing to financial stability in some of the emerging countries and hence contributing to global financial stability. Thus, in the light of the process of globalization this paper intends to briefly focus on some of the issues with respect to trade in financial services and FDI in banking services.

The remaining part of this paper is structured as follows: Section 2 discusses trade in financial services, Section 3 discusses FDI in banking services, Section 4 deals with the benefits and costs of FDI in banking, Section 5 deals with FDI activities in some emerging countries and Section 6 concludes.

2. Trade in international financial services

As reported in Moshirian et al. (forthcoming), the OECD has broadened the definition of trade in financial services to include "financial investment income" and