F. William Hawley*

I guess I am one of those industries that Mr. Ascher was referring to as having put all the heat on Government to finally recognize the importance of some of these issues. I have to plead guilty to having been involved in this effort for some time. In response to Professor Wilner's comment "why now?" or "why is the timing so urgent?", my immediate reaction is that we have not only the culmination of a process that has been going on for some time as Mr. Ascher mentioned, but also there is an important conjuncture here with technological advancements, particularly in the telecommunications and related fields that Mr. Aronson will discuss. These services are the lifeblood of the international financial system. Instantaneous-transfers of funds and other transactional communications through that network around the world have brought about a globalization of the system. This makes it especially urgent that we recognize that we are living in an instantaneous transaction type of global system which requires global multilateral rules. It is high time that we face the questions that are implied in that recognition.

From the viewpoint of the banking system, why are we concerned, and what kinds of barriers do we face around the world? Let me give a couple of examples from among the many countries that impose a wide range of barriers to their markets. Some do not allow any foreign bank to be represented (or at least no new entries from abroad) in their home markets. Other countries, some of which are in Europe, until recently would allow a subsidiary but not a branch of a bank, so that transactions were limited by capital restraints on subsidiaries and other rules. Other countries will allow both subsidiaries and branches of foreign banks, but will not allow them to fund themselves by issuing certificates of deposit or by having access to the discount window of the central bank or to other means of funding. They will put very difficult restraints on the ability of the bank to offer a wide range of financial services within the community so that the local banking operators are protected in the market that they prefer to dominate. Finally, there are countries that are wide open to foreign competition because

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their governments have recognized the advantages that can accrue to the domestic economy from offering a more competitive array of financial services to the manufacturing and other sectors in the economy. So we have a wide range of concerns from our industry’s standpoint.

Until recently, I would have put Europe in the category of the countries that allow virtually unrestricted access, but now we have some worries about this very fashionable topic of “EC 1992”. This is obviously of particular interest to your profession, because there seems to be a conference organized by a legal organization almost every 48 hours that you can attend for $450. I welcome you all to that competitive activity. But “EC 1992” does present an important challenge, and it raises some questions which as recently as two or three years ago we would not have felt worth even mentioning. We now face not the restrictions of the types I mentioned in (predominantly) the Third World, but we face the prospect of a market-closing operation in certain sectors in Europe under the terms of the banking and securities directives that I will refer to later.

Now let me make a couple of general points on the importance of the GATT negotiations. The “Uruguay Round” must address the problems that I outlined, and it offers a tremendous opportunity; however, there are some serious problems, and there is some serious resistance to going the route that we are advocating. I will explain what some of the sensitivities are and how we are trying to overcome them.

The agreement is important to all parties. It is important to the U.S. private sector and to the private sector of other countries because most economies throughout the world, certainly in the industrialized world but increasingly in the Third World, are made up predominantly of the service sector. The welfare, per capita income and living standards of all economies will increasingly depend on our ability to deal in a public policy sense with the implications of the growing role of the service sector.

The rest of the economy, in turn, is importantly dependent on the functioning of the service sector of the economy. As you study the trend of the evolution of manufacturing, you run across the phenomenon of the “dematerialization of product”: less and less of the value of a product reflects the raw materials that are in the product, and more and more is dependent on the service content of the product, the design, the marketing, the financial packages, the transportation, etc. So the inter-relationships here are very important.
The urgency was stressed recently in a statement that has lessons for all of us. In Australia, at a recent conference that I addressed, a friend of mine representing the Japanese Kaidanren gave a presentation on the importance Japan attaches to reaching an agreement on trade in service. His explanation was that the inter-relationship between the various parts of the service sector and the manufacturing sector is so complex and so important that Japan risks losing its competitive edge in the manufacturing sector because of retarded competitiveness in the service sector. It seems to me if that is important to, and recognized as important by, the Japanese, then that must be important for the rest of the world. There is a lesson in that, both for the United States and also for the developing countries concerned with the development process. The developmental studies done by the UNCTAD have also recognized this inter-relationship, and the increased importance and urgency of formulating sound policies related to the service sector of the economy.

Where UNCTAD still differs with my reasoning is at the fork in the road that determines trade policy. All too often, I feel that the UNCTAD economists are advocating a line that says "yes, this is important,—in fact it is so important that we have to build a wall around it and protect it from international competition." So we still have our differences. I would argue much more strongly that the past models of development based on import substitution and infant industry strategies have been disappointing to all observers, including the inhabitants of the countries that have followed those models. Today, increasingly in the discipline of economics as well as in the political structures of the Third World, people are recognizing these realities and are moving more to the open economy model. So I see some hope that we are moving into an environment in which we can get some mutual recognition of the advantages of increased international competition and the lowering of barriers.

Services differ from manufacturing in one important respect—a key point for the type of negotiation that we are talking about here. In manufacturing, a product coming into your country from abroad stimulates economic activity primarily in the country where the good was manufactured. In the services sector in general, and certainly in financial services, it is the recipient economy which gets the added stimulus because service providers typically establish a physical presence within that country's market, providing employment to local workers, training, and technology transfer. This
is another important reason why we feel that a lowering of barriers in this area constitutes an important contribution to the development process. Technology transfer, stimulation of employment, and training occur naturally, as essential ingredients in the way service companies have to do their business. There is no way that a bank can successfully operate by parachuting one hundred Yale or Princeton graduates into Egypt and asking them to successfully operate a bank. There is no way to do that. We are hiring locally, we are training locally, we are promoting locally; it is the only way these companies can successfully operate.

I would like to make a couple of comments on the objectives that we seek. It is going to be difficult to deal with a regulated industry such as banking, because you do have some special concerns there that relate to safety and soundness. It is no simple matter for the Treasury Department and the Federal Reserve Board in Washington to sign on to an international negotiation affecting their responsibility to protect the safety and soundness of our banking system. So this is one aspect of the service negotiations that is going to require some work. This is also an important issue for the Third World—the implications of lowering barriers and welcoming more investment and trade in services for their own control over their economy, and their ability to run their own economy in the way that they feel is appropriate. Our answer to this is that the objective we are seeking in the framework agreement is not based on trying to get everybody to have the same regulatory system that we have and to mirror the Federal Reserve system or any other system. God help any country that would take on the Glass-Steagall Act and our interstate banking restrictions. We are not trying to push anybody to go to our model or to any other standard model.

The reason we have advocated the “national treatment” approach is precisely because it offers every country the flexibility to tailor its own regulatory system to its own needs. All we are asking is that they apply the same criteria to the foreign institutions that they do to the domestic ones. This approach gives them all the protection they need in the “safety and soundness” area, but allows them to get the benefit of the competitive process in upgrading the quality of their financial system. Because of the inter-relationships I mentioned before, these countries will get benefits for the other sectors of the economy as well. We feel that this is an important ingredient in the negotiations, and I will get back to this because
there are some challenges to this that are beginning to emerge. The national treatment approach allows flexibility.

Some people, including government officials, have asked me whether I really want to get the banking sector involved in the international trade negotiations, in view of the difficulties some American banks may have in competing with the foreign banks if they all come into the U.S. and compete in our markets. I point out that, since the enactment of the International Banking Act in 1978, “national treatment” has been the official U.S. policy. Every foreign bank that wants to operate in the United States and that has a serious interest in operating here is already here. There is no reason why they cannot be. They have to face the same restrictions that we do once they are here. Once they have picked a home state to operate out of, usually New York, California or Illinois, they face the same restrictions that domestic banks do in crossing state lines and in moving beyond straight commercial banking and into securities and other businesses.

Since national treatment is already the official policy of the United States, another difficulty we face in the negotiations is that we have “given away the store”. We have opened our economy wide to the rest of the world’s banking systems and from that position we are looking for the leverage that will allow the lowering of barriers abroad.

It obviously creates some complication when one talks only within that one sector of how to accomplish what we would like to see accomplished and what we feel is to everyone’s mutual benefit. This is obviously another reason why we favor a very broad negotiation that covers many sectors and many types of problems so that in the final cost-benefit mix we can find some progress in what we feel is an essential sector for all participants.

Let me mention one emerging problem, because I promised to get back to it when I talked about the challenge to national treatment. Mr. Hunnicutt concluded with the statement, “In the Uruguay Round as well as in policies for post Uruguay, the underlying principles of GATT which are still the foundation on which trade liberalization is founded—non-discrimination, transparency, and reciprocity—should remain our guides.” This is quite accurate in the way that he has intended it, but I circled the word “reciprocity” because, as many of you are aware, the word is one that is used by trade negotiators in at least two very different senses. The classic sense in which the Americans as well as other nationalities who created the GATT system used the word reciprocity is a very dif-
ferent sense from that in which the European Community is beginning to use it now as they draft the directives that make up the internal market program for 1992.

The Europeans appear to be moving toward a strict bilateral sectoral reciprocity approach which could destroy not only our hopes of getting a more sane world regime in the financial sector but could also put a serious road block in the way of the entire Uruguay Round process. The Europeans are saying that they are not going to define equal treatment or fair treatment as it would exist under a "national treatment" approach—where you are comparing within the same marketplace what the foreign institutions and domestic institutions receive in terms of regulatory treatment and access to the marketplace—but rather they are going to use a very different comparison. They are going to compare what foreign companies receive in terms of treatment in their market versus what treatment their companies receive in the foreign market, and if they are not the same, the EC is going to threaten to close down access to their markets. They view this strategy as useful leverage, as a market-opening wrench. However commendable their intentions are—to use this as a market opener particularly directed against the Glass Steagall Act in the United States and against our interstate banking restrictions—given the political realities in this country that we have been struggling with for 50 years on some of these subjects, it is extremely unlikely that this strategy will lead to the results that are intended. The results that are more likely to occur are a forced closing of a part of our access to the European market.

This would have broader consequences than simply blocking our access to the European banking, investment and insurance markets. Moving to a "reciprocity" strategy could cripple the Uruguay Round negotiations on services. Every developing country needs some flexibility to design its own regulatory system to meet its own circumstances. Those needs can only be met by going forward with more of a "national treatment" approach. We want them to treat foreign and domestic companies in their market similarly, and give them the same competitive opportunity within their market. We are not going to ask developing countries to mirror the systems that the

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1 Subsequent to the Trade Conference, the EEC adopted modifications of its Second Banking Directive which have allayed the concerns of many—including Mr. Hawley—about the EC's "reciprocity" approach discussed here by Mr. Hawley. —Ed.
United States or the Europeans have, which is one of the implications of the reciprocity approach. Therefore, the Europeans are risking adopting a process that will inevitably lead them to close down some of their own markets to us in terms of the breadth of financial services that can be offered. The European position might also cripple our abilities to reach an agreement with important Third World markets that are looking for the flexibility inherent in the "national treatment" approach rather than the rigid harmonization implications of the "reciprocity" approach. This issue is becoming more important as we follow the discussions in Geneva with the Third World.