Our Ability to Compete Effectively in International Markets

REMARKS

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Good afternoon, ladies and gentlemen. It's a great pleasure to be here again with my friends from the American Enterprise Institute.

One of the major problems facing the U.S. financial industry is the topic you chose for this conference -- our ability to compete effectively in international markets.

Globalization of business, finance and even politics is now a fact. Broad international markets have been developed for products that were once restricted by geographic considerations. Increased competition from abroad has resulted in the restructuring of major U.S. industries.

The U.S. auto industry is a good example. Increased competition from Japan and Europe radically changed the way the "Big Three" auto makers do business. A decade of investing in new plants and products has created a more efficient industry. Further, joint ventures and equity exchanges have created a truly international auto industry.

It's logical for banks, foreign and domestic, to follow commercial customers into international activities. And that is certainly the case with foreign banks in the U.S.

However, a recent GAO report on the European Community says U.S. financial firms are not expanding -- at least not in Europe. A majority of the U.S. bank officials interviewed for that report believe U.S. bank laws and regulations place them at a competitive disadvantage in relation to banks abroad. And they're right!

The Banking system is outdated and inefficient. It hampers the ability of our financial institutions to effectively compete both at home and abroad.

Banks have had to go into riskier business ventures because their traditional business customers have found new and less expensive providers. Banks cannot provide similar services because of regulatory restrictions.

Thus, we see the recent downgrading of our major institutions by the rating agencies. Third world loans, highly leveraged transaction loans and concentrations in real estate lending have been the primary cause of this fall from credit grace. All of the above lending resulted from riskier activities, sought to replace traditional lending, and the result is a weakened industry. Unfortunately, this weakness becomes evident just as international competition really gets underway.

It is true that certain foreign regulations limit the ability of our banks to compete effectively. Recent actions by other governments to modernize their domestic financial systems will help create a more level playing field. But even a level playing field won't help us if we continue to handicap our players with an antiquated banking system.

In order for our banks to become more competitive, we are going to have to lower their handicap by adopting a more efficient financial system. With proper safeguards in place to ensure safety and soundness, our financial institutions can prosper if they are free to attract capital and compete effectively, at home and abroad. The position of the FDIC is that fundamental structural reform of our entire financial system is necessary to achieve that goal.

We will have to take some positive steps that will require legislative action. We can't depend on luck to change our fortune.

We believe four basic changes must be made to achieve a more competitive industry:

First, banking laws that regulate the activities of nonbanking entities -- primarily, the Glass-Steagall Law -- should be dismantled and replaced with a system that provides regulation along functional lines. Other major countries currently allow banks to engage in a wider range of activities than permitted by the U.S. Liberalization is necessary for our banks to better diversify risk.

Functional supervision would also eliminate costly layers of regulation necessary when financial institutions are subject to the jurisdiction of both the banking agencies and the functional regulators. No other country has such a costly regulatory system imposed on their banks.

Second, the banks holding company regulatory structure, designed to achieve separation of commerce and finance concentrations should be eliminated. It is not necessary to protect the financial system from abuse and in fact; the converse is true. Commerce and finance should be combined in order to provide financial resources to the banking system. Our corporations should be allowed to own banks. The way our present system works like asking one Siamese twin to hold the net while the other twin swings on the trapeze.

Third, geographic restrictions on bank expansion must be curtailed. They have contributed to greater risk in the system because they discourage diversification. These restrictions create an inefficient system and should be removed. Right now we have no truly national banking organization. We have New York or Illinois banks, but no all-American banks.

Finally, deposit insurance must be reformed and the "too big to fail" doctrine reviewed in a global context. As banks continue to operate across international borders, we will have to determine whether the way we handle major bank failures needs to be or should be changed. Does the ABA plan for required failure and loss by uninsured depositors when a big bank fails help or hurt international safety and soundness? Does it help or hurt our competitive position?

Next fall, the FDIC plans to sponsor a meeting of representatives from the major financial centers around the world. We'll discuss international policies on deposit insurance and the "too big to fail" doctrine in the U.S. and internationally. As the chairman, Paul Volcker said recently in an address before The Institute of International Bankers:

"I feel it would be useful if the debate were not confined largely to the United States. What will logically be needed is a broad international consensus on how to reconcile the compelling need for banking flexibility and competitive force with the equally compelling needs to avoid contagious and destructive financial breakdowns and to maintain prudent lending standards."

We agree with Paul and we hope the FDIC sponsored conference will be the beinning of that consensus. I'm not certain we'll find much agreement in the way we view the concept of "too big to fail" but perhaps we'll all realize that it is "too big" to ignore.

Our banking system needs improvement and needs it now. If it is to be truely competitive in the financial world of tomorrow. If we make the four changes I've suggested, we'll have a system that will hold its own with the best.

AEI is the birthplace of many of the best ideas in use in government today. I hope this conference spawns some real winners for the U.S. financial system. The system needs AEI's good work and leadership role. Even if you lead to us to an agreed solution to improving the system's basic economics, getting it done politically will still be the challenge of the 90's.

Thank you