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International investment in financial services

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Abstract

This paper analyzes and models the significant components of international trade in financial services, namely, foreign direct investment in banking for the US, the UK and Germany. It distinguishes between banks' activities abroad and FDI in banking by banks and non-banks. A model for FDI in banking is proposed which contains certain explanatory variables peculiar to FDI in banking as compared to FDI in manufacturing. The components of the model of FDI in banking is different from those models designed to explain banks activities abroad. The empirical results of this study of FDI in banking indicate that bilateral trade, banks' foreign assets, the cost of capital, relative economic growth, exchange rates and FDI in non-finance industries are the major determinants of foreign investment in banking. © 2001 Elsevier Science B.V. All rights reserved.

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1. Introduction

According to the UN World Investment Report (1994), world-wide flows of foreign direct investment (FDI) have grown at unprecedented rates, to reach a total outflow of $225 billion in 1990 (from an outward stock of $1.7 trillion).

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The average annual growth rate of FDI has been high between 1987 and 1997 and this growth far exceeded that of merchandise exports and nominal GDP. One of the major categories of US FDI abroad is FDI in banking. US FDI in banking has increased fivefold over the period 1983–1997. Statistical data also show that German FDI in banking has increased over fivefold during the period 1983–1997, while UK FDI in banking has more than tripled during the same period of time. [1] It is worth noting that for all three countries Europe remains a primary host for foreign banking expansion, whilst Japan remains relatively closed. In fact, apart from the continued growth in the number of foreign banks in Hong Kong and Singapore, Asia still lags behind the developing countries of Latin America as host countries for FDI in banking. This can be attributed to the delayed and incomplete approach many of the Asian nations are taking toward financial deregulation.

The growth in FDI in banking has been encouraged by a global trend towards financial deregulation, information and telecommunication advances, and globalisation of the capital market. Indeed, growth in FDI in banking has not only provided new opportunities for banks to expand their international businesses from the home country, but has also allowed them to use FDI in banking to expand their international activities. As more countries deregulated their financial markets during the 1980s allowing foreign banks and non-banks to invest in their banking industry, the study of FDI in banking is more significant than ever before.

Despite the continued increase in international investment in banking during the 1980s and 1990s, there have been few major studies of US banks' activities abroad, partly due to the lack of quarterly data on FDI in banking. Researchers have had to use indirect data related to the assets of foreign branches of US banks, or the number of foreign branches of US banks to study FDI in banking. Goldberg and Johnson (1990) who examined those factors which determine the number of foreign branches of US banks and those factors affecting the assets of foreign branches of US banks over the period 1972–1985, remains one of the few and indeed the last major study of US banks' activities abroad. However, the recent unpublished quarterly data on US FDI in banking has provided an opportunity for researchers to measure both bank and non-bank US foreign investment activities in banking for the first time. Thus, this study is the first study

[1] FDI in banking of the United Kingdom and Germany are in the following countries: the UK (Germany only), Belgium, Denmark, Germany (for the UK only), France, Greece, Ireland, Italy, Netherlands, Portugal, Spain, Austria, Sweden, Switzerland, Africa, Hong Kong, Brazil, Japan, Australia, New Zealand, South Africa. The United States not only has FDI in the above countries but also in the following countries: Norway, Turkey, Argentina, Chile, Columbia, Mexico, Romania, Nigeria, Israel, India, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, Thailand. Note that over 70% of the total FDI in banking from these three countries (i.e., the US, the UK and Germany) are to OECD countries.

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