

Discussion by

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## Financial Crises and The Presence of Foreign Banks

Adrian Tschoegl

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The comments provided are those of the discussant, Linda Goldberg, and need not represent the views of the Federal Reserve Bank of New York or the Federal Reserve System.

Adrian Tschoegl offers us an interesting, informative, and provocative paper.

### Roadmap for my comments as discussant

- a brief comment on the paper's style
- the issue of branch vs. subsidiary choice in developing countries
- missing themes relevant for emerging markets.

### My Main conclusions

- Richly informative narrative on tradeoffs associated with foreign banks
- But, the branch vs. subsidiary distinction is overstated.
- Foreign banks can have help with crisis avoidance, even after leaving EMs.

### A brief stylistic comment

The paper seems to have 2 authors, or one author with 2 very different voices.

Author 1 of introductory sections writes provocatively, to invite controversy

- The style baits those readers who are antagonistic to foreign banks – author initially appears as an ally. An example:

“In the banking realm the foreign banks are weeds, the early opportunistic species. By their entry the foreign banks erode the conditions that drew them. The foreign banks come to disturbed, hospitable soil.” (p.7)

Author 2 wrote the rest of the paper, with well-researched logical discussion of pros and cons of foreign bank participation. I like this author much better.

- But, will those readers who are not antagonistic, ex ante, to foreign banks read the paper long enough to appreciate Author 2’s scholarship?

## Branches vs Subsidiaries & Affiliates: What Underlies the Entry Mode Choice?

Tschoegl. P.3 “Legal form is not an arbitrary formality but is intimately tied to both the banks’ strategies and to the regulatory environment.”

Regulatory environment does matter.

In practice, parent bank choice of mode of entry into EMs depends on what is permitted by host country: this is the primary decision factor.

The links between bank strategies and modes of entry in EMs are more tenuous.

In interviews, parent banks note differences between subsidiaries and branches

- Subsidiaries cost more: parent banks may need to post bonds for financing or raise funds in the host country markets (domestically, e.g. through depositors).
- Subs have some greater autonomy in lending and human resource decisions.

But, parents banks also claim to treat their subsidiaries and branches similarly

- Some large parents claim that there are few notable differences in their treatment of branches versus subsidiaries (fully or largely controlled by the parent) in areas of decision making, management, and control.
- In both modes, the head office makes many of the strategic and management decisions that drive the operations in EMs.
- If challenged in the courts, would the operational and management separation of a subsidiary with respect to the parent bank be sufficient to satisfy the legal criteria for distinct corporate entities?
- If subsidiaries are not sufficiently separate from the parent, is the distinction between branch and subsidiary legally binding?

Does the mode of entry matter for the role of foreign banks in a crisis?

Tschoegl. P.12 “[with affiliates] the expectation of parental support is a bet and not a consequence of legal form as is the case with branches.”

Yes, technically.

In practice, parental support for branches also may be a bet.

- Some countries follow a “separate entity” doctrine and are able to place their own depositors and creditors as senior claimants ahead of those of other countries, irrespective of liquidation laws.

- Ring-fencing limits spillovers to parents for branches
  - Example: the repayment of dollar denominated deposits of foreign branches of a U.S. bank may be payable in the U.S. only when explicitly stated in the contract. Some banks stamp deposit slips to state limits of parent responsibility.
  - Example: parental support limited if crisis or pressures are due to events such as exchange controls or expropriation.

Conversely, parents may support subsidiaries as they would support branches.

The reputational consequences for the parent bank are similar if the mode of entry is via branches or via subsidiaries.

- Population / markets will not differentiate along these lines if there is limited support for the host country operation, or exit from the crisis country.
- These consequences are in crisis country and in other countries (current and future) where the parent bank has or wants a presence.

Can foreign banks help with crisis avoidance, even after leaving EMs?

Tschoegl argues that the participation of foreign banks in emerging markets is self limiting. The message is that foreign banks have a temporary and limited role in influencing crisis avoidance, crisis outcomes.

Even if the self-limiting theme is true (is it??), can foreign banks nonetheless have a long-lasting positive effect on EMs?

YES. Two forms of evidence support this.

- Evidence based on the recent experiences with foreign banks in EMs.
- Evidence from non-financial FDI into emerging markets.
- “Financial FDI and Host Countries: New and Old Lessons” Goldberg (2003) argues that non-financial FDI research contains many lessons pertinent for financial FDI.

## **A few examples of positive and lasting effects of foreign financial FDI**

- The ability of the Government to direct bank lending remains interrupted (Tschoegl) so long as banks are privately held, and accountable.
  - While serving as a means of fiscal stimulus, this directed lending crowds out intermediation to worthy private borrowers.
  - If banks are better regulated and subject to parent bank oversight, foreign banks operating in EMEs may be better able to resist local suasion.
  - As such, they may better discipline host country fiscal or monetary “irresponsibility” and be less amenable to forced purchases of government bonds or forced lending to favored political constituents.

- FDI leads to improved allocative efficiency when foreign investors enter into industries with high entry barriers and reduce local monopolistic distortions.
- The presence of foreign producers may also induce higher technical efficiency: the increased competitive pressure or some demonstration effect may spur local firms to more efficient use of existing resources.
- Higher growth trajectories are associated with less government ownership of banks.

LaPorta, Lopez-de-Silanes, Shleifer (2002), Sapienza (2002).

- Financial FDI may lead to improved bank supervision, with regulatory spillovers

Crystal, Dages and Goldberg (2002). Foreign banks have contributed to enhanced domestic financial stability by engaging in more aggressive risk management techniques.

## Concluding Remarks

The paper presents a very thoughtful discussion of the role of foreign banks in emerging market crises.

There is a provocative typology of banks, 12 short case studies, and a discussion of modes of entry and motives of types of banks.

I continue to believe that foreign banks can or will play a role in crisis prevention, and resolution. The positive spillovers from well-run, well-regulated banks are sufficiently important that such banks should continue to be welcome and potentially embraced by emerging market economies.