A Comparison of the Banking Industry in Spain, Portugal, and Mexico

An Honors Thesis (HONRS 499)

by

Karyn E. Guse

Thesis Advisor

Cecil E. Bohanon, Ph. D.

Cecil E Bohanon

Ball State University

Muncie, Indiana

May, 1994

Expected date of graduation: May, 1994

SpColl
Thesis
LD
2459
.Z4
1984
.G37

Purpose of Thesis

This discussion covers the economies and banking sectors of Spain and Portugal in relation to those of Mexico. A special emphasis is placed on the European Community experiences of Spain and Portugal, and the EC's effect on those economies as contrasted with the expected effect of the North American Free Trade Agreement on Mexico's economy and banking sector. Though this comparison, an estimation of the success of Mexico's entry to NAFTA will be made.

TABLE OF CONTENTS

Introduction 1

Current Statistics and Regulations of the Banking System 3

- Mexico 3
- Portugal 4
- Spain 5

Political Past: Socialism and Dictatorship 7

- Spain and Portugal 7
- The Spanish Experience 7
- The Portuguese Experience 8
- The Mexican Experience 8

Present Government: The move to the Right 10

- Mexico 10
- Spain 11
- Portugal 13

Banking Past and Future 16

- Banco Central 16
- Banco Espirito Santo & Comercial de Lisboa 19
- Banco Santander 20
- Banco Comercial Portuguese 21

Summary 23

Introduction

As the rest of Europe recovers from a wave of recession, Spain and Portugal have held their ground economically, maintaining one of the fastest growing economies in the Economic Community [EC].

Mexico experienced a precipitous economic decline during the 1970's and 1980's, but now stands ready to enter the economic union of the North American Free Trade Agreement [NAFTA]. Each country is embarking on a change in its political, social and industrial institutions in order to improve the quality of the domestic economy, and the lives of their citizens.

Fifteen years ago, government squeezed prospects for economic progress, yet now the flow of competition from the global marketplace is part of the economy, due to past events.

Spain, Portugal, and Mexico are at distinct economic disadvantages with their neighbors and key trade partners. Mexico has an economy about one-twentieth the size of the US economy (Wood, "Free" S6). Spain's and Portugal's economies, fifth and tenth in the EC, are also weaker than neighbors, France and Germany ("Not Quite Cousins" 22).

Post economic instabilities lurk in the shadows. Inflation in all three countries still threatens to erupt; unemployment has not declined; and interest rates must be better managed if the economy is to be held in check.

The EC played a large role in Spain's and Portugal's turnaround. Its economic advice, incentives, and regulations added fuel to the countries growths. Competition forced companies and government alike to tighten their belts. It brought new meaning to the words "market share" and "customer satisfaction" in countries where, before, the government, "was always right".

The banking industry shows the benefits of economic integration clearly. Banks consolidate and streamline, while customers benefit, and the counties profit. The success or demise of Spanish and Portuguese banks reflect the outcome of Spain and Portugal as a whole. At the same time, Mexico can see its future through events in Spain and Portugal as NAFTA's wave of deregulation sweeps over the entire economy.

A study of the banking industry and the surrounding factors that influenced that industry since Spain and Portugal entered the EC in 1986 will provide insight into the impact that NAFTA will have on Mexico. Conditions vary within each country, but common themes in all of them make it possible to estimate Mexico's success in NAFTA.

Current Statistics and Regulations of the Banking System

Mexico

Privatization of industries throughout the 1980's into the beginning the 1990's culminated in June, 1991. President Carlos Salinas began a thirteen month spree during which he privatized 18 state banks which held 98 percent of the assets of the overall banking system. Investors paid $12.4 billion for the highly regulated, technologically backward, over-staffed banks. Potential growth in Mexico's banking sector was a primary factor in their decision (Hennessy F13).

By 1989 standards, the ratio of bank branches to potential customers averaged 6,000 people to every branch; the US carries ratios of 4,000:1 and Germany's ratios are 1,400:1. Net interest income of 5.6 percent of assets in Mexico is well above averages of 3 percent posted in Europe and less than 2 percent in Japan (Peagam, "Booming" S12). These figures indicate a profitable and growing market.

Government regulations compounded the effect of the nationalization of the Mexican industry in 1982. Financing mounting debt in the public sector was a primary concern for the socialist-minded government. This policy forced banks to invest in government securities and borrow from low interest, government loans. At the same time, government forced banks to lend at high interest rates to depositors (Wood, "Respect Restored" S3-S4). Finally, in 1988 and 1989, the government eliminated regulation of interest rates and allowed privatized banks to compete on price (Wood, "Big Bang" S16). Special credit lines to "priority sectors" in industry were also cut. Legal reserve requirements of 90 percent which also contributed to government finance were reduced to 30 percent ("Suddenly" 24-25). Overall government ownership fell dramatically during privatizations in 1991 and 1992 to 8.8 percent holdings in Mexico's three most influential banks: Bancomer, Banco Servin, and Banco Internacional. Even those shares are expected to be sold off soon (Golden C2).

Regulations limiting foreign and large group ownership continue to disappear. As of 1989, foreign investors could own as much as 30 percent of Mexican banks. Foreign subsidiaries as a group could not hold more than 8 percent (Peagam, "Agreement" 26; "The North" 28). Domestic industrial and investment groups are also excluded from owning more than 5 percent of the capital in an individual bank (Marray

165). In enacting these measures, Mexico wanted to prevent foreign investment from owning a majority share any Mexican company. It also hoped to change the structure of the banking sector. Before nationalization, the power of banks and many other industries were held by only a few groups. The oligopoly concentrated power in a handful investors. With the privatization of 1991, government moved towards breaking the monopoly, increasing the number of shareholders from 8,000 to 130,000 (164).

Portugal

The Captain's Revolution of 1975 became the backdrop for the rise of socialism in Portugal. Revolution brought a new constitution and nationalization of key industries, including banking (Britannica 1059-1060). Not until almost ten years later, in 1985, did the government finally reopen portions of banks to the private sector (Humphreys, "Banking" 60). In the meantime, regulations fostering protectionism and oligopolistic practices ingrained themselves into the Portuguese government policy. Full privatization of larger banks, for instance, was hampered by a constitutional dictate created during the 1975 revolution which forbade the privatization of "conquests of the revolution ("Inch" 100)."

Portugal liberalized the economy during the 1980's. Conforming to EC regulations necessitated these changes more often than a voluntarily removal of restrictions, however. For example, the central bank has just recently slipped out from under the government's thumb. A 1990 statute of the European Exchange Rate Mechanism caused the change (Evans, "Steering" 142)

Previously, the central bank was responsible for elements of the fiscal and monetary policy, only when their decisions fell "within the guidelines" established by the Finance Ministry, but new statues mean new freedoms. The central bank now sets policy, "'taking into account' government policies. It will, 'collaborate in defining' monetary and exchange rate policy and 'keep watch over the stability of the financial system' ("Not Quite" 35)". No longer can the economic policy of the banking system be the servant of the political whims of the present administration.

The government also stopped providing itself with cheap financing through high reserve rates and forced borrowing imposed on banks (36). This had also been the case in Mexico. Other times, Portuguese banks supported the socialist party program with state-enforced lending to state-controlled companies (Blum, "Onwards" 47). Again, rather than

being caused by a voluntary desire to open trade, change arose from EC rules, as well as competitive pressure in 1993 threatening to crowd out banks hampered by uncompetitive regulations. Instead, the government now finances its debt through the sale, on the open market, of treasury bills or variable and fixed-interest bonds ("The Big Sell" 52).

The impact of the deregulation has been impressive. By freeing banks of capital controls, credit controls, and branch opening controls, the Portuguese government allowed banks to compete aggressively for the first time in twenty years. Staffs, which rose by as much as 70 percent during the reign of nationalizations, finally started to drop ("Home Free" 151). Even as the number of branches rose dramatically after the 1990 introduction of liberalized rules for new branches, total employee counts continue to fall. Labor regulations and unionism have slowed progress, but cost efficiencies outweigh the inefficiency of unneeded staff ("Not Yet" 97).

Portugal is still under-banked by EC standards at one branch per 4,000 people. Room for profits is available, but net interest income has fallen, down from 6 percent in 1991 to just 4.5 percent in 1992 (97).

Restrictions on foreign ownership of state companies limit foreign entry into the Portuguese market to approximately 25 percent of any company. Policy changed in 1993, however, when the EC removed Portugal's restrictions on the flow of capital. Foreign capital now supplements the scant supply of local capital. Sales of bonds, international loans, and development funds support the government's infrastructure program and debt financing, obligations to which domestic banks were once held (Humphreys, "Portugal Plumps" 106).

Spain

Problems with regulations and efficiency in Spanish banks may as severe as with Portugal or Mexico. The unorthodox nature of the market, though, served as a natural barrier to foreign entry in the short run.

The unusually high ratio of banks to people, one for every 1,200, makes economies of scale too costly to achieve by foreign investors ("Already" 94). Nevertheless, Spain has also had its fair share of regulations with which to keep out foreigners. It invoked a three-branch limit for foreign banks, increased that number to eight branches per bank, and then eliminated the limit entirely in 1993. The retail banking market also slowly removed protections by phasing out a 40 percent limit on the share of deposits that foreign banks can obtain from that market (94).

Even with protective regulations, banks continue to struggle to emerge strong enough to compete with the rest of the EC. The very regulations that protected them, other inefficient industries, and the economy as a whole, have slowed down banks. Up until around 1985, banks still had to invest 50.5 percent of all their deposits into one of three areas: government debt, the central bank, or nationalized industries (94). Happily, by 1993, the government made a strategic about-face, enacting accounting rules that prohibited exposure to industry through loans and investment to 40 percent, 20 percent by 1999 (Parry, "Conde's" 66).

Costs, stemming from high labor costs and poor technology, cut into margins that now rest at about 4.5 percent ("The Best" 79). Lifted regulations will only help cut margins further to the EC average, as mergers and competitive forces impact the Spanish market that has been an oligopoly of the state for so long. Deregulation of interest rates in 1987 may also help to maintain some of the profits. Growth in lending (credit) ceilings and reserve requirements, lifted in 1991 and 1990 respectively, will also contribute to greater efficiencies and economies of scale ("Serenading" 66; Evans, "Looking" S2).

Political Past: Socialism and Dictatorship

Spain and Portugal

Problems with Spain's and Portugal's integration into the EC stem from a history that encouraged many of the poor habits that the countries are today trying to break.

> So much of their history is shared: the legacy of exploration and empire; the manipulation by greater powers in the eighteenth century; the comic-opera procession of incompetent kings, libidinous queens, rebellious uncles and military strongmen in the nineteenth; above all the frustrations of rule by Western Europe's only post-1945 dictators.
>
> ("Not Quite Kissing Cousins" 24)

The Spanish Experience

General Francisco Franco made his own contributions to the decline and ultimate revival of the Spanish state. During the 1930's until World War II, civil war, near famine, and state-controlled industry, cut national incomes to the point that they returned to levels present in 1900. Economic protectionism also contributed to Spain's decline. Franco's alliance with the Axis powers during World War II further emphasized Spain's isolationism, even though Spain depended on the Allies for food and oil. Western opposition was unsustainable, though, because of Franco's strategic position in the balance of the Cold War.

In 1953, a shift from a state controlled economy to a market controlled one led the country out of decades of economic stagnation. Economic growth shot up as did inflation and wages. These factors, and the decision of an aging Franco to begin a transfer of his power, led to an opening of the country and its political system. Franco developed legislative and executive branches of government and hand picked a successor to chief of state. In 1975, Franco's era ended with his death on November 20 and Juan Carlos became the king of Spain (Britannica 58).

The Portuguese Experience

Portugal's history was no less turbulent than that of Spain. Antonio de Oliveira Salazar influenced Portuguese politics from 1928 until his death in 1970. After taking over the Ministry of Finance in 1928, he became prime minister in 1932, steering his country through World War II and much of the latter half of the century. During his reign, Salazar created a new constitution, government structure and plans for economic development that held throughout his tenure.

Not until after his death did opposition within the governing National Assembly, economic crisis, and colonial policy in Mozambique and Angola undermine the government. The 1974 Captain's rebellion consisted of a core 200 service captains whose primary objective was to end the long, costly wars that vainly attempted to continue Portuguese control of the African colonies.

A brief period of communist rule followed from 1974 to 1976, but a new constitution quickly replaced them, completing the country's shift to democratic socialism. A number of governmental variations on the same socialist theme followed. In 1983, Mario Soares' Socialists held a coalition government with the Social Democrats long enough to implement a program to control the severe economic problems plaguing Portugal. After an 18 month emergency program and a four-year modernization program, Portugal gained admittance into the EEC in 1986 (Britannica 1059-1060).

The Mexican Experience

Porfirio Diaz's rule closely resembled that of Salazar and Franco. From 1876 to 1911, he dominated Mexico. He emphasized economic development through a policy of *"pan o palo"* (bread or the club). This meant that conforming to his government would guarantee a livelihood, even prosperity, but objection would just as surely guarantee harassment, imprisonment, or death. With such a system, Diaz established a stable economy that attracted foreign investment for the construction of infrastructure and, most importantly, oil production.

The success of the Diaz regime ultimately led to its demise. A growing middle class, cleansed by years of relative prosperity, forgot the suffering before Diaz and began to question the need for total obedience to a dictatorship. Acts of opposition brought acts of repression onto the Mexican people, which only enflamed revolutionary sentiments. By 1911, enough citizens had joined former presidential candidate turned

revolutionary, Francisco I. Madero, to overthrow the aged, inefficient government and army. The country continued to wage civil war until a constitution could be written in 1917.

Relative calm fell over Mexico after 1917. Power passed successfully until 1928, when the assassination of the next president caused the incumbent, Plutarco Elias Calles to form the single party system run by the National Revolutionary Party. This system, more than the Diaz regime, resembled the leftist governments of Spain and Portugal under Franco and Salazar.

Under General Lazaro Cardenas' presidency in 1938, the Mexican government nationalized the petroleum industry. These and other actions effectively removed foreign power from Mexico. It also began the process of economic slowdowns, due largely to socialist reforms on the part of Cardenas.

The US and Mexico resolved hostile relations during World War II and Mexico benefited from smooth political and economic progress for the next thirty years. During this time, the National Revolutionary Party changed its name to the Institutional Revolutionary Party (PRI).

Ironically, international loans used to finance the economy during the 1970's eventually led to the near bankruptcy of the state—a state that so adamantly opposed foreign influence earlier in the century. The government assumed that they would pay for the nearly $80 billion in loans with the revenues gained from oil production of reserves found in the Tabasco and Chiapas states in 1976. Unfortunately, sharply falling oil prices in the early 1980's made payment of even the interest on the debt impossible. Presidents Jose Lopez Portillo and Miguel de la Madrid Hurtado feverishly combated a period of triple digit inflation, high unemployment, and flight of Mexican capital abroad.

Austerity measures, such as the nationalization of the country's banks and foreign currency controls set in place in the 1970's and early 80's, took nearly a decade to make an impact. Not until the election of Carlos Salinas de Gortari in 1988 did Mexico emerge from the "lost decade" (Britannica 45-47; Wood, "Respect Restored" S4).

Present Government: The move to the Right

Mexico

As Mexico's inflation rates returned from its vacation at the stratospheric level of 159 percent in 1987 to a more sedentary 12 percent in 1989, President Salinas did what that last two presidents had been unable to do; get to work (Wood, "Respect Restored" S3). The impetus the Salinas government's strategy is his vision that the world is forming into several distinct trade blocks. Mexico must join if it wishes to continue growing (S4). Foreign entry capital, this time in the form of investments, competition, and advice rather than loans, is essential, hence Mexico's push for NAFTA.

The singular nature of the government helped make Salinas' vision a reality. Without strong opposition, the PRI pushed through tough reform legislation that may otherwise have caused an electoral ousting. Indeed, many believe that the PRI fixed the 1988 election in order to prevent an opposition party win. Fortunately, Mexico began to receive some of the benefits from the years of strict monetary policy just in time. GDP growth is finally increasing at a rate of 2-3 percent annually (Peagam, "Booming" S12). Part of the timeliness is due to the dirty job of austerity measures undertaken by the previous presidents, but credit must also be reserved for the current administration and its depth of talent.

> Aided by a circle of ministers boasting—as he does—post-graduate degrees in economics from America's best universities, the president has been able to transform the country. Mexico probably has the most economically literate government in the world. It is certainly one of the few countries where the economics profession is still revered rather than held in contempt.
>
> (Wood, "Respect Restored" S4)

Under Salinas and his crew, the government deficit fell from a frightening level of 16 percent of the GDP in 1987 to a surplus of 1 percent in 1992. The $12.4 billion raised during privatizations of banks, plus the money earned in other similar measures with other industries, cut outstanding public-sector debt to 39 percent of the GDP, a full 20 percent lower than the debt figures in the US and Japan (S3). These measures encouraged confidence from both domestic and foreign

investors. Since it began reforms of the government and banking system, about $4 billion in flight capital has returned to Mexico, along with $20 billion in new foreign capital in 1991 alone (Hennessy F13).

Fear of US domination is another, more subtle, hurdle that the Salinas government successfully cleared before NAFTA. Mexico and its people now envision themselves as an up and coming player in the international arena; its dependence on the US for capital forming a fraternal rather than a paternal bond (Wood, "Respect Restored" S4).

The government itself may be a final obstacle in the way of an economic victory for Salinas. The enormous multitude of laws and decrees created by the state since its conception hampered efforts to swiftly make changes necessary for economic reform. Thus, reform within the government was necessary. In 1989, Salinas chose Santiago Levy, a technocrat in the Salinas administration and an economics professor at the private Mexican university, ITAM, to head the office of deregulation. The office set about clearing up the cobwebs of bureaucracy that cluttered the Mexican state for over 70 years (Wood, "House Cleaning" S18).

The domestic trucking market is a prime example of the deregulatory office at work. Company freight costs fell by 25 percent as the office lifted price controls and restrictions on the market. Levy also removed rules forcing trucks to travel empty of cargo because they could or couldn't load freight at certain points.

Cleverness of Senor Levy's caliber remains markedly absent outside the government, though. Years of statism and anti-capitalist sentiments placed undue importance on jobs in the government, drawing the best and brightest to the public sector, leaving the private sector with a marginal worker pool (S19). The government managed to suck the economic wealth of the country up for itself in the past. In 1988, the government used over 50 percent of available credit, but that is quickly changing. Those figures dropped to only 15 percent in 1992 ("Suddenly" 25). The real crime is the theft of intellectual wealth from the financial and industrial sector, an asset not so easily replaced (Wood, "House Cleaning" S19).

Spain

The relative political stability of Mexico from the 1920's until the 1970's contributed to the quickness of the government's turnaround in the

1980's. Spain and Portugal political positions were more precarious when the economic troubles of the 1970's began.

As Juan Carlos began his term as king of Spain, he found himself responsible for the enviable yet ominous task of reforming the government into a full democracy. Within two years, a minority government formed, immediately initiated reforms, and created a new constitution. Members of the Civil Guard threatened the delicate beginnings of democracy, however, when they attempted a military coup in 1981. Juan Carlos personally intervened during the crisis, cutting short the overthrow attempt. As a result, the event served to strengthen the position of both Carlos and the government.

The final test came during the elections of 1982, when a socialist majority beat the original minority government. Governmental power changed hands peacefully, and the new administration began attacking problems of the state.

The swiftness with which Mexico is switching to a market driven economy is unparalleled in Spain. Unfortunately, the price of democracy is often democracy. Fear of upsetting voters, or worse, having voters lose their jobs, challenge any change and harsh cuts necessary to reform both the economy and the banking sector. Only EC regulations or competition can force deregulation and improvements in the economy to occur.

Entry into the EC and, more recently, entry into the Economic Monetary Union now underlies any motivation for economic reform. Government's focus concentrated on achieving the four economic goals set forth by the Maastricht treaty and conforming to full integration of capital, labor, goods, and services by 1993. The efforts lowered inflation rates and disproportionately raised interest rates in order to keep the exchange rate within its band. In return, the economy slowed, caused by steps taken that have sometimes been detrimental to the banking industry (Spain "Will" C7).

One tactic for meeting debt ratios and exchange rates for 1993 involved forcing banks to place 30 percent of borrowing in foreign credit into the central bank, even though the banks paid interest on the total amount. One foreign bank complained, "We're all having to pay for the fact that the Bank of Spain does not know how to control its exchange rate. It's a Third World-type move ("Knock" 65)."

Financing the public deficit by making Spanish banks buy treasury bills with 10 percent of all deposits and enforcing an unusually

high reserve requirement has also hurt banks. Before EC integration removed the requirements, Private Banking Association chairman Rafael Termes argued against the restrictions by saying, "If the government got rid of the T-bill ratio and reduced to a reasonable level the reserve requirement, it could stop worrying about the banks' capacity to compete with the EEC, because banks would take care of the rest (Chislett, "From Minnows" 67)."

Fortunately for the banking sector, the competition of 1993 took these tools out of the hands of the Spanish government. EC freedom of capital requirements gave Spain no choice but to lift credit restrictions and limits on foreign borrowing, unless it wished for foreign competition to overwhelm its banks (Chislett, "No End" 41). From now on, for the government to control debt, it will have to reduce costs, not increase revenue. To reduce inflation, interest rates, and stay within the ERM, it will have to control its money supply, not its banks.

Portugal

The coalition government under Mario Soares' Socialists and the Social Democrats lasted long enough to gain admittance into the EEC. The Socialists fell soon afterwards, in 1985. Anibal Cavaco Silva, leader of the right wing, became head of the Social Democrats. Amidst nationwide strikes and political demonstrations calling for an end to the coalition government, the Social Democrats became the largest single party in Portugal. Cavaco Silva became the prime minister, and Soares became the first civilian president of Portugal in 60 years.

The move by Silva in 1985 cemented many of the goals of the previous administration to join the EC. The idea of a free market economy, once so foreign to Portugal, had now become a priority. Trouble with implementing a plan for such a goal begins and ends with that same inexperience with the system. Government and industrial structure are still struggling to adapt to the free market system.

A significant trouble with the government of Portugal, as with Mexico, is the staggering number of laws and regulations that overlap and slow down attempts for change. Whereas Mexico chose to cut out the regulations, Portugal chose to add more. In the financial sector, for example, a White Book contains the codified changes for the financial sector. In one section, credit institutions are broken down into three main categories: state-owned companies; commercial and investment banks; and specialized credit institutions. Any new law in the White Book ends the legal power of any old laws.

Such a concept for reform is very representative of the Latin culture of all three countries. Codified law is a practice of southern Europe, existing since Roman times and solidified through the Napoleonic codes. By its nature, such law produces inflexibilities and because of its resistance to change, slows down procedures as the rules set down by the legislatures become antiquated. This type of legal system impeded efforts to move away from the state controlled economy. The codes first necessitated the development of new codes in the legislature before they could take effect. Also, the character of the codified law sank into the culture of the Latin people.

To a degree, this form of law, along with the centrist history of the countries, encouraged dependence on the state for initiative and support throughout any commercial endeavor. The dependence then encouraged the state to make more rules concerning the conduct of business. In addition, the idea of changing the system and mind set of the people is an awesome one, considering the lack of desire to change and the potential hardships that change can incur.

As a result, until recently, the use of banks to affect the monetary policy continued to be a favorite tool of the Portuguese government. Reserve requirements at 17 percent and severe foreign currency limitations cut the competitiveness of banks. Low interest assets and bad loans to public enterprises in the past also hurt, but provided easy money for the state. Credit ceilings most hurt smaller private banks and foreign banks because they couldn't produce the high capitalization and volume of long-term deposits necessary to turn a profit (Blum, "Energizing" 51). Banks have tried to get around restrictions, but government undermined their efforts.

> The two-monthly credit ceilings are now enforced every two weeks. "Before everyone knew what to do," says Carlos de Frias, a senior officer of Banco Commercial Portuguese in Lisbon. "At the beginning of every two-month period, every bank would lend aggressively and then call the loans in before the end of the period to satisfy the regulations. You can't do that with fortnightly ceilings."
>
> (Evans, "Late Frost" 67)

> "The new rules seriously distort the market," complains Rodrigues. "The financial system is modeled around one basic need: funding the government's huge deficit. All the regulatory jargon is used just to try and disguise this fact."
>
> (68)

The Portuguese state is less able than the Spanish to lose the socialist views which have held back its industries for so long. Regardless of their view, the EC removed restrictions on foreign and domestic banks by the end of 1992 (Warner 14).

Public debt is a major factor influencing the continued policy, as is inflation. The public sector debt/GDP ratio is still above acceptable levels stipulated by the Maastricht treaty for monetary union. Inflation neared double the European average in 1992, due in part to the governments determination to keep the escudo in the ERM system. Since then, it has sunk to 6.3 percent. Unemployment, unlike Spain's 20 percent, is at a respectable 4.5 percent (Kochan 135; Humphreys, "Portugal Plumps" 103-104).

Without help from EC infrastructure inflows, the situation would probably be considerably worse. In December 1992, the European council doubled the structural funds entering Portugal until 1999. Inflows from that source alone accounted for 3.5 percent of the GDP in 1992, and sustained the GDP for the country between 1986 and 1992 at 3.8 percent, 1.2 percent above the EC average. Spain receives similar funds and both also receive money from the Organization for Economic Cooperation and Development (OECD). Even with the inflows, recession and tighter policies reduced the GDP to less than 2 percent in 1993 (103-104).

Significantly affecting both Portugal and Mexico, is its size in relation to the rest of the EC, especially its neighbor Spain. In terms of the size of the economy, Spain ranks fifth-largest in the EC, while Portugal is tenth. Portugal is also geographically isolated from the rest of Europe by its position to the west of Spain. Thus, it is dependent on its roads, rail, and electricity grid to contact the EC by land. Spain has consistently dominated trade and investment between the two. Although the trade gap is narrowing, Portugal still had to pay $1.1 billion for the 40 percent of imports not covered by its exports in 1989 ("Not Quite Kissing Cousins" 21-22). Such a position poses a threat to a government and people whose ideas of nationalism are still strong.

Banking
Past and Future

Concrete comparisons can be made between the Iberian countries' and Mexico's political and economic structure. All three countries experienced economic slowdowns under state-controlled economies.

As controls lessened, economic growth expanded, but each experienced a crisis during the 1970's into the 1980's: a period marked by high inflation and a build-up of public debt. Nationalization occurred around this time, and banks became heavily regulated. State control greatly reduced the efficiency and the financial health of the organizations as bad loans and over-staffing became the norm. Restrictions on banks contributed to downturns. Government severely limited banks' decision-making capacity and ability to evolve beyond the limits of a state enterprise.

Several years after the privatization of banks in Spain and Portugal, the banks took the opportunities that a liberalized economy gave them and developed strategies unique to each other. Each of the banks carried different strategies to enter adapt to the EC. The strategies depended on an element of each of four main categories 1.) the size of the bank; 2.) the type of bank; 3.) the management that took over the bank when it was privatized; and 4.) the type of demanding clientele.

More subtle variations exist, but in order to make a comparison of the effect of liberalization of markets on the banking sector. The most extreme, characterizing parts of each category serve as the best models. Four banks from the Iberian peninsula each achieved a degree of success, employing markedly different strategies, each from a different background. The four are Banco Central of Spain; Banco Espirito Santo & Comercial de Lisboa (BESCL) of Portugal; Banco Santander of Spain; and Banco Comercial Portugues of Portugal (BCP).

Banco Central

As much as BCP represents the modern capitalist version of a bank, Banco Central represents banks at the height of nationalization. The sheer size of Banco Central's 2,800-branch system demonstrates the attributes of a national champion. During the mid-1980's, Banco Central was the largest bank in Spain with domestic operations employing over 24,000 employees and carrying 2,900 branches.

Industrial holdings are vast even today. A current market value estimate is Ptas300 billion (Sington, "Spain's Sluggard" 62-64).

Inefficiency is another hallmark of Banco Central and its employees. Information and credit-risk analysis systems are considered antiquated and employee productivity is low, as are employee salaries.

> In terms of operating cash flow on ATA, Central staff recorded little more than Ptas4 million a head in 1989, dividends included. Santander staff recorded Ptas6.7 million and Popular staff 7.4 million. Says one analyst: "Central staff aren't good, but they're cheap."
>
> (64)

Return on assets [ROA] isn't much prettier. Against the 2.51 average ROA of the Spain's seven largest banks, Central rates 0.47 percentage points below. With non-banking business excluded, the figures drop to 1.89 percent, which is 0.62 points below that average.

Septuagenarian Alfonso Escamez Lopez takes full responsibility for the results of his bank. His presidency lasted almost two decades. His rule was one of a strong-man. In his administration, delegating is minimal and directing is maximal.

> Escamez controls everything he thinks important," says a senior Spanish banker, "including all the biggest clients. Valls [president of Banco Popular] only controls the clients who get into trouble, to decide when credit should be stopped.... At Banco Central any kind of important decision will be taken by the chairman.... Management moves like an elephant.
>
> (62)

With a record like Banco Central's, it's a wonder that it is even operating, but Escamez has a plan, and so far it is working against the odds.

When the Spanish government finally released the banking sector from the many financial controls it had placed on banks during nationalization, most were quick to divest themselves of the burden of industrial loans and minimize industrial holdings. Some, like Banesto, sold struggling industrial assets in order to maintain profitability and conform to new ceilings limiting a bank's exposure to industry from 40 percent of equity to 20 percent over six years (Parry, "Will" 136).

Banco Central has no such problems. Industrial holdings, such as Compania Espanola de Petroleos and Autopistas del Mare Nostrum, are among the healthiest and most profitable in their sector, constituting almost 3 percent of the Spanish GDP ("Spanish Merger" 7;). Although in the medium term they may falter, in the long term, Central can hold out until economic prosperity returns (Sington, "Spain's Sluggard" 66).

In the end, the greatest asset Banco Central owns may be Escamez himself. The unorthodox strategies that he believes in may be the very ones that have kept Central in the running so long. The balance is a precarious one though. Much is dependent on the unique relationship he holds with the clients of the bank. The majority are retail clients with low-incomes and basic needs, reached by the vast network of branches in some of the poorer parts of Spain. A corporate commercial market, capital gains, dividends, and low-yielding loans from industrial holdings, and foreign loans also helped support the resulting low profitability (61-62).

All of this is just fine with Escamez. This is a point he proved when Banco Santander instigated a deposit war by offering high interest rates on the *supercuentas*, Banco Central did not bite. Instead, Central maintained its current strategy and emerged relatively unscathed. Client base was again a major reason for the strategy's success. Interest on *supercuentas* only paid to customers who held several million pesetas in the accounts, which Central's low-income clients didn't have. Also, competition was the driving force behind the war. In most cases, Central's branches only have one local competitor, so competitive incentives are not needed (65-66).

His strategy has complemented his philosophy well. Escamez is still of the socialist school of first serving the community and the country, and lastly serving the margin and the shareholder.

> He thinks of the bank as a service to the citizen, as a tool to drive forward projects, to get businesses on their feet, to make things. The concept is of a bank that serves others. The bank that helps. And to work better it is necessary to grow. In branches, in resources, in people.
>
> (63)

This is a goal that Escamez has achieved with zeal. From the time as head of the international department, he built up foreign branches, especially Latin American countries, to the point where Central's assets account for a little less than 20 percent of Spain's global total assets. Mergers at home have also been his responsibility. As director-general,

he handled takeovers of five banks, and as head, he took over an additional three Spanish banks, making it the largest bank in Spain by the 1980's (63).

Nevertheless, the traditional era of Banco Central drew to a close. In 1991, Banco Hispano Americano merged with Banco Central to form Banco Central Americano. With it, a new management style emerged along with a more transparent accounting criteria. Under Central, the bank often used accounting ruses to improve numbers in the profit-loss account. Another favorite trick was to sell shares in industrial holdings to the company's subsidiaries at book value. The subsidiaries then sold them on the market and paid dividends to Central with the capital gains, who incorporated them into net income (Chislett "No End" 42). For an instant, though, Alfonso Escamez Lopez made the old ways work for him.

Other banks are proving that privatization can bring new opportunities, change, and profit. Banco Espirito Santo & Comercial de Lisboa and Banco Santander are cases in point. Still, each has created a different, successful approach.

Banco Espirito Santo & Comercial de Lisboa

Before the nationalizations in 1975, Group Espirito Santo was one of the powerful banking families of Portugal. Revolution brought exile to the family, but not an end to the hopes of one day buying back from the government the bank that it had founded.

> [Between 1975 and 1992] the family bought stakes in banks in London, Paris (Societe Bancaire de Paris) and Brazil. They have a stake in a bank in the US (Espirito Santo Bank of Florida), a fund management company in Lausanne, and their holding company is based in Luxembourg. Shortly after returning to Portugal, the group bought Banco Industrial del Mediterraneo, a small Spanish bank with a group of branches close to the Portuguese border.
> ("Home Free" 151)

In addition, Group Espirito Santo re-bought its old insurance company, Tranquilidade and purchased an investment bank, ESSI, a broker, ESER, and a private bank Banco Internacional de Credito (150).

Size ranks BESCL (Portuguese banking section only) as the third largest retail and commercial bank in assets, and second in terms of profitability. Of the $15 billion holding company, Group Espirito Santo,

BESCL is the largest asset at $11.6 billion. It captures 7.5 percent of the deposits and 8 percent of the loans in Portugal (151).

Part of the present success of BESCL is attributable to wise management during nationalization. The system and credit policy of the bank before nationalization remained much the same. Management kept government loans and bad risks to a minimum. Conservatism still reigns at BESCL. Growth in credits for the system as a whole rose 22 percent in 1991, but only 17 percent for Espirito Santo. Loans and investment have also been slow to accumulate. BESCL is extremely cautious about the risk of economic crisis in Portugal.

Technology and work force were the only major drawbacks to arise out of nationalization. Staff grew from 4,000 to 6,800 and people per branch rose to 29. An increase in the number of branches helped reduce this number to 27, along with a cut in staff to 6,000. Heavy investment in information technology also brought the bank up to date.

Espirito Santo was aggressive in recruiting help from outside the company to develop management strategy. Through management consultants McKinsey Company, and French bank Credit Agricole, who as a friendly investor holds a 20 percent stake in the company, BESCL has developed both ESSI and itself. For ESSI, it took a leading role in the increasingly important project finance and corporate finance sector in Portugal. Its projects include the financing of the Pego power station project, gas projects, and the new bridge over the River Tagus.

BESCL also used the two advisors to develop skills and strategies to draw in the private client. Cross-selling is a major success between insurance company, Tranquilidade, and the bank. The bank now sells about 66 percent of the life products of the insurance company. Credit Agricole also earned an additional $4 billion a year for BESCL by introducing them to the business of moving emigrants' remittances from France to Portugal (ISI).

Espirito Santo took a traditional banking family and adapted it from rural roots to the growing needs of the Portuguese economy. Banco Santander did much the same thing in Spain, but with a riskier edge.

Banco Santander

The deposits war waged by Spain's biggest banks in September of 1989, was widely know as the victory of Banco Santander's; a masterful display of what aggressive marketing and high risk can reward. Through the introduction of the high-yield *supercuenta*, Santander increase its market

share of total deposits by 50 percent, from 3.5 percent to 5.2 percent. In 16 months, it captured 15 percent of total new deposits. Average cost of deposits rose from 7.33 percent to 8.51 percent. Staff rose by 1,493, but consolidated pre-tax profits rose by 18.25 percent to Pta96.1 billion ("Well Placed" 18).

> We thought that someone would do it sooner or later. From international analysis, we thought the one that struck first would be the winner. The only risk was that somebody else would jump first.
>
> (Evans, "Leaders" 29)

The goal of Banco Santander is market share at the expense of operating profits, which fell by 5.6 percent. Asset soundness also tempers the aggressiveness. As with Mexico, Spain's banking criteria are remarkably high, but Santander's capital-adequacy ratios are higher than those criteria at around 13%, and higher than the '85 minimum set by Basel's Bank for International Settlements (BIS) for 1993 at 8% (Chislett, "No End" 41-42).

At this moment, Santander is extremely well placed. It is the fifth largest and most technologically advanced of the banks of Spain. Its branches eliminate paperwork with fully computerized links to national and regional offices. Its number of employees per branch is low at 9.7 (Chislett, "Changing the Rules" 62; Sington, "Defending El Dorado" 53).

Despite enormous consolidated assets increased by the *supercuentas*, domestic mergers are not in the cards. Banco Santander's focus is on establishing an international network. It is already in collaboration with the Royal Bank of Scotland, and has acquisitions in West Germany, Belgium, and Italy. Santander also created joint-ventures, the most profitable being an Anglo-Spanish operation, Banco NatWest March (55).

Banco Comercial Portuguese

Banco Comercial Portuguese has the final bank strategy. As a newly formed Portuguese bank in 1986, it had capital of Esc3.5 billion and staff of 255. By 1991, it had grown to 2,500 employees and had capital of Esc66 billion.

Youth and risk are the primary assets of BCP. The average age of employees at BCP averages 30, 10 years lower than the industry average (Humphreys, "Banking" 60-61). Its gains are largely due to faster, more efficient services available through modern techniques and the use of

computers (Blum, "Onwards" 48). Also in the formula for success is its entry into the retail market of Portugal, a sector dominated by large and inefficient banks, previously owned by the state (Evans, "Late Frost" 68-69). With this strategy, BCP is able to avoid much of the foreign competition that is slowly taking over the wholesale banking sector.

> If BCP runs a retail strategy it should be able to compete. They know this place and while a foreigner can get to know it well, it would have to be very sharp to beat them . . .
>
> (Shreeve 97)

A potential problem forming with BCP is the possibility of non-performing loans associated with the high risk, high growth strategy it has taken. "The worry is that in their scramble to put on weight, the banks are giving credit to anyone who can sign a contract," says one Portuguese banker. This may be the case, but for right now, success is in the hands of BCP.

(Humphreys, "Banks" 114)

Summary

Each of the four banks just cited represents a potential marketing strategy for Mexican banks as the Mexican economy evolves into a liberalized economy. Other factors may take effect. Government policy such as the new worker pension fund scheme will provide Mexican banks with a dramatic growth in deposits (Laurie 43). Inevitably, foreign banks will enter the economy. This is one of the goals of NAFTA. More important to the success or failure of the Mexican banks will be the decisions made by its own government.

Economic downturns are just beginning to hit the Spanish and Portuguese markets. As businesses fail, profits fall, and foreign products overtake some domestic ones, the temptation is for government to intervene, to protect. Inflation and unemployment may grow severe enough before disinflation and wage moderation sinks in that political pressure could force a reversion to old policies.

Mexico is protected to an extent by the dominance of the single political party, the PRI. Election of the next president in 1994 is almost guaranteed, given the success of the Salinas administration. Eventually, though, a real democracy must run the Mexican government. American pressures for democracy will only grow in the future, as will pressure from opposition political parties such as the National Action Party (PAN), the second minority party in Mexico (Wood, "Primitive Politics" S11).

A new democracy could bring instabilities, but the greatest strength of NAFTA, and other economic accords like it, is its stability. What NAFTA brings to Mexico and other developing countries, as seen in Spain and Portugal, is an institutionalized set of economic regulations and guidelines that provide a path to economic liberalization. In addition, it serves as a restraint to the government, taking economic policy out of the hands of administrations, whose policy could ebb and flow with the mood of the electorate.

The European Community tackled these factors in Spain and Portugal, and NAFTA will most likely have the same effect on Mexico. The determination of the people and the government of Mexico have made liberalizations all but a reality, as evidenced through the speed with which it has changed directions and opened its doors to the outside.

Bibliography

1. "Already at Home." *The Economist* 7 Sept. 1985: 94.
2. Blum, Patrick. "Energizing the Nucleus." *The Banker* Dec. 1989: 51-52.
3. Chislett, William. "Changing the Rules of Battle." *The Banker* Apr. 1989: 61-63.
4. Chislett, William. "From Minnows to Big Fish?" *The Banker* Apr. 1988: 65-70.
5. Chislett, William. "No End to the Fiesta." *The Banker* Apr. 1992: 41-43.
6. Evans, Garry. "Late Frost Grips the Banks." *Euromoney* Jun. 1989: 67-74.
7. Evans, Garry. "Leaders of the Pack." *Euromoney* Dec. 1990: 22-32.
8. Evans, Garry. "Looking on the Bright Side." *Euromoney* Mar. 1991: s3-s6.
9. Evans, Garry. "Steering the Middle Course." *Euromoney* Jun. 1993: 136-144.
10. Golden, Tim. "Mexico Sells Off Last of 18 Banks at Big Proit." *The New York Times* 7 July 1992, national ed.: c2.
11. Hennessy, John M. "Lessons from Mexico." *The New York Times* 15 Nov. 1992, national ed.: f13.
12. "Home Free and Looking to the Future. *Euromoney* Jun. 1993: 149-152.
13. Humphreys, Gary. "Banking on Privatization." *Euromoney* Jun. 1991: 60-61.
14. Humphreys, Gary. "Banks Act on Costs as Margins Narrow." *Euromoney* Mar. 1993: 112-114.
15. Humphreys, Gary. "Portugal Plumps for Posterity." *Euromoney* Mar. 1993: 102-106.
16. "Inch by Inch." *The Banker* May 1988: 100-101.
17. "Knock, Knock." *The Banker* Apr. 1989: 65.
18. Kochan, Nick. "The Treasury Goes Sparingly to Market." *Euromoney* Jun. 1993: 135-6
19. Laurie, Samantha. "Mexican Meltdown." *The Banker* Oct. 1992: 42-43.
20. Marray, Michael. "Privatisation Can Be a Complicated Process." *Euromoney* Sept. 1990: 163-165.
21. "Mexico." *Encyclopedia Britannica* 1993: 45-47.
22. "Not Quite a Revolution." *The Banker* Dec. 1990: 35-6.

23. "Not Quite Kissing Cousins." *The Economist* 5 May 1990: 21-24.
24. Parry, John. "Conde's Tour de Force" *Euromoney* Mar. 1993: 64-6.
25. Parry, John. "Will Tougher Regulation Hurt the Banks?" *Euromoney* Apr. 1993: 131-132.
26. Peagam, Norman. "Agreement Brings down Banking Barriers." *Euromoney* Jan. 1993: s26-s27.
27. Peagam, Norman. "Booming Banks Must Stay Vigilant." *Euromoney* Jan. 1993: s2-s15.
28. "Portugal." *Encyclopedia Britannica* 1993: 1059-60.
29. "Serenading the Pesetas: Spain's Banks." *The Economist* 28 July 1990: 66.
30. Shreeve, Gavin. "The Fear and Challenge of 1992." *The Banker* May 1988: 97-99.
31. Sington, Philip. "Defending El Dorado." *Euromoney* July 1989: 51-63.
32. Sington, Philip. "Spain's Sluggard May Laugh Last." *Euromoney* August 1990: 61-66.
33. "Spain." *Encyclopedia Britannica* 1993: 58.
34. "Spain Will Act on Inflation." *The New York Times* 22 Feb. 1989, national ed.: c7.
35. "Spanish Merger Fever Rages On." *The Banker* June 1991: 6-7.
36. "Suddenly this Summer." *The Banker* Apr. 1991: 22-27.
37. "The Best of the Bunch." *The Economist* 6 Apr. 1991: 79.
38. "The Big Sell-Off." *The Banker* Dec. 1991: 52.
39. "The North American Free Trade Agreement: financial Services." *Euromoney* Jan 1993: s27.
40. Warner, Allison. "Lisbon Looks for a New Line." *The Banker* Dec. 1992: 14-15
41. "Well Placed to Weather the Storm." *The Banker* Apr. 1991: 17-20.
42. Wood, Christopher. "A Latin Big Bang." *The Economist* 13 Feb. 1993: s16-s18.
43. Wood, Christopher. "Free Trade's Virtues." *The Economist* 13 Feb. 1993: s6-s8.
44. Wood, Christopher. "House Cleaning." *The Economist* 13 Feb. 1993: s18-s20.
45. Wood, Christopher. "Primitive Politics." *The Economist* 13 Feb. 1993: s8-s12.
46. Wood, Christopher. "Respect Restored." *The Economist* 13 Feb. 1993: s3-s4.