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The Foreign Conquest of Latin American Banking: What's Happening and Why?

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Executive Summary

International banks aggressively expanded into Latin America during the 1990s as democracies replaced authoritarian regimes and economic growth accelerated throughout the region. Foreign banks now control 45 percent of Latin America's banking assets. Mexico has the highest foreign ownership share at 84 percent, with only one big domestic bank left to be acquired. The two biggest banks in Spain have led the "conquest" of Latin American banking, accounting for slightly more than half of all foreign banks assets.

This paper documents the dramatic changes in the banking markets of the major Latin American countries brought about by the foreign penetration. It discusses the reasons for the greater presence of foreign banks and the impact of these banks on the allocation of credit. This is not only important but timely given the current economic and political turmoil in the region. This situation has created growing concern about increased foreign ownerships in local economies. Only through a better understanding of the role that foreign banks play in Latin America can one appropriately assess whether they benefit or harm local economic growth and development.

The Foreign Conquest of Latin American Banking: What's Happening and Why?[1]

I. Introduction

Latin America's real GDP grew at a fairly rapid annual rate of 5.2 percent from 1950 to 1980. This growth was interrupted by a foreign debt crisis, however. It began in Mexico in the early 1980s and then spread throughout the region. Economic growth thus slowed to a sluggish 1.4 annual percentage rate during the 1980s. The slower growth and resulting greater unemployment helped bring about a change in political regimes. Authoritarian regimes were replaced with democracies. The decade of the 1980s began with 12 democracies out of 26 countries in Latin America. By the end of the decade, all but five countries were democratic. Today only Cuba is not.[2]

The new political environment of the 1990s was accompanied by the deregulation of national financial systems and the easing of controls on capital flows and foreign currency transactions in many Latin American countries. Government-owned firms were also privatized throughout much of the region. These actions made it easier and more attractive for foreign firms to enter those countries in which reforms were implemented. As economies became more open, Latin America's economic growth increased to an annual rate of 3.5 percent from 1990 to 1998. This more favorable economic environment boded well for the market-oriented reforms.

Severe financial crises in the latter half of the 1990s disrupted the progress being made in Latin America, especially in Argentina, Brazil and Venezuela. This situation

[1] The authors are grateful for the excellent assistance of Cindy Lee and for very helpful comments from Harry Makler.

[2] See Alvarez, Cheibub, Limongi, Przeworski (1999) for information on the categorization of political regimes of countries around the world.

continues to the present time and has generated growing criticism of the so-called "Washington Consensus," i.e., the American-backed free-market model that is frequently used to characterize the reform policies pursued by countries in the region. If the turmoil continues, it most likely will further stiffen and broaden local opposition to freer trade among countries, to still more privatization of government-owned businesses, and to even greater foreign ownership of domestic firms.

The purpose of this paper is to examine an important aspect of the free-market model now common in Latin America. Specifically, we document and assess the recent and dramatic change that has occurred in the structure of banking markets in the region. The main focus is on the foreign "conquest" of Latin American banking. The striking penetration by foreign banks, particularly Spanish banks, into the domestic banking market, throughout the region is due to a variety of factors. Many of the more important factors in explaining this expansion will be examined and whenever possible evidence regarding their importance noted. Some of the broader effects of the increased foreign bank presence on several aspects of financial and economic activity will also be discussed.

The remainder of the paper proceeds as follows. Section II provides an overview of some data and statistical measures that demonstrate the importance of a nation's financial system for economic growth and development. This overview includes a discussion of the overall size of a financial system as well as the major constituent components of such a system. Section III presents information on the wide disparity in the size of the banking sectors for different Latin American countries. Information on differences in output structure across countries is also presented and its implications for the allocation of credit within countries mentioned. Since six countries dominate the region in several important dimensions, a more detailed discussion of the changing structure of the banking industry of

each of these countries is provided. This includes a discussion of differences in the structure, scope and independence of bank supervision in these countries. It also includes a discussion of what the term "bank" means in these countries. Section IV presents data showing differences in the allocation of credit and the performance of foreign-owned and domestic-owned banks in the dominant six countries. Section V discusses several key questions raised by the recent changes in the structure of banking in Latin America. Section VI provides more recent data and a few remarks about the two biggest Spanish banks that have expanded into the region. The last section contains the conclusions.

II. An Overview of the Importance of Financial Systems

There has recently been a tremendous resurgence in interest in the relationship between finance and economic growth. The figures presented in Table 1 underscore the reason for this interest. High-income countries account for 81 percent of the world's GDP but only 18 percent of the world's population. Low-income countries, in contrast, account less than 3 percent of the world's GDP but 34 percent of the world's population. High income countries also account for 94 percent of the world's total financial assets, whereas low-income countries account for less than 1 percent.[3] These figures clearly document the striking and alarming inequality in the distribution of world income and financial assets among countries. At the same time, they support those who believe efforts should be made to encourage and assist poor countries in doing more to develop their financial systems so as to promote economic growth and development.

[3] Latin America, in comparison, accounts for 8.3 percent of the world's population, 6.2 percent of the world's GDP, and 1.1 percent of world's total financial assets.

Table 1
National Financial Systems Promote Economic Growth
(1999)

	High Income Countries	Upper Middle Income Countries	Lower Middle Income Countries	Low Income Countries	*Latin America*
Population	17.8	11.4	37.0	33.8	*8.3*
GDP	80.5	9.7	7.2	2.6	*6.2*
Bank Assets	93.2	4.5	1.3	1.0	*2.2*
Equity Market Capitalization	93.4	4.0	2.0	0.7	*1.6*
Bond Market Capitalization	96.8	2.1	0.7	0.5	*0.8*
Total Financial Assets	94.3	3.6	1.4	0.7	*1.1*

Note: Economies are divided among income groups according to 1999 GNI per capita, calculated using the World Bank Atlas method. The groups are: low income, $755 or less; lower middle income, $756–2,995; upper middle income, $2,996–9,265; and high income, $9,266 or more.
Source: *Statistical Abstract of the United States: 1999*, U.S. Census Bureau; *World Development Indictors*, World Bank; World Bank and OCC Bank Supervision and Regulation Database; *Size of World Bond Market Capitalization*, Merrill Lynch

Table 1 specifically shows that there is positive relationship between the income-category's share of GDP and its share of total financial assets as one moves successively from the lower to the higher income categories. It also shows that this relationship holds for each of the three separate financial components of the total. As one moves successively up the four income categories starting from the lower-income countries and ending with the high-income countries, the corresponding shares of world GDP, bank assets, equity-market capitalization, and bond-market capitalization accounted for by those categories all increase in tandem. It is clear from the table, moreover, that banks become increasingly less important than equity and bond markets as the level of income increases. Indeed, world equity-market capitalization tripled and world bond market capitalization almost doubled during the 1990s. World bank assets remained relatively flat, however. In today's world, mature economies simply do not need the size of banking systems established in their earlier

and more formative growth years. Even in such bank-centered countries as Germany and Japan the dominance of banks has declined relative to stock and bond markets over the past decade.

Some additional evidence to underscore the importance of finance for growth is presented in Table 2. This table contains the empirical results of several simple cross-country regressions. Although these results are only meant to be suggestive, they nonetheless emphasize that the size, composition, and ownership structure of a country's financial system may importantly affect its level of economic development (as measured by real GDP per capita). They also emphasize that the tightness of the restrictions a country places on allowable bank activities may importantly affect its level of economic development. The results in the table indicate the following:

- The size of a nation's financial system (i.e., bank assets, stocks, and bonds) is positively and significantly correlated with economic development. Levine (1997) provides an excellent review of the evidence linking finance and growth. Also, the importance of finance for growth is documented in the recent and comprehensive book by the World Bank (2001).
- All three of the individual components comprising a nation's financial system are positively and significantly correlated with economic development. Levine and Zervos (1998) and Beck and Levine (2001) in rigorous studies find that both bank credit and stocks promote economic growth.
- The composition (i.e., bank assets relative to stocks and bonds) of a nation's financial system is not significantly correlated with economic development. This is consistent with the view that banks and capital markets should be viewed as complements, not as perfect substitutes for one another. Policy should therefore

not favor the development of banks at the expense of capital markets, or vice versa. Demirgüç-Kunt and Levine's (2001) important book provides analyses that document the complimentary nature of banks and capital markets.

- The government-owned share of a nation's bank assets and economic development are negatively and significantly correlated. This is consistent with La Porta, Lopez-De-Silanes and Shleifer's (2002) finding that government ownership of banks is negatively associated with income per-capita. Barth, Caprio and Levine (2002), moreover, find that government ownership is negatively associated with bank development, which, in turn, has been shown in other studies to be positively associated with economic growth. This evidence supports the view that market-oriented privatization programs promote economic growth and development.
- The foreign-owned share of a nation's bank assets and economic development are not significantly correlated, either positively or negatively. This suggests, at the very least, that allowing foreign-ownership of domestic banks is not harmful. Importantly, Demirgüç-Kunt, Levine, and Min (1998) find that it is the foreign-owned share of the number of banks, not the share of total assets, that is positively and significantly related to economic growth. A greater presence of foreign banks, even without gaining greater asset share, can promote growth through competitive pressures and thus efficiency gains throughout the domestic banking sector. This is consistent with the view that market-oriented reforms that ease foreign-bank entry restrictions yield economic and social benefits.
- The government share of a nation's bond-market capitalization and economic development are negatively and significantly correlated. Although there is little

evidence bearing directly on this relationship, Domowitz, Glen and Madhavan (2001) do find that macroeconomic stability is highly and positively correlated with the development of bond markets. Also, Herring and Chatusripitak (2000) state that "[a]s the Thai example shows, bond markets matter for financial development. Certainly an economy can grow rapidly without an active bond market. But the cost is an increased vulnerability to a financial crisis and a loss of information to guide savings and investment decisions."

- Tighter restrictions on the allowable activities of banks and economic development are negatively and significantly correlated. This is consistent with the view that broader powers for banks (e.g., universal banks) promote economic growth and development. Barth, Caprio and Levine (2001) find evidence that such restrictions retard bank development. And, based on the work of Beck, Loayza and Levine (2001), lower bank development adversely affects economic growth.

Table 2
Simple Regressions Between Real GDP per Capita and Selected Measures of the Size, Composition and Restrictions of a Nation's Financial System
Dependent Variable: Real GDP per Capita

Independent Variable	Coefficient (t-stat)	R^2	Number of Countries	Relationship
Bank Assets, Equities, Bonds / GDP	0.02 (2.94)***	0.22	33	Significantly Positive
Bank Assets / GDP	0.01 (4.11)***	0.19	74	Significantly Positive
Equity Market Capitalization / GDP	0.08 (5.61)***	0.29	78	Significantly Positive
Bond Market Capitalization / GDP	0.18 (4.76)***	0.39	38	Significantly Positive
Bank Assets / Equities and Bonds	-0.01 (-0.54)	0.01	33	None
Percent of Bank Assets Foreign Owned	-0.02 (-0.39)	0.00	81	None
Percent of Bank Assets Government Owned	-0.13 (-2.80)***	0.08	88	Significantly Negative
Overall Restrictions on Bank Activities	-8.35 (-5.11)***	0.22	97	Significantly Negative
Government Bonds / Bond Market Capitalization	-0.18 (-2.43)**	0.14	37	Significantly Negative

Note: **,and *** denote 5%, and 1% level of significance, respectively.

These types of correlations, of course, are only suggestive. They do not rigorously demonstrate that finance promotes economic growth and development. Nonetheless, it is widely agreed that financial systems do indeed mobilize savings, allocate savings and monitor firms, and augment liquidity and facilitate risk management. And it is in providing these services that one would expect finance to be an important driving force in promoting growth. Yet, some researchers express concerns about even rigorous empirical analyses demonstrating that such a relationship exits, and most importantly question whether there is a causal linkage running from finance to growth. The argument is that important factors affecting growth might be omitted, individual country-specific traits might be ignored, and/or endogeneity might not appropriately be taken into account in empirical studies of finance and growth. In response to these concerns, researchers have included in their analyses a variety of plausible conditioning or control variables, employed panel methods to

allow for unobservable country specific heterogeneity, used plausible instrumental variables, employed firm-and industry-level data, used time-series data and methods, and performed individual country case studies. Some of the most rigorous and convincing recent studies finding a causal linkage between finance and growth include those by Beck, Loayza and Levine (2000), Demirgüç-Kunt and Maksimovic (1998) and Levine and Zervos (1998). The growing consensus based on the findings of these and other recent studies is that there is currently sufficient evidence to conclude that financial systems do indeed promote economic growth and development.

III. The Structure of Banking in Latin America

A. Some Basic Differences Across Countries

There are wide differences in population, GDP, and bank assets among Latin America countries. Table 3 documents that this is indeed the case for 26 countries. Brazil and Mexico clearly stand out from the others in terms of all three measures. They are the biggest by far in terms of these measures. Together they account for more than half of the region's total population, GDP and bank assets. Several countries do rank higher than these two countries on a GDP per capita basis. This is particularly the case for the Bahamas and Barbados. Some countries also rank higher than Brazil and Mexico when comparing bank assets as a share of GDP. This is particularly the case for the Bahamas and Panama. But on the basis of the absolute measures rather than ratios among the measures Brazil and Mexico are clearly dominant.

Table 3
An Overview of Latin American Countries: Population, GDP and Bank Assets (2001)

Country	Population (000s)	GDP (US$ Millions)	GDP per Capita (US$)	Bank Assets (US$ Millions)	Bank Assets / GDP (%)
Argentina	**37,385**	**268,697**	**7,187**	**99,717**	**37**
Bahamas	298	4,971	16,681	108,381	2,180
Barbados	275	2,484	9,033	2,392	96
Belize	256	786	3,070	557	71
Bolivia	8,300	8,002	964	4,794	60
Brazil	**174,469**	**504,030**	**2,889**	**303,806**	**60**
Chile	**15,328**	**66,450**	**4,335**	**47,355**	**71**
Colombia	**40,349**	**82,720**	**2,050**	**26,543**	**32**
Costa Rica	3,773	16,157	4,282	6,829	42
Dominican Republic	8,581	21,395	2,493	9,131	43
Ecuador	13,184	17,896	1,357	7,296	41
El Salvador	6,238	13,739	2,202	N/A	N/A
Guatemala	12,974	18,716	1,443	5,595	30
Guyana	697	698	1,001	571	82
Haiti	6,965	3,685	529	1,056	29
Honduras	6,406	6,386	997	3,296	52
Jamaica	2,666	9,846	3,693	4,669	47
Mexico	**101,879**	**617,865**	**6,065**	**242,563**	**39**
Nicaragua	4,918	2,536	516	1,995	79
Panama	2,846	10,171	3,574	24,500	241
Paraguay	5,734	7,175	1,251	2,457	34
Peru	27,484	52,942	1,926	20,523	39
Suriname	434	749	1,726	357	48
Trinidad & Tobago	1,170	8,323	7,114	4,715	57
Uruguay	3,360	18,662	5,554	19,983	107
Venezuela	**23,917**	**126,158**	**5,275**	**23,831**	**19**
Total	509,886	1,891,239	3,709*	972,912	51*
Memo:					
Spain	40,038	583,656	14,578	908,857	156

Source: Population, *Statistical Abstract of the United States*; GDP, *World Economic Outlook Database*, IMF; Bank Assets, *International Financial Statistics*, IMF.
Note: * denotes the average value.

The same basic information is presented for Spain for comparative purposes. Spain has less than one tenth of the total population of these 26 Latin American countries, but nearly one third of their collective GDP. Spain's banking system, moreover, is not much smaller than the combined systems of all these countries.

The Latin American countries also differ with respect to the structure of output. Table 4 specifically shows that there are wide differences among these countries in terms of the contribution that agriculture, industry, manufacturing (which is a subcomponent of

industry), and services make to GDP. The most significant differences involve agriculture, ranging from a low of 2 percent of GDP in Trinidad and Tobago to a high of 28 percent in Haiti. Perhaps not surprisingly, the correlation between agricultural's GDP share and real GDP per capita for these countries is negative and highly significant. Furthermore, service's GDP share is significantly and positively correlated with both bank assets relative to GDP and real GDP per capita. As countries grow and develop their economies, they become increasingly service oriented and less agriculture dependent. This is also seen in the corresponding figures in the table for Spain.

Table 4
Structure of Output in Latin American Countries
(2000)

	Agriculture (% of GDP)	Industry (% of GDP)	*Manufacturing* (% of GDP)*	Services (% of GDP)
Argentina	**5**	**28**	***18***	**68**
Bahamas	N/A	N/A	*N/A*	N/A
Barbados	6	21	*9*	73
Belize	21	27	*17*	52
Bolivia	22	15	*13*	63
Brazil	**7**	**29**	***24***	**64**
Chile	**11**	**34**	***16***	**56**
Colombia	**14**	**31**	***14***	**56**
Costa Rica	9	31	*24*	59
Dominican Republic	11	34	*17*	55
Ecuador	10	40	*17*	50
El Salvador	10	30	*23*	60
Guatemala	23	20	*13*	57
Guyana	N/A	N/A	*N/A*	N/A
Haiti	28	20	*7*	51
Honduras	18	32	*20*	51
Jamaica	6	31	*13*	62
Mexico	**4**	**28**	***21***	**67**
Nicaragua	32	23	*14*	45
Panama	7	17	*8*	76
Paraguay	21	27	*14*	52
Peru	8	27	*14*	65
Suriname	10	20	*8*	70
Trinidad & Tobago	2	43	*8*	55
Uruguay	6	27	*17*	67
Venezuela	**5**	**36**	***14***	**59**
Memo:				
Spain	4	31	*N/A*	66

Source: *World Development Indicators*, World Bank.
Note: Agriculture includes forestry and fishing. Industry comprises mining, manufacturing, construction, electricity, water and gas. *denotes manufacturing is included in the industry total. Also, the correlation between real GDP per capita and the share of GDP accounted for by agriculture is negative and highly significant. Both bank assets/GDP and real GDP per capita are significantly, positively correlated with the share of GDP accounted for by services.

The structure of a country's output has implications for the allocation of credit within it. To the extent that credit is needed to support the different sectors, one might expect the overall allocation of credit to each sector to reflect its relative contribution to GDP. One might not, however, expect the same to be the case for the proportion of bank credit allocated to each sector. The reason is that firms in the industrial sector, including its subcomponent manufacturing, may be better able to access funds by issuing stocks and

bonds than firms in the other sectors. If this is the case, bank credit will be all the more important for those firms in the other sectors that are least able, if at all, to obtain funding from the capital markets. This would undoubtedly include small and medium-sized enterprises (SMEs). It is therefore important to assess the effect of the changing structure of banking markets on the allocation of bank credit. Some limited information on this issue will be presented later in the paper.

B. Some Basic Differences Among the Dominant Countries

Table 3 shows that six countries dominate Latin America in terms of population, GDP and bank assets. Table 5 reinforces this fact by showing that Argentina, Brazil, Chile, Colombia, Mexico and Venezuela collectively account for more than 75 percent of each measures total for all 26 Latin American countries. For this reason, the remainder of the paper focuses on the changing structure of banking in these countries.

Table 5
Six Countries Dominate in Terms of Population, GDP and Bank Assets (2001)

	Share of Region Total		
Country	**Population (%)**	**GDP (%)**	**Bank Assets (%)**
Brazil	34.2	26.7	31.2
Mexico	20.0	32.7	24.9
Argentina	7.3	14.2	10.2
Chile	3.0	3.5	4.9
Colombia	7.9	4.4	2.7
Venezuela	4.7	6.7	2.5
Total Share of Top Six	77.1	88.1	76.5

Source: Population, *Statistical Abstract of the United States*; GDP, *World Economic Outlook Database*, IMF; Bank Assets, *International Financial Statistics*, IMF.

National Financial Systems The size and composition of the national financial systems of the top six countries (scaled by their respective GDPs) are shown in Table 6. There are substantial differences across the countries in terms of total financial assets and their distribution among bank assets, stocks and bonds. Chile has the most developed financial system on the basis of all three components. Venezuela, on the other hand, has the least developed system. Chile, moreover, has the largest share of debt securities, both domestic and international, accounted for by the private sector. In Argentina, the heaviest debt burden is in terms of international public debt, whereas in Brazil it is domestic public debt. This means that Brazilians to a greater degree than Argentineans owe the public debt to themselves. The corresponding figures for Spain are also included for purposes of comparison. It ranks at the top in terms of all three components of a national financial system. Chile, however, is not far behind in terms of equity market capitalization and even slightly ahead in terms of private domestic debt securities.

Table 6
Size and Composition of Top Six National Financial Systems (2000)

Country	Bank Assets / GDP (%)	Equity Market Capitalization / GDP (%)	Debt Securities / GDP (%)			
			Domestic		International	
			Public	Private	Public	Private
Argentina	40.5	58.3	12.5	4.9	20.2	5.0
Brazil	50.6	38.0	41.8	8.1	4.5	5.0
Chile	71.9	85.6	28.1	18.1	0.7	6.5
Colombia	29.8	11.8	N/A	N/A	10.0	2.3
Mexico	36.8	21.8	10.2	2.3	5.8	5.6
Venezuela	19.1	6.7	N/A	N/A	4.8	4.3
Memo:						
Spain	151.8	90.3	50.0	14.0	6.2	21.7

Source: GDP, *World Economic Outlook Database*, IMF; Bank Assets, *International Financial Statistics*, IMF; Debt Securities, *Bank for International Settlements.*

Bank Supervision Attention is now focused more narrowly on the banking systems in these top six Latin American countries. Table 7 shows the structure, scope and independence of bank supervision in these countries. All six countries have a single supervisor based upon official governmental sources. [However, as documented more fully in Barth, Nolle, Phumiwasana, Yago (2002), governmental and private sources sometimes provide conflicting information as in the case of Argentina in which private sources indicate there are two supervisors]. Furthermore, the Central Bank is a supervisor in only two of the six countries. These two, Argentina and Brazil, have adopted the same practice as the United States. In contrast, the other four - Chile, Colombia, Mexico and Venezuela - have adopted the same practice as has been recently implemented in Germany and the United Kingdom. Barth, Nolle, Phumiwasana, and Yago (2002) find that such differences are only weakly related, if at all, to bank profitability. More research is needed, however, to determine whether these types of differences matter for other measures of bank performance and, most importantly, for bank stability.

Table 7
The Structure, Scope, and Independence of Bank Supervision in the Top Six Latin America Countries

Country	Bank Supervisory Authority	Structure: Single Supervisor or Multiple Supervisors	Structure: Role of Central Bank[1]	Scope of Supervisory Authority[2]	Degree of Supervisory Independence[3]
Argentina[4]	Central Bank of Argentina, Superintendency of Financial and Foreign Exchange Institutions	Multiple	CB	B	Low
Brazil	Central Bank of Brazil	Single	CB	B	Low
Chile	Superintendency of Banks	Single	NCB	B	Low
Colombia	Superintendency of Banking	Single	NCB	B&S	N/A
Mexico	National Banking and Securities Commission	Single	NCB	B&S	Low
Venezuela	Superintendent of Banks and Other Financial Institutions	Single	NCB	B	Medium
Memo:					
Spain	Bank of Spain	Single	CB	B	High

Sources: Primary sources are Barth, Caprio, and Levine (2001 and 2002), and Office of the Comptroller of the Currency using information from national supervisory authorities; secondary source is Courtis (1999). Also, see Institute of International Bankers, various issues. Unless otherwise indicated, information is for 1999.

Notes: [1] "CB" indicates that the central bank is a banking supervisory authority; "NCB" indicates that the central bank in not a banking supervisory authority.

[2] "B" indicates that the supervisory authority(ies) has(have) responsibility only for the banking industry; "B&S" indicates that the supervisory authority(ies) has (have) responsibility for the securities industry as well as for the banking industry; "B&I" indicates that the supervisory authority(ies) has (have) responsibility for the insurance industry as well as for the banking industry; "BSI" indicates that the supervisory authority(ies) has (have) responsibility for the banking, securities, and insurance industries.

[3] See Barth, Nolle, Phumiwasana and Yago (2002) for an explanation of the categorization of the degree of supervisory independence.

[4] According to Courtis (1999), this country has a single bank supervisory authority.

Table 7 also shows that in four of these countries the supervisory authority has responsibility only for the banking industry, which is also the case in the U.S. In Colombia and Mexico, however, the supervisors' responsibility extends to the securities industry as well. The information in the table also shows that the degree of supervisory independence is low in four of the countries, and only medium in the case of Venezuela. The problem that arises in such situation is that without a high degree of independence, the supervisory authorities may not be able to exercise appropriate oversight of banks. This, in turn, may lead to imprudent bank behavior and thus to greater bank fragility than otherwise. The Central Bank of Spain, in comparison, is the sole bank supervisory authority, with responsibility only for the banking industry, and it has a high degree of independence.

Bank Activity and Ownership Restrictions Table 8 provides information that essentially tells one what the term "bank" means in these different countries. There are several points to be made in this regard. First, since there is an explicit deposit insurance scheme in every one of the six countries, a bank is an insured institution in these countries. This is also the case in Spain. Second, a bank may engage not only in commercial banking activities but also in securities and insurance activities in all of the countries (including Spain), except Mexico. In Mexico, securities activities are restricted, while insurance activities are prohibited. Third, in all the countries (including Spain) real estate activities are either restricted or prohibited, except in Argentina and Colombia. In both of these countries, banks are permitted to engage in real estate activities. Fourth, Chile and Venezuela restrict the mixing of banking and commerce (i.e., bank ownership of nonfinancial firms and vice versa), as does the U.S. The other four countries (and Spain) do not restrict nonfinancial firm ownership of banks. In the case of bank ownership of nonfinancial firms, Argentina and Mexico (and Spain) do not impose restrictions, whereas Brazil and Colombia do.

Table 8
Permissible Activities, Mixing Banking and Commerce, and Deposit Insurance in Selected Latin America Countries (2001)

	Securities	Insurance	Real estate	Bank Ownership of Nonfinancial Firms	Nonfinancial Firms Ownership of Banks	Explicit Deposit Insurance Scheme
Argentina	Permitted	Permitted	Permitted	Unrestricted	Unrestricted	Yes
Brazil	Permitted	Permitted	Restricted	Restricted	Unrestricted	Yes
Chile	Permitted	Permitted	Prohibited	Restricted	Restricted	Yes
Colombia	Permitted	Permitted	Permitted	Prohibited	Permitted	Yes
Mexico	Restricted	Prohibited	Restricted	Permitted	Permitted	Yes
Venezuela	Permitted	Permitted	Restricted	Restricted	Restricted	Yes
Memo:						
Spain	Unrestricted	Permitted	Restricted	Unrestricted	Permitted	Yes

Source: World Bank's Banking Supervision and Regulation Database
Note: a. Securities Activities: the ability of banks to engage in the business of securities underwriting, brokering, dealing, and all aspects of the mutual fund industry.
b. Insurance Activities: the ability of banks to engage in insurance underwriting and selling.
c. Real Estate Activities: the ability of banks to engage in real estate investment, development, and management.
d. Banks Ownership of Nonfinancial Firms measures restrictions on the ability of banks to own and control nonfinancial firms.
e. Nonfinancial Firms Ownership of Banks measures restrictions on the ability of nonfinancial firms to own and control banks

These types of differences in "banks" across countries should be recognized when comparing the banking industries in different countries. Differences in allowable bank activities, for example, may matter when attempting to explain differences in bank development, performance and stability across countries. Indeed, recent work by Barth, Caprio and Levine (2002) shows that this is the case. Also, Table 8 indicates that Spanish banks have experience in a wide range of activities and in broad ownership structures. This should make it easier for them to enter and adapt to banking markets with different types of banks.

Government vs. Foreign Participation in Banking Sector Tables 9 and 10 show that the banking industries in the top six Latin American countries have undergone dramatic ownership change in recent years. In particular, Table 9 shows that the government-owned share of total bank assets declined in all six countries from 1996 to 1999. The relatively small decline in the case of Mexico is explained by the fact that it had already undertaken efforts earlier in the 1990s to re-privatize its banking industry, after its nationalization in the early 1980s. Table 10 shows that accompanying the declining share in total bank assets accounted for by government-owned banks was an increase in the share accounted for by foreign-owned banks. The increases in foreign-bank shares have been quite large in countries experiencing severe banking crises during the past decade. This reflects the liberalization of foreign-bank entry and ownership restrictions to attract foreign banks with the capital necessary to help resolve the crises in a less-costly manner than would have otherwise been possible. In the case of Mexico, it also reflected the provisions provided by the North American Free Trade Agreement (NAFTA), which took effect in 1994. In Spain, both government and foreign ownership have been relatively small and stable over the past several years.

Table 9
Government-Owned Bank Share of Total Bank Assets in Top Six Countries

	1996	1997	1998	1999
Argentina	34%	31%	31%	27%
Brazil	52%	51%	47%	43%
Chile	15%	15%	14%	14%
Colombia	N/A	17%	23%	N/A
Mexico	41%	41%	40%	36%
Venezuela	30%	7%	6%	6%
Memo:				
Spain	1%	1%	1%	0%

Source: OCC Survey.

Table 10
Foreign-Owned Bank Share of Total Banks Assets for Top Six Countries

	1996	1997	1998	1999	2001
Argentina	27%	46%	48%	71%	64%
Brazil	10%	13%	21%	24%	31%
Chile	21%	21%	26%	47%	46%
Colombia	N/A	25%	15%	N/A	15%
Mexico	10%	4%	4%	8%	78%
Venezuela	38%	41%	46%	43%	41%
Memo:					
Spain	6%	5%	6%	5%	6%

Source: OCC Survey and BankScope for 2001.
Note: BankScope Release 147.1 does not include 2001 bank assets data for Banco Santiago, Banco Santander Chile and Banco Industrial De Venezuela. Both Banco Industrial de Venezuela and Banco Caracas are part of Santander Central Hispano as of December 2001. We included them as separate institutions. As of April 2002, Banco Industrial de Venezuela fully absorbed Banco Caracas. In Tables 10 to 15, information for these banks was obtained from http://www.santander.cl/, http://www.bancosantiago.cl and Solomon Smith Barney's *Venezuelan Bank Reference Guide*.

Domestic vs. Foreign Participation in Banking Sector Table 11 provides more detailed information on foreign participation in the banking sectors of the top six countries. Foreign participation in all of these countries is quite high, in terms of both the share of the total number of banks and the share of the total assets of banks. The participation is greatest in Chile in terms of the share of banks (68 percent), while it is greatest in Mexico in terms of share of bank assets (78 percent). Colombia ranks lowest in terms of foreign-bank asset share (15 percent) and next to lowest in terms of foreign-bank number share (28 percent).

Foreign banks have clearly reshaped the banking landscape in all these countries. Spain, in contrast, has relatively high foreign participation in terms of number share (35 percent), but very little participation in terms of asset share (6 percent).

Table 11
Top Six National Banking Systems: Domestic vs. Foreign Participation (2001)

	Number of Banks					Total Assets				
	All	Domestic		Foreign		All	Domestic		Foreign	
		Number	Percent	Number	Percent		Amount (US$ Bil.)	Percent	Amount (US$ Bil.)	Percent
Argentina	72	40	56	32	44	92.4	33.0	36	59.4	64
Brazil	102	58	57	44	43	445.2	307.8	69	137.4	31
Chile	22	7	32	15	68	55.8	29.9	54	25.9	46
Colombia	25	18	72	7	28	26.6	22.5	85	4.1	15
Mexico	30	12	40	16	60	164.8	35.8	22	128.9	78
Venezuela	42	28	67	14	33	29.8	17.5	59	12.3	41
Memo:										
Spain	85	55	65	30	35	811.1	766.4	94	44.7	6

Source: BankScope

Tables 12-15 show the degree of concentration of bank assets for the top six countries, broken down by all banks, foreign-owned banks and Spanish-owned banks. Table 12 shows that the top 5 banks in each of the countries account for a low of 45 percent of total bank assets in Colombia and to a high of 77 percent in Mexico. The top five banks across all six countries account for 32 percent of the collective bank assets of these countries. In Spain, the top five banks account for 84 percent of total bank assets. All these countries clearly have quite high concentration ratios.

Table 12
Concentration of Total Bank Assets for Top Six Countries
(2001)

	Total Bank Assets (US$ Millions)	Total Number of Banks	Top Bank	Top 3 banks	Top 5 Banks	Top 10 Banks	Top 20 Banks
Argentina	92,367	72	17%	39%	55%	75%	88%
Brazil	445,227	102	16%	38%	55%	74%	89%
Chile	55,807	22	17%	49%	75%	93%	100%
Colombia	26,645	25	13%	32%	45%	72%	97%
Mexico	164,758	30	28%	61%	77%	95%	99%
Venezuela	29,757	42	14%	41%	55%	79%	95%
Total of Six Latin American Countries	814,561	293	9%	21%	32%	49%	63%
Memo:							
Spain	811,109	85	39%	77%	84%	90%	95%

Source: BankScope

Table 13
Foreign Bank Concentration Among Biggest Banks in Top Six Countries*
(2001)

	Total Number of Banks	Total Number of Foreign Banks	Top Bank	Top 3 banks	Top 5 Banks	Top 10 Banks	Top 20 Banks
Argentina	32 (2)	72	0 (0)	2 (2)	4 (2)	7 (2)	15 (2)
Brazil	44 (5)	102	0 (0)	0 (0)	0 (0)	4 (1)	11 (3)
Chile	15 (2)	22	1 (1)	1 (1)	2 (2)	4 (2)	13 (2)
Colombia	7 (1)	25	0 (0)	0 (0)	0 (0)	2 (1)	6 (1)
Mexico	18 (4)	30	1 (1)	3 (2)	4 (3)	7 (3)	10 (4)
Venezuela	13 (3)	42	1 (1)	2 (2)	2 (2)	4 (3)	6 (3)
Total of Six Latin American Countries	129 (17)	293	0 (0)	0 (0)	1 (1)	4 (2)	10 (6)
Memo:							
Spain	30	85	0	0	0	3	4

Source: BankScope

Note: * in parenthesis is the number of Spanish Banks. Banco Santander Chile is a Spanish bank and is included in this table.

Table 14
Foreign Bank Concentration of Total Bank Assets in Top Six Countries (2001)

	Total Bank Assets (US$ Bil.)	Total Foreign Banks Share	Top Foreign Bank	Top 3 Foreign banks	Top 5 Foreign Banks	Top 10 Foreign Banks	Top 20 Foreign Banks
Argentina	92,367	64%	11%	30%	45%	56%	64%
Brazil	442,227	33%	5%	14%	18%	25%	29%
Chile	55,807	46%	17%	37%	42%	46%	46%
Colombia	26,645	15%	5%	11%	14%	15%	15%
Mexico	164,758	78%	28%	61%	74%	77%	78%
Venezuela	29,757	41%	14%	33%	40%	41%	41%
Total of Six Latin American Countries	814,561	45%	6%	13%	18%	24%	33%
Memo:							
Spain	811,109	5%	1%	3%	4%	5%	5%

Source: BankScope

Table 15
Spanish Bank Share of Total Bank Assets in Top Six Countries (2001)

	Total Bank Assets (US$ Bil.)	Total Spanish Bank Share	Top Spanish Bank	Top 3 Spanish banks	Top 5 Spanish Banks	Top 10 Spanish Banks	Top 20 Spanish Banks
Argentina	92,367	22%	11%	22%	22%	22%	22%
Brazil	445,227	8%	5%	8%	8%	8%	8%
Chile	55,807	33%	17%	33%	33%	33%	33%
Colombia	26,645	5%	5%	5%	5%	5%	5%
Mexico	164,758	44%	28%	44%	44%	44%	44%
Venezuela	29,757	27%	14%	27%	27%	27%	27%
Total of Six Latin American Countries	814,561	19%	6%	10%	13%	18%	19%

Source: BankScope

Tables 13 and 14 show the relative importance of foreign-owned banks among the biggest banks in the top six countries. The two tables differ insofar as the former shows foreign presence in terms of number of banks, whereas the latter does so in terms of assets. There are 129 foreign-owned banks out of 293 banks (Table 13) and they account for 45

percent of the collective bank assets (Table 14) in these countries. There are significant differences across the countries, however. Foreign-owned banks are very well represented in all the countries, with the possible exception of Colombia, in terms of both number of banks and share of total bank assets. Spain, as already noted, has quite a few foreign-owned banks but these banks account for a small percentage of total bank assets. Indeed, the foreign-bank share in Spain is smaller than for every one of the top six Latin American countries.

These two tables also show that foreign-owned banks are among the biggest banks in all six countries. Indeed, in three of the countries, Chile, Mexico and Venezuela, the biggest bank is a foreign-owned bank. In these cases, moreover, it is a Spanish-owned bank. Furthermore, all three of the biggest banks in Mexico are foreign-owned banks, two of which are Spanish. More generally, four of the biggest ten banks across these six countries are foreign-owned banks and they account for 24 percent of the collective bank assets of these countries. The corresponding figures for Spain are three foreign-owned banks and 5 percent of total bank assets, respectively.

Table 15 shows the same total asset-share and concentration information for just Spanish-owned banks. These banks account for their largest shares of total bank assets in Mexico, Chile, Venezuela and Argentina. The shares in these countries are 44, 33, 27 and 22 percent, respectively. The corresponding shares for Brazil and Colombia are 8 and 5 percent, respectively. Overall, Spanish-owned banks account for 19 percent of the collective bank assets of these top six countries, or 40 percent of the total for all foreign owned banks in these same countries.

IV. Differences in Portfolios and Performance of Domestic- and Foreign-Owned Banks

Table 16 presents information on the portfolios and performance of domestic-owned and foreign-owned banks in the top six Latin American countries. More detailed financial information than provided in these tables is very important for a more thorough examination of differences in the portfolios and performance of domestic-owned versus foreign-owned banks, and even government-owned banks. Nonetheless, the information presented in the table does enable one to draw the following broad but necessarily tentative conclusions:

- The allocation of assets to loans ranges from a low of 34 percent in Brazil to a high of 63 percent in Chile. In all the countries, moreover, the differences in allocation between domestic and foreign banks are relatively small, except for Chile. In this country, foreign banks allocate 20 percentage points fewer assets to loans than do domestic banks.
- The differences in the mortgage loans-to-total asset ratios between domestic and foreign banks are greatest in Colombia (20 percentage points) and Chile (6 percentage points). For the other two countries for which data are available, Argentina and Mexico, the differences are relatively minor.
- The allocation of assets to government securities is greater for foreign banks in every country, with the greatest difference being nearly 10 percentage points in the case of Venezuela. Although no data are available for Brazilian banks, it is widely reported that these banks hold significant amounts of public-sector bonds.

- In all the countries, equity investments are quite low as a percentage of total assets. This is the case for both domestic and foreign banks. Domestic banks in Mexico have a ratio of 3.2 percent, which is triple the ratio for foreign banks. The reverse holds in the case of Brazil.
- Mexico is the only country in which total deposits fund a larger proportion of the assets of foreign banks than domestic banks, but the difference is only 2.6 percentage points. Domestic banks account for larger ratios than foreign banks in the other countries, the biggest difference being 20 percentage points in the case of Chile.
- The profitability of domestic and foreign banks differs widely across the countries. In Argentina, Brazil and Colombia, foreign banks underperform domestic banks, whereas the reverse is the case in Chile, Mexico and Venezuela.
- Foreign banks generally neither uniformly generate more noninterest income nor operate less expensively than domestic banks in the top six countries.
- In the case of Spain, one of the biggest differences between domestic and foreign banks is that domestic banks allocate 11 percentage points more of their assets to government securities than do foreign banks. They also are more profitable and fund a much smaller percentage of their assets with deposits than do foreign banks.

Table 16
Domestic and Foreign Banks: Selected Balance Sheet and Income Statement Items
(2001)

	Argentina		Brazil		Chile		Colombia		Mexico		Venezuela		Spain	
	Dom.	**For.**	**Dom.**	**For.**	**Dom.**	**For.**	**Dom.**	**For.**	**Dom.**	**For.**	**Dom.**	**For.**	**Dom.**	**For**
Number of Banks	40	32	55	44	7	13	18	7	16	14	33	11	53	32
Balance Sheet														
Customer Loans to Total Assets	50.8	50.2	34.1*	33.6*	48.2	34.4	42.1	55.0	49.6	45.4	43.9*	48.3*	53.1*	56.2*
Mortgage Loans to Total Assets	9.8	8.1	N/A	N/A	14.2	8.3	20.0	0.3	6.1	7.2	N/A	N/A	N/A	N/A
Total Loans to Total Assets	60.6	58.3	34.1	33.7	63.3	43.5	62.7	55.6	59.3	54.6	47.6	50.9	53.9	56.4
Problem Loans to Total Loan	N/A	N/A	N/A	N/A	1.4	1.8	1.0	0.7	6.0	3.6	7.6	4.9	1.6	0.3
Loan Loss Reserves to Total Loans	6.4	7.2	6.3	5.2	2.3	3.5	6.9	4.2	6.7	5.2	7.2	4.7	2.8	0.3
Government Securities to Total Assets	5.2	6.2	N/A	N/A	3.3	6.5	5.4	13.3	8.6	8.7	5.7	15.1	17.5	6.4
Equity Investments to Total Assets	0.6	0.5	0.8	2.6	0.1	0.2	N/A	N/A	3.2	1.1	1.5	1.6	2.1	0.3
Demand Deposits To Total Assets	8.0	12.4	7.6	4.1	11.9	6.6	14.5	10.9	36.4	27.5	39.8	35.8	11.6	20.9
Total Deposits to Total Assets	69.8	62.9	40.9	29.8	70.4	59.8	76.4	70.2	81.9	84.7	82.2	80.8	71.1	85.6
Equity to Total Assets	11.2	10.6	8.3	10.7	7.1	14.0	12.5	10.7	11.0	8.6	13.9	15.0	7.3	6.4
Income Statement														
Return on Assets (Pre-Tax Profit to Total Assets)	1.2	0.2	2.0	-0.5	1.3	1.7	1.7	1.0	0.8	2.1	2.9	3.4	1.3	0.3
Net Interest Revenue to Total Assets	4.5	3.6	5.2	6.2	3.8	3.7	4.5	3.9	5.8	4.2	11.0	10.2	2.9	1.8
Return on Equity (Pre-tax Profit/Total Equity)	11.0	1.7	24.3	-4.6	18.3	11.8	13.7	9.8	7.7	24.5	20.6	22.3	17.2	5.3
Net Commission, Fee and Trading Income to Total Assets	3.4	3.4	1.0	0.5	1.0	1.8	4.6	7.0	2.6	2.8	N/A	N/A	1.4	1.3
Personnel and Administrative Expenses to Total Assets	3.4	3.5	5.8	5.6	1.7	1.8	2.7	2.7	5.1	4.2	9.2	8.4	2.2	2.4

Source: BankScope.

Note: The figures are not averages of individual banks but instead unweighted totals. Also, customer loans include loans to municipalities and government, loans to group companies and associates, and other corporate loans and loans to bank.

* denotes that these figures include mortgage loans.

Much more detailed work remains to be done in examining the differences in the portfolios and performance of domestic and foreign banks. The conclusions just noted, once again, are quite tentative due to the nature of the data and the fact that even in this case the data only pertain to a single year.

V. Recent Changes in Bank Structure Raise Important Questions

The documented changes in the structure of Latin America's banking markets in recent years are quite profound. At the same time that governments have decreased their participation in these markets through direct ownership of banks, foreign banks have increased their participation through mergers and acquisitions of domestically-owned entities. These developments raise many important questions that merit further examination and discussion. A few of these questions will now be addressed.

1. What explains the recent penetration by foreign-banks into Latin America?

   There are several important factors that help explain this penetration. These include the following:

   - Foreign banks may face less competition and have more market opportunities in Latin American than in their home countries. In this regard, Focarelli and Pozzolo (2000) find that foreign bank entry is greater in those countries with inefficient banking industries and expected high rates of economic growth.
   - Entry restrictions and other financial regulations (including tax treatment) have been eased in recent years throughout Latin America, which makes foreign bank entry easier and more attractive. In many cases these actions coincided with banking crises and the privatization of government owned

banks. The entry of foreign banks brought outside capital into the domestic banking sector.

- Spanish banks, in particular, face fewer linguistic and cultural barriers in Latin America as compared to other parts of the world. Furthermore, these banks can grow and expand more easily in this still financially less developed region than in the more financially mature economies of the European Union (EU) or the U.S.
- Foreign banks have expanded into the region as their own domestic clients with international operations have done so in search of bigger markets. This does not necessarily imply that foreign banks will provide financial services to only or to even mainly the affiliates of their home-country clients. Foreign bank penetration in the region, moreover, may induce the entry of foreign nonbanking firms.
- Foreign banks with large home-market shares have incentives to seek risk diversification opportunities abroad. Also, economies of scale and scope may drive bank expansion into other countries. Facarelli and Pozzolo (2000), for example, find that bigger banks have greater degrees of internationalization.

2. Will the penetration by foreign-banks lead to safer and sounder banks and, more generally, to more developed and better functioning financial systems?

   Some points worth considering in this regard are as follows:

   - Foreign banks can bring new technology, management skill, and capital to the domestic banking industry which should help promote safer and sounder institutions.

- Greater competition brought about by foreign banks should encourage domestic banks to search out the most profitable uses of their funds. In this regard, Levine (2000) finds that foreign banks tend to spur competition and contribute to a more efficient domestic banking industry. Claessens, Demirgüç-Kunt and Hizinga (2001) also find that foreign bank entry leads to greater efficiency in the domestic banking system.
- Rajan and Zingales (2001) find that international openness tends to limit the rent-seeking activities of domestic banks, and thereby promotes financial and economic development.
- Claessens and Glaessner (1998) point out that the "presence of foreign financial firms is more likely to reduce capital flight, as was observed in several recent episodes (e.g., in Argentina and Thailand foreign banks received large amounts of deposits from domestic banks when concerns arose about the quality of domestic banks)."
- Barth, Caprio and Levine (2002) find that restrictions on foreign entry are associated with greater banking-sector fragility.
- Peria, Powell and Hollar (2002) find that foreign banks are less susceptible to pro-cyclical shocks. Indeed, Dages, Goldberg, and Kinney's (2001) study of Argentina during the 1990s found that foreign banks had higher loan growth rates than domestic banks and foreign bank credit grew even during crisis periods.
- The presence of foreign banks may help to constrain any political efforts to use the banking system as an instrument of "crony capitalism."

3. How is the allocation of credit impacted by the presence of foreign banks and what is the reaction of domestic banks to the foreign-bank penetration?
    - Dages, Goldberg, and Kinney (2000) examined the lending behavior of foreign and domestic banks in Argentina and Mexico during the mid-1990s. They found the portfolio compositions of both types of banks to be quite similar in Argentina, while this was also the case for banks with low levels of problem loans in Mexico.
    - Clarke, Cull, Peria and Sanchez (2002) examined bank-level data for Argentina, Chile, Colombia, and Peru during the mid-1990s. They found that small foreign banks lent considerably less to small businesses than small domestic banks in all four countries. However, they found that large foreign banks lent more to small businesses (as a share of total lending) than large domestic banks in Chile and Colombia. In Argentina and Chile, they found that lending to small businesses by medium and large foreign banks grew faster than for domestic banks of similar size.
    - Gelos and Roldos (2002) found that "at least 37 M&A transactions involving private sector financial institutions occurred in Brazil between end-1995 and end-2000. Several of these transactions were driven by the three largest domestic private banks' attempts to remain competitive in the main regions of the country, as well as the perception by many medium and small banks that they would not be able to sustain positive earnings in such a competitive environment, especially in the wake of few large foreign acquisitions."

Much more detailed work needs to be done in assessing the effect of the changing structure of banking markets in Latin America on the allocation of credit, especially given

how recent and dramatic these changes have been. However, Fernando de Paula (2001) provides an excellent assessment of the determinants and impacts of foreign bank presence in Brazil.

4. Will the penetration of foreign banks lead to greater integration of financial markets in the region?

A few comments about financial integration both within and across national borders will be made on the basis of Table 17. It contains information on selected measures of the financial environment in the top six Lain American countries. The same information is presented for both Spain and the U.S. for comparative purposes. First, in every country, except Chile, a very low amount of bank credit is extended to the private sector (scaled relative to GDP). Indeed, despite being the second biggest economy in the region, the amount of private credit extended by Mexico's banks is only 10 percent of GDP. This indicates there is substantial opportunity for expansion in credit to the private sector by both domestic and foreign banks. Second, more progress can be made by these countries with respect to improving contract enforcement, curtailing corruption, reducing the costs of establishing a business, and providing greater access to capital by business firms. Third, the overall banking environment scores for the six countries emphasize the need for still more progress in improving the financial sector by all of them. Last, attention has to be paid to the extent to which the regulation and supervision of financial institutions and markets needs to be harmonized throughout the region, including whether a regional regulatory/supervisory authority should replace separate national authorities. Only through these efforts can one expect greater financial integration and convergence in Latin American countries.

Table 17
Selected Measures of the Financial Environment in the Top Six Latin American Countries, Spain and the United States

	Bank Private Credit/GDP (%) 2001[4]	Contract Enforcement 2001[2]	Cost of Business Entry (% of GNP Per Capita) 2001[2]	Corruption 2002[3]	Capital Access Index 2002[1]	Banking Environment Score 2002[1]
Argentina	20	5.39	10.38	2.8	4.02	5.89
Brazil	29	3.06	12.02	4.0	3.59	5.42
Colombia	19	4.11	14.13	3.6	3.35	5.97
Chile	65	4.56	13.44	7.5	4.53	N/A
Mexico	10	4.71	20.88	3.6	3.65	5.87
Venezuela	11	6.01	16.51	2.5	3.33	7.00
Spain	106	5.24	15.5	7.1	4.78	n/a
United States	50	2.61	0.69	7.7	5.5	3.24

Source:
[1]Milken Institute (1 least access, 7 greatest access; 1 best environment, 10 worst environment).

[2]Worldbank (low value indicates greater contract enforcement).
[3]Transparency International (0 most corrupt, 10 least corrupt)

[4]International Financial Statistics.
Note: Banking Environment Index (BEI) ranks the banking environment with regard to legal systems, creditor and property rights, effectiveness of bank supervision, accounting practices, competition in the banking sector and financial environment.

VI. Additional Remarks about the Two Largest Spanish Banks

The two largest banks in Spain are Banco Santander Central Hispano (BSCH) and Banco Bilbao Vizcaya Argentina (BBVA). In January 1999, Banco Santander and Banco Central Hispano merged to form BSCH. This resulted in the merger of their respective subsidiaries, Banco Santander Chile and Banco Santiago, the two largest banks in the country. These two banks today are called Banco Santander Chile. In January 2000, Banco Bilbao Vizcaya and Argentina merged to form BBVA. As of June 30, 2002, BSCH had $387 billion in assets, and BBVA had $282 billion in assets. On the basis of total assets, these two banks ranked first and second in Spain. Together they account for nearly 70 percent of the country's total banking assets.

As of June 30, 2002, BBVA had 22 percent of its total assets in Mexico and 9 percent of its assets in other Latin American countries. Of its net profit of $1,163 million in the first half of 2002, 18 percent is from its operations in Mexico and 9 percent is from other Latin American countries. For the same time period, BSCH had 31 percent of its total assets in Latin America. Of its net profit of $1,194 million, 67 percent is from its operations in Latin America. These two banks account for about one-fourth of the total banking assets in Latin America.

Clearly, the fact that these two banks account for more than one third of Spain's banking assets means that their performance essentially drives the entire industry's performance. Their heavy exposure to Latin America, moreover, means that whatever happens in the region necessary affects the banking industry in Spain. To the extent that adverse shocks in Spain and in Latin America are negatively correlated, diversification benefits will be achieved.

VII. Summary and Conclusions

Many important developments occurred in Latin America over the past decade. Authoritarian regimes were replaced with democracies throughout the region. There has been a proliferation of multinational and bilateral free trade agreements in the region. The most important agreement is the Free Trade Agreement of the Americas (FTAA), which is due to be completed in 2005. The structure of Latin America's banking markets has also undergone a dramatic change. Government ownership of banks in most of the countries in the region has significantly declined, while foreign ownership has simultaneously increased. Indeed, the latter process has continued. For example, in 2002, HSBC acquired Mexico's Gupo Financiera Bital. This increased the foreign bank share of Mexico's total bank assets to

84 percent. Today, there is only one big domestic bank left to be acquired, Banorte. In Mexico and other parts of the region, Spanish banks have played an important role in this "conquest" of Latin American banking.

Recently, however, there has been turmoil in many of the countries in the region, especially Argentina, Brazil and Venezuela. This situation has promoted greater and more widespread uncertainty about the near-term prospects for further reform efforts toward freer trade, more privatization of government-owned enterprises, and increased ownership of domestic banking assets by foreign banks. There are reports, moreover, that some international banks are withdrawing from parts of Latin America or at least curtailing expansion plans given the current economic and political uncertainty. Esterl (2002), for example, states that "Canada's Bank of Nova Scotia, France's Credit Agricole SA and Italy's IntesaBCI SpA all have announced plans this year to decamp from South America's second-largest economy after recession-racked Argentina defaulted on most of its public debt, scrapped dollar parity and imposed harsh capital controls."

Despite the current uncertainty about the economic, and even political, situation in many of the Latin America countries, and their implications for reform, one can nonetheless be optimistic about the longer-term prospects. Substantial progress in several important dimensions has already been made in the region and will not likely be totally reversed. Specifically, as regards financial systems, governments everywhere now recognize the importance of well functioning banking and capital markets for economic and social prosperity.

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