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FOREIGN BANKS IN THE BRAZILIAN ECONOMY IN THE 1980s */

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FOREIGN BANKS IN THE BRAZILIAN ECONOMY IN THE 1980s 1/

1. Introduction

According to the Central Bank, in December 1987 total foreign registered capital in the Brazilian financial sector amounted to US\$ 1 397 billion. The commercial banking sector was by far the most important one, with 64.1 percent of the total foreign capital invested in it. 2/ In this paper we will restrict our analysis to the commercial banking sector. In doing this we are obviously only taking into account one particular aspect of the participation of foreign companies in the Brazilian financial market. There are two main reasons for doing this. The first one is that for the great majority of foreign financial institutions there is no consolidated balance sheet information. The second one is that the importance of the commercial banking sector in total foreign investment in the Brazilian financial sector has increased substantially over the last 15 years. In this respect it is worth mentioning that while in the mid 1970s the registered foreign capital in investment banks amounted to almost half of total foreign investment in the financial sector, by 1987 it represented only 20 percent.

In 1987 there were 29 commercial banks in Brazil fully or partly owned by foreigners. Their total assets amounted to US\$ 13.7 billion, which represented 24.7 percent of the assets of all commercial banks excluding Banco do Brasil (34.2 percent of the assets of private commercial banks). 3/ These banks had 448 branches, amounting to just over 3 percent of the total number of bank branches in Brazil. The great majority of these branches was located in the Southeast region. The state of São Paulo alone, for instance, had 189 foreign banks branches. The share of the United States, France, and Japan in total foreign registered capital in the commercial banking sector was close to 60 percent.

The presence of foreign banks in the Brazilian financial market dates back to last century. The first foreign institution to operate in this country was a British one, the London and Brazilian Bank, which opened its first branch in 1863. Afterwards, other European banks followed that bank and came to Brazil. Most of these banks were attracted by the Brazil's increasing foreign trade activities. They specialized in providing financing for importers and exporters and in dealing in foreign currency. During the 20th century there was a steady declining tendency in the participation of foreign banks in the commercial banking sector, no matter what indicator one chooses. This downward trend was interrupted at the end of the 1970s when foreign banks started increasing their market share.

The paper is organized as follows. In section 2 we give a broad picture of the presence of commercial foreign banks in the Brazilian economy in 1987. We analyze the balance sheet structure of the five largest foreign banks and compare them to the largest private domestic commercial banks. We also discuss the characteristics of the labor force in the banking sector. In section 3 we deal with the evolution of foreign banks since the establishment of the London and Brazilian Bank in 1863. We pay special attention to the more recent period, and in particular to the last 20 years. In this section we also discuss the different legislation which defined the establishment and operation of foreign institutions in the Brazilian financial sector. Section 4 examines in detail how foreign banks evolved in the 1980s. We have attempted to assess if the characteristics pointed out in section 2 were already there. In section 5 we examine the possible effects the external debt problem had on the way foreign banks have carried on their activities in Brazil. Finally, section 6 offers some concluding comments.

2. Foreign Commercial Banks in the Brazilian Economy in 1987

At the end of 1987 there were 19 commercial banks fully owned by foreigners. Table 1 shows the banks fully owned by foreigners and the country where the headquarters is located. Of these 19 banks, 11 are European, 5 Latin American, 2 American, and 1 Canadian.

Besides these 19 banks fully owned by foreigners, there were 10 commercial banks with both Brazilian and foreign shareholders. In Table 2 we present these 10 banks as well as the participation of the foreign shareholder. As one can see these 10 banks have European, American, and Japanese shareholders.

In this paper we will consider any commercial bank with a foreign shareholder as foreign. It should be mentioned that we are not following the classification utilized by the Brazilian Central Bank. According to the Banking Instruction Guideline (Manual de Normas e Instruções), a bank is only considered to be foreign when it is a branch of a bank with headquarters abroad.^{4/} The reason for considering any bank with a minority foreign shareholding position as a foreign one is that in the majority of cases the foreign shareholder in practice has the either the control or is responsible for the management.

The size of the foreign banks operating in the Brazilian financial market is quite diverse. While total assets of the largest bank, Citibank, reached US\$ 3 052 million in 1987, total assets of the smallest bank, Union de Bancos de Uruguay, amounted

Table 1

PRIVATE COMMERCIAL BANKS FULLY OWNED BY FOREIGNERS, 1987

Banks	Country
Banca Commerciale Italiana	Italy
Banco de Boston	U.S.A.
Banco Europeu para a América Latina - BEAL	Belgium
Banco Exterior de Espana	Spain
Banco Financial Português	Portugal
Banco Hispano Americano	Spain
Banco Holandês Unido	Netherlands
Banco de la Nación Argentina	Argentina
Banco de la Provincia de Buenos Aires	Argentina
Banco de la República Oriental del Uruguay	Uruguay
Banco Royal do Canada	Canada
Banco Santander	Spain
Banco Union	Venezuela
Centrobanco	Spain
Citibank	U.S.A.
Deutsche Bank Adtiengesellschaft	Germany
Lloyds Bank International Limited	U.K.
Nederlandsche Middenstandsbank - NMB -	Netherlands
Union de Bancos del Uruguay	Uruguay

Source: Revista Bancária Brasileira, several issues, and Costa Manso (1985).

Table 2

PRIVATE COMMERCIAL BANKS WITH FOREIGN PARTICIPATION
IN BRAZIL, 1987

Bank	Participation of the Foreign Shareholder in Total Capital (%)	
Banco América do Sul	14	Fuyo Bank (Japan)
Banco Brasileiro Iraquiano	50	Raffidin Bank (Iraq)
Banco Chase Manhattan	100	a/ The Chase Manhattan Bank (US)
Banco Cidade	45	Banque Nationale de Paris (France)
Banco Francês e Brasileiro	53.5	b/ Credit Lyonnais (France)
Banco Mitsubishi Brasileiro	85	Mitsubishi (Japan)
Banco Sogeral	36	Société Générale (France)
Banco Sudameris Brasil	56.3	Banque Sudameris (Paris) c/
Banco Sumitomo Brasileiro	100	a/ The Sumitomo Bank (Japan)
Banco de Tokyo	100	a/ Bank of Tokyo (Japan)

Source: Revista Bancária, several issues, Costa Manso (1985), and Brasil Company Handbook, 1989 Edition.

- a/ Brazilian shareholders with less than 0.1 percent of total capital.
- b/ Direct participation of Credit Lyonnais amounts to 43.5 percent. The additional 10 percent is held through a brazilian holding company (Comaco) fully controlled by Credit Lyonnais.
- c/ The major shareholders of Banque Sudameris (Paris) are Banque de Paris et des Pays Bas (PARIBAS) and Banca Commerciale Italiana.

to only US\$ 2.4 million in that same year. This discrepancy in size leads to a large concentration of assets, loans, and deposits in a few banks. In this respect one may note that total assets of the five largest foreign banks, Citibank, Francês e Brasileiro, Lloyds, Chase Manhattan, and Sudameris, represented in 1987 almost 65 percent of total assets of all 29 foreign commercial banks. In relation to demand and time deposits, the degree of concentration was even higher. These five banks held almost 70 percent of all foreign bank deposits.

In Table 3 we present the total assets of each one of the 15 largest foreign commercial banks at the end of 1987. Looking at that table one has a clear picture of how concentrated is the distribution of assets among foreign commercial banks in Brazil. The 15 largest banks held 96.1 percent of total assets of all foreign banks.

It can also be seen in Table 3 that in 1987 total assets of all 29 foreign banks amounted to 35 percent of the total assets of all private commercial banks and to 25.3 percent of the entire commercial banking sector (excluding Banco do Brasil). 5/ This gives an idea of the relative importance of the foreign banks in the Brazilian economy. 6/ It should be pointed out, however, that this comparison clearly overestimates the participation of foreign banks in the Brazilian financial sector. This is due to the segmentation of the country's financial market and to the fact that while private domestic banks have been able to circumvent this segmentation through the establishment of subsidiaries in all financial markets, foreign banks have not.

a) Balance Sheet Structure of the Commercial Foreign Banks in 1987

In this section we will examine the balance sheet structure of the foreign commercial banks operating in the Brazilian economy. We will restrict our analysis to the 5 largest foreign banks. Given the high degree of concentration of assets, loans, and deposits among a few banks we are not missing very much by restricting the analysis to the largest banks.

We will compare the foreign banks to the 5 largest private domestic commercial banks. Since in practice all financial companies controlled by these private domestic commercial banks operate in an integrated way, it is important to also have some information on their consolidated balance sheet.

Table 3

ASSETS OF THE FOREIGN COMMERCIAL BANKS IN DECEMBER, 1987,
(US\$ million and percentage)

Banks	Assets	Market Share	
Citibank	3 052.1	21.74	
Francês e Brasileiro	2 133.7	15.16	
Lloyds	1 373.9	9.78	
Chase Manhattan	1 261.9	8.99	
Sudameris	1 175.0	8.37	
America do Sul	1 012.2	7.21	64.04
Tokyo	628.8	4.48	
Boston	610.7	4.35	
Mitsubishi	474.3	3.38	
Sumitomo	394.5	2.81	
Cidade	341.0	2.43	
Sogeral	326.5	2.33	
BEAL	286.3	2.04	
Holandês Unido	222.0	1.58	
Royal do Canadá	197.4	1.41	
1. All Foreign Banks	14 042.0	100.00	96.06
as % of 2	34.96		
2. All Private Banks	40 165.8		
as % of 3	25.25		
3. All Banks <u>a/</u>	55 603.6		

Source: Revista Bancária, February, March, and April, 1988, and Boletim Mensal do Banco Central do Brasil, vol. 24, No. 6, June, 1988.

a/ All banks except Banco do Brasil.

Table 4 presents the assets composition of the largest foreign and private domestic commercial banks at the end of 1987. The most obvious difference that can be pointed out is related to the share of liquid assets (cash and short term securities) in total assets. While for the 5 largest private domestic banks cash and securities amounted to 27.62 percent of total assets (22.86 percent in the consolidated balance sheets), for the foreign banks these assets represented only 19.67 percent. The higher share of cash and securities in private domestic banks total assets reflects the fact that demand deposits are a much more important source of funding for them. We will return to this point later on in section 4a.

The share of permanent assets in total assets is much higher for the private domestic than for foreign banks. In 1987, permanent assets represented 7.43 percent of total assets of these banks (6.47 percent when we consider the figures of the consolidated balance sheets), while it only amounted to 4.50 percent in the foreign banks. The higher share of permanent assets reflects the fact that the private banks have a much larger network of branches.

Finally, in Table 4 we can see that the total consolidated assets of all financial companies controlled by the 5 largest private domestic commercial banks (including obviously the assets of the commercial banks) are more than 50 percent higher than the total assets of the commercial banks alone. Although we do not have any consolidated balance sheet information for any foreign bank the importance of the commercial bank in relation to the other financial companies is much higher. In the case of Chase Manhattan, 7/ for instance, total assets of the commercial bank were more than 40 times higher than total assets of the investment bank.

Looking at the share of long term assets in Table 4 one would be led to the conclusion that while private domestic commercial banks have specialized exclusively in providing short term financing, foreign banks are still active in providing medium and long term credits.^{8/} Indeed, as Table 4 shows, while the participation of long term assets in the total assets of the five largest private domestic banks was less than 3 percent at the end of 1987, the share of these assets in total assets of the five largest foreign banks in that year amounted to almost 12 percent. However, when we examine the consolidated balance sheet structure of the private domestic bank we see that long term loans assets amounted to 11.94 percent of total assets. It is therefore important to examine the composition of loan portfolio of both foreign and domestic banks to see if there are any differences.

Table 4

CASH, SECURITIES, LOANS, LONG TERM ASSETS,
AND PERMANENT ASSETS OF COMMERCIAL BANKS IN DECEMBER 1987,
AS A PERCENTAGE OF TOTAL ASSETS

Banks	Cash	Securities	Loans	Long Term Assets	Perm- anent	Total (US\$ million)
Private Foreign 5 Largest <u>a/</u>	1.16	18.51	59.99	11.80	4.50	9 235
Private Domestic 5 largest <u>b/</u>	3.80	23.82	33.57	2.67	7.43	23 366
Total consolidated assets	7.08	15.78	50.80	11.94	6.47	36 579

Source: Revista Bancária, January, February, March, and April, 1988, and Boletim do Banco Central do Brasil, several issues.

- a/ The 5 largest foreign commercial banks are: Citibank, Francês e Brasileiro, Lloyds, Chase Manhattan, and Sudameris.
- b/ The 5 largest private domestic commercial banks are: Bamerindus, Bradesco, Itau, Nacional, and Unibanco.

Table 5 shows the composition of the largest private and foreign commercial banks loan portfolio at the end of 1988. For previous years we do not have such information. The figures for the private banks were taken from their consolidated balance sheets. Looking at that Table one can see that on average one fourth of the credits advanced by the largest foreign banks in 1988 went to exports and imports financing. In that same year the largest private domestic banks, with the exception of Bamerindus, channeled less than 10 percent of their loans to foreign trade activities.

Another important and quite unexpected difference between foreign and private domestic banks is related to the exposure to the public sector. While public sector exposure is very low in private domestic banks (less than 5 percent of total loans), in Citibank, Lloyds, and Chase Manhattan credits to the government represent more than 20 percent of the portfolio of loans. Since these foreign banks are quite active in providing trade financing to several state-owned companies, the exposure to the public sector may be even higher. Banco Francês e Brasileiro and Sudameris have very low public sector exposure.

The very high exposures of Citibank, Chase Manhattan, and Lloyds in the public sector point out to the fact that one cannot portray foreign banks in Brazil as risk averse institutions that only lend to prime borrowers (especially transnational companies) and therefore charge minimal spreads.

Examining Table 5 one can see that a substantial amount of the largest private domestic banks credits goes to real-estate financing. In the case of Bradesco, for instance, mortgages and other kinds of credits to the housing sector represent almost 40 percent of its loan portfolio. Foreign banks, on the other hand, do not have any exposure in real-estate. This pronounced contrast results from the fact that foreign banks have not been allowed by the Central Bank to hold any stake (not even a minority position) in Savings & Loans companies.

Finally, Table 5 shows that credits to agriculture activities represent on average a higher share of the largest private domestic banks portfolio of loans. This is due to the fact commercial banks are required to channel around 15 percent of their demand deposits to the financing of the agricultural sector and that these deposits are quite unimportant for the largest foreign banks.

Table 6 presents the structure of the liabilities of the largest foreign and private domestic commercial banks at the end of 1987. Looking at this Table one may note that the two most striking differences between foreign and domestic commercial banks are related to the participation of demand and time deposits in total liabilities. While for the 5 largest foreign banks demand

Table 5

COMMERCIAL BANKS LOANS TO THE PUBLIC SECTOR,
AGRICULTURE, REAL-ESTATE, AND FOREIGN TRADE AS
PERCENTAGE OF TOTAL LOANS IN DECEMBER, 1988

(Percentage)

Banks	Public Sector	Agriculture	Housing, Mortgages	Foreign Trade
Largest foreign:				
Citibank	30.01	2.53	-	27.07
Francês	1.73	2.08	-	28.08
Lloyds	22.20	0.67	-	27.80
Sudameris	2.24	1.08	-	32.57
Chase	20.01	0.58	-	18.40
Largest domestic:				
Bradesco	0.98	6.19	39.57	5.93
Itau	3.74	5.18	27.23	9.00
Bamerindus	4.62	4.55	37.16	15.93
Unibanco	2.95	1.54	20.10	4.54
Nacional	3.58	2.77	16.12	4.35

Source: Revista Bancária Brasileira, January and February 1989.

Table 6

DEMAND DEPOSITS, LONG TERM LIABILITIES, FOREIGN CURRENCY
LIABILITIES, AND NET WORTH OF COMMERCIAL BANKS IN DECEMBER 1987,
AS A PERCENTAGE OF TOTAL LIABILITIES.

Banks	Demand Deposits	Time Deposits	Savings Deposits	Foreign <u>a</u> / Currency	Net Worth
Private Foreign 5 Largest <u>a</u> /	1.61	18.76	-	33.48	6.03
Priv.Domestic 5 largest <u>b</u> /	15.09	5.00	-	9.56	13.42
Total consolidated	5.34	8.05	24.34	5.29	8.56

Source: Revista Bancária, January, February, March, and April, 1988, and Boletim do Banco Central do Brasil, June, 1988.

- a/ Includes all foreign currency liabilities. It should be noted most foreign currency liabilities are long term.
- b/ The 5 largest foreign commercial banks are: Citibank, Francês e Brasileiro, Lloyds, Chase Manhattan, and Sudameris.
- c/ The 5 largest private domestic commercial banks are: Bamerindus, Bradesco, Itau, Nacional, and Unibanco.

deposits amounted to 1.6 percent of total liabilities, for the largest private domestic commercial banks it reached more than 15 percent. With respect to time deposits, their share in total

liabilities of the foreign and private domestic banks were 18.8 percent and 5.3 percent respectively. For the private domestic banks as a whole demand deposits have a much lower importance as a source of fundings (5.34 percent of total liabilities). The most important source of funds in recent years has been the savings deposits 9/, which in 1987 amounted to almost one quarter of all liabilities.

Another important difference in the balance sheet structure of foreign and private domestic banks is the share of foreign currency liabilities. While for the domestic banks these liabilities represented less than 11 percent of total liabilities, for the foreign banks they amounted to 32.4 percent. The share of long term liabilities in total liabilities of the foreign banks is also much higher than in the domestic ones. The higher share of foreign currency liabilities in foreign banks total liabilities is related to the much higher ability of these banks to borrow abroad. This ability to borrow abroad is also responsible for the much higher share of long term liabilities in foreign banks since the Brazilian Central Bank over the last years has only allowed short term borrowing abroad for trade financing.

The differences in the balance sheet structure that we have pointed out are to a great extent explained by the fact that while domestic banks operate both in the retail and in the wholesale markets, foreign banks activities are almost completely concentrated in the latter. The choice of the foreign banks for the wholesale market must be attributed to the tight restrictions imposed by the Central Bank on the number of branches they could have. 10/ To better understand why the restrictions on branching kept the foreign banks out of the retail market one should note that as interest payments on demand deposits were (and still are) prohibited by law, the most effective way to attract new demand deposits was through offering the convenience of a closely located branch. We will return to this point in section 4.

Finally, one should note that net worth represents a much large share of total liabilities of the private domestic banks. While net worth of the five largest foreign banks amounted to 6.03 percent of total liabilities, in the case of the largest private domestic ones it reached 13.42 percent of the total liabilities (8.56 percent in the consolidated balance sheets). The much lower net worth/total assets ratio presented by foreign banks probably reflects the fact that these banks have a superior capacity to raise funds when needed. They are perceived by the public in general as being low risk institutions and this allows them to operate with a high degree of leverage.

Table 7 shows that in 1987 the loans in liquidation of the largest foreign banks amounted to 2.6 percent of their portfolio of loans. In that year, the ratio of loans in liquidation to total loans of the 5 largest private domestic banks reached 2.7 percent.^{11/} This very high percentage of bad loans was into a great extent the result of the Cruzado plan. We will return to this point later on in section 4a.

It is important to emphasize once again that the very high percentage of bad credits in the largest foreign banks loan portfolio indicates that it does not seem to be appropriate to characterize these banks as conservative financial institutions that lend primarily to prime borrowers.

Finally, in Table 7 we also present for foreign and private domestic commercial banks net income before tax as a percentage of the net worth. In 1987 the average rate of return on net worth for the 5 largest foreign banks operating in the country reached 30 percent. The rate of return on net worth for the 5 largest private domestic banks was only 16.1 percent (20.2 percent in the consolidated balance sheets). Although the percentage of bad loans was high, profitability remained in very satisfactory levels.

We have suggested before that foreign banks concentrate their activities in the wholesale market and that their main customers are large transnational companies. As these companies in general are able to borrow paying an interest rate close to prime rate, it would be surprising that foreign banks were more profitable than domestic banks. To understand why this was the case it is important to have in mind the fact that foreign banks are able to operate in a very leveraged way. Since they have an extremely low net worth/total assets ratio, small spreads are not incompatible with a high profit rate.

b) Geographical Distribution of Activities

The activities of the foreign banks are very concentrated in a few states. To illustrate this concentration we present in Table 8 the share of Rio de Janeiro and São Paulo states in total outstanding loans, demand deposits, and branches of the largest foreign and private domestic commercial banks. Looking at that Table we can see that 46 percent of all loans given by the 5 largest foreign banks in 1987 went to companies and/or persons from the states of Rio de Janeiro and São Paulo. In relation to demand deposits and branches, the share of these two states was even higher. More than 65 percent of the 5 largest foreign banks demand deposits came from the states of Rio de Janeiro and São Paulo.

Table 7

FOREIGN AND PRIVATE DOMESTIC COMMERCIAL BANKS,
LOANS IN LIQUIDATION AS A PERCENTAGE OF TOTAL LOANS AND
NET INCOME BEFORE TAX AS A PERCENTAGE OF NET WORTH IN 1987

Banks	Loans in Liquidation	Net Income Before Tax	
	Total Loans	Net Worth	Assets
Private foreign <u>a/</u> 5 largest	2.56	29.58	1.78
Private Domestic 5 largest <u>b/</u>	2.75	16.14	2.17
Total consolidated assets	2.14	20.21	1.73

Source: Revista Bancária, February, March, and April, 1988.

- a/ The 5 largest foreign commercial banks are: Citibank, Francês e Brasileiro, Lloyds, Chase Manhattan, and Sudameris.
b/ The 5 largest private domestic commercial banks are: Bamerindus, Bradesco, Itau, Nacional, and Unibanco.

Table 8

SHARE OF RIO DE JANEIRO AND SÃO PAULO STATES IN PRIVATE FOREIGN
AND PRIVATE DOMESTIC COMMERCIAL BANKS LOANS, DEMAND DEPOSITS,
AND BRANCHES IN DECEMBER, 1987

(Percentage)

Banks	Loans	Demand Deposits	Branches
Private Foreign <u>a/</u>	54.6	66.2	55.5
Private Domestic	37.7	66.2	45.3

Source: Banco Central do Brasil

- a/ The foreign commercial banks are the 5 largest ones, namely Citibank, Francês e Brasileiro, Lloyds, Chase Manhattan, and Sudameris.
- b/ The private domestic commercial banks are the 5 largest ones, namely Bamerindus, Bradesco, Itau, Nacional, and Unibanco.

Although the activities of the largest private domestic banks also present a high degree of concentration, they are more homogeneously distributed over the different states. In fact, loans to companies and/or persons located in these two states represented in 1987 only 37.7 percent of all loans given by the 5 largest private domestic banks. This figure is well below the share of Rio de Janeiro and São Paulo in foreign banks loans. With respect demand deposits and branches, the degree of geographical concentration is not very different from the one presented by foreign banks.

c) Employment

The information on employment in the Brazilian banking «sector is very limited. For private banks (including the foreign ones operating in Brazil) we must rely entirely on surveys conducted by the Brazilian Banking Federation (Febraban). For state-controlled banks, the Secretariat for the Control of Federal Public Enterprises (SEST) started providing information in the early 1980s.

According to the most recent survey conducted by Febraban, total employment in a sample of 20 private commercial banks operating in Brazil was 342 820 in June, 1988. The five foreign banks included in the survey employed only 13 628 persons.

In Table 9 we present the total number of employees of the 5 largest foreign and private domestic banks at the end of 1988. To be able to compare these figures we also present in that Table the number of employees per branch, per total assets, and per deposits. For the foreign banks we have considered the employment figures from the Febraban survey. For the private domestic banks we have taken the employment information from their annual reports. In most cases they include the total number of employees in all companies, financial and non-financial, controlled by the commercial bank. 12/

As it can be seen in Table 9, there is a sharp difference between Citibank, Chase Manhattan, and Lloyds and the largest private domestic banks with respect to the number of employees per branch, per total assets, and per deposits. While the average number of employees per branch in these three foreign banks was 92.7 it was, for instance, 82.7 in the entire Bradesco group. The others private domestic banks had an even lower employee/branch ratio. In relation to the number of employees per total assets and per deposits the differences were still more pronounced. While deposits per employee in Citibank, Chase Manhattan, and Lloyds was US\$ 155.7 thousand, it amounted only to less than US\$ 50 thousand in the 6 largest private domestic banks.

Table 9

EMPLOYMENT IN THE COMMERCIAL BANKING SECTOR, 1988

Banks	Number of Employees		Deposits a/ per Employee (US\$ 000)	Total Assets per Employee (US\$ 000)
	Total	per Branch		
Foreign:				
3 largest b/	6 583	92.7	216.62	895.96
Sudameris	4 030	55.2	154.33	425.52
Frances	3 787	68.9	129.76	525.14
Domestic:				
Bamerindus	41 000	47.8	52.84	180.51
Bradesco	138 000	82.7	54.22	100.50
Itau	84 169	50.6	54.63	106.62
Nacional	24 288	60.1	46.49	149.78
Unibanco	27 000	42.5	65.44	167.08
B. do Brasil	135 425	50.7	60.24	465.79

Source: Febraban, Sistema de Informações de Recursos Humanos, May 10, 1989, Revista Bancária, several issues. All Banco do Brasil figures were taken from Banco do Brasil, Anuário Estatístico, 1986 and Annual Report for 1987. Unibanco, Sudameris, and Francês e Brasileiro employment figures were taken from Brazil Company Handbook, 1989 Edition.

a/ Demand, time, and savings deposits.

b/ Chase, Citibank, and Lloyds.

In the case of Banco Francês e Brasileiro and Sudameris the number of employees per branch was much lower than in the three other foreign banks. These two banks had at the end of 1987 only 51.4 employees per branch, less than the average of the largest private domestic banks. Total assets and total deposits per employee, however, were much higher than the domestic banks figures.

The Febraban survey also provides a great deal of information on the characteristics of the labor force in the Brazilian banking sector. It should be noted that this information only comprehends the employees of the commercial banks. As we can see in Table 10, foreign banks employees are on average older, better educated, and less likely to either quit or be fired as compared to the ones employed in private domestic banks. In the 6 largest private domestic banks only 17.5 percent of the employees had a university degree. The percentage of the employees with a university degree in Citibank, Chase Manhattan, and Lloyds reached almost 60 percent. We have also included information on Banco do Brazil. The percentage of employees with a university degree in that bank is much higher than in the private domestic banks but lower than in Citibank, Chase, and Lloyds.

The fact that the largest private domestic banks concentrate their activities in the retail market is very well illustrated by the high percentage of tellers among their employees. As Table 10 shows, more than one fifth of all persons employed in these banks are tellers. In Citibank, Chase Manhattan, and Lloyds the share of tellers is below 3 percent. This low figure can be used as evidence to the fact that for these three banks the retail market has virtually no importance at all. The share of tellers in Banco Francês e Brasileiro and Sudameris is much higher than in the three other foreign banks. The fact that these two banks are not fully owned by foreigners have allowed them to expand their network of branches and therefore compete for demand deposits, payments, and collections.

Finally, one can also see that labor turn-over is slightly lower in foreign banks than in domestic ones. While in the six largest private domestic banks labor turnover reached 13.43 percent, in Citibank, Chase Manhattan, and Lloyds it was 10.39 percent. As it could be expected, labor turn-over in Banco do Brazil is the lowest of all banks.

Table 10

CHARACTERISTICS OF THE LABOR FORCE IN THE BANKING SECTOR, 1988.

(Percentage)

Banks	University Degree	35 Years Old or More	Teller	Labor Turn-Over
Foreign:				
3 largest <u>a/</u>	57.84	23.33	2.93	10.39
5 largest <u>b/</u>	37.00	23.13	9.77	11.48
Domestic:				
Large <u>c/</u>	17.54	8.98	20.18	13.43
Small <u>d/</u>	26.09	23.12	9.26	15.16
Banco do Brasil <u>e/</u>	44.04	36.72	n.a.	1.02

Source: Febraban, Sistema de Informações de Recursos Humanos, May 10, 1989, and Banco do Brasil, Anuário Estatístico, 1986.

a/ Chase, Citibank, Lloyds.

b/ Francês e Brasileiro, Sudameris.

c/ Bamerindus, Bradesco, Itau, Nacional, Real, and Unibanco.

d/ Boavista, and Mercantil de Desconto.

e/ The Banco do Brasil figures are for 1986.

In Table 11 we present the average monthly wage paid by selected foreign and private domestic commercial banks according to the survey conducted by Febraban in mid 1988. We have set the Bradesco figure to 100. As it should be expected the average wage paid by foreign banks is substantially higher than the one paid by private domestic banks. The average Citibank employee, for instance, receives a wage that is more than five times higher than the one received by the average Bradesco employee. This wage differential reflects the fact that foreign banks hire better educated persons, in many cases fluent in a foreign language.

To check the relative wage figures from the Febraban survey we have calculated the average monthly personnel expenses in US dollars for the largest foreign and private domestic commercial banks along 1988. It should be noted that these expenses include not only salary payments but also employer's social security

contributions, pay-roll taxes, and training expenses. It is important to mention that we have used the average exchange rate to convert the personnel expenditures in cruzados from the balance sheets into US dollars. In doing this we are implicitly assuming that the pattern of personnel expenses is relatively flat. 13/

As one can see, foreign banks personnel expenses are much higher than the private domestic banks. While the average monthly personnel expenses per employee of Citibank, Chase Manhattan, and Lloyds, for instance, reached US\$ 2 018, in the case of Bradesco it only amounted to US\$ 592. Sudameris's monthly personnel expenses per employee, which is the lowest among the largest foreign banks, is almost 50 percent higher Banco Nacional's expenses, which is the highest among the private domestic banks.

The monthly personnel expenses figures are quite consistent with the data from the Febraban survey. Sudameris' personnel expenses, for instance, are 91 percent higher than Bradesco's. This is exactly the difference in salaries reported in the Febraban survey. The only point of divergence between the relative wage and personnel expenses figures is related to the private domestic banks. While the Febraban survey indicates that the average wage paid by Bamerindus is more than twice the one paid by Bradesco, personnel expenses per employee of the two banks suggests that there are no differences between these two banks in labor cost per employee.

It should be noted that Banco do Brazil's expenses per employee are completely out of proportion when compared to any other commercial bank operating in the country. As one can see in Table 11, they are more than twice higher than the average of Citibank, Chase, and Lloyds personnel expenditure per employee.

Table 11

AVERAGE MONTHLY PERSONNEL EXPENDITURES PER EMPLOYEE, RELATIVE WAGES, AND ADMINISTRATIVE EXPENDITURES AS A PERCENTAGE OF TOTAL ASSETS IN THE COMMERCIAL BANKING SECTOR, 1988

Bank	Relative Average Wage (Bradesco = 100)	Personnel Expenses <u>a/</u> (US\$)	Administrative Expenses (as % of assets)
Foreign:			
I. 3 largest		2 018	
Chase	355.6		5.20
Citibank	584.4		4.88
Lloyds	384.4		5.09
Francês	277.8	1 847	5.06
Sudameris	191.1	1 138	5.92
Private Domestic:			
Bamerindus	266.7	593	6.06
Bradesco	100.0	594	10.11
Itau	122.2	635	11.43
Nacional	184.4	762	10.78
Unibanco	171.1	541	8.78
Banco do Brasil	n.a.	5 262	14.89

Source: The relative average wage and employment of foreign banks were taken from Febraban, Sistema de Informações de Recursos Humanos, May 10, 1989. Personnel expenditures and employment of Bradesco, Itau, and Nacional were taken from Revista Bancária, February and March, 1988.

a/ per month per employee.

We have also included in Table 11 information on administrative expenditures (which include all staff costs) for the largest foreign and private domestic banks and for Banco do Brasil. As one can see, foreign banks administrative expenditures as a percentage of total assets are substantially lower than the ones of the private domestic banks. While in Citibank administrative costs in 1988 amounted to less than 5 percent of total assets, in Bradesco they reached more than 10 percent.

Finally, it is important to point out that administrative costs of the Brazilian banks are extremely high when compared to other countries. Staff costs as a percentage of total assets in the commercial banking sector in OECD countries has remained below 1.5 percent in the current decade. ^{14/} Even when the Brazilian figures are compared with the ones of the other Latin American countries it remains quite clear that they are well above the average. ^{15/} This very high administrative costs is into a great extent the result of a non-price competition mechanism brought about by an environment of high inflation and interest payments regulation. In such an environment, competition for demand deposits, payments, transfers, and collections leads to an overinvestment in permanent assets and too much hiring. This may cause serious problems to the Brazilian commercial banking sector in case a future stabilization program is successful in achieving price stabilization in a permanent basis.

3. Foreign Banks in Brazil: An Historical Perspective

In this section we look at the evolution of foreign banks in the Brazilian economy since last century when the London and Brazilian Bank open its first branch in Rio de Janeiro. «BB» We start with a review of the different legislation governing foreign capital in the Brazilian financial market.

It should be mentioned that all information on the participation of foreign banks provided in this section are entirely limited to banks fully owned by foreigners. We do not have any information on domestic banks with foreign shareholders.

a) Legislation

The distinction between foreign and domestic banks appeared for the first time in Brazilian law in the Constitution of 1934. Article 117 of that Constitution mentions that foreign banks should be progressively nationalized. This nationalistic approach was reinforced by the Constitution of 1937. According to that

Constitution, in Article 145, only financial institutions belonging to Brazilian citizens would be allowed to operate in the country. All existing foreign banks were to be sold in a "reasonable" number of years. The time period for the nationalization of the foreign banks was defined on April 9, 1941, through decree law 3 182. This decree established June 1, 1946 as the deadline after which all commercial banks operating in the country could only have Brazilian shareholders.

The first loophole to Decree Law 3,182 came six months after its promulgation. On November 1, 1941, Decree Law 3 786 established that the 1946 deadline would not be applied to American banks operating in the country. The benefits given to American banks were extended to Canadian banks in September of 1942 and to the Bank of London and South America in June of 1943. 16/

Just a few months before the 1946 deadline was reached, Decree Law 8 568 authorized Brazilian banks with foreign shareholders to continue to operate in the country. The more liberal tide was also reflected in the Constitution of 1946. In that Constitution there was no explicit references to foreign institutions in the financial sector. Besides, the sole article that dealt with financial matters mentioned that it would be left to the common law how the financial institutions would be organized (Article No. 149).

At the end of 1964 the military government implemented a radical reform on the financial sector which was put forward by law 4,595. The new legislation introduced, once again, important distinctions between domestic and foreign financial institutions. In fact, according to Article 18 of law 4,595 financial institutions would only be allowed to operate in the country with the previous approval of the Central Bank and foreign institutions would require the approval of the Executive.

In practice, Article 18 has worked as a barrier to the entrance of new foreign banks in the Brazilian economy, either directly or indirectly through the acquisition of shares of domestic commercial banks. The main exception to this has been due to reciprocal agreement with certain countries in order to allow Brazilian banks, most notably Banco do Brazil, to expand their network of branches abroad. Law 4 595 has also imposed severe restrictions on the existing foreign banks, especially on the fully owned ones, as it led to an almost complete freeze in the number of their branches.

It is important to point out that law 4 595 did not contain any specific prohibition to the expansion of foreign banks in the country. All restrictions were imposed by the Central Bank itself since the opening of any new bank branch had to be previously approved by the Monetary Authorities. The entrance of new banks in the country depended both on the Central Bank's and on the President's approval.

The restrictions with respect to other financial institutions were less severe. According to law 4 595, foreigners could hold up to 49 percent of the total capital and 33 percent of the voting capital of any non-banking domestic financial institutions.

b) The early period: From XIX Century to World War II

The first foreign bank to operate in Brazil was the London and Brazilian Bank, which opened its first branch in Rio on February 1, 1863. Its main purpose was to provide trade financing both to Brazilian coffee exporters and to import companies. ^{17/} Sooner afterwards, other British as well as German and French banks followed the London and Brazilian Bank and established themselves in the country. The smaller European countries only started setting up their own banks in Brazil during the 1880s and 1890s. By the turn of the century, foreign banks had a substantial share of the Brazilian banking market. They concentrated their operations in trade financing and in the exchange market.

Information on foreign banks in the period before World War I is very limited. We have to rely entirely on the Statistical Yearbook for 1908/1912 which contains some information on the Brazilian financial sector in the first years of the 1910s. Information on banks is limited to the ones operating in Rio de Janeiro.

According to the Statistical Yearbook for 1908/1912 there were 7 foreign commercial banks operating in Rio de Janeiro in 1912. As Table 12 shows, these banks held more than one quarter of demand deposits kept in all banks operating in the city. ^{18/} They had 46 percent of the assets and 37 percent of the capital of Rio's banking sector. For the 1920s we can rely on the Statistical Report for 1939/1940 which contains detailed information on all foreign banks. As one can see in Table 12 there was a steady declining trend in the participation of these banks in the commercial banking sector in the period after World War I. From 1925 to 1935, for instance, the share of foreign banks in total commercial banks assets went from 36 percent to 26 percent. The share of foreign bank capital did not present a downward trend, remaining around 15 percent.

After 1935, and especially during World War II, the participation of foreign banks suffered a dramatic fall. As Table 12 shows foreign banks share in the commercial banks total assets went from 26 percent in 1935 to around 5 percent in 1945. In this period, there was also a strong reduction in the participation of

Table 12

FOREIGN COMMERCIAL BRANCHES, ASSETS, AND CAPITAL
AS A PERCENTAGE OF THE COMMERCIAL BANKING SECTOR,
1912-1945

Year	1912 <u>a/</u>	1925	1930	1935	1940	1945
Branches	n.a.	n.a.	n.a.	n.a.	5.6	1.8
Assets	45.8	36.3	24.7	25.5	15.2	5.2
Deposits <u>b/</u>	26.1	24.8	<u>c/</u> 26.4	21.6	15.2	<u>d/</u> -
Capital	37.0	13.9	13.4	14.5	12.6	3.1

Source: Anuário Estatístico do Brasil, 1908-12, vol. II, pp. 212-213 and Anuário Estatístico do Brasil, 1939-1940, pp. 380, 388-389, 1941-45, p. 231, 1947, p. 254.

a/ These figures are exclusively for banks operating in Rio de Janeiro.

b/ Demand deposits.

c/ This figure is for 1926.

d/ This figure is for 1938.

foreign banks capital in total. The dramatic reduction in foreign banks participation that occurred in the first half of the 1940s was caused by the nationalization of the German banks that took place after Brazil declared war on Germany.

c) From World War II to the 1980s 19/

During the 1950s, the combination of a rising inflation rate with a legal ceiling of 12 percent on the nominal interest rate led to the appearance of new financial institutions. These new institutions were able to circumvent the legal ceiling and attracted an increasing share of the domestic savings. Indeed, the participation of demand and most notably time deposits in total financial assets fell considerably. As a result the participation of commercial banks in total financial assets decreased from 40.8 percent in 1950 to 36.8 percent in 1960. 20/

Within the commercial banking sector there was a steady decline in the participation of foreign banks along the 1950s and first half of the 1960s. After 1970 this declining tendency was interrupted. To show these trends we present in Table 13 several measures of the participation of foreign banks in the commercial banking sector in the period 1950-80. Looking at that Table one can see that foreign banks share in total capital, loans, demand deposits and number of branches of the commercial banking sector suffered a pronounced reduction. Most of the fall took place in the period 1950-1965. In fact, the share of foreign banks loans in total commercial banks loans fell from 5.3 percent in 1950 to 1.3 percent in 1965. The reduction in foreign banks participation in other segments of the financial market was even higher. Demand deposits in foreign banks, which amounted to 8.5 percent of all such deposits in 1950, represented 15 years later only 1.6 percent of the total.

After 1965 the Central Bank stopped presenting separate information on foreign banks in its Annual Reports. Information on the share of these banks in total deposits, loans, and assets is not readily available. To have an idea of how the participation of foreign banks in the Brazilian banking sector evolved during the 1970s we have calculated their share in total commercial banking sector capital by taking the registered foreign capital at the Central Bank invested in that sector and dividing it by total net worth of the commercial banking sector. As Table 13 shows, the share of foreign banks in commercial bank capital went down from 9.5 percent in 1965 to 6.3 percent in 1970, and remained around that level until the end of the decade.

Table 13

NUMBER OF HEADQUARTERS, BRANCHES, CAPITAL, DEPOSITS,
AND LOANS OF FOREIGN BANKS AND INDICATOR OF, 1950-1980

(Number and ratios)

Year	1950	1960	1965	1970	1975	1980
Headquarters	8	8	8	8	9	17
Branches <u>a/</u>	1.6	0.8	0.7	0.5	0.4	0.3
Capital <u>b/</u>	n.a.	10.7	9.5	6.3	6.0	7.0
Capital <u>c/</u>	7.3	4.1	6.6	n.a.	n.a.	n.a.
Deposits <u>d/</u>	8.5	3.2	1.6	n.a.	n.a.	n.a.
Loans	5.4	2.8	1.3	n.a.	n.a.	n.a.

Source: Boletim do Banco Central do Brasil, several issues, Relatório do Banco Central do Brasil, several issues, and Banco Central do Brasil, Boletim Especial, vol. 24, No. 1, Jan., 1988.

- a/ Share of foreign banks branches in the total number of branches of the commercial banking sector.
- b/ Foreign registered capital in the commercial banking sector divided by total commercial banks capital accounts.
- c/ Foreign banks paid capital divided by total paid capital in commercial banks.
- d/ Demand deposits.

The participation of foreign banks branches in the total experienced a declining tendency throughout the whole 1950-1980 period. While in 1950 foreign banks had 1.6 percent of all commercial banks branches, in 1980 they had only 0.3 percent. This reduction was brought about by a sharp rise in the number of branches of the largest domestic banks while the number of foreign banks branches remained virtually unchanged.

It is should be noted that in the second half of the 1970s the number of fully owned foreign banks operating in the Brazilian economy almost doubled. After almost a quarter of a century with virtually no entry of any new institution, the number of fully owned foreign banks in the Brazilian economy jumped from 9 in 1975 to 17 in 1980. Most of this increase must be attributed to Banco do Brazil's desire to expand its network of branches abroad. A number of countries in which Banco do Brazil wanted to open a full branch conditioned their permission to receiving the same right in Brazil. The great majority of banks that entered the country through these reciprocal agreements have remained very small in size.

4. Foreign Banks in the 1980s

The financial sector in Brazil presented a phenomenal growth in the first years of the 1980s. According to the Brazilian national accounts, from 1980 to 1984 financial sector output increased by almost 27 percent while real GDP remained virtually unchanged. As a result, the share of the financial sector in GDP in these four years jumped from 7.6 percent to 11 percent.

This financial boom was caused by the rise in the profitability of financial sector brought about by the upward jump of the inflation rate that took place at the end of the 1970s. Basically, there are two channels linking inflation and financial sector profitability. First, the public's attempt to reduce their holdings of paper currency and demand deposits in response to a rise in the inflation rate will go through banks and other financial intermediaries. This will imply higher demand for the service of these institutions, allowing them to charge a higher service fee, ^{21/} leading therefore to higher profits. It is true, however, that inflation will also reduce demand deposits. The increase in the demand for other services provided by the bank must compensate this reduction. The second and more important linkage between inflation and financial intermediaries' profitability is due to the fact that an inflationary spurt usually leads to a deterioration of the budget deficit. This is what has been called in the literature the Olivera-Tanzi effect. As the majority of payments in the economy is made through the banking system, a

fraction of the government losses in real revenues due to inflation will end up being appropriated by the banks. In Bodin de Moraes (1989) it was shown that, indeed, in the Brazilian economy permanent upward jumps in expected inflation would in general lead to rises in the real share prices of Bradesco, Itau, and Banco do Brazil at the Stock Exchange. 22/

The boom in financial intermediation led to a dramatic increase in the number of commercial banks branches. From 1980 to 1984, while per capita income presented a steady declining tendency, the total number of branches increased by more than 30 percent. The number of inhabitants per branch went from 10.8 thousand to 9 thousand. In Bodin de Moraes (1988a) we have argued that this branching phenomenon was the result of a non-pricing competition process for the higher profits. In an environment in which banks could not pay interest on demand deposits, the best way to attract additional customers was to offer the convenience of a closely located branch.

The number of branches of the foreign banks did not present such a dramatic growth. In Table 14 we present the evolution of the total number of foreign commercial banks branches for selected years during the 1980s. As one can see, in the first four years of the decade the growth of the number of branches of foreign banks was moderate, going from 297 in 1980 to 359 in 1984. The share of foreign banks branches in the total number of commercial banks branches was reduced from 2.65 percent to 2.43 percent. It should be noted that most of the increase in the number of branches of the foreign banks was due to the ones with Brazilian shareholders. While the number of branches of these banks increased by 22 percent, the branches of the fully owned foreign banks only went up by 15 percent in the period.

The totally divergent pattern of evolution of foreign and private domestic banks branches is explained by the severe limitations imposed by the Brazilian Central Bank on the expansion of the former. Foreign banks were unable to compete for demand deposits and payments and collections offering the convenience of a nearby branch. It should be mentioned, however, that the mentioned restrictions on foreign banks branching apparently did not have any impact on the Citibank and Chase Manhattan. Between 1980 and 1984, for instance, the number of Citibank's branches went from 11 to 15. One may suspect that the reason for allowing this increase was somehow related to the external debt negotiation.

After 1984 there was a strong rise in the number of foreign banks branches. The occurrence of this phenomenon indicates that the restrictions on foreign banks branch expansion were somehow lowered. The number of branches of the foreign banks with no

Table 14

NUMBER OF BRANCHES, FOREIGN COMMERCIAL BANKS, 1980-1987

Banks	1980	1984	1986	1987
Fully Owned Foreign Banks:				
Commerciale Italiana	1	2	2	2
Boston	5	5	14	16
BEAL	6	6	6	6
Exterior de Espana	1	1	1	1
Financial Português	2	3	3	3
Hispano Americano	1	1	1	1
Holandês Unido	5	5	5	8
Nación Argentina	2	2	2	2
Provincia de Buenos Aires	1	1	1	1
República Oriental del Uruguay	1	1	2	2
Royal do Canada	4	4	4	4
Santander	0	1	1	1
Union	1	1	1	1
Centrobanco	1	1	1	1
Citibank	11	15	15	15
Deutsche	1	1	1	1
Lloyds	1	1	14	16
NMB	1	1	1	1
Union de Bancos del Uruguay	1	1	1	1
	46	53	76	83
Foreign Banks with Brazilian Shareholders:				
Chase Manhattan	15	21	36	34
Mitsubishi	16	18	18	19
Sudameris Brasil	62	72	72	75
Sumitono Brasileiro	4	4	4	4
Tokyo	5	5	6	7
América do Sul	91	101	124	121
Brasileiro Iraquiano	0	1	1	1
Cidade	10	22	23	26
Francês e Brasileiro	46	51	63	63
Sogeral	2	11	16	15
	251	306	363	365
Total Foreign Banks	297	359	439	448
	2.65%	2.43%	2.99%	3.18%
Total	11 251	14 736	14 679	14 087

Source: Banco Central do Brasil

Brazilian shareholders, for instance, jumped from 53 in 1984 to 1983 in 1987. While this happened, the domestic banks, especially the large private ones, put a halt on their expansion programs. The initial perception that inflation could be drastically reduced after the adoption of the Cruzado plan at the beginning of 1986 made the large banks realize that were clearly overdimensioned to operate in a low inflation economy. The share of foreign banks in total commercial banks branches jumped from 2.43 percent in 1984 to 3.18 percent in 1987.

The rapid growth in commercial banks branches had obviously an immediate impact on total employment in the sector. In Table 15 we present the number of employees in the commercial banking sector in selected years during the 1980s according to two surveys conducted by Febraban. According to the first survey on a sample of 90 commercial banks, between 1980 and 1984 total employment increase by 41.6 percent, from 468 296 to 662 926. As it should be expected, employment in the foreign banks included in the Febraban survey only rose by 2.5 percent. Obviously, what accounts for the different employment pattern is the restrictions on the number of foreign banks branches.

The figures for 1988 suggest that in the last four years once again employment in foreign and domestic banks followed a different pattern. This time employment in the foreign ones rose while in the domestic ones declined. It is important to mention, however, that since employment figures for 1988 come from a different sample of commercial banks, one should compare them with the ones for the beginning of the decade with some caution. The fact that the rate of growth of Banco do Brazil's total employment also present a declining tendency, however, can be used in support of what we have said.

It is interesting to examine if and how the mentioned restrictions on the expansion of foreign banks had an impact in their market share along the current decade. In Table 16 we present the participation of foreign banks in the commercial banking sector in selected years of the 1980s. We restricted our analysis to the 5 largest banks.

The figures presented in the Table 15 suggests that the restrictions on foreign banks branching did not cause any harm to them. The share of foreign banks in total commercial banks assets, for instance, increased from 12.6 percent in 1980 to 16.6 percent in 1984. The share of foreign banks in total loans and total deposits (demand plus time deposits) also rose. In 1980 the largest foreign banks were responsible for 16 percent of the credit advanced by the commercial banking sector (excluding Banco do Brazil). Four years later the foreign bank share had jumped to 31 percent. After 1984 the loan portfolio of the largest foreign banks

Table 15

NUMBER OF EMPLOYEES IN THE COMMERCIAL BANKING SECTOR, 1980-1988

Bank	1980 <u>a/</u>	1984 <u>a/</u>	1988 <u>b/</u> , <u>c/</u>
Foreign Banks	11 880	12 177	13 628
Private Domestic	282 668	426 620	329 820
State-Owned Banks	79 993	107 473	n.a.
Banco do Brasil	93 755	116 656	128 528 <u>d/</u>

Source: Conjuntura Econômica, Feb. 1986, Febraban, Sistema de Informações de Recursos Humanos, May 10, 1989, and Anuário Estatístico do Banco do Brasil, 1986.

- a/ From a sample of 90 commercial banks.
b/ From a sample of 20 private commercial banks.
c/ as of June.
d/ 1987.

Table 16

DEPOSITS AND LOANS OF THE COMMERCIAL BANKS, 1980-1987,
(US\$ Million and percentage)

Year	1980	1984	1987
Total Deposits <u>a/</u>			
1.Foreign <u>b/</u>	1 473.6	1 589.9	1 881.2
2.All <u>c/</u>	18 334.5	12 151.1	16 022.4
1 as % of 2	8.0	13.1	11.74
Demand Deposits			
3.Foreign <u>a/</u>	663.4	255.5	148.6
4.All <u>b/</u>	13 851.1	4 742.5	7 932.9
3 as % of 4	4.8	5.4	1.8
Loans			
5.Foreign <u>b/</u>	4 646.3	7 567.9	5 539.9
6.All <u>c/</u>	29 112.3	24 299.6	28 602.6
5 as % of 6	16.0	31.1	19.4
Total Assets			
7.Foreign <u>b/</u>	6 210.8	8 696.6	9 235.3
8.All	49 248.2	48 314.4	55 603.6
7 as % of 8	12.6	18.0	16.6

Source: Revista Bancária, several issues, and Boletim do Banco Central do Brasil, several issues.

a/ Demand and time deposits.

b/ These are the 5 largest foreign banks (see Table 4)

c/ All commercial banks except Banco do Brasil.

started losing ground in relation to the other banks. In 1987 credits advanced by the 5 largest foreign banks amounted to 19.3 percent of all commercial banking sector loans.

Not surprisingly, the only market segment in which the restrictions on the number of branches were effective was in demand deposits. In this segment foreign banks were not able to compete with domestic banks and ended up losing terrain. In fact, while in 1980 the 5 largest banks had 4.8 percent of all demand deposits excluding the ones in Banco do Brazil, in 1987 their share had fallen to 1.8 percent. This reduction in market share for demand deposits only took place in the second half of the 1980s. Apparently, until then foreign banks were able to maintain their market share.

We have seen that the restrictions on branch expansion were not effective in the sense that foreign banks not only maintained but in some cases increased their market share. We now turn our attention to how the participation of each foreign bank evolved along the 1980s. It might be the case that some banks were more effective in circumventing the restrictions imposed on them.

We present in Table 17 the sum of total assets of the 10 largest foreign banks in the selected years in the period 1980-1987 and the share of each bank in that total. Looking at that Table one cannot see any clear tendency towards the concentration of assets in a few banks. Citibank kept throughout the whole period its dominant position.

Chase Manhattan was the bank that lost more ground. Its share declined from 15.51 percent in 1980 to 11.34 percent in 1987. At the same time, Lloyds and the three fully owned Japanese banks presented substantial increases in size. The share of Banco de Tokyo, Mitsubishi, Sumitomo in total assets of the 10 largest foreign banks jumped from 8.73 percent to 12.22 percent.

Finally, it is important to point out that Chase Manhattan was able to increase its number of branches in the first half of the decade while at the same time its market share plunged. This clearly indicates that the restrictions on branch expansion had a limited importance. Since foreign banks were already out of the retailing market, they were not seriously affected by these restrictions.

a) Foreign Banks Balance Sheet Composition during the 1980s

We have shown that in 1987 there were profound differences in the balance sheet structure of foreign and private domestic commercial banks. We have argued that these differences resulted

Table 17

TOTAL ASSETS OF THE FOREIGN COMMERCIAL BANKS, 1980-1987

(Percentage)

Banks	1980	1984	1987
Citibank	27.54	32.92	25.19
Francês e Brasileiro	17.06	11.55	17.61
Chase Manhattan	15.51	12.77	11.34
Lloyds	7.80	12.59	10.42
Sudameris Brasil	9.53	7.75	9.68
América do Sul	9.94	6.23	8.35
Boston	3.89	4.16	5.19
Tokyo	3.49	4.95	5.04
Mitsubishi	2.77	3.42	3.92
Sumitomo Brasileiro	2.47	3.66	3.26
Total of foreign banks (in US\$ million)	100 (\$8 020.3)	100 (\$9 232.0)	100 (\$12 117.1)
as a % of Total All Banks <u>a/</u>	16.3	19.1	21.8

Source: Revista Bancária, several issues, and Boletim do Banco Central do Brasil, several issues.

a/ Total assets of all commercial banks except Banco do Brasil.

from two main factors. The first factor is that private domestic and foreign banks concentrate their activities in different segments of the financial market. While the former are retailing banks, the latter concentrate their activities in the wholesale market. The second one is related to the fact that foreign banks are able to carry on their activities in a highly leveraged way. Since there is the widespread perception that headquarters will not allow the Brazilian subsidiary to go bankrupt, these banks are in general able to raise funds much faster (and in a much easier way) than other private banks.

In this subsection we will examine how the balance sheets of the largest foreign and private domestic banks evolved along the 1980s. We have also included information on all private commercial banks. It should once again be noted that this information is based on the consolidated balance sheets provided by the Central Bank.

Table 18 presents the composition of assets of the largest foreign and private domestic and of all private commercial banks in selected years along the current decade. Looking at the Table we can see that the participation of loans and long term assets in total assets fell quite considerably in all banks. At the same time, the share of securities soared, especially in 1987.

The reduction in long term assets was due to the increasing difficulty in obtaining long term financing. We will discuss this later on when we analyze the changes in the liabilities structure of the commercial banks. The upward jump in the share of securities in the balance sheet that took place in 1987 is into a great extent explained by the fact that before that year any security acquired by the bank and financed permanently through overnight transactions would be left out of the bank's financial statements. Since this operation simultaneously appears in both sides of the balance sheet, it was simply excluded from it. ^{23/} The counterpart in the liabilities side to the inclusion of the securities financed through overnight operations in the financial statements was the appearance of new item called "open market operations".

Finally, it is worth emphasizing that the changes that occurred in the composition of assets followed a similar pattern in both foreign and private domestic banks. The existing differences that we have mentioned in section 2a were already present at the beginning of the decade.

Along the 1980s there was a dramatic change in the structure of liabilities of the commercial banking sector. Looking at Table 19 one can see that the importance of demand deposits as a source of funding was drastically reduced. While in 1980, these deposits amounted to almost half of the borrowed funds of the largest private banks, in 1987 they represented around 15 percent of their total liabilities. The evolution of the balance sheets of the 5

Table 18

**CASH, SECURITIES, LOANS, LONG TERM ASSETS, AND PERMANENT
ASSETS OF COMMERCIAL BANKS IN DECEMBER OF SELECTED YEARS,
AS A PERCENTAGE OF TOTAL ASSETS**

Banks/ Year	Cash	Securities	Loans	Long Term Assets	Perm- anent	Total (US\$ mi- llions)
Private Foreign <u>a/</u>						
1980	3.17	6.51	74.81	15.64	2.89	6 211
1983	1.43	2.28	90.09	15.11	2.76	7 559
1986	2.03	5.55	83.88	17.09	5.47	7 594
1987	1.16	18.50	59.99	11.80	4.50	9 235
Private Domestic <u>b/</u>						
1980	12.06	8.33	65.40	8.04	12.31	11 647
1983	3.26	12.80	57.96	10.93	14.03	12 075
1986	9.74	10.04	60.77	5.47	12.89	22 426
1987	3.82	23.82	33.57	2.67	7.43	23 366
All Private						
1980	n.a.	5.85 <u>c/</u>	52.09	n.a.	8.43	32 883
1983	n.a.	6.19 <u>c/</u>	40.10	n.a.	10.41	33 019
1986	n.a.	8.63 <u>c/</u>	58.45	n.a.	11.58	45 576
1987	n.a.	23.66 <u>c/</u>	41.84	n.a.	13.36	40 165

Source: Revista Bancária, several issues, and Boletim do Banco Central do Brasil, several issues.

- a/ The foreign commercial banks are the 5 largest ones, namely Citibank, Francês e Brasileiro, Lloyds, Chase Manhattan, and Sudameris.
- b/ The private domestic commercial banks are the 5 largest ones, namely Bamerindus, Bradesco, Itau, Nacional, and Unibanco.
- c/ It only includes federal and state government bonds.

largest foreign banks also shows a substantial reduction in the share of demand deposits. In the period 1980-1987 the share of demand deposits declined from 10.68 percent to 1.61 percent.

The fall in the share of demand deposits was brought about by the rise in the inflation rate. The higher opportunity cost of holding money led to the substitution of indexed short term assets for demand deposits. In fact, the only interruption in the downward trend presented by the share of demand deposits occurred in 1986 when the price freeze stabilization program (the Cruzado plan) was adopted.

Looking at Table 19 we also can see that foreign currency liabilities initially presented a strong upward trend. From 1980 to 1983 its share in the balance sheets of all private banks jumped from 36.1 percent to 56.23 percent. In 1983 foreign currency liabilities amounted to more than 70 percent of all liabilities of the largest foreign banks. It should be mentioned that since the Central Bank did (and still does) not allow Brazilian banks to issue liabilities in foreign currency, most of these foreign currency liabilities were borrowed abroad. Thus, foreign banks operating in the Brazilian economy were in 1983 acting simply as a broker, intermediating financial transactions between headquarters and the borrower in the country.

After 1983, the upward trend of foreign currency liabilities was totally reversed. The decline was more accentuated in the large private domestic banks. Indeed, from 1983 to 1987 the share of these liabilities in the balance sheet of the large private domestic declined from more than 30 percent to less than 10 percent. The reason for this decline was probably due to the virtually suspension of voluntary lending to all highly indebted countries after the Mexican moratorium in August of 1982.

The share of long term liabilities followed a pattern very much similar to the one presented by foreign currency liabilities. Looking at Table 19 we can see that for both foreign and private banks the share of these liabilities increased in the period 1980-83 and fell afterwards. To understand why the participation of long term liabilities went up during the first three years of the 1980s one should recall that the Central Bank only allowed short term borrowing abroad to finance trade transactions. A great deal of the foreign currency liabilities had a maturity well over six months. The plunge in the share of long term liabilities that took place after 1983 was into a great extent brought about by the rise in both the level and in the degree of variability of the inflation rate.

Table 19

DEMAND DEPOSITS, LONG TERM LIABILITIES, FOREIGN CURRENCY LIABILITIES, AND NET WORTH OF COMMERCIAL BANKS IN DECEMBER OF SELECTED YEARS, AS A PERCENTAGE OF TOTAL LIABILITIES.

Banks/ Year	Demand Deposits	Time Deposits	Long Term Liabilities	Foreign <u>a</u> / Currency	Net Worth
Private Foreign <u>b</u> /					
1980	10.68	13.04	21.48	56.15	4.04
1983	2.86	11.13	32.36	71.46	4.31
1986	4.34	38.01	17.02	34.32	6.51
1987	1.61	18.76	11.19	33.48	6.06
Private Domestic <u>c</u> /					
1980	49.61	2.94	7.49	19.33	11.42
1983	19.71	4.51	17.56	32.54	14.72
1986	42.69	17.55	4.03	11.28	14.34
1987	15.09	5.02	3.07	9.56	13.42
All Private					
1980	30.50	6.92	n.a.	36.11	10.26
1983	13.02	9.69	n.a.	56.23	13.47
1986	30.38	28.91	n.a.	22.45	14.63
1987	12.52	15.79	n.a.	24.09	17.21

Source: Revista Bancária, several issues, and Boletim do Banco Central do Brasil, several issues.

- a/ It includes all foreign currency liabilities. It should be noted that a great deal of long term liabilities are also foreign currency liabilities.
- b/ The foreign commercial banks are the 5 largest, namely Citibank, Francês e Brasileiro, Lloyds, Chase Manhattan, and Sudameris.
- c/ The private domestic commercial banks are the 5 largest ones, namely Bamerindus, Bradesco, Itau, Nacional, and Unibanco.

Finally, we should mention that the much higher share of securities in total assets of the largest private domestic banks in 1987 reflects the fact that open market operations are more important for these banks than for the foreign ones. We have just mentioned that with the rise of the inflation rate there was a flight away from demand deposits. These funds ended up being channeled to the financing of government bonds. This was possible because the banking sector was able to transform a medium term bond into an indexed overnight deposit.

We have pointed out in section 2a that the largest private domestic commercial banks had in 1987 a much larger credits in liquidation/total outstanding loans than the largest foreign banks. It is interesting to examine if this has always been the case or if it only occurred in that year.

In Table 20 we present the evolution of the loans in liquidation as a percentage of total outstanding loans in the commercial banking sector in selected years during the 1980s. As we can see, foreign and private domestic banks presented in all years but 1987 very similar loans in liquidation/total loans ratios, with the first being slightly higher than the second. These similar ratios indicate that it is not appropriate to characterize the largest private domestic banks as aggressive and risk prone institutions while the largest foreign banks are conservative ones. Apparently, the fact that domestic banks concentrate their activities in the retail market while foreign banks operate mainly in the wholesale market did not have any significant impact on the degree of riskiness of the portfolio of loans.

The figures for non-performing credits as a percentage of total outstanding loans that comes out of the consolidated balance sheets of the private commercial banking sector along the 1980s suggest that medium and small size domestic banks are much more aggressive and risk prone than the largest foreign and private domestic ones. In fact, in all years included in Table 20 with the sole exception of 1987, loans in liquidation as a percentage of total loans in the largest foreign and private domestic banks were well below the average of the entire private commercial bank sector.

Finally, it should be pointed out that in 1987, the percentage of loans in liquidation in the entire commercial banking sector soared. The rise in non performing loans was much higher in the case of domestic banks. Loans in liquidation as a percentage of total loans of the these banks jumped from 0.20 percent in 1986 to 1.73 percent in 1987. In the balance sheet of the foreign banks that ratio only rose from 0.28 percent to 0.79 percent. This deterioration in the quality of banks portfolio of loans that occurred in 1987 had its origin in the Cruzado plan. The initial

Table 20

LOANS IN LIQUIDATION AS A PERCENTAGE OF TOTAL LOANS
IN FOREIGN AND PRIVATE COMMERCIAL BANKS, 1980-987

Year	Loans in Liquidation/Total Loans		
	Foreign <u>a/</u>	Large Private Dom. <u>b/</u>	All Private
1980	0.27	0.21	0.44
1983	0.63	0.76	1.07
1986	0.30	0.23	0.39
1987	2.56	2.75	1.85

Source: Revista Bancária, several issues and Boletim do Banco Central do Brasil, several issues.

- a/ The foreign commercial banks are the 10 largest, namely Citibank, Francês e Brasileiro, Lloyds, Chase, Sudameris, América do Sul, Tokyo, Boston, Mitsubishi, and Sumitomo.
- b/ The private domestic commercial banks are the 6 largest ones, namely Bamerindus, Bradesco, Itau, Nacional, Real, and Unibanco.

euphoria with the success of the price freeze program and the pronounced increase in demand fueled by wage increases led to a vigorous expansion in the demand for credit. ^{24/} With the rise in demand deposits that followed price stabilization, commercial banks were able to satisfy the higher demand by increasing the volume of credit. In the first six months of the price freeze commercial banks (excluding Banco do Brasil) credits to the private sector increased 40 percent in real terms. The collapse of the Cruzado plan was followed by a reduction in demand and by a wave of small and medium size companies failures.

We have mentioned before in our broad picture of the Brazilian commercial banking sector that foreign banks profitability rate in 1987 was almost twice higher than the one of the largest private domestic banks. In order to know if what happened in 1987 was an isolated fact or a tendency we have calculated for the entire decade the net income before tax/net worth ratio. Table 21 shows the evolution of this ratio for the largest foreign and private domestic banks.

The figures presented in Table 21 shows two important things. The first one is that the higher profitability of the foreign banks is not restricted to a particular year. In the period 1980-1984, for instance, foreign banks net income before tax as a percentage of net worth almost reached 53 percent, while in the largest private domestic banks it was only 27 percent. This is a considerable difference in profitability over a long period of time. The second important thing is that the profitability rate has declined quite considerably for all banks. In fact, the figures for 1986 and 1987 in both foreign and domestic banks are significantly lower than the averages of the first half of the decade.

The pattern followed by the rates of return in the period 1985-1987 suggests that a reduction in inflation has a depressing impact on profitability. When inflation was put to a halt by a price freeze at the beginning of 1986 net income before tax as percentage of net worth presented a sharp decline both in foreign and private domestic commercial banks. With the collapse of the Cruzado plan and the return to a high inflation environment, foreign banks profitability rate went back to the 1985 level. The profit rate of the largest private domestic banks, however, did not recovered and continued presenting a downward trend. This was into a great extent due to the sharp increase in non performing loans that occurred in 1987.

As a final comment it should be pointed out that the rates of return presented by foreign banks operating in the Brazilian economy in the first half of the 1980s were very high. While in the OECD countries net earnings before tax as a percentage of total assets in the commercial banking sector remain in general below 1 percent, in Brazil they have averaged well above 2 percent in the 1980-1987 period.

Table 21

NET INCOME BEFORE TAX AS A PERCENTAGE OF NET WORTH
IN THE COMMERCIAL BANKING SECTOR, 1980/1987

Year	Net Worth as % of Net Earnings		Assets as % of Net earnings <u>a/</u>	
	Foreign <u>b/</u>	Priv. Domestic <u>c/</u>	Foreign <u>b/</u>	Priv. Domestic <u>c/</u>
1980-1984	52.96	27.08	2.16	3.43
1985	24.58	26.24	1.50	4.60
1986	18.78	19.31	1.22	2.77
1987	29.58	16.14	2.19	1.73

Source: Revista Bancária, several issues.

a/ Net Earnings are Profits Before Tax.

b/ The foreign commercial banks are the 5 largest, namely Citibank, Francês e Brasileiro, Lloyds, Chase Manhattan, and Sudameris.

d/ The private domestic commercial banks are the 5 largest ones, namely Bamerindus, Bradesco, Itau, Nacional, and Unibanco.

5. Foreign Banks and the External Debt Problem

The evolution of the Brazilian economy during the 1980s has been very much influenced by the external debt problem. After the interruption of voluntary lending flows to all highly indebted countries that occurred when Mexico stopped paying her foreign obligations in August 1982, Brazil had to adjust her economy to the new reality. The huge current account deficit had to be reversed in a short period of time.

One issue that has not received sufficient attention is the discussion on the impact of the external debt problem on the foreign banks operating in the country. To better understand the potential objectives foreign banks operating in the country might have one should recall two things that have characterized the Brazilian financial market in the last decades. First, financial activities in general and commercial banks in particular have presented extremely high profitability rates. As we have pointed out in section 4a banks earnings as a percentage of total assets in the Brazil (at least for the largest banks) have remained well above 2 percent. This is well above the average of the OECD countries. Secondly, foreign banks, especially after the adoption of Resolution No. 4 595 in 1965, have faced a great deal of restrictions. They have not been able to either enter in some segments of the financial sector or expand their net of branches.

Having in mind the combination of high profitability with restrictions to both entry and branch expansion it seems reasonable to assume that Brazil's foreign creditors must have pressed for the lessening of these restrictions. In order to check if indeed this was the case one can compare the evolution of the commercial banks controlled by the country's main lenders to the other foreign financial institutions in the Brazilian banking sector.

Shortly after the Mexican moratorium Brazil's main foreign banks creditors constituted a committee. This committee which has been known as Bank Advisory Committee for Brazilian foreign debt is composed by 14 banks. Citibank is the Chairman and J.P. Morgan and Credit Lyonnais are the co-Chairman. In Table 22 we present these 14 banks. As one can see out of the 14 foreign commercial banks, 6 have a either a subsidiary or a majority stake position in a Brazilian commercial bank. Besides these 6 banks there are 5 other members with a stake in investment banks and non banking financial companies.

In section 4 we have pointed out that there was a pronounced rise in the number of branches of foreign banks. It jumped from 297 branches in 1980 to 448 branches in 1987. Examining in detail the evolution of the number of branches of banks controlled by

Table 22

FOREIGN BANKS ADVISORY COMMITTEE FOR BRAZILIAN DEBT

Banks	Operating in Brazil
Citibank	Chairman yes
J.P. Morgan	Co-Chairman yes <u>a/</u>
Manufacturer's Hannover	yes <u>a/</u>
Chase Manhattan	yes
Chemical	no
Bankers Trust	yes <u>b/</u>
Bank of Montreal	yes <u>c/</u>
Lloyds Bank	Co-Chairman yes
Credit Lyonnais	yes
Deustch Bank	yes
Swiss Bank Corp.	no
Union Bank Switerland	no
Bank of Tokyo	yes
Arab Bank Corp	yes <u>b/</u>

Source: CEPAL/CET (1989), p. 65.

- a/ Banks controlling a non-banking financial company in Brazil.
b/ Banks with a minority participation in a Brazilian investment bank.
c/ Bank with a fully owned investment bank in Brazil.

foreigners one can see that members of the Bank Advisory Committee had a clear advantage. The two most important members of the Committee, Citibank and Lloyds, were among the banks that have benefited the most from the lessening in the restrictions to branch expansion. Citibank, for instance, after having the size of its net of branches kept almost constant during the whole 1970s was able to add after 1982 4 more branches to its net of 11 branches. Chase Manhattan and Banco Francês e Brasileiro (Credit Lyonnais) were also able to substantially expand their net of branches. One may assume that the lessening of the restrictions in relation to foreign branch expansion was an implicit negotiation issue in the rescheduling agreements.

In some highly indebted countries foreign banks have extensively benefited from debt-equity conversions. It has been argued that in several cases foreign banks have been able to through this operation swap bad loans for good capital. 25/ Additionally, one may assume that foreign banks operating in the country that adopts a debt-equity conversion program will also benefit in indirect way since most likely they will intermediate a great deal of the total transactions. Having this in mind one should expect that foreign banks must have always pressed in external debt negotiations for the allowance of debt-equity conversions.

In Table 23 we present for the period 1981-1988 the evolution of the Brazilian medium and long term foreign debt to banks and the annual volume of foreign investment made in the country through debt-equity swaps. We also present all debt-equity conversions in which a foreign bank is the final investor. Looking at that Table it is quite apparent debt-equity swaps have not been an important instrument to reduce foreign banks exposures in Brazil. In all years, with the sole exception of 1988, the annual volume of debt-equity conversions has remained below 1.5 percent of Brazil's medium and long term outstanding debt to foreign banks.

Between 1983 and 1985, foreign banks invested in the country US\$ 256 million through debt-equity swaps. When we note that total foreign registered capital in the Brazilian financial sector in 1983 was US\$ 803 million one can realize the importance of these conversions. Although we do not have information with respect to where this capital was invested, one may expect that a substantial part of it was channeled to the financial market. Citibank, for instance, moved its Brazilian headquarters to a new building in the heart the São Paulo financial center. Foreign banks were therefore able to capitalize their subsidiaries in Brazil at a very favorable exchange rate.

Finally, it is worth mentioning that 1988 will stand as the year in which there was a complete reversal in the Central Bank policy with regard to the entry of foreign institutions in the

Table 23

MEDIUM AND LONG TERM FOREIGN DEBT TO BANKS AND DEBT-EQUITY
CONVERSIONS, 1981-88,

(US\$ million)

Year	Debt to Foreign Banks <u>a/</u>	Debt-Equity Conversions		Foreign Registered Capital in the Foreign Sector <u>b/</u>
		Foreign Banks	Total	
1981	41 013	n.a.	1.8	665.3
1982	47 874	n.a.	143.2	771.5
1983	54 708	66.5	452.0	803.3
1984	60 632	67.7	745.6	848.9
1985	59 915	121.7	581.2	968.9
1986	61 217	10.7	205.9	1 126.6
1987	63 152	86.6 <u>c/</u>	343.6	1 294.2
1988	60 854	112.8 <u>d/</u>	2 095.9	1 495.7 <u>e/</u>

Source: Boletim do Banco Central do Brasil, vol. 25, Nos. 5 and 6, 1989, Brasil - Programa Econômico, several issues.

a/ Medium and long term foreign debt.

b/ It does not include insurance companies

c/ Total debt-equity conversions applications made by foreign banks and received by the Central Bank between April and July 1987. All these applications had as destination a financial company.

d/ debt-equity conversions through auctions (Central Bank Resolution No. 1,460) made by foreign banks in the Brazilian financial sector. Informal conversions are not included.

e/ As of June, 1988.

Brazilian financial sector. The lessening of the restrictions to foreigners may be indirectly attributed to the negotiations between the Brazilian Central Bank and the World Bank for a US\$ 500 million loans, aiming at the reform of the Brazilian financial sector. Even before concluding the negotiations the Brazilian authorities approved a series of measures that were known to be advocated by World Bank officials. The most important measure was the issuance of Resolution No. 1 524 in September 1988 by National Monetary Counsel (Conselho Monetário Nacional). This Resolution will put an end in an explicit way to the segmentation that has characterized Brazil's financial system in the last two decades since it allows financial companies that operate in distinct segments of the market to merge into a sole company (what has been called a "multiple bank"). Several recently established foreign investment banks have received from the Central Bank permission to operate as a "multiple bank". ^{26/} This will allow them to issue all kinds of liabilities and to lend to all sectors.

What still remains unclear is if the Central Bank will allow foreign institutions to issue savings deposits and lend to the housing sector. The Central Bank denied a request made recently by Citibank a Savings and Loans company. ^{27/} It should be pointed out, however, Sudameris was allowed to have a minority stake in a Savings and Loans company called Eurameris.

6. Concluding Remarks

In this paper we have examined the role and evolution of foreign banks in the Brazilian economy in the 1980s. We have concentrated our attention to the 5 largest foreign banks and compared them to the largest private domestic ones as well as to the entire private commercial banking sector. It is important to recall once again that by only analyzing foreign commercial banks we have considered one particular aspect of the financial sector. The two reasons for doing this are the following: First the commercial banking sector is by far the most important sector in the whole financial market; and second we do not have consolidated balance sheets information for the great majority of foreign banks.

We have pointed out that in 1987 there were 29 commercial banks fully or partly owned by foreigner operating in the Brazilian. The share of these banks in total commercial banking assets was close to 25 percent. This is substantially larger than the average share of foreign banks assets in the OECD countries.

We have shown that there are several important differences between foreign and private domestic banks with respect to the balance sheet structure. The most apparent one is that the

importance of demand deposits as a source of funding for the largest foreign banks is much lower than for the private domestic banks. While in 1987 demand deposits amounted to less than 3 percent of foreign banks total liabilities, for the private domestic ones they represented almost 15 percent. This large difference was into a great extent the result of the restrictions imposed on the foreign banks branch expansion by the Central Bank. Foreign banks could compete with private banks for demand deposits, collections, and payments since they were not able to offer the convenience of a closely located branch. Another important difference in the balance sheet composition is the much larger share of time deposits and foreign currency liabilities in foreign banks total liabilities. On the assets side the most apparent difference is related to the participation of long term assets. While for the largest foreign banks these assets in 1987 amounted to almost 12 percent of total assets, for the largest private domestic banks they represented less than 3 percent.

We have argued that the differences in the balance sheet structure are explained by the fact that foreign and private domestic banks operate in distinct segments of the financial market. While the former concentrate their activities in the wholesale market, the latter are retailing banks. To understand why there is a clear separation of activities one should bear in mind the mentioned restrictions on foreign banks branch expansion.

We have also pointed out that in the case of Citibank, Chase Manhattan, and Lloyds credits to the public sector amounts to more than 20 percent of their loan portfolio. This suggests that it is not appropriate to characterize foreign banks as risk averse institutions that charge very low spreads and lend to prime borrowers (especially transnational companies).

We have indicated that the profitability of the foreign banks operating in the Brazilian economy has been extremely high during the current decade. Indeed, this has been the case not only when we compare to the profits rate presented by foreign banks in their own markets but also when compared to the largest private domestic banks. We have also mentioned that in the last few years all banks have presented a declining profitability.

The very high rates of return on equity presented by the largest foreign banks operating in the Brazilian economy in the 1980s was into a great extent due to their ability to operate in a extremely leveraged way. In this respect it is worth mentioning that in the period 1980-1987 net worth as a percentage of total liabilities averaged around 13 percent for all private commercial banks, while in the case of the 5 largest foreign banks it remained below 7 percent.

We have also examined the possible impacts of the external debt problem on the foreign banks operating in the Brazilian

financial sector. We have argued that one of the hidden negotiation issues was related to the lessening of the restrictions on branch expansion. The members of the Bank Advisory Committee were clearly favored in this respect. We have also mentioned that until 1988 there were no discounts on the debt-equity swaps. Foreign investors in general and foreign banks in particular were therefore able to invest in the country at a very favorable exchange rate. Between 1983 and 1985 foreign banks invested in the country through this mechanism US\$ 256 million. Although there is no information with respect to where this investment was made it seems reasonable to assume that a substantial amount went to the financial sector.

We may conclude by saying that there are no clear policy recommendations that can be made with respect to the future role of foreign institutions in the Brazilian financial market. It is much easier to argue that the presence of state owned banks and Banco do Brasil should be severely curtailed or that market segmentation should be abolished. It is not at all clear that the participation of foreign institutions should be allowed to increase. The current share of foreign banks in total banking assets is higher than the average of the OECD countries. Besides, the number of commercial banks is probably high enough to guarantee that there is no monopoly power left in any segment of the financial market. Thus, one cannot argue that allowing the entrance of new, foreign and or domestic, institutions will lead to lower spreads and therefore to welfare gains. It is also not reasonable to argue that foreign banks have played a key role in bringing in new technology to Brazil's financial market. Private domestic institutions like Bradesco and Banco Itau have kept the country quite updated with respect to computerized financial services.

Finally, it should be mentioned that the interest of foreign institutions in the Brazilian financial market is to a great extent related to the fact that rates of profits in that sector have been extraordinary high at least over the past 15 years. Government officials in Brazil should have this in mind when negotiating with our external creditors. While the foreign debt problem remains unsettled, all restrictions on foreign banks should be not be unilaterally removed. This would at least increase Brazil's bargaining power in the negotiating table.

Notes

1/ I am grateful to Marcelo Abreu and Michael Mortimore for helpful comments and discussions and to Ilan Goldfajn, Luciano Soares, and Patricia Lima for research assistance.

2/ The presence of foreign investors in the Brazilian financial sector at the end of 1987 was distributed as follows: 64.1 percent in insurance companies, and 8.0 percent in other financial institutions like brokerage firms, securities dealerships, leasing companies, etc. See Banco Central do Brazil, Boletim Mensal, Separata, July 1988.

3/ It is interesting to compare the Brazilian figure with the ones of the industrialized countries. The average share of foreign banks in total banks assets in the OECD countries in 1985 was 20.8 percent. See OECD Economic Survey, 1987/1988, U.S.A., p.61.

4/ Chase Manhattan, for instance, is considered a private domestic bank in the statistics presented by the Central Bank.

5/ The reason for excluding Banco do Brazil is that in practice it behaves like a monetary authority. In fact, until quite recently its demand deposits were included in the definition of high powered money.

6/ The foreign banks assets figures are not strictly comparable to the ones provided by the Central Bank for all private commercial banks and for the entire commercial banking sector. While the former are the ones reported in the financial statements, the latter are based on consolidated balance sheets.

7/ Chase Manhattan is the only one among the 5 largest foreign banks to have a controlling stake in an investment bank. All of them have brokerage, leasing, and dealership companies.

8/ According to the Brazilian legislation, long term assets are assets with a maturity period higher than six months.

9/ These are non negotiable deposits which pay the monetary correction (inflation) plus 6 percent per year on a monthly basis.

10/ We discuss the restrictions on foreign banks branch expansion in some detail in section 3a.

11/ It should be mentioned that in 1987 according to the Brazilian Central Bank the ratio loans in liquidation/total loans for all private banks was 1.83 percent. Both the largest foreign and private domestic banks had a higher share of bad loans. See Boletim do Banco Central do Brazil, vol. 25, No. 3/4, 1989, p. 50.

12/ This explains why the total number of employees of the largest private domestic banks presented in Table 10 is much larger than the figure reported in the Febraban survey.

13/ This is not the case in relation to wage payments. Employees receive an extra month of pay which is usually paid in the last two months of the year.

14/ Staff costs as percentage of total assets in the commercial banking sector in OECD countries reached 1.28 percent in 1986. See Caminal, Gual, and Vives (1989), Table 5.

15/ In Uruguay, for instance, staff costs as a percentage of total assets in the commercial banking sector in the period 1980-1988 fluctuated around an average of 1.35 percent. See on this Banda (1989), p. 28.

16/ Decree Law 4,650 of September 2, 1942 and Decree Law 5 618 of June 24, 1943, respectively.

17/ For a detailed discussion of foreign banks in general and British banks in particular in the Brazilian economy in the XIX century see Joslin (1963).

18/ According to the Statistical Yearbook for 1908/1912 there were 13 banks operating in Rio de Janeiro. The largest bank was by far Banco do Brazil with almost 30 percent of all assets.

19/ For a detailed discussion of the evolution of the Brazilian financial sector in the 1950s and 1960s see Sochaczewski (1980). For the 1970s and 1980s see Carneiro and Bodin de Moraes (1988).

20/ See on this Goldsmith (1986), p. 257.

21/ See Dornbusch and Pechman (1985).

22/ In this paper it was assumed that the Brazilian Stock Exchange Market was efficient in the sense that share prices were determined by the present discounted value of expected future profits.

23/ To better understand this operation let us describe how it works. Assume bank A buys a T-Bill. Instead of financing the purchase with its own capital, the bank sells it to company B with a buy-back agreement for the next day.

24/ For a discussion of the impact of the Cruzado plan on aggregate demand see Bodin de Moraes (1988b).

25/ See, for instance, Dornbusch (1989), pp. 73-76.

26/ In 1988 ten foreign investment banks received authorization to operate as a "multiple bank". Out of these ten, six banks started operating in the country in the period 1987-1988. See on this Waehnelde (1989).

27/ The international press strongly criticized the Brazilian position. See, for instance, The Economist, May 27, 1989.

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