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SPAIN AND THE E. E. C.:

Monetary and financial aspects

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The purpose of this study is to analyse the main consequences that the eventual entry of Spain into the European Economic Community would have for the Spanish monetary and financial system. At the present moment there is no "integrated" financial system in the Community, and indeed there continues to exist a diversity of financial habits, institutions and structures, and even a disparity of attitudes between the authorities of the different countries with regard to the most desirable orientation for their respective systems. For its part, the Spanish system has been undergoing an important process of change for some years past. In such a situation, this study will keep to a general level, in an attempt to identify the apparent trends towards the monetary and financial integration of the Community, and to relate them to the most probable lines of evolution of the Spanish system.

Such trends are both the result of legislative initiatives inspired by the desire to make progress towards the integration of the various financial systems, and an expression of the reaction of the Community countries to problems faced by all of them due to the evolution of the world economy. And it may be said that the trends towards greater monetary and financial homogeneity within the E.E.C. during recent years owe more to the second of these phenomena than to the first; that is to say, they are the fruit of reactions by the Community countries to economic processes which presented common

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problems, rather than the expression of concerted legislative moves inspired by a will for integration. Thus during the present decade national reactions to general circumstances have given impetus to common lines of evolution in the varied financial systems of the Community countries, aimed at attaining a greater degree of freedom, competition and security; and the Spanish financial system has also participated in this common evolution.

## I

To begin with, we shall consider the efforts made since the earlier part of the present decade by the Commission of the E.E.C., directed towards the homogenization of the financial systems of the member countries. The Commission has been working, with unequal results, in three directions: the harmonization of national legislation on credit and finance, the liberalization of professional activities and the freeing of capital movements.

In the earlier part of the present decade, the Commission initiated its activities on an over-ambitious scale. Indeed, in 1972 it produced a text which could be considered a draft European Banking Law which, in more than forty articles, attempted to establish detailed regulations for the functioning of banking institutions in the Community. The objections provoked by this project, the additional difficulties arising from the enlargement of the E.E.C. in 1973 ( especially due to the incorporation of Great Britain), and the negative results of the energy crisis on the efforts to harmonize monetary policies, made it advisable to abandon the projected European Banking Law and adopt a more pragmatic and gradual approach.

Nevertheless, the draft law contained some general criteria which have tended to prevail due to their essential validity: firstly, the admission of a credit entity should be judged according to objective criteria, eliminating discretionary elements. Secondly, once the credit entities are admitted, they can specialise in accordance with their preferences, following the principle of the "universal bank". Thirdly, the credit entities will be free to establish branches anywhere in the Community, and the supervision of their activities will always correspond to the country of origin (although the supervisory authorities will have to work in close cooperation). In all probability, the future of credit entities in the E.E.C. will be inspired more in the British principles of liberty and flexibility than the complex systems of regulation that still persist in several member countries of the Community.

Once the draft European Banking Law had been filed, the gradual approach towards integration in financial matters materialised in the preparation, by the Commission, of a Directive on the suppression of restrictions on the freedom to offer services and establish branches, which was approved by the Community Council in June 1973.

In accordance with this Directive, the member countries should suppress restrictions based on discrimination for reasons of nationality, placed on banks and other financial institutions and their freedom to offer services, as long as they were not linked to international capital movements or, if they were so linked, the capital movements should already have been liberalised (Lists A and B of the Agreements of May 11, 1960 and December 18, 1962). The Directive included a list of professional categories affected by this agreement, as well as of the restrictions that each member country ought to eliminate from its legislation in order to conform to the terms of the Directive within a period of eighteen months.

Nevertheless, in order for the freedom of establishment and to offer services (even within the limits contained in the previous Directive) to have effective results in the area of integration, it is necessary that the member countries should take steps towards the harmonization of legislation on the authorization of credit establishments, opening of branches, treatment of branches and subsidiaries of banks originating in third countries, and systems of banking supervision. An example of progress made along these lines is the new draft Commission Directive of December 1974, which has been recently (December 1977) approved by the Communities' Council.

This new Directive is intended to be applied to all credit institutions (which receive deposits and grant loans) without any type of discrimination, be it geographical, of legal structure, of types of loan granted, etc. The only entities excluded from the system are the Central Banks, the Post Office Savings Banks, and a series of organisms in each country which are explicitly listed. Its contents are as follows:

- 1.- Creation of an official procedure for the authorization of credit establishments. The Directive is silent on the minimum requirements to be satisfied in each country by the institutions applying for a licence. Consequently, the States remain free to set these requirements, being obliged only to: a) impose a minimum amount of subscribed capital, b) refuse authorization to any entity that is the undertaking of a single individual, and c) grant an answer to requests within six months, and permit appeal by the interested parties in the case of negative decisions. It also anticipates that the causes which could lead to the cancellation of an establishment's licence should be included in the national legislations.

- 2.- As a final objective to be attained in the future, this Directive poses the right of any credit institution established in one country to operate in any other without needing prior authorization and under its original legal form. At present, prior authorization is still required, and conditions for it must be identical to those which govern the credit entities of the respective country.
- 3.- It establishes common coefficients of liquidity and solvency, defined in a similar form for all countries, to be calculated by the monetary authorities on a regular basis. These coefficients are calculated for statistical and comparative purposes. The Directive does not oblige the monetary authorities to demand from their respective financial institutions the observance of these coefficients.
- 4.- Mechanisms are established to permit cooperation between the national authorities responsible for the supervision of credit entities, and a Consulting Committee is set up, composed of representatives of the national supervisory authorities, in order to adequately develop this Directive and eventually to prepare others.

It is obvious that this second Directive does not constitute an important advance in the process of harmonizing the different legislations. Its content is of a partial and generic nature, compelling the member States in very few respects - moreover, setting very long periods of adaptation, of five and up to eight years -. With regard to the conditions



set for access to the activity of credit institutions, the various national criteria continue to predominate; the only area in which a certain degree of harmonization has been introduced is in regard to guarantees of procedure and form in the concession and withdrawal of licences for credit institutions. The opening of branches by credit entities originating in other member countries continues to be subject to the legislation of the receiving countries. There is no attempt to harmonize the treatment of branches and subsidiaries of credit institutions proceeding from third countries - although they cannot be accorded a more favourable treatment than that granted to entities proceeding from the member states -. Neither has any attempt been made to tackle the difficult problem of controlling the activity of the intra-Community branches and subsidiaries, where any advance has to confront the predominating principle of territorial sovereignty and the resistance of national authorities to renounce their control over matters of liquidity and solvency.

This explains why many consider that the most positive aspect of this second Directive is the creation of the Committee whose task is to intensify the cooperation between the national authorities in charge of supervising the credit entities. This Committee will work along the following major lines: the establishment of common methods for the valuation of assets and the presentation of bank accounts; to study possible standards for the measurement of solvency and liquidity to be applied by the various member countries; the introduction of mechanisms to assemble information on credits (centralised credit risk control) on a supra-national level; the establishment of systems of deposit insurance, and to study measures to be adopted to meet crises of financial establishments.

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It is highly probable that the administrative cooperation between member States will have to precede the harmonization of the legislative systems of the Community countries on banking matters, as the defenders of the eventual efficacy of the Committee claim. In any case, the Committee has to concentrate on certain areas where, as will soon be seen, there have been some convergences in national legislations during recent years in response to events. On the other hand, it is certain that advances by the member countries with regard to the freedom of capital movements and an approach towards monetary union, will prove more effective than simple legal efforts to promote an adequate degree of harmonization between national legislations on banking matters.

## II

If the efforts of the Commission on a legislative level have, up to now, had few practical repercussions in relation to the achievement of a common market for credit institutions, the imperative of events has, in the recent past, led the finance systems of the various member countries to a series of transformations, resulting in the creation of structures which are convergent to some extent. Despite this, certain basic tendencies can be perceived with reasonable clarity, and it can be stated quite certainly that the process will continue in the immediate future.

In this evolution a first stage can be detected, starting in the latter part of the decade of the 1960's, characterised by a growing liberalization of the finance markets and a progressive strengthening of the market forces. The change in the world economic situation which occurred in 1973

may be considered as the beginning - and to a large extent the cause - of a new stage in the development of the financial institutions in contrast to its previous course of evolution. Indeed, from this date onwards frequent crises in banking entities began to occur in industrialised countries, leading to reactions by the economic authorities. And these reactions form the central trend of the second stage, characterised by a reinforcement and a flexibilization of the control and inspection organs charged with the supervision of the financial institutions in each country.

Although being forced to remain on a level of generalizations, it is possible to give a brief description of the general tendencies observed during the two periods mentioned above.

1. The first stage may be characterised by a change in the attitude of the monetary authorities with regard to the regulation of their respective financial systems. The Introduction to the Report of the "Commission on Financial Structure and Regulation", Hunt Commission (1971), reflects a way of thinking that came to be followed - more or less radically - by most countries. It was stated there that the direction of the changes to be made should tend ... "insofar as possible, towards the freedom of the finance markets, and the equipping of all the institutions with the powers needed to allow them to compete in these markets. Once these powers and new services have been authorised, and a reasonable period of time has passed, each institution shall be free to determine its own path. The public will benefit from such competition. The markets will work more effectively in the placing of funds, and savings will increase sufficiently to satisfy public and private needs".

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This tendency, which may be considered general for the most representative countries, was directed towards the strengthening of market forces and competition, and towards a transformation of the existing institutions into others of a general character, capable of handling all operations with no limitations beyond their own ability and vocation. As may be supposed, this implied a change in the traditional forms of control used until then by the monetary authorities and which were based on the prevailing structure of the financial system which, in turn, they helped to shape. The new approach tended more towards a standard, uniform and simplified set of regulations for all entities in accordance with the type of operations that they really conducted, rather than to control the ideal operations of a "typical" entity which no longer existed. This change may be detected at different levels, both in the wider scope of measures of monetary policy, now applied to a growing number of institutions, and in the disappearance of norms tending to maintain the separation of different fields and the regulation of typical entities. This latter point refers specifically to the establishment of conditions for banking operations, and to the regulations controlling the creation, registration or expansion of credit and deposit entities.

Most countries of the E.E.C. adopted measures tending in this direction. In France, in 1966-67, reforms were introduced with the aim of eliminating the differences between commercial and industrial banks, reducing the limitations on the opening of branches, and permitting greater freedom to fix the rates of interest applied to operations. Also in the Netherlands, in 1973, similar measures were adopted, with the elimination of direct controls and the homogenization of institutions in respect of operations (from that date, Savings Banks and Cooperatives can, if they so wish, conduct the same

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operations as the banks). In Great Britain a plan for reform, Competition and Credit Control, was approved in 1971; it encouraged greater competition between banks by prohibiting agreements on interest rates between the Clearing Banks, and extending standard control regulations to all the institutions acting as banks. The same trends may be observed in other countries outside the Community; thus, similar reforms were introduced in Canada, Sweden and the United States.

2. As mentioned above, from 1973 onwards, banking crises began to occur with an intensity unknown since the nineteen-thirties. The main countries of the Community suffered these problems, the most notable examples being Great Britain, with the crisis of the "secondary banks" in 1973, and Germany, with the crisis which culminated in the bankruptcy of the Herstatt Bank in 1974. The process of liberalization, already described, experienced by the financial institutions in the preceding years, made it possible to undertake and participate in a greater number of operations which, while increasing returns, implied an inevitable increase in risk. This, combined with a rapid transition from a strong expansion to a world-wide recession of notorious intensity, the development of highly restrictive monetary policies intended to combat inflation and the greater risk of exchange operations in a system of fluctuating exchange rates subject to important oscillations, led to the appearance of serious banking problems.

At the present time we are less interested in the causes of these problems than in the reactions of the monetary authorities - those directly affected by the problem or those who followed their example - to the crisis mentioned above. These reactions were of two kinds: one specific, the other more general. Those that we have called specific, solutions like the "Rescue Committee" organised by the Bank of England, are

not of great interest at this moment, since they are attempts to deal with a specific problem when this has already arisen. Of greater importance for our purposes are the reforms of a more general character introduced by the different economic authorities, with the aim of "forestalling", insofar as possible, the appearance of banking crises.

Limiting our attention to this latter category, it can be said that the reactions of the national authorities of the great majority of the Community countries, have been directed towards a reinforcement of the mechanisms of control over the credit institutions, without impairing the greater degree of flexibility and freedom attained in the previous stage. The basic idea of the process consists in accepting the fact that a greater degree of freedom and competition in the financial markets requires a stricter supervision of the conditions of liquidity and solvency of credit entities.

The reactions have certainly not been uniform, since the authorities of the various Community countries started from very different positions with respect to methods and instruments of bank supervision, and even regarding the extent to which the State should feel obliged to protect savers with deposits in banking entities. In this respect, the British system of supervision is particularly different from that of the other E.E.C. countries. The Bank of England's supervision is of a more informal nature, being based on regular contacts with the banking entities and on a specific analysis of the conditions of liquidity and solvency of each entity, over and above the observance of legal ratios required on a general basis. On the other hand, in the British system it has traditionally been considered that there are strict limits to the obligation of the State to protect savers, and that bank depositors and, generally, financial investors have to assume an important

margin of risk, which can be evaluated on the basis of clear, punctual and adequate information on the entities which receive savings.

Despite the fact that these disparities in the starting points have inevitably conditioned the measures adopted by the authorities of the Community countries, in the search for a greater degree of security compatible with, and required by, freer and more flexible credit systems, the reforms introduced in recent years have shown quite a number of convergent features.

There has been a tendency to reinforce the powers and inspection services of the authorities responsible for banking supervision, and the regular information received on the evolution of credit entities has been improved and extended; stricter regulations have been enforced with regard to the diversification of risks and the regulation of those activities - mainly in foreign currency - which imply a greater degree of potential risk, and there has been a tendency to create "centralised credit risk controls" or to improve existing ones; deposit insurance systems have been created to ensure protection of the small saver; and, finally, objective and stricter standards have been applied to the opening of new banks, and the powers of the authorities to suspend the administrators or withdraw the licence of credit establishments in dangerous situations, have been extended and strengthened.

The converging elements that economic realities have introduced into the systems of the Community countries during the course of the two stages described - which have reinforced the factors of practical integration resulting from interbank cooperation, multinational financial operations, etc. - do not, however, mean that bank integration is just around the corner

in the Community, nor do they minimise the great difficulties that the Commission has to face in its efforts to coordinate and homogenize the financial systems of the member countries.

Homogeneity and harmonization in the area of the financial markets is not equivalent to an attempt to impose uniformity on systems developed within the framework of different financial, economic and political histories. There is today no banking model which will be imposed in all the Community countries, and neither can one be discerned in the foreseeable future - however, it does seem probable and desirable that the most open and flexible tendencies will eventually prevail, due to the pressure of events -; and, certainly, this lack of uniformity should not be an obstacle for the integration of the credit markets. But this integration will be seriously impeded by the continuation of the important differences existing in the national systems of banking regulation and supervision, capable of distorting competition among institutions and curtailing the possibilities offered by the absence of discrimination with regard to the opening of establishments and the offering of services.

At the present time, it would not be realistic to suppose that the member states will renounce their national systems of banking regulation and supervision. However, there would appear to be a possibility of a concerted approximation of national legislations on matters such as the definition of a bank, the setting of objective criteria - with no discretionary elements - for permission to operate as a bank, the system of opening branches, or methods of supervising bank solvency; and certainly such an approximation is a necessary stage in the advance towards the integration of credit markets which seems today both difficult and remote.

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## III

The E.E.C. Commission has increased its efforts to attain a growing degree of financial integration in fields other than banking and, especially, in the stock markets. Also in this area the general policy has been one of gradualism, flexibility and pragmatism. Starting with the basic fact of the diversity of regulations and practices, the Commission has directed its efforts, in the first stage, towards a voluntary harmonization of the regulations of the member countries, seeking always the attainment of a high degree of transparency in the markets. This objective is expressed in the proposal for practical measures designed to ensure the formation of market prices with general validity, and to offer adequate protection to the investor by means of better information.

In this respect, the most advanced work of the Commission is centred on the preparation of a "European Code of Conduct", and the coordination of conditions for the admission of stocks to quotation on the different stock markets. Amongst these conditions, the most important is the obligatory preparation of an "Issue Prospectus". The Commission is also working on regulations for entities handling collective investment, and book-keeping controls of companies issuing stocks quoted in the stock market.

The "Code of Conduct", based on those already existing in some Community countries, has a double objective: to improve information and protection of the public, and to take a first step towards the integration of regulations and practices. Towards this end, it establishes general principles referring basically to the following aspects: the need for savers to possess complete and correct information on the evolution and

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situation of the companies; that shareholders should benefit from the principle of equality, especially in the case of takeovers of companies by new groups; and the importance of certain persons who hold key positions in a company (especially professional and financial intermediaries) respecting certain ethical standards in their behaviour, without seeking immediate and unfair advantage which could damage the credibility and efficacy of the stock markets.

For its part, the "Issue Prospectus" would be obligatory before the admission of stock to quotation on an exchange, as is already the case in some Community countries. The Prospectus is prepared according to common standards, referring not only to its content, which is very ample (persons who assume the responsibility, the stock which is the object of the operation, general information on the company, operating figures, commitments, figures for the past five years, etc.), but also to control over its publication.

In the stock market field also, it is possible to observe spontaneous developments in the markets and the institutional systems which point towards relatively convergent rules of action and regulation. For example, the development of the European options market in Amsterdam, where it is possible to negotiate options to purchase the principal stocks quoted on the European exchanges, constitutes an important phenomenon in the field of homogenization. A similar valuation may be placed on the appearance of national vigilance and supervision organs for the stock markets in countries such as Great Britain, Belgium, France and Italy. These organs could issue increasingly standardised regulations for the treatment of the principal problems affecting the European stock markets, and can act as the appropriate channels for putting into practice the recommendations and directives of the Brussels Commission.

Nevertheless, it would be a mistake to ignore the persistence in Europe, despite these unifying tendencies, of very different models of organization for stock markets: the Anglo-Saxon model exemplified by the London Stock Exchange; the Germanic type which predominates in the Federal Republic of Germany and the Nordic countries; and the Latin model which operates, with certain variations, in France, Belgium and Italy. And despite the converging movements, a long time will still have to pass before, for instance, the figures of the British jobber, the German "marklar" and the French exchange agent converge into a common type of intermediary. It should be sufficient to recall that the Directive on liberalization of the activities of stock exchange intermediaries has been pending since 1973, despite pressure from the European Parliament.

#### IV

The full financial integration of the E.E.C. member countries implies an effective liberalization of capital movements and an economic and monetary union. At the present time these are long-term objectives. However, it is clear that even a pragmatic and gradual advance towards financial integration will only reach important stages of real progress if accompanied by a firm process of liberalization of capital movements and an effective advance towards monetary union.

One of the objectives set by the Treaty of Rome, though not formulated in a particularly incisive way, is the liberalization of capital movements between the different member countries. The development of this objective has been only partial up to the present moment, being expressed in the Directives of 1960 and 1962. These Directives established four lists

(A, B, C D) of possible capital movements subject to different degrees of liberalization. The first two implied an unconditional liberalization; in the third this was subject to the condition that its introduction should not prove an obstacle to the economic policy of the country in question; and nothing has been decided on the fourth, which basically covers short-term capital movements.

The first two lists contain direct investments, investments in real estate, capital movements of a personal nature, concession and repayment of credits connected with commercial operations, and operations relating to stocks and shares. In principle these capital movements are liberalized. However, it is deceptive to judge the effective degree of liberalization of capital movements within the E.E.C. simply from a reading of the legal texts. These permit the member countries to adopt provisional measures of protection when application of the norms could be detrimental to their economies. This means that the degree of effective liberalization of capital movements varies considerably from one country to another.

Of even greater relevance to the process of financial integration are the slight advances made in the area of monetary union. In present-day conditions, where the national authorities are intensely suspicious of any limits on their sovereignty, it would be useless to propose as an immediate objective the achievement of full monetary union, which requires the integration of monetary, fiscal and regional policy, etc. Nevertheless, an effective advance towards the distant objective of monetary union, has to be judged by the degree of voluntary acceptance on the part of the E.E.C. member countries of an increasingly close coordination of their economic policies.

This growing coordination of economic policies will not necessarily be achieved by simple projects for the creation of a zone of relative exchange stability in the E.E.C., no matter how desirable this may be in a world of strong exchange-rate fluctuations, not always tending towards stability. Such projects do no more than offer a degree of possibility for attempts at coordination, while emphasising the need for such coordination. For experience has proved that without an effective coordination of economic policies, attempts to create areas of exchange stability eventually fail to achieve their original aims, becoming reduced to limited zones formed by countries which either are linked by a relationship of economic domination, or pursue relatively similar economic policies.

The difficult problems of adjustment which had to be faced after the petrol crisis, and the very different rhythms of inflation still experienced by the economies of the E.E.C. member countries, undoubtedly make for a difficult starting point in any attempt to create a European Monetary System, at least if this is seen simply as an attempt to establish an area of exchange stability. But if a European Monetary System is seen as a framework for voluntary cooperation in increasing the coordination of economic policies, then the difficulty of the starting point may be compensated by the introduction of a sufficient degree of flexibility in the exchange-rate structure (increasing the margins proposed for the fluctuation of the rates, applying different margins to different groups of countries, etc.); the important point will be to achieve a progressive convergence in the economic evolution of the member countries, by means of an adequate coordination of their respective economic policies.

However, it seems - as these lines are being written - that the discussions of the member countries about the new European Monetary System, have tended to confuse or

mix the matters under debate. Those who have given most support to the project have insisted on the advantages of a European area of exchange stability, refusing to bring to the forefront of attention the basic problem of coordinating economic policies, a problem at once qualitatively distinct and more profound than the questions of agreement about exchange-rate intervention, or consultation in the case of persistent difficulties in maintaining a currency within the foreseen margin of fluctuation. And those who have emphasised the inadequacy of such an approach and the need to advance towards a joint and coordinated framework for formulating the economic policies of the member countries, have tended to confuse the basic issue by associating it with problems about the E.E.C. budget, fiscal transfers within the area and the need to reconsider the Community agricultural policy, all of which are important problems but beyond the strict limits within which the subject of monetary unification should be discussed at the present time.

While there does not exist among the E.E.C. member countries a decided will to coordinate their economic policies in order to encourage a convergent evolution of their economies, no important advances will be made towards the objective of monetary union. This is the position from which to judge the effective contribution to such an objective of the different projects to create European areas of exchange stability.

## V

The previous sections point towards the affirmation that the eventual entry of Spain into the E.E.C. should neither present serious problems nor lead to rapid or profound transformations in the Spanish financial system. The financial integration of the Community is not yet in an advanced phase which would oblige new member countries to make a rapid adaptation. The Community has not established a banking model to which the institutional arrangements of the recently incorporated national systems would have to conform. The financial panorama of the E.E.C. is marked by the coexistence of a great variety of systems, and a lack of harmony between the legal frameworks and the methods of banking supervision in many important aspects. And the common trends which, as mentioned above, have affected the different systems of the Community countries in recent years, have also been conditioning factors in the recent evolution of the Spanish financial system.

This does not mean that the entry of Spain into the E.E.C. would have no consequences at all for the Spanish financial system. In this as in other areas of Spanish economic activity, development has occurred in an uncompetitive climate and within a closed framework of State regulation; the logical consequences have been the limited development of financial markets, the relative backwardness of their practices and instruments, and the high cost of the services of intermediaries. Any wind of change which brings a greater degree of competition and dynamism, must have a favourable effect on the evolution of the Spanish financial system. In other words, Spain's entry into the E.E.C. could encourage a more open spirit which, given the situation of financial integration within the Community, would not cause abrupt changes or traumatic modifications.

and the modernization of the Spanish financial system by means of a greater degree of competition and flexibility should be encouraged quite apart from its effect on Spain's entry into the Community.

Throughout the present decade, the Spanish financial system has been undergoing a process of transformation which is changing its traditional characteristics in both the operational and structural aspects. The starting point certainly made profound changes unavoidable: for many years Spain had not had an active and continuing policy for controlling the basic monetary volumes, and lacked adequate instruments to develop such a policy; interest rates were controlled and maintained at artificially low levels, so that the rationing of loan funds took the place of the market mechanism; a multitude of legal coefficients blocked a substantial portion of bank and savings bank assets to ensure the financing of specific enterprises and sectors by means of loans and credits, the obligatory purchase of private stock and the diverting of resources through official credit entities; the credit institutions corresponded to legally defined types, which determined their field of activity; and a set of restrictive regulations on the establishment of credit institutions, the opening of branches, etc., completed the block on factors which favour competition.

Starting in 1969 and continuing through almost a decade, the instruments were created to permit the development of an active monetary policy. In the first place, automatic access to the liquidity of the Bank of Spain was ended, since this had prevented the Bank from exercising any active control over the monetary volumes. Next came the return to a flexible rediscount rate (or base rate of the central bank), which had been almost unusable until then. Later, legal cash coefficients



were introduced, firstly in the banks and afterwards in the savings banks. And from 1973 onwards, the Bank of Spain began the daily regulation of bank liquid assets, using a system of distributing credits at very short term and the issue of Treasury bonds, which provided a means of avoiding the difficulties arising from the impossibility of undertaking open market operations. In this manner it has been possible to create the instruments necessary for an active monetary policy based on controlling the money supply - paying special attention to its widest definition, usually known as M3 -, with regularly announced objectives; despite the still limited extent of the money market, these instruments are essentially similar to those used by other member countries of the Community.

This policy of active monetary control has been accompanied, in relation to the external sector, by increased flexibility in the system of floatation used for the peseta, and in the domestic sphere by a process of progressive freeing of interest rates. The most significant moments in this process - and, in general, in the liberalization of the financial system - may be situated in the summers of 1974 and 1977. The interest rates applied by banks and savings banks on loans and deposits (at a term equal to or above one year) have been freed in two stages. Those interest rates still subject to control, corresponding to loans and credits of banks and savings banks under obligatory coefficients and of the official credit entities, have been simplified and brought closer to the market rates. There has also been an increase in the yield on public funds placed with banks and savings banks, to provide resources for the official credit entities, and the State has begun to issue Public Debt at market rates. Parallel to these developments, a start has been made in the programmed reduction of the legal coefficients which are aimed at creating an artificial demand for certain financial assets, both public and private,

on the part of the banking institutions. This reduction will apply both to the investment coefficient of the banks and to those coefficients of the savings banks relating to special credits, public funds and other fixed-interest stock eligible for inclusion; the eligibility of these latter stocks has been established with reference to general and objective criteria.

With regard to the organization and structure of the credit entities, it was decided to abandon the system of classifying them into specific, legally-defined groups according to type, in order to move towards a model of "universal bank" in which specialization is the result of the capacity and vocation of the institutions, and not of legal limitations. Thus there has been a tendency to blur the legal distinctions between commercial and industrial banks, and the savings banks have been authorised to undertake all types of banking operations and, particularly, to discount trade paper. Furthermore, much more liberal criteria have been adopted on the opening of bank and savings bank branches, although the savings banks continue to be considered as entities with a merely provincial or regional field of action. Progress has been much more limited, however, in the fixing of objective criteria for the establishment of new banks and the opening of subsidiaries and branches of foreign banks, since the objective conditions which have been set, are accompanied by a very high degree of discretionary authority, and there are severe restrictions on the operations that authorised foreign banks are permitted to undertake.

As can be seen, the Spanish financial system has been affected to an important degree by the general trends which, as already indicated above, have been felt also by many E.E.C. countries during the present decade, in favour of a strengthening of the market mechanisms. And it may reasonably

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be hoped that the reforms of the system, inspired by the criteria of freedom and flexibility, will continue in the future. Indeed it is proposed to complete the liberalization of interest rates by terms of the operations, and to reform official credit institutions, giving them the form of public banks with a greater degree of autonomy in their lending operations - which today are basically decided in accordance with the Government's sectoral policies -, while a substantial part of their resources would be obtained in market conditions.

Furthermore, a Commission established to examine stock exchange reform presented a Report to the Government in April 1978, containing a series of proposals destined to improve the flexibility and transparency of the market. To this end, in its Report the Commission recommended the adoption of the basic principles of the "European Code of Conduct" prepared by the E.E.C. Commission, as well as of the conditions proposed by the same organism for the admission of stock to official quotation on the exchanges.

Spain has also been affected by the second general trend mentioned with regard to the recent evolution of the financial systems in the Community, namely the tendency to reinforce the methods employed to supervise bank solvency and security in response to the economic crisis and its effects on the credit institutions.

These functions of banking supervision correspond, in the Spanish financial system, to the Bank of Spain. This institution, under the terms of laws dated 1946 and 1962, makes regular or ordinary inspections of the banking entities, as well as the extraordinary ones that it considers appropriate. In these inspections it can request all types of documentation relating to the entity under investigation in order to analyse

its performance, and as a consequence of the inspections it can draw the attention of the respective boards of directors to practices which, although not contravening legal precepts, are considered inadequate; furthermore, it can apply penalties, or propose to the Ministry of the Economy that appropriate penalties should be applied (according to the severity of the penalty proposed) when it discovers that the law has been broken. These penalties can range from a simple warning or a private or public caution, to exclusion from the register of banks and bankers and dissolution of the sanctioned entity; other possibilities are fines of various amounts, suspension of the advantages derived from the relationship with the Bank of Spain, and suspension of members of the institution's management.

In addition to this supervision exercised by means of inspections of each banking entity, there are in Spain a number of general norms and objectives intended to diversify the risks of credit institutions, limit the concession of credits to members of the Board of Directors, ensure the maintenance by these entities of a minimum proportion between subscribed capital (with reserves) and customers' funds (the guaranty coefficient), etc. And this supervision is completed by a "central credit risk register" which functions in the Bank of Spain, to which the banking entities have to inform of risks above a certain amount (at present four million pesetas).

There is clearly no possibility to devise preventive regulations and inspection systems capable of impeding the appearance of crisis situations in certain banking entities. And real experience has proved in recent times that Spanish legislation on banking supervision had become antiquated, both in respect of the actions available to the Bank of Spain in extreme situations, and with regard to the penalties that it could apply or propose.

For this reason, and in view of the banking problems that have arisen in recent years, not only has there been a reinforcement of the inspection activities of the Bank of Spain, and of its capability to suspend and renew administrative organs of banking entities in serious situations, but also a draft law is now in preparation and will soon be submitted to the "Cortes" (Parliament), to update the regulatory armoury of preventive actions and penalties available to the Bank of Spain.

In any case, when crises occur it is necessary to possess appropriate instruments which, on the one hand, permit the repercussions on the rest of the system to be minimised, and, on the other, protect the small saver. With this in mind, the Bank of Spain has established, with a 50% participation of the private banks, a "Corporación Bancaria" (Banking Corporation) as a non-profit entity to purchase majority shareholdings - at a fair price determined by independent auditors - and take on the administration of banks which are in a difficult situation but could, with adequate management, achieve full recovery. And in November 1977 a Deposit Guaranty Fund was created in accordance with the recommendations of the Community authorities, subscribed 50% by the Bank of Spain and 50% by the private banks; this Fund insures the deposits of banks in a state of bankruptcy or "suspensión de pagos" (legal suspension of payments), up to an amount of Ptas. 500.000 for each depositor.

To sum up, in recent years there has been a movement in the Spanish financial system towards giving a greater role to the market mechanisms, and introducing a greater degree of institutional flexibility. Parallel to this movement, there has been a trend towards reinforcing the mechanisms for supervising the credit institutions. Both paths are convergent with that followed by the E.E.C. member countries during the same period.

The reforms of the Spanish system have not yet been completed, even in the ambitious but limited spheres in which they have been proposed; and it still remains to attempt reforms in fields as important as the official credit institutions and the stock market. The Spanish financial system still requires a much greater degree of competition, flexibility and transparency if it is to become more modern and efficient. This need is intrinsic, quite apart from the question of Spain's entry into the Community; but the need is even greater when this factor is taken into consideration, since incorporation into the Community will be a challenge to the general efficiency and performance of the Spanish economy.

As already stated, the financial system is not an area in which one should fear traumatic effects, or profound and rapid institutional changes, as a consequence of entry into the E.E.C. But the progressive liberation of capital movements will have an important incidence on the regulations which at present limit foreign investments in Spain and Spanish investments abroad, as well as other capital movements linked to the services of financial intermediaries, irrespective of the liberality with which, at least in some aspects, the existing restrictions are administered today in Spain, and whatever may be the complex series of exceptions, precautions and periods of adaptation established in the Community's regulations. And entry into the E.E.C. will imply a reduction in the discretionary elements which today predominate in the regulations governing the establishment of new credit institutions. Above all, it will require the elimination of discrimination based on nationality in respect of the functioning in Spain of credit entities and financial intermediaries from other E.E.C. member countries. As already mentioned, the lack of harmony in the national legal frameworks is slowing down the effect of the factors tending towards financial integration contained in the

partial liberalization of capital movements, and in the principle of non-discrimination on grounds of nationality in the functioning of entities and the freedom to offer financial services within the Community. Nevertheless, by both these paths a greater degree of competitiveness could reach the Spanish financial system, with favourable consequences for its operational mechanisms, cost of services by intermediaries, desire for institutional specialization, etc.

In a country like Spain, where self-financing by companies is low and the credit institutions play an absolutely dominant role in the external finance of the private sector, it is necessary to expand the issues market; this would require a greater degree of transparency and information, and an improvement in the "marketing" arrangements for stocks and shares, while the secondary market would have to be able to supply a volume of liquidity adequate to the stocks. In addition, it is essential that the credit system should increase its efficiency and competitiveness. After long years of controls and generalised State intervention, these objectives can only be attained by means of a progressive introduction of greater degrees of freedom, and by a gradual strengthening of the market mechanisms.

However, the obstacles which such a policy has to overcome should not be ignored. Economic freedom and the market economy offer general possibilities of improvement and progress, while the interventionist policy is oriented towards partial and concrete interests. Economic freedom is a wager at medium and long term; interventionism always fights its battles with reference to the short term. For this reason, plans for liberalizing the financial system will always be menaced by regressive elements: there will always be concrete interests which see the solution to their immediate problems

in subsidised interest rates and legal coefficients which assure them cheap finance; there will always be groups of financial intermediaries and agents who resist the greater discomforts which are the corollary of an open, competitive system; and the authorities will always be tempted to solve problems at the expense of the market, with apparently sufficient arguments, at least in the short term. The project for integration into the E.E.C. should, in this as in other fields, provide important additional arguments in favour of continuing the reform of the financial system along the lines of the market system and competition.

In this as in other fields, the project for integration into the Community is, in the last instance, a decisive argument in favour of increasing the flexibility of an economy which has accumulated all types of rigidity in the long years of interventionism, and of attacking the problems which today face the Spanish economy in the shape of pending readjustments. It would be most advantageous if those who show themselves to be in favour of an open and immediate integration of Spain in the E.E.C., were to be consistent with this position and draw the obvious conclusion that we have to make an effort, above all, to put our economy into better order; if they were to understand, for example, that with inflation rates of 18% or 20%, it is not possible to enter the Community or anywhere else.

If the European Monetary System is not going to imply - as it seems is going to occur - an effort to attain increasing coordination of economic policies, its relevance to the final objective of monetary union will be small. In such a case, the incorporation of Spain into the E.M.S. will be a problem of political convenience in relation to the general negotiations, in which the decision will depend on the terms



of the invitation extended, eventually, to Spain, and on its possible repercussion on internal economic policy. If, on the contrary, the coordination of economic policies becomes the nucleus of the E.M.S., the most appropriate course for Spain would be to join the system from the beginning. In either case, the discussions of the E.E.C. member countries about the new monetary system must give pause for thought, and for drawing the pertinent consequences for the Spanish economy; because the convergence of the economies of the member countries is essential if the Community is to have a future relevant to the articulation of Europe.

The last consequence is that the project to incorporate Spain into the E.E.C. does not require, in the monetary and financial fields, the introduction of strategies different from those which would be appropriate and necessary for the future of the Spanish economy in any case. The project of integration does no more than reinforce considerably the arguments in favour of these strategies.

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December 9th, 1978