"INTERNATIONAL BANKING: ITS MARKET AND INSTITUTIONAL STRUCTURE"
Ente per gli studi monetari bancari e finanziari Luigi Einaudi
Perugia, 19-20/IX/1981

(1) programma e lista dei partecipanti
(2) Committee on Banking Regulations and Supervisory Practices: "Supervision of banks' foreign establishments"
(3) Council of the European Communities: "Proposal for a Council Directive on the supervision of credit institutions on a consolidated basis"
(4) Heimann,John G.: "International banking: its market and institutional structure"
(5) Jaans,Pierre: "International banking: its market and institutional structure"
(6) Leslie,Peter E.: "International banking: its market and institutional structure"
(7) Mayer,Hemlut W.: "International banking: its market and institutional structure"
(8) Monti,Antonio: "Recent trends in international banking"
(9) Swoboda,Alexander K.: "International banking: current issues in perspective"
(10) tabelle e statistiche

ENTE PER GLI STUDI MONETARI BANCARI E FINANZIARI

«LUIGI EINAUDI»

Round table on

« INTERNATIONAL BANKING: ITS MARKET AND INSTITUTIONAL STRUCTURE »

Perugia, 19th and 20th September 1981

SCUOLA DI AUTOMAZIONE PER DIRIGENTI BANCARI
DELLA BANCA D'ITALIA
(S.A.DI.BA.)
(Telephone: 0039 - 75 - 43744 or 43745)

ENTE
PER GLI STUDI MONETARI
BANCARI E FINANZIARI
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Transportation from Perugia Hotels to S.A.DI.BA. will be available

PROGRAMME

SATURDAY, 19th SEPTEMBER

WORKING SESSION No 1

9.00 - 9.30	Opening speeches		
9.30 - 10.00	Paper:	Alexander K. SWOBODA	
10.00 - 11.30	Discussants:	Francesco BIGNARDI Giacomo LUCIANI Giovanni MAGNIFICO	
11.30 - 12.30	Free debate		
13.00	Lunch at S.A.DI.BA.		
	Coffee break around 10.30		

WORKING SESSION No. 2

15.30 - 16.00	Paper:	Antonio MONTI
16.00 - 17.40	Discussants:	Gerard AUBANEL Engelbert DICKEN Pierre JAANS Helmut W. MAYER
17.40 - 18.30	Free debate	
20.30	Dinner at " Brufani Palace Hotel "	
	Tea break around 16.30	

SUNDAY, 20th SEPTEMBER

WORKING SESSION No. 3

9.00 - 10.00	Papers:	John G. HEIMANN Peter E. LESLIE
10.00 - 11.45	Discussants:	David HOLLAND David T. LLEWELLYN Ulpiano QUARANTA Wolfgang RIEKE
	Free debate	
11.45 - 12.45	GENERAL DEBATE and close of meeting	
13.00	Buffet lunch at S.A.DI.BA.	
	Coffee break around 10.30	

DISCUSSANTS ON THE THEMES OF THE WHOLE CONFERENCE:

David BARBER, Paolo CLAROTTI, Jan EKMAN, Karl JANJORI, Conrad J. OORT, Georg RICH.

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PERUGIA ROUND TABLE

PARTICIPANTS PRESENTING PAPERS AND DISCUSSANTS

FIRST SESSION

PROFESSOR ALEXANDER K. SWOBODA
INSTITUT UNIVERSITAIRE DE HAUTES ETUDES INTERNATIONALES - GENEVE

DISCUSSANTS:

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DR. GIACOMO LUCIANI
ISTITUTO AFFARI INTERNAZIONALI

DR. GIOVANNI MAGNIFICO
CENTRAL MANAGER FOR OPERATIONS DEPARTMENTS - BANCA D'ITALIA

SECOND SESSION

DR. ANTONIO MONTI
CHAIRMAN - BANCA COMMERCIALE ITALIANA

DISCUSSANTS:

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DIRECTEUR ADJOINT - DIRECTION GENERALE DES SERVICES ETRANGERS
BANQUE DE FRANCE

HERR ENGELBERT DICKEN
VORSTANDSMITGLIED BEI DER COMMERZBANK

M. PIERRE JAANS
COMMISSAIRE AU CONTROLE DES BANQUES - LUXEMBOURG

DR. H.W. MAYER
ASSISTANT MANAGER OF MONETARY AND ECONOMIC DEPARTMENT
BANK FOR INTERNATIONAL SETTLEMENTS

THIRD SESSION

MR. JOHN G. HEIMANN
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MR. PETER E. LESLIE
DIRECTOR AND GENERAL MANAGER OF BARCLAYS BANK CORP.
INTERNATIONAL LTD.

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PROFESSOR OF MONEY AND BANKING - UNIVERSITY OF LOUGHBOROUGH
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(1)

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Prof. Francesco BONELLI	Chief Executive Officer

BANCA D'ITALIA

Dr. Lamberto DINI	Director General
Dr. Mario SARCINELLI	Deputy Director General
Dr. Alessandro PAMPANELLI	Manager, Perugia Branch
Dr. Domenico BARONE	Manager, SADIBA School

Supervision of Banks' Foreign Establishments*

2

Introduction

The object of this report is to set out certain guidelines for cooperation between national authorities in the supervison of banks' foreign establishments, and to suggest ways of improving its efficacy.

Three types of foreign banking establishments are distinguished: branches, which are integral parts of a foreign parent bank; subsidiaries, which are legally independent institutions incorporated in the country of operation and controlled by one foreign parent bank; and joint ventures, which are legally independent banks incorporated in the country of operation and controlled by two or more parent institutions, most of which are foreign and not all of which are necessarily banks.

In addition, banking supervision is considered in this report from three different aspects: liquidity, solvency, and foreign exchange operations and positions. The Committee recognizes that these different aspects are to some extent overlapping. For instance, liquidity and solvency problems can shade into one another; and both liquidity and solvency considerations are among the reasons why countries supervise their banks' foreign exchange operations.

The Need for Cooperation

The Committee is agreed that the basic aim of international cooperation in this field should be to ensure that no foreign banking establishment escapes supervision.

It is also agreed that each country has a duty to ensure that foreign banking establishments in its territory are supervised; and that in the case of joint ventures involving parent institutions in more than one country there is no practicable alternative to supervision by host authorities.

Acceptance that supervisory authorities are responsible for ensuring that foreign banks in their territory are supervised will not, however, necessarily preclude there being gaps in the supervision of such establishments. Thus, owing to differences in definition, a particular foreign establishment may be classified as a bank by its parent, but not by its host, supervisory authority; and in some countries not represented on the Committee there may be no supervision whatever of foreign banking establishments.

* This is a report to the Governors by the Group of Ten's Committee on Banking Regulations and Supervisory Practices. The work of the Committee is briefly described in Section III. The document reproduced here is the 1975 Concordat, which was aimed at ensuring that banks' foreign establishments were adequately supervised. In March 1981 the document was released to the public by Peter Cooke, Chairman of the Committee.

Furthermore, it is desirable not only that all foreign banking establishments are supervised but that this supervision is adequate, judged by the standards of both host and parent authorities. In that connection the Committee noted that host authorities are interested in the foreign banks operating in their territories as individual institutions and from the point of view of what happens in their own markets, while parent authorities are interested in them as parts of larger institutions which they are responsible for supervising.

For a variety of reasons, therefore, adequate supervision of foreign banking establishments, without unnecessary overlapping, calls for contact and cooperation between host and parent supervisory authorities. It is one of the Committee's purposes to foster cooperation of that kind among its member countries. In addition, the Committee considers that any guidelines for cooperation it may agree on should be communicated to other countries with a significant role in international banking, in the hope of obtaining their cooperation too. The Committee has already established contacts with the supervisory authorities of a number of such countries and, if the Governors accept this report, will consider which other countries it might approach.

Supervisory Responsibilities and Interests of Host and Parent Authorities

Having agreed on the need for contact and cooperation between supervisory authorities, the Committee went on to consider the extent to which the division of responsibilities for supervision could be codified. Their discussions showed that it is not possible to draw up clear-cut rules for determining exactly where the responsibility for supervision can best be placed in any particular situation. Nevertheless, the Committee was able to agree on a number of general guidelines in this field.

Liquidity. In managing their liquidity foreign banking establishments rely heavily on local practices and comply with local regulations, including those established for monetary policy purposes. Responsibility for supervising their liquidity must therefore rest in the first place with the host authority. Moreover, in practice, only the authority on the spot can carry out the continuous supervision of liquidity which may from time to time be required. For the management of liquidity in foreign currencies, and especially the currency of the parent bank, local practices and regulations may be less important and not all host authorities accept the same degree of responsibility.

In the case of a foreign branch, liquidity cannot be judged in isolation from that of the whole bank to which it belongs. This applies particularly when a branch is free to deposit funds with its parent bank. Furthermore, the parent authority, in controlling the liquidity of the parent bank, must take account of calls that its foreign branches might make on its liquid resources. For these reasons the liquidity of foreign branches is a matter of concern to parent authorities also.

In the case of foreign subsidiaries or joint ventures, too, parent authorities may be concerned. For example, such banks may have stand-by facilities available to them from their parent institutions. In such cases the parent supervisory authority concerned ought to be informed by the host authorities of the importance they attach to these stand-by facilities in judging the liquidity of the banks in question. Moreover, though the legal position of foreign subsidiaries and joint ventures is different from that of foreign branches, parent authorities cannot be indifferent to the moral responsibilities of the parent institutions.

Solvency. In the case of solvency controls, there is again some sharing of responsibility for supervision between host and parent authorities, with the emphasis varying according to the type of establishment concerned. For foreign subsidiaries and joint ventures, primary responsibility rests with host authorities; but, in addition, parent authorities must take account of the exposure of their domestic banks' foreign subsidiaries and joint ventures because of those parent banks' moral commitments to those foreign establishments. For foreign branches, solvency is indistinguishable from that of the parent bank as a whole. It is therefore essentially a matter for parent supervisory authorities. The "dotation de capital" imposed by the host authorities in certain countries on foreign branches is above all intended to do two things: to oblige foreign branches that set up in business in those countries to make a certain minimum investment in them; and to equalize competitive conditions between foreign branches and domestic banks.

Foreign Exchange Positions. Banks' foreign exchange positions are supervised partly for prudential reasons, partly for balance of payments reasons and partly for the purpose of maintaining orderly market conditions. So far as concerns prudential supervision the considerations set out in the previous paragraphs govern the division of responsibility, while the other matters are by definition the concern of host authorities.

Aids to Cooperation

The Committee considers that, in seeking to improve the supervision of banks' foreign establishments and to implement the guidelines for cooperation set out earlier in this report, efforts should be made to remove, or at any rate reduce, certain restraints which at present hamper such cooperation. In particular, it believes that action could usefully be taken in the following areas:

1. Direct Transfers of Information Between Supervisory Authorities

Parent authorities may wish to obtain copies of reports submitted to host authorities, particularly in cases where host authorities waive certain requirements in respect of foreign banks established in their territory, where their control requirements are less stringent than those of the parent authorities or where they take into account, for prudential purposes, commitments to such banks by their parent institutions. Normally they should obtain such reports direct from the banks concerned, provided that host authorities are previously informed. At the same time it would be desirable that host authorities be permitted to transfer copies of such reports to parent authorities when circumstances so warrant. The Committee is aware that such transfers of information are often impossible because of banking secrecy laws in host countries; but many of its members consider that the operation of these laws should over time be modified so as to permit them. (This same point also applies in the case of the proposals in 2 and 3 below.) The Committee wishes to emphasize that the sole purpose of such transfers would be to facilitate prudential control of banks and that in no circumstances would they be directed to the affairs of individual customers.

2. Direct Inspections by Parent Authorities of Their Domestic Banks' Foreign Establishments

These are likely to be particularly helpful for purposes of solvency control, including control of banks' foreign exchange positions. Such inspections already take place, sometimes on an informal basis and sometimes as a result of formal reciprocal agreements between pairs of countries. Wherever possible steps should be taken to facilitate such arrangements, if necessary by amendment of legislation.

3. Indirect Inspections of Foreign Banking Establishments by Parent Authorities Through the Agency of Host Authorities

Host authorities that do not allow direct inspections by parent authorities of their domestic banks' foreign establishments should give favourable consideration to carrying out, at the request of the parent authorities concerned, specific inspections of foreign banks operating in their territory and to reporting their overall findings to them.

The Committee believes that in seeking to remove restraints on transfers of information between, and foreign inspections by, supervisory authorities it would be wise to begin with foreign branches, where the problems presented appear less difficult than with subsidiaries and joint ventures.

The Committee asks that the Governors, if they are in agreement with the recommendations of this report, should take advantage of any opportunities that present themselves to further the removal of restraints on cooperation.

September 26, 1975

Proposal for a Council Directive
on the Supervision of Credit Institutions on a
Consolidated Basis

(3)

Explanatory Notes

I. General

The First Council Directive of 12th December 1977 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (1), set out as an ultimate objective the overall supervision of a credit institution operating in several Member States by the competent authorities in the Member State where it has its head office. To this end it is necessary to progress towards a system whereby all credit institutions operating in the Community are subject to similar supervisory regimes. This proposal for a Directive requiring all Member States to supervise credit institutions on a consolidated basis is a step in this direction.

Although, as explained above, the origin of this proposal lies in the First Directive the timing of this particular proposal was affected by an initiative taken by the Central Bank Governors of the so-called Group of ten countries plus Switzerland. As a result of work done by the Basle Committee on Banking Regulations and Supervisory Practices the President of the Bank for International Settlements wrote, on behalf of the Central Bank Governors, to the supervisory authorities in the Group of ten plus Switzerland in June 1979, expressing his hope that all the countries would take steps to introduce supervision on a consolidated basis and that host authorities would be prepared to cooperate internationally so as to permit such consolidation. In response to this initiative the Commission put forward proposals for consideration by the Advisory Committee for Banking Coordination. This present proposal therefore takes account of the Advisory Committee's opinion on the form and content of a Directive on the supervision of credit institutions on a consolidated basis.

In preparing a proposal for a Directive the aim has been on the one hand to impose a legal obligation on Member States to supervise their credit institutions on a consolidated basis and on the other hand to keep the Directive as simple as possible in order to secure its rapid adoption. Accordingly the Directive now proposed should be seen as a first step only, concentrating on establishing the principle and leaving a good deal of discretion on the details to Member States. This said, however, it is felt that the proposal represents a desirable community response to the growing

(1) OJ. N° 322, 17.12.77, Doc. N° 77/780/EEC

international concensus in favour of prudential supervision on a consolidated basis.

Whilst it is desirable that there should be a measure of consistency between the requirements for consolidated accounting and those for consolidated supervision, it is not necessary for harmonisation of these two aspects of consolidation to be simultaneous. Supervisory authorities tend to rely more on prudential returns than on published accounts for their information and may wish to have a greater degree of flexibility in the treatment of minority interests than is necessary for consolidated accounts. This proposal, therefore, in no way impinges on the proposed seventh Directive on Group Accounts and does not pre-empt the subsequent coordination of consolidated accounts for credit institutions.

Four of the Member States, Italy, Luxembourg, Germany and Greece do not have any provision for consolidated supervision at present, although Italy and Germany are currently considering the possibility.

In Belgium and France the banking legislation allows for prudential measures to be calculated on a consolidated basis but this is not common practice at present.

In Denmark certain prudential ratios are calculated on a consolidated basis but this does not apply the main solvency or liquidity ratios.

The remaining three Member States, Ireland, Netherlands and the United Kingdom already make extensive use of consolidated information for supervisory purposes.

The proposal contains eight articles :

Article 1 defines certain terms used in the Directive.

Article 2 defines the scope of the Directive and the provisions for deferred application

Article 3 establishes the principle of supervision on a consolidated basis and the procedures to be adopted.

Article 4 sets out the form and extent of consolidation required in particular circumstances.

Article 5 deals with the cross border flows of information which are necessary for consolidation to be effected.

Article 6 is concerned with the application of supervision on a consolidated basis to establishments of domestic institutions located outside the Community.

Articles 7 and 8 contain the final dispositions.

II. Commentary on the Articles

Article 1: Definitions

This article defines the terms used throughout the Directive . The definition of "credit institution" is taken from Directive 77/780/EEC (1). The definition of "financial institution is intended to cover primarily those institutions who engage in business carrying a banking type risk but which do not fall within the definition of "credit institution" because they do not take deposits from the public. "Participation" have been defined here to avoid a long explanatory phrase whenever the term used in the Directive. The definition is not exactly the same as that used for "participating interest" in Directive 78/660/EEC (2). Although the same percentage is used in both cases it was not thought desirable to give Member States the power to set a lower percentage as is the case in Article 17 of Directive 78/660/EEC.

A very general definition of "supervision" is used in order to give the competent authorities a degree of flexibility which is necessary pending subsequent coordination of supervisory techniques.

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(1) O.J. N° L 322 17 December 1977
(2) O.J. N° L 222 14 August 1978

Article 2 : Scope of Application

This Article states that the Directive will apply to all credit institutions except those exempt from the provisions of Directive 77/780/EEC and specifically listed in this article. It is important not to confuse the scope of the Directive with the scope of consolidation. Thus although it is proposed that only groups headed by a credit institution should be subject to this Directive, it is envisaged that consolidation of such groups will embrace not only credit institutions but also financial institutions within the group which contribute to the banking activities of the group; these will mainly be institutions with financial assets which fall outside the definition of credit institution because they do not take deposits from the public.

Article 3: General Principles

This Article sets out the main aim of the proposal - Supervision of Credit institutions on the basis of their consolidation with other credit or financial institutions within the group.

It should be noted that consolidation is only required where a participation is held by a credit institution. If a number of credit institutions are owned directly by a financial institution or any other type of body the provisions of this Directive will not apply. Indirect holdings of credit institutions are, however, covered, so that the provisions of the proposal cannot be avoided by inserting a holding company between two credit institutions.

The exceptions listed in paragraph 1 are designed to deal with situations where consolidation is either not possible or not necessary from a supervisory point of view.

In the absence of coordinated consolidated accounts and prudential returns it is not possible to aim for entirely consistent methods of consolidation in all Member States. Paragraph 2 of this Article, therefore, provides for national procedures to be used pending further coordination.

This Article also specifies that consolidated supervision shall be exercised by the supervisory authorities of the country where the head office of the credit institution is situated.

To avoid any possible misunderstanding, paragraph 4 of this Article specifically states that the proposal does not affect the present practices of Member States with regard to supervison on an unconsolidated basis; so that a subsidiary of a credit institution whose parent is in another Member State may find that it is still supervised by the host supervisory authority on an unconsolidated basis as well as providing information to its parent for the purpose of consolidated supervision.

Article 4 : Form and extent of consolidation

The proposal distinguishes between situations where a credit institution owns the majority of the capital of another credit or financial institution and those where only a minority of the capital is owned.

In majority situations the competent authorities of the parent credit institution can choose between full or pro rata consolidation. It is necessary to leave the choice to the supervisory authorities because in certain cases a bank's moral responsibility for another credit institution in which it has a participation might be considered to extend beyond its equity share especially where it is the largest single shareholder and even more so if the other shareholders are non-banks.
In such cases full consolidation would normally be appropriate. However, in cases where, for example, the other shareholders were also banks, pro rata consolidation might be deemed appropriate.

For minority participations, where a situation of effective control exists consolidation will normally be required, with the method of consolidation being left entirely to the discretion of the competent authorities of the parent institution. However, pending further coordination on the treatment of minority interests it was felt necessary to provide for consolidation to be avoided in cases where both the competent authorities of the parent institution and those of the institution in which the participation is held agree that it is not necessary.

In all other cases of minority participations the question of whether consolidation should take place or not is left to the discretion of the competent authorities of the parent institution.

The treatment of minority interests in this Article is important because of the implication it holds for Article 5 where the obligation on Member States to allow the necessary flow of information is restricted to that which is "necessary for the implementation of this "Directive". The relationship between these two articles is such that a requirement to consolidated, automatically gives the right to the necessary information.

Article 5: Facilitating measures

This Article deals with the exchange of information, between a parent credit institution and its subsidiaries, and between the competent authorities of the Member States, which is necessary for the authorities of the parent company to be able to supervise on a consolidated basis. It can, of course, only legislate for flows of information between Member States; the exchange of information with third countries is dealt with in Article 6.

It is envisaged that principle flow of information for consolidation purposes will be between a subsidiary company and its parent. Direct exchange of statistical information between supervisory authorities would only take place in exceptional circumstances.

The proposal does not contain any provisions concerning the direct inspection of credit institutions situated in other Member States by the supervisory authority of a parent credit institution. It does however give the supervisory authorities concerned the right to appoint a local firm of auditors to verify the information it has received. There is nevertheless a presumption that if necessary inspection rights could be obtained by way of bilateral agreements.

Article 6 : Third Countries

As Community legislation cannot be applied to parent institutions situated in third countries or credit institutions in third countries whose parent company is within the Community, this Article provides for bilateral agreements between the Member States and third countries to facilitate the flow of information necessary for consolidation to be effected. The objective being to allow supervisory authorities in the Member States to supervise parent credit institutions on the basis of their world wide operations and supervisory authorities in third countries to include where appropriate credit institutions situated in the Community in the consolidation of their banks.

The Commission is charged with a coordinating rôle only at this stage but it is hoped that eventually these bilateral agreements can be replaced by agreements between the Community and third countries.

Proposal for a Council Directive

on the supervision of credit institutions on a consolidated basis

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing in the European Economic Community and in particular Article 57 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas the Directive 77/780/EEC[1)] on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions, states that, in order to make it easier to take up and pursue the business of credit institutions, it is necessary to eliminate the most obstructive differences between the laws of the Member States as regards the rules to which these institutions are subject ;

Whereas the eventual aim is to provide for overall supervision of a credit institution operating in several Member States by the competent authorities in the Member State where it has its head office, in consultation as appropriate with the competent authorities of the other Member States concerned in such a way that distortions of competition are to be avoided between such credit institutions and the domestic credit institutions of their host countries, to that end controls and supervisory practices applied to credit institutions operating within the Community must be broadly similar from one Member State to another;

Whereas this objective can only be attained by stages, the establishment of the principle of supervision on a consolidated basis is one such stage;

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1) O.J. N° L 322, 17.12.77

Whereas supervision on a consolidated basis should enable the supervisory authority of a parent credit institution to make a more considered judgement about the prudential situation of that credit institution;

Whereas this Directive is concerned solely with ownership, partial or complete, of one credit or financial institution by another credit institution;

Whereas the principle of supervision on a consolidated basis is broadly accepted, whereas Member States will therefore seek to conclude bilateral agreements with non-member countries designed to ensure that credit institutions from such countries with holdings in the Community are subject to equivalent supervision and that credit institutions from the Community with holdings outside the Community are able to apply the principles laid down in this Directive without the flow of information being hindered;

Whereas, pending coordination of consolidated accounts and prudential returns it is not possible to implement consolidated supervision on a consistent basis in all Member States, this Directive represents an interim measure designed to establish the principle of supervision on a consolidated basis and to eliminate the obstacles which have hitherto prevented Member States from implementing the principle on a unilateral basis;

Whereas pending further coordination the process of consolidation shall be performed by Member States according to their National procedures;

Whereas the provisions of this Directive shall not prejudice supervision of individual credit institutions by the competent authorities of the host Member State;

Whereas financial institutions as defined herein-after are not subject to either the Directive 77/780/EEC or this Directive their inclusion in the consolidation procedure is necessary in order to ensure complete consolidation of all the appropriate activities within a group.

Whereas this Directive does not contain any provisions concerning the rights of the supervisory authorities of a parent company to inspect credit institutions in which the parent company has a participation, which are situated in another Member State; the Member States shall presume that they can obtain such rights by way of bilateral agreements; whereas as an interim measure supervisory authorities will be able to appoint auditors to verify information received from credit institutions in another Member State.

HAS ADOPTED THIS DIRECTIVE :

Article 1 : Definitions

The following definition shall apply to the terms used in this directive :

- "credit institution" shall, in accordance with Article 1, first indent, of Directive 77/780/EEC (1) on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions, mean an undertaking whose business is to receive deposits or other repayable funds from the public, and to grant credits for its own account.

- "financial institution" shall mean an undertaking, not being a credit institution, whose principal activity is to grant credit facilities (including guarantees), to acquire participations or make investments.
- "participation" shall mean the ownership by a credit institution directly or indirectly of 20 % or more of another credit or financial institution.
- "supervision" shall, pending subsequent coordination, mean those techniques, in whatever form and howsoever implemented, employed by the competent authorities in each Member State in order to monitor prudential aspects of a credit institution's business.

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(1) OJ Nº L 322 of 17.12.1977.

Article 2 : Scope

1. Subject to Article 3 (1) below, this directive shall apply to all credit institutions.

2. Those institutions exempted from the provisions of - and listed in Article 2 of - Directive 77/780/EEC shall be exempted from the provisions of this directive.

3. Member States may defer the application of this directive to certain institutions. Such deferment shall be on the terms set out in Article 2 (5) and (6) of Directive 77/780/EEC.

Article 3 : General Principles

1. Any credit institution which holds a participation in another credit or financial institution shall be subject to supervision on the basis of the consolidation - to the extent and in the manner required by Article 4 of this Directive - of its financial situation with that of the institutions in which it holds such participation, unless :
   - the activities of the credit institution holding the participation are at least 80 % consolidated with another credit institution which is subject to supervision on a consolidated basis by the competent authorities of one of the Member States and the credit institution in which the participation is held is, without prejudice to the following indents, included in this supervision on a consolidated basis, or
   - the credit or financial institution in which the participation is held is situated in a third country where there are legal impediments to the transfer of the necessary information, or
   - the participation represents less than 2 % of the capital and reserves of the credit institution which holds the participation or less than 500,000 E.C.U. whichever is the lower, or
   - the nature of the business of the credit or financial institution in which the participation is held is such that, in the opinion of the competent authorities of the credit institution which holds the participation, consolidation would be inappropriate or misleading.

2. Pending subsequent coordination, and except as otherwise provided in this Directive the process of consolidation shall be performed according to the national procedures applicable to the credit institution which holds the participation.

3. Supervision on a consolidated basis shall be exercised by the competent authorities of the country in which the credit institution which holds the participation has its head office.

4. Such supervision shall take place at least once a year and shall be without prejudice to supervision on an uncolisated basis and without prejudice to supervision carried out by the competent authorities in other Member States.

Article 4 : Form and extent of consolidation

1. Where a credit institution holds a participation in another credit or financial institution which is greater than 50 %, the competent authorities of that credit institution shall require either full or pro rata consolidation of the institutions concerned.

2. Where a credit institution holds a participation of 50 % or less in another credit or financial institution and, in the opinion of the competent authorities of that credit institution, a situation of effective control exists, it shall be a matter for the discretion of those competent authorities how consolidation should be effected. Pending further coordination, however, the competent authorities in the Member State in which the credit institution has its head office and the competent authorities of the credit or financial institution in which the participation is held may agree that consolidation of such a holding is not required in given cases.

3. Where a credit institution holds a participation of 50 % or less in another credit or financial institution and a situation of effective control does not exist, it shall be a matter for the discretion of the competent authorities of that credit institution whether and how consolidation is to be effected.

Article 5 : Facilitating Measures

1. Member States shall ensure that there are no legal impediments to prevent any credit or financial institution supplying information to a credit institution which has a participation in them which is necessary for supervision on a consolidated basis to be effected in accordance with this Directive.

2. Member States shall permit the exchange between their competent authorities of the information necessary for supervision on a consolidated basis to be effected in accordance with this Directive, it being understood that, in the case of financial institutions, the collection of information shall in no way imply a supervisory function over such financial institutions by those competent authorities.

3. Any exchange of information between competent authorities provided for in this Directive shall be subject to the obligation of professional secrecy as set out in Article 12 of Directive 77/780/EEC and any such information shall be used exclusively for the purposes of supervision on a consolidated basis as required by this Directive.

4. If, in applying the provisions of this Directive to a credit institution, the competent authorities in one Member State wish to verify the information received from a credit or financial institution in another Member State they may appoint an auditor, approved for this purpose by the competent authorities of the other Member State concerned, to perform such verification.

Article 6 : Third countries

1. The application of the principle of supervision on a consolidated basis to credit institutions, the parent institutions of which have their head offices in third countries, and establishments of domestic credit institutions located outside the Community, shall be a matter for bilateral arrangements, on the basis of reciprocity, between the competent authorities of the Member States and the third country concerned. Such arrangements shall seek to ensure that Member States' competent authorities are able to obtain the necessary information to enable a credit institution within the Community, with participations in credit or financial institutions outside the Community, to be supervised on a consolidated basis, and that supervisory authorities in third countries can obtain the information they need to supervise parent institutions having their head office in their country who have participations in credit institutions in one or more Member States.

2. The Commission and the Advisory Committee set up under Article 11 of Directive 77/780/EEC shall be kept informed of such steps as may be taken in this context and the Commission will undertake the coordination of the arrangements.

Final Provisions

Article 7

1. Member States shall bring into force the measures necessary to comply with this Directive within months of its notification. They shall forthwith inform the Commission thereof.

2. The Member States shall ensure that they communicate to the Commission the texts of the main laws, regulations and administrative provisions which they adopt in the field covered by this Directive.

Article 8

This Directive is addressed to the Member States.

ENTE PER GLI STUDI
MONETARI BANCARI E FINANZIARI
" LUIGI EINAUDI "

(4)

"INTERNATIONAL BANKING: ITS MARKET AND INSTITUTIONAL STRUCTURE"

John G. Heimann

PRELIMINARY DRAFT

Remarks of John G. Heimann

The Ente Einaudi

International Banking: Its Market and Institutional Structure

Perugia, Italy, September 19-20, 1981

Introduction

Over the past several years, international banking activity, particularly the Euromarket, has grown rapidly. International operations account for a large portion, often a majority, of the assets and earnings of the world's major banks. Since the mid-1970s, spreads and margins have been getting thinner. In the first quarter of 1976, the average published spread on Eurocredits was 160 basis points and the lowest spread was 100 basis points. By February of this year, the average spread was approximately 60 basis points and some borrowers were obtaining spreads of as little as 38 basis points. For major U.S. banks, margins are estimated to have shrunk by some 15 percent during 1980.

The current narrow margins in international banking are of concern because they put pressure on bank profits and therefore on the ability of banks to generate sufficient capital to support continued growth. Although spreads and margins do not present the entire picture on earnings, they are often used by market participants--lacking any other convenient measure--as guides in assessing developing trends. The decline in capital ratios for many of the world's largest banks over the past several years confirms the concerns about the potential effect of narrow margins.

What is the significance of these developments? A response to this question requires careful consideration of margins, capital and the role of supervisors in international banking. I do not come with a handful of easy solutions, nor is my view particularly optimistic; neither, however, will I speak of unmitigated gloom.

Fundamental Observations

A look back over the events of the past decade reveals several important characteristics of international banking today. First, banking has become more risky because of increasing international competition, persistent inflation, economic dislocation and imbalances stemming from spiraling energy costs, and political uncertainty. The narrow spreads which exist today result in part from increasingly intense competition among banks. The continuing tendency of banks not previously active in foreign banking to establish their presence in Euromarket centers and then expand their international activities has greatly added to the numbers of competitors.

In some cases, internationalization has been driven by regulatory changes, such as when banks have sought to minimize the effects of domestic asset-growth limitations--for example, the credit controls in France--by becoming more active in the international arena. The volatile movements of interest rates have been greatly affected by relative inflation rates and by expectations of future inflation. In addition, inflation over the past decade has contributed to the erosion of capital positions, as the rate of nominal asset growth has outpaced the rate of return on assets for many banks. Finally, the price increases for oil and other raw materials have contributed to the emergence of balance of payments deficits on the part of many nations, industrial and developing alike. The banking system has assumed a major role in recycling balance of payments surpluses to fund these deficits. As these deficits have become chronic, the perceived risk of lending to sovereign borrowers for the purpose of funding the deficits has grown.

A second basic observation is that the banking industry, for the most part, does not appear to have reached the point of attempting to exercise self-restraint with respect to narrowing spreads. Indeed, it is not clear that any concerned banker can do much more than lament a perceived imbalance in risk and reward in international lending. There have been occasional withdrawals by banks in the face of softening terms--for example, American banks last year. Also, regional German banks have shifted the emphasis of their international activities from participation in large syndicated Eurocredits to provision of export financing for their German customers, at least partially because of the narrow spreads available on Euroloans. However, most of these retreats have been temporary, and the banks have returned to the market even though conditions for spreads, risks and potential profits have not appreciably improved. Also noteworthy have been those withdrawals inspired by supervisory action. Responding to the wishes of their government, Japanese banks temporarily suspended Euromarket activity in 1979. When the Japanese government relaxed its restrictions, the banks returned to the market. The more recent withdrawal of the German banks, in voluntary arrangement with their central bank, is another example. The revision of capital requirements by Swiss and German authorities, prompted in part by concerns about their banks' exposure to risks from their foreign operations, may also cause some adjustment in the banks' international activities.

Banks have demonstrated over the past two decades that they will move certain operations to jurisdictions where regulation is least burdensome or intrusive and costs are presumably lower. This is being illustrated today in the U.S. as money center banks move to shift consumer lending operations to the states of Delaware and South Dakota, which have effectively deregulated consumer loan rates. The paradox of this adaptability of banks in their search for profit is that, because many banks have similar notions, competition in these less regulated markets drives margins down to levels which are significantly below those extant in many banks' regulated domestic markets. The lesson for supervisors is that any one supervisor, acting alone to impose or enforce a particular requirement, may find his regulatory action blunted and incapable of significantly affecting a given banking practice, because banks may simply shift their operations out of his jurisdiction.

The banking crises of 1974, in retrospect, were an important watershed marking renewed sensitivity and attention of bank supervisors to the possible fragility of the unregulated Euromarket and to the vulnerability of banks active in the market. The continuing decline in spreads coupled with perceptions of increased risks in the market has turned this awareness into concern on the part of many bank supervisors. There has been a continuing debate on the desirability of regulating the Euromarket for macroeconomic purposes, but there has been no consensus, and the wide range of views renders such consensus unlikely. However, the prospects for coordination for prudential purposes may be better, though agreement in this area may be constrained by the differing economic conditions and banking policies of various nations as well as by competitive pressures.

I have not been persuaded that Euromarket regulation is necessary for macroeconomic reasons. However, I do favor increased harmony of regulatory requirements in the interest of prudence and a fair competitive balance, and on that score some progress has been made, mostly through the Cooke Committee's efforts, and there is reason to expect further, if gradual, movement in the right direction.

Margins in the Euromarket

It might be useful to focus for a moment on questions surrounding margins in Euromarket lending. Margins are at historically narrow levels. A number of forces exert pressure on margins. Despite the occasional withdrawal of banks from the market, competition remains at an intense level. Euromarket activity on the part of a particular nation's banks is affected not only by Euromarket conditions, but also by conditions in their domestic market. Since domestic market conditions vary among nations, banks from one country may be very active in the Euromarket while those from another country are concentrating on their domestic market. Also, not all banks are equally well established in the market. Therefore, at any given time there may be a group of international banks competing more aggressively than the majority of participants in order to increase their market shares or to carve out new niches for themselves. These waves of competition will tend to maintain the narrow level of margins.

Another factor which may be contributing to the currently narrow margins is the pricing advantage accruing to banks with relatively low capital ratios. Given a cost of capital which exceeds the cost of other funding sources, those banks with relatively lower capital ratios--higher leverage--will be able to lend at relatively lower margins and remain profitable. Thus, while today's narrow margins may put pressure on the earnings of some banks, others may be less affected. Also, those banks which concentrate on the rate of growth of assets and place a relatively lower emphasis on the rate of return on equity will be similarly advantaged.

In addition to examining the reasons for today's narrow spreads on Eurocredits, it is valuable to explore their significance with respect to profits and capital. Generally speaking, concentrating solely on the spread will not give the entire picture. First, published spreads are most often over LIBOR, or in some recent cases, the prime rate. Banks generally obtain funds at varying rates below LIBOR, so their actual spread is greater than the published spread.

Also, Eurocredits generate fees in addition to interest payments, especially for lead banks. There are participation and management fees, commitment fees on unused portions of loans, and sometimes annual agents' fees. All of these fees serve to increase the effective yield on a loan above the stated spread and, along with other possibly relevant details, such as security agreements, must be considered in any discussion of the issue. A recently reported deal illustrates the danger of looking at spreads alone. The Malaysian Airline System has obtained a 10-year loan at LIBOR--a published spread of zero. Certainly its lenders do not intend to give away something for nothing, so they must expect to profit from low-cost funding or loan fees, or both. While available data on fees is very limited, fee income is significant. Indeed, more than a few bankers have favorably considered the possibility of arranging a loan and receiving the management fees but selling all of the loan to other banks. This would be a nice way for a bank to increasek earnings without tying up any of its own money, but of course it is impossible for all banks to do it simultaneously.

While relatively low-cost funding and fee income permit banks to price aggressively, so too does the current high level of interest rates. Assuming a stable capital-to-assets ratio, as the level of interest rates rises, the spread required to maintain a given return on equity narrows. It has been estimated that for every 100 basis points the level of interest rates rises, spreads may narrow by 7 basis points with no decline in the return on equity and without any change in leverage. Thus, a comparison of the first quarter of 1979, when 6-month Eurodollar rates were between 10.50 and 11.00 percent and the average spread was 87 basis points, with February of 1981, when rates averaged 17.00 percent and spreads 60 basis points, indicates that despite the narrower spreads, profitability as measured by return on equity may have declined less than it is generally assumed.

Implications for Bankers and Supervisors

The narrowness of spreads and margins is clearly a cause for concern both for bankers and bank supervisors--even though the situation may not be quite so grim as it first appears to be--because many banks are experiencing difficulty maintaining desired capital ratios. However, the implications of this concern are not entirely clear.

Many bankers feel that they are not in a position to do anything about the squeeze on margins. The intense level of competition and the abundant liquidity in the Euromarket prevent any individual bank from widening spreads. The alternative of withdrawing from participation in the market until spreads improve is not considered to be a viable option because of the need to maintain a presence and to service customers. Therefore, a few bankers have called upon the bank supervisors to "do something."

Bank supervisors' concern with narrow spreads is based on the effect such spreads have on profitability and thus on capital, and therefore ultimately on the ability of the international financial system to withstand periods of economic uncertainty or instability. Capital plays important roles both in assuring the solvency of the banking system and in maintaining confidence in the banking system, and neither of these roles can be ignored with impunity. If supervisors determine that something needs to be done about the chain of narrow spreads, low profits and inadequate capital levels, they can act on any one of those links. However, neither the bankers nor the supervisors want regulation of spreads or margins, and mandating specific profit levels would be a practical impossibility. That leaves capital, and in fact, supervisors <u>are</u> actively working to improve the situation in the only reasonable way they can: reviewing and in some cases revising capital requirements.

Germany and Switzerland, for example, have widened the scope of their requirements in order to encourage their banks to more reasonably provide for the risks they incur in their international activities.

The instability surrounding the events of 1974 convinced the supervisors that they needed to be aware of conditions outside of their domestic markets. Supervisors learned that they could not ignore the greater leverage and risk-taking which banks were pursuing in the Euromarket than in their domestic markets. It was made obvious that Euromarket problems could quickly be translated into domestic banking difficulties. Mechanisms now exist so that there is continuous dialogue among the bank supervisors through the Cooke Committee, under the auspices of the Bank for International Settlements. This dialogue is fostering understanding and often agreement on the part of various nations' bank supervisors and will serve to improve their ability to react quickly should circumstances require it.

The instability of the mid-1970s also demonstrated the inadequacy of the information then available on the condition and activities of banks from various countries. This information gap was especially acute with respect to banks' international operations. Today, more information is being obtained from the banks by supervisors. More information is being publicly disclosed as well, although it undoubtedly does not tell the whole story. With better information, supervisors will be better positioned to anticipate and deal with difficulties in the Euromarket.

Conclusion

The international banking environment has been changing over the past decade and will continue to evolve. The new environment, marked by increased competition, volatility and risks will, obviously, confront bankers and bank supervisors with challenges. Thus far, both bankers and supervisors have shown that they can respond to this evolutionary process, although it has on occasion taken a period of severe instability to awaken them to the changes. However, bankers must not rely totally on their supervisors to solve their problems for them. As I made clear during my tenure as Comptroller of the Currency in the U.S., I believe that supervisors must strive to avoid stifling the innovation of the banking industry or insulating bankers from the consequences of their own decisions through excessively restrictive or protective measures. It seems clear that in the future both bankers and supervisors must continue to accept change and adapt to it. If they become reluctant to deal with changes as they develop, it is nearly certain that another crisis will arise to again awaken them to their responsibilities.

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MONETARI BANCARI E FINANZIARI
" LUIGI EINAUDI "

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" INTERNATIONAL BANKING: ITS MARKET AND INSTITUTIONAL STRUCTURE "

PIERRE JAANS

Remarks by Pierre Jaans

delivered at a round table

held in Perugia on 19 and 20 September 1981

organized by:

Ente per gli studi monetari, bancari e finanziari "Luigi Einaudi"

Theme : International Banking : its Market and Institutional Structure

INTRODUCTION

In his comprehensive and altogether concise report on "Recent Trends in International Banking", Dr. Monti has undertaken to extrapolate present developments in international banking and, in doing so, he has come to the tentative conclusion that "domestic and international banking will grow more and more integrated and that any attempt to draw a dividing line between the two will cease to be a meaningful exercise".

Although such a development, if it were to materialize, would seriously endanger the future of pleasant seminars like the one we are just enjoying, I can, from my post of observation as a supervisor in an international banking center, broadly endorse Dr. Monti's conclusion on this point.

There is indeed little doubt that international banking, which at its inception was basically limited to funding operations, has been in recent years and is gradually evolving towards a more full range of banking operations and services.

The growing integration of domestic and international activities of banks is also illustrated by degree of interest and involvement of high level bank management in the monitoring and conduct of the international part of their bank's business. While in the late sixties and early seventies in many cases international banking was an accepted, and in some instances rather a tolerated hobby of a bank's board member in charge of external business, we can witness now that the international section of a bank attracts the collective interest and active

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identification of the boards at highest levels. This evolution in managerial attitude indicates that international banking is perceived as an important and integrated part of the global business strategy of most major banks.

Private enterpreneurial initiative in the banking sector is thus building up a technically sophisticated and economically highly competitive and efficient international financial market. What have public authorities, central banks and supervisory authorities, done so far; have they been outdistanced, are they barking behind events ? To put the question in these terms is neither polemic nor disgracious because in our liberal system of society it is an intrinsic and important feature that private initiative should be followed with cautious distance by public authorities. On the other hand this is not intended to say that there is no role for public authorities to play in this context.

Quite rightly therefore Dr. Monti has raised this issue in the latter part of his exposé. His diagnosis is that the issues of supervision and support remain somewhat confused for the time being and his suggestion is that a clear and equitable framework should be set for the lender-of-last-resort and supervisory roles in international banking.

I would like to focus my remarks successively on the issue of supervision and the often discussed and maybe evergreen question of the lender-of-last-resort in international banking.

An overlapping pattern of supervisory responsibilities

Let us first look at the issue of supervision. Up to 1974 bank supervisors enjoyed a frugal and almost hidden life in their respective national administrations. Even the more qualified part of public opinion was scarcely aware of their existence. With the exception of EEC-countries, they very often had not ever met in person their opposite numbers in major countries.

This country-side situation changed rather quickly in the wake of the events which are commonly referred to as the Herstatt-crisis. Bilateral and multilateral contacts and cooperation were organized and institutionalized. In 1981 the inventory of these bodies is the following :

(1) The EEC Group of Bank Supervisory Authorities also called Groupe de contact

(2) The Committee on Banking Regulations and Supervisory Practices or Cooke-Committee at the level of the G-10 countries plus Switzerland and Luxembourg.

(3) The Banking Advisory Committee at the level of EEC -countries.

(4) A bank supervisors conference with world wide ambitions and an actual coverage of roughly 80 countries. This pattern of meeting, although it does not result from a formal international agreement, is likely to occur once every two years.

It would be a good question to ask whether there is not some redundancy in this apparently busy social life. My answer would be "yes, perhaps to a certain extent". To be fair I would, however , say that so far the work of these bodies has been reasonably coordinated and can therefore be considered mostly as complementary.

The committees have worked on such topical issues as : foreign exchange risk, maturity transformation, country risk exposure, banking secrecy a.s.o. The most visible and operational output so far, however, is the concept of supervision on a consolidated basis also and perhaps less accurately referred to as parental responsibility.

The ambitions pursued with this approach to supervision are twofold :

(1) to enable the supervisory authorities of a bank with international affiliations to make a periodic risk assessment covering the accounts of the parent bank under its direct jurisdiction aggregated with those of all overseas banking affiliates where the parent bank holds a significant participation.

(2) to enable supervisory authorities eventually to impose certain norms and limitations with regard to solvency, cluster-risks a.s.o. on a consolidated basis.

This concept, which emerged as soon as 1976, was not new for a number of countries. How was it received by those banking communities for whom it was actually an innovation? The first reaction was rather reserved if not frankly negative. Profits in international banking were at record levels in 1976 and 1977 and country risk exposure was still within limits which looked reasonable. The general business climate for international banking was too euphoric to be favourable to this supervisory consolidation idea, which, after all, meant that an additional and annoying father confessor and eventually even specific limitations might be imposed on a prosperous activity.

In the course of 1978 first signs that trouble might be ahead for international banking appeared and as spirits became gradually more gloomy the readiness to accept supervision on a consolidated basis increased. At present I think it would be fair to say, that opposition to this device of banking supervision has virtually vanished everywhere.

Let me turn now briefly to the reaction of those supervisory authorities for whom the concept of supervision on a consolidated basis was or still is a new experience. As this approach looked fairly obvious from an intellectual point of view a concensus on its usefulness could be reached quickly. In reasoning a bit further, however, some tricky aspects cannot be denied either.

Bank supervision pertains to public order and by legal tradition every state is responsible only for what happens on its own territory. In this respect the concept of "parental responsibility" is an entirely new alley on a less than secure legal ground.

To illustrate this point we can imagine the case of an unpleasant liquidation of a bank with a number of international banking affiliates in other countries. Let us assume that the troubles arise in 1985 that is in an environment of consolidated bank supervision. Depositors and their lawyers file suits in all directions including, of course, against supervisory authorities. The juridical outcome of this would probably be an authentic mess and we would in all likelihood be fortunate enough not to face the final result in our lifetime. Nightmares, such as Franklin National or Herstatt would gain an additional and considerable dimension.

I have resorted to this bit of fiction to show that the present implementation of parental responsibility in bank supervision, however clear or evident it may be, does have legal implications which have not yet been fully thought over. In any case it will probably take some time, if not a long time, before this matter will be settled in a fully coherent and satisfactory way.

In this meanwhile we will have to live with an overlapping pattern of bank supervision and supervisory responsibilities. Coming back to Dr. Monti's call for a clear and equitable framework for the supervisory role in international banking, I am inclined to say that in the forseable future this matter will be settled in an equitable way, insofar as satisfaction and frustration will be shared between supervisors. I am, however, afraid that the concept of parental responsibility will have to remain somewhat unclear for some time.

The hard-to-think-off lender-of-last-resort in international banking

Let me turn now to the issue of a lender-of-last-resort in international banking, a subject which is not very rewarding.

It is a distinctive feature of international banking that the assets which banks accumulate in this type of activity are as a rule not eligible for mobilization or refunding with a central bank. Moreover

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these assets are, as far as European banks are concerned, mostly denominated in currencies where the banks have no stable home base.

If you look at this situation from the point of view of traditional national banking, it appears as something abnormal and disquieting. The discomfort is further increased through the, perhaps deliberately, sibylline attitude of central banks on this point. Only once, in the midst of the crisis of 1974, the central banks of the G-10 countries plus Switzerland made a joint public statement that they would ensure an adequate overall level of liquidity that would prevent the collapse of the market. The same statement however gave a stern warning that this general attitude did not mean that central banks might feel responsible in cases of imprudence on the part of individual banks. There is ample room for semantics in this statement.

Should the central banks be blamed for escaping responsibilities ? Is their atttitude not incoherent in as far as on the one hand they praise international banking for handling the challenging problem of recycling and on the other hand they are not willing to provide a liquidity safety net with clear and publicized rules ?

To answer these questions might appear at first sight to be a matter of opinion or political choice. Let us therefore try to look a little closer at the issue in order to stay as long as possible on a rational ground when trying to form a judgement.

It is undisputed that the primary duty of each central bank is to protect the value of the money it issues and to provide an amount of liquidity which has to be compatible with stability and a satisfactory functioning of the national economy.

In order to achieve this goal a central bank offers to the commercial banks on its territory a certain volume of credit against a number of financial assets which have to be provided as security. As a rule these instruments are types of claims against the private or public sector of the domestic economy which are widespread in the domestic banking sector. Also as a rule, the volume of credit or liquidity offered by the central bank is equivalent to a moderate fraction only of the outstanding volume of assets which are theoretically eligible for mobilization with the central bank. A further trivial rule is that a central bank can, in all normal circumstances, only be expected to provide liquidity in its own currency.

With these basic facts in mind let us try to imagine what might happen if the central banks of major eurocurrencies would, either individually or in the framework of a joint venture, try to provide a regular lending-of-last-resort facility for international banking.

In a first instance the catalogue of assets eligible for mobilization would have to be expanded in order to encompass assets which are typical for international banking. This problem would be of a technical nature and could probably be solved as categories of international banking assets which are of excellent qualtiy and of a reasonably standardized nature do already exist or could easily be developed.

A second step would be to define ceilings for the volume of liquidity which would be provided through this new window and it is here that the real problems arise. Two alternatives could be thought of :

(1) The volume of liquidity provided to international banking would not be additional to a given domestic policy stance. This option would be of limited help to international banking.

(2) An additional volume of liquidity would be provided. This might indeed give some comfort to international banking, but, given the high degree of osmosis between international and national financial markets, it could be devastatingly selfdefeating for domestic policies.

For these reasons it would not seem realistic that central banks, solo or in a common venture, could be expected to run a regular liquidity facility for international banking. It would not seem useful either because any amount of an international currency that is compatible with the domestic monetary policy goals of that currency can be provided through the existing channels of domestic lending-of-last-resort. If there is a problem, it is the problem of price as all of us know out of recent and present experience.

There is the temptation to argue that beyond their domestic responsibilities central banks which issue internationally used currencies, do also have an external responsibility. This argument, which was fed into the debate about the high dollar interest rates, is essentially political and can therefore only be tested against considerations of equity and fairness. The application of these criteria would probably imply that if you put an international responsibility on the policy stance of a central bank, you would have to grant it the right to limit this burden by limiting the international use of its currency, eventually through administrative means. To say the least, this would not be very helpful to international banking.

Dr. Monti rightly pointed at the increasing risk in international banking. Handling international commercial and sovereign risk, in the framework of liberal economies is basically a task for final or direct lenders, banks, the IMF, the World Bank and the regional development banks, but not for central banks.

For an individual bank, engaged in international banking, either directly or through specialized affiliates, it would therefore seem important to cautiously limit its involvement in this market which feeds partly on illusions : the illusion of depositors who through the repetition of investing short, actually stay long and the illusion of banks who through the repetition of granting medium-term credits to the same borrower actually do grant long-term credit.

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"INTERNATIONAL BANKING: ITS MARKET AND INSTITUTIONAL STRUCTURE"

Peter E. Leslie

PERUGIA : SEPTEMBER 29TH, 1981

NATURE OF THE INTERACTION BETWEEN MARKET STRUCTURES AND FORCES AND INSTITUTIONAL SYSTEMS

IN HIS BRIEF OUR PRESIDENT HAS ASKED THAT JOHN HEIMANN AND MYSELF SHOULD TRY AND BRING TOGETHER THE ECONOMIC AND JURIDICAL ANALYSES OF INTERNATIONAL BANKS AND CONCENTRATE ON THE INTERACTION BETWEEN SYSTEMS AND MARKET STRUCTURES, WITH PARTICULAR REFERENCE TO THE PROBLEMS OF EUROPEAN BANKING INTEGRATION.

1. GENERAL MARKET CONDITIONS FOR THE 1980S

COMPARING THE LIST OF THE TOP 100 BANKS IN 1980 WITH 1970 ONE IS STRUCK ON THE ONE HAND BY HOW DRAMATIC HAS BEEN THE GROWTH IN BALANCE SHEET TERMS AND ON THE OTHER HOW FEW THE CHANGES HAVE BEEN IN THE NAMES OF THE BANKS CONCERNED. BROADLY SPEAKING THEY ARE THE SAME. OF COURSE, THERE ARE SOME DIFERENCES: THE BIGGEST BANKS HAVE BECOME PROPORTIONATELY BIGGER, AND THE SHARE OF THE BULK OF THE US BANKS HAS DROPPED, WHILST THOSE OF THE FRENCH AND GERMANS - UNTIL RECENTLY - HAVE INCREASED, AS HAVE THE JAPANESE. THE BANCO DO BRASIL HAS APPEARED FROM NOWHERE, THE UK BANKS HAVE - THANKS TO STERLING - RECOVERED THEIR EARLIER POSITION AND THE ITALIAN AND CANADIAN BANKS ARE PROBABLY SLIGHTLY DOWN. IN THE OTHER EUROPEAN COUNTRIES MOST BANKS ARE IN THE 50/100 RANGE AND REMAIN SO, ALTHOUGH THE DUTCH AND THE SWISS BANKS HAVE SHOWN SOME INCREASE. THIS SUGGESTS THAT THE WORLD BANKING STRUCTURE HAS PROVED REMARKABLY STABLE AND THAT BOTH INTERNATIONALLY AND DOMESTICALLY ALL HAVE SHARED IN WORLD GROWTH AND IN THE INTERMEDIATION ROLE WHICH THE OIL PRICE INCREASES OF THE 1970S IMPOSED ON WESTERN BANKING. THUS, ONE MAJOR ASPECT OF THE INSTITUTIONAL SYSTEMS IN THE FORM OF THE WORLD BANKS HAS REMAINED REMARKABLY UNCHANGED IN THE 1970S.

A NUMBER OF THE CHANGES IN MARKET FORCES HAVE ALREADY BEEN REFERRED TO. IF I CAN SUMMARISE THE MAIN ONES BRIEFLY:

A) THE GREATLY INCREASED POLITICAL TURBULENCE WHICH WE ARE ALREADY EXPERIENCING SUGGESTS THAT THE STABLE POST-WAR PERIOD IS LARGELY AT AN END.,

B) THE RATE OF REAL GROWTH IN THE WORLD CONTINUES ITS DOWNWARD TREND - AND THIS IS CLOSELY INTERLINKED WITH A) ABOVE.,

C) THE SOCIAL PRESSURES ARE INCREASING NOT ONLY IN THE DEVELOPING WORLD BUT IN THE DEVELOPED WORLD.,

D) THE VERY SUCCESS IN ''INTERNATIONALISING'' EXCHANGE RATES AND INTEREST RATE MOVEMENTS IS MAKING FOR INCREASED VOLATILITY.,

E) THE RATE OF GROWTH OF BANKS HAS BEEN GREATLY INFLUENCED BY THE OPEC SURPLUSES. THESE ARE BECOMING AN INCREASINGLY UNCERTAIN FEATURE AND WILL TEND TO MOVE MORE TO ARAB RECYCLING INSTITUTIONS.,

F) NATIONAL GOVERNMENTS WILL CONTINUE TO WISH TO LIMIT THE PROVISION OF FOREIGN BANKS IN THEIR ECONOMIES:

G) THE THRESHOLD OF RISK WILL CONTINUE TO LOWER BOTH NATIONALLY AND INTERNATIONALLY:

H) THE SHARE OF THE PUBLIC SECTOR IN MOST ECONOMIES WILL CONTINUE TO GROW.

I WOULD NOT WISH YOU TO CONCLUDE FROM THIS GLOOMY SCENARIO THAT THE ROLE OF INTERNATIONAL BANKING IS AT AN END. I DO, HOWEVER, THINK THAT THE 1970S HAVE PERHAPS BEEN A UNIQUE PERIOD OF VIRTUALLY TROUBLE FREE EXPANSION AND THAT THE 1980S ARE GOING TO BE A VERY TESTING PERIOD INDEED.

2. NEED FOR INCREASED CAPITAL STRENGTH

IT FOLLOWS THAT THE MAIN CRITERIA FOR A SUCCESSFUL BANK IN THE 1980S WILL BE OF CONTINUED CAPITAL STRENGTH AND MANAGEMENT SKILLS.

A) WE HAVE ALREADY DISCUSSED THE QUESTION OF THE EFFECT OF INFLATION ON CAPITAL RATIOS. I WOULD FULLY ACCEPT THAT THERE ARE NO ABSOLUTES WHERE RATIOS ARE CONCERNED AS WE CAN SEE FROM THE WIDE VARIETY OF RATIOS WHICH ARE CONSIDERED PERFECTLY ACCEPTABLE. IT IS TO A CONSIDERABLE EXTENT A MATTER OF CONFIDENCE AND ALL OF US CAN RECALL HOW THE WHIFF OF TROUBLES AT A PARTICULAR BANK HAS MADE US ALL RE-EXAMINE OUR LINES, AS HAPPENED OVER A NUMBER OF LEADING BANKING NAMES AT ONE POINT OR ANOTHER IN THE LAST TEN YEARS. THE INCREASED FOCUS BY REGULATORY AUTHORITIES ON RATIOS HAS IN ITSELF AN IMPORTANT EFFECT AND FOCUSES ATTENTION ON THE ODD MAN OUT. FOR INSTANCE, THE FEDERAL RESERVE BANK'S COMMENT ON THE MIDLAND/CROCKER DEAL OF THE GENERAL NEED TO SEE AN IMPROVEMENT IN RATIOS WILL SERVE TO HIGHLIGHT THE WEAKNESS OF PARTICULAR NAMES IN COMPARATIVE TERMS.

CLEARLY DECLINING PROFITABILITY - IN REAL TERMS - IS AN INITIAL INDICATOR OF ILL-HEALTH AND A CERTAIN ADVERSE INFLUENCE ON RATIOS. THERE IS NO DOUBT THAT SQUEEZES, BOTH IN EUROCURRENCY MARGINS, AS WELL AS IN DOMESTIC MARKETS, TOGETHER WITH INCREASED COSTS OF THE WELFARE STATE AND LOWER GROWTH, ARE ALL HAVING THEIR EFFECT, AND IT IS DIFFICULT TO SEE THAT THE TREND TO LOWER PROFITS CAN EASILY BE REVERSED.

B) HOWEVER, I BELIEVE OF FAR GREATER IMPORTANCE IS THE RE-EVALUATION OF RISK. ON THE QUESTION OF SOVEREIGN RISK, I BELIEVE WE KID

OURSELVES WHEN WE PERSUADE OURSELVES AND OUR AUDITORS AND OUR REGULATORY AUTHORITIES THAT ACTUAL OR PROBABLE RESCHEDULING REMOVES THE NEED FOR PROVISION. WE HAVE KICKED UNDER THE TABLE ALREADY THE RISK OF A NUMBER OF THE SMALLER LDCS, WHETHER THEY HAVE RESCHEDULED OR NOT, BUT IT IS DIFFICULT TO SEE THAT THE INCREASED LEVEL OF GOVERNMENT INDEBTEDNESS WILL ALLOW THE POSSIBILITY OF REPAYMENT ON MATURITY, PARTICULARLY WHEN THE PRACTICE OF GRACE PERIODS ONLY SERVES TO PUT OFF THE DAY OF RECKONING. THE BEST THAT WE CAN HOPE IS THAT THEY WILL BE ROLLED OVER FOR EVER - AS IS OUR OWN NATIONAL DEBT. I CANNOT BELIEVE THAT THIS IS A REALISTIC APPROACH. HOWEVER, THE ALTERNATIVE, WHICH WE WOULD NORMALLY APPLY TO COMMERCIAL DEBTS, OF PROVIDING PRUDENTIALLY AGAINST AT LEAST PART OF THOSE WHO ARE UNABLE TO REPAY IS A HORRIFYING ONE FROM THE POINT OF VIEW OF THE BALANCE SHEETS AND SOLVABILITY OF MOST LEADING BANKS. EVEN A PROPORTION OF TURKEY, POLAND, ROMANIA, BRAZIL, SOUTH KOREA EXPOSURE WOULD MAKE A VERY SIZEABLE HOLE IN MOST INTERNATIONAL BANKS' CAPITAL RESOURCES.

C) WE HAVE EXPERIENCED ALREADY AN INCREASED RISK IN <u>MULTI-NATIONAL COMPANIES</u> AND IT IS CERTAIN WE WILL SEE MORE. IF ANYBODY HAD MENTIONED THE NAMES OF CHRYSLER, MASSEY FERGUSSON, INTERNATIONAL HARVESTER, AS WELL AS A FEW OTHERS WHICH HAVE NOT YET REACHED SUCH SERIOUS PROPORTIONS, IN 1970, THEY WOULD PROBABLY HAVE BEEN DISMISSED OUT OF HAND. THE INCREASED INTERNATIONALISATION OF MANY MANUFACTURING INDUSTRIES HAS EXTENDED CONSIDERABLY THE VULNERABILITY OF MAJOR COMPANIES IN A NUMBER OF SECTORS.

D) THE EXTENSION OF <u>INTER-BANK TRANSACTIONS HAS</u> MADE US ALL MUCH MORE VULNERABLE TO RISK OF BANK FAILURE. WHILST WE LIKE TO THINK THAT THE INCREASED ROLE OF THEIR SUPERVISORS WILL GIVE US ADDITIONAL PROTECTION HERE, IT IS NOTICEABLE THAT LEGAL LIABILITY IS NORMALLY RESTRICTED TO RETAIL DEPOSITS INSURANCE SCHEMES, ALTHOUGH I WOULD FULLY ACCEPT THAT MOST CENTRAL BANKS HAVE SHOWN THEMSELVES MUCH MORE WILLING TO MOUNT MAJOR RESCUE OPERATIONS.

E) HOWEVER, GREATER THAN ALL OF THESE IN MY OPINION IS THE RISK OF <u>MISMATCH</u>, BOTH IN EXCHANGE EXPOSURE AND INTEREST EXPOSURE. WHILST

PREVIOUSLY WE HAVE TENDED TO THINK THAT THIS WAS A PRINCIPLE PROBLEM OF WHOLESALE BANKING, THE EVENTS IN THE STATES HAVE EMPHASIZED HOW QUICKLY THE RETAIL MARKET CAN ALSO MOVE AT TIMES OF INCREASED RATE VOLATILITY. WE ARE ALL INVESTING MORE AND MORE MANAGEMENT SKILLS IN THIS AREA AND, OF COURSE, WE HAVE SEEN SOME CONSPICUOUS EXAMPLES OF THE PROBLEMS THAT CAN ARISE IN

THIS FIELD - NOT LEAST IN LOSS OF PNDS31M. IN LONDON LAST YEAR BY A LEADING US BANK. I AM CONCERNED THAT THERE ARE STILL BANKS, INCLUDING MANY OF THE BEST NAMES, WHO GAMBLE IRRESPONSIBLY IN THIS AREA GIVEN THE SCALE OF MOST OF OUR BOOKS. THE DEGREE OF THE DOWNSIDE RISK IS QUITE SUFFICIENT TO HAVE A VERY SERIOUS IMPACT ON OUR SOLVABILITY AND LIQUIDITY. WITH THE SCENARIO THAT I HAVE GIVEN I AM CERTAIN THAT THE BANKS WHO WILL SURVIVE IN THE 1980S WILL BE FOLLOWING VIRTUALLY A FULLY MATCHED POLICY.

3. THE MEANS OF REINFORCEMENT

NONE OF THE POINTS MADE IN 2. SUGGEST THAT IT IS GOING TO BE VERY EASY TO INCREASE ONES CAPITAL STRENGTH - INDEED ALL THE TRENDS ARE IN THE OTHER DIRECTION. AS ALWAYS, THERE ARE REALLY TWO DIRECTIONS IN WHICH ONE CAN GO:

A) CUTTING ONESELF BACK TO SIZE AND RATIONALISING ONE'S BUSINESS, OR
B) BY EXPANSION THROUGH TAKEOVER, MERGER OR INCREASED INVESTMENT.

GIVEN THE FACT THAT AT TIMES OF REDUCED GROWTH IT IS MUCH MORE DIFFICULT TO ACHIEVE THIS THROUGH INCREASED INVESTMENT ON ITS OWN, I WISH TO CONCENTRATE ON THE TAKEOVER/MERGER LINE.

AS WE HAVE SEEN, THIS HAS HARDLY BEEN A FEATURE OF THE 1950S, 60S AND SEVENTIES.

A) LOOKING FIRST OF ALL AT THE DOMESTIC MARKET, IN MANY COUNTRIES THE

TREND TO CONCENTRATION AND A DESIRE FOR COMPETITION HAVE REACHED NEGATION IN THE PREDOMINANCE OF COMPARATIVELY SMALL NUMBERS OF DOMINANT BANKS, SAY 3 OR 4. THUS IN MOST COUNTRIES THERE IS LITTLE SCOPE FOR FURTHER ACTIVITY HERE. THERE HAS, HOWEVER, ALREADY BEEN AN INCREASING TREND TO MOVE INTO OTHER FINANCIAL SERVICES, SUCH AS CONSUMER CREDIT, LEASING, MORTGAGE BANKING, MERCHANT BANKING, PORTFOLIO INVESTMENT MANAGEMENT, AND INSURANCE BROKING - IN MANY CASES AREAS WHERE NON-BANKING INSTITUTIONS HAVE SHOWN SUBSTANTIAL GROWTH SINCE THE WAR. IN MANY COUNTRIES THESE AREAS ARE MUCH LESS CLOSELY REGULATED THAN BANKING AND I HAVE NO DOUBT THERE WILL BE VERY CONSIDERABLE PRESSURE FOR THE COMMERCIAL BANKS TO MOVE INTO THIS AREA AND IN MANY CASES RECOVER THEIR SHARE OF TOTAL FINANCIAL MARKETS WHICH THEY HAVE TENDED TO LOSE OVER THE LAST 30 YEARS. HOWEVER, ONE SNAG IS THAT IN A NUMBER OF AREAS THESE

MARKETS ARE DOMINATED BY PUBLIC SECTOR INSTITUTIONS, AND IN THOSE COUNTRIES IT REQUIRES A MAJOR POLITICAL CHANGE BEFORE THIS CAN HAPPEN. THERE IS OF COURSE ONE AREA, THE UNITED STATES, WHICH OFFERS THE LARGEST SINGLE POSSIBILITY OF CHANGE IN THE NEXT TEN YEARS, ALTHOUGH THE DEGREE AND SPEED REMAINS THE WORLD'S BIGGEST QUESTIONMARK.

B) THE SCOPE FOR INTERNATIONAL MERGER/TAKEOVER REMAINS UNCERTAIN.

IN MANY COUNTRIES BANKING IS A SECTOR PRESERVED TO PUBLIC SECTOR OR NATIONAL INSTITUTIONS AND IT IS DIFFICULT TO SEE MUCH SCOPE FOR GROWTH IN AFRICA, LATIN AMERICA, OR ASIA. THE KEY AREAS ARE:

I) USA - THERE IS NO DOUBT THAT THIS HAS PROVED AN IMMENSELY FRUITFUL FIELD ALREADY TO THE EXPANSION OF INTERNATIONAL BANKS AND IN SPITE OF THE INTERNATIONAL BANKING REGULATIONS, I SEE THIS REMAINING THE BIGGEST SINGLE MARKET OPPORTUNITY FOR THE FOREIGN AS WELL AS THE US BANKS. WHILST IT IS DIFFICULT TO SEE THAT THE TAKEOVER OF THE THREE OR FOUR MAJOR BANKS WOULD BE ACCEPTABLE, NO COUNTRY IS LESS XENOPHOBIC AND MORE FAIR MINDED THAN THE UNITED STATES. AS THE FED SAID IN ITS MIDLAND/CROCKER JUDGEMENT, IT IS NOT THE FED'S RESPONSIBILITY TO TAKE THE NATIONALITY OF THE ACQUIRING BANK INTO ACCOUNT.

II) OTHER DEVELOPMENTS IN NON-EEC COUNTRIES. IT IS ENCOURAGING THAT COUNTRIES LIKE CANADA AND AUSTRALIA AND SPAIN HAVE ALL EITHER INTRODUCED A MORE LIBERAL ATTITUDE OR ARE IN THE COURSE OF THINKING ABOUT IT, AND THERE IS CLEARLY SOME SCOPE FOR SOME INCREASED ACTIVITY HERE, ALTHOUGH I WOULD NOT SUGGEST THAT THIS WOULD BE OTHER THAN MINOR.

III) EEC: THE EEC OFFERS, OF COURSE, IN THEORY A UNIQUE OPPORTUNITY FOR THE EMERGENCE OF GENUINE COMMUNITY WIDE BANKS. AND YET, IT IS DIFFICULT TO SEE IN THE 80S, ANY MORE THAN IN THE 70S, THAT NATIONAL GOVERNMENTS WOULD BE PREPARED TO SURRENDER SOVEREIGNTY OVER SUCH A KEY AREA OF THEIR DOMESTIC ECONOMIES AS COMMERCIAL BANKING. REGRETFULLY ONE HAS TO SAY THAT IT IS DIFFICULT TO SEE THAT THE MERGER OF AMRO AND MIDLAND OR COMMERZBANK AND CREDIT LYONNAIS WILL TAKE PLACE IN THE WORKING LIVES OF MOST OF US. IT IS ONLY PERHAPS A MAJOR CATACLYSM IN INTERNATIONAL BANKING THAT WOULD BRING FORWARD THIS EVENT. THAT DOES NOT MEAN TO SAY THAT I DO NOT BELIEVE THAT A CONSIDERABLE AMOUNT CAN BE ACHIEVED TOWARDS GREATER FREEDOM OF COMPETITION WITHIN THE

COMMUNITY BY DEVELOPING THE LEGISLATION WHICH IS ALREADY IN EXISTENCE. THERE IS NO DOUBT THAT IN MANY COUNTRIES THERE EXISTS THE BELIEF THAT THE UNFETTERED COMPETITION BY BANKS OF OTHER COUNTRIES OF THE COMMUNITY NEEDS TO BE CONTROLLED IN VARIOUS INDIRECT WAYS IN ORDER TO PROTECT NATIONAL BANKS AND THEIR CUSTOMERS FROM THIS INCREASED COMPETITION. WHILST IT IS DIFFICULT TO ARGUE STRONGLY THAT CONTROL OF DOMINANT BANKS SHOULD PASS TO OTHER NATIONS - EVEN IF THEY ARE IN THE COMMUNITY - THERE IS NO DOUBT THAT THE REDUCTION OF THOSE BARRIERS WOULD PROVE - AS THEY HAVE DONE IN SO MANY COUNTRIES - OF BENEFIT TO THE COUNTRY AND THEIR CONSUMERS. TO THIS END THE FEDERATION BANCAIRE HAS OPENED A DIALOGUE WITH THE COMMISSION TO IMPROVE THE DEGREE OF COMPETITION IN THE EEC.

4. CONCLUSION

I HOPE I HAVE SAID ENOUGH TO INDICATE THAT I CERTAINLY DO NOT THINK THAT BANKING IN THE 1980S IS GOING TO BECOME IN ANY WAY DULL OR UNADVENTUROUS. INDEED, I THINK WE HAVE GOT A POSSIBILITY OF A RESTRUCTURING OF BANKING IN A NUMBER OF DIFFERENT AREAS IN ORDER TO IMPROVE THE CAPITAL STRENGTH OF OUR MAJOR INSTITUTIONS, BUT IF I HAD TO SELECT ONE WORD WHICH SHOULD APPEAR ON THE COAT OF ARMS, OR IN THE MANA GING DIRECTORS OFFICE OF ALL BANKS, IT IS THE WORD ''PRUDENCE''.

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MONETARI BANCARI E FINANZIARI
"LUIGI EINAUDI"

7

"INTERNATIONAL BANKING: ITS MARKET AND INSTITUTIONAL STRUCTURE"

HELMUT W. MAYER

Helmut Mayer

Comments on Monti's Paper on
Recent Trends in International Banking

Signor Monti's interesting paper gives an insider's view of recent trends in the development of international banking and, being in a way an outside observer, I have read it with great interest and have learnt a great deal from it.

Signor Monti stresses the evolutionary nature of the internationalisation of banking, with the banks quite naturally following their customers and their customers' business abroad. But just as in nature the evolutionary process is not only the outcome of infinitesimal steps, but is fostered by spontaneous mutations, there are certain aspects in the internationalisation of banking that are more than just an extension of the kind of business the banks had been doing at home. One of these new aspects is that an increasing proportion of banks' total business is conducted, or at least booked, through so-called offshore centres, where it is not subject to the kind of regulatory constraints to which it is subject at home. And secondly, in the field of international capital flows, the banks have taken over a rôle that was formerly mainly played by direct investments, the bond markets and official capital aid, namely the provision of long-term development finance to a broad range of countries. And in fact it is mainly in connection with these two original aspects of the internationalisation of banking that much of the macro-economic and NEW concerns about international banking have arisen.

From a macro-economic point of view the conduct of business in the unregulated centres is perhaps not so worrying as long as it is genuinely international, comprising, for example, the provision of balance-of-payments or development finance. But it becomes much more of a problem if an increasing proportion of the domestic money and credit circuits is also channelled or booked through these offshore centres, thereby potentially impairing the effectiveness of domestic monetary controls and policy. This macro-economic problem has been heightened in recent years by two developments: firstly, the sharp increase in nominal interest rates as a result of mounting inflation, which has increased the real cost burden of non-interest-bearing reserve requirements. For example, in the early spring of last year, when short-term dollar interest rates were quoted at around 20 per cent. and US reserve requirements on new managed liabilities stood as high as 18 per cent., the resultant cost advantage of the Euro-market in comparison to doing business in the United States amounted to as much as between 350 and 400 basis points - certainly a huge incentive for the expatriation of domestic banking business from the United States to the Euro-market. A second development which has exacerbated this problem of the diversion of domestic money and credit circuits to the offshore centres has been the de-emphasis of interest rates and the growing reliance on the monetary aggregates as the principal target variables of monetary policy. Unfortunately, from the point of view of international banking, this was a move in the wrong direction. While the displacement of domestic money and credit circuits will not very much impair the relevance of an interest target, it can obviously render rather meaningless the use of the domestic monetary aggregates as target variables.

Under these circumstances it may not be too surprising that the US authorities have in the past pressed for the extension of reserve requirements to the Euro-market. However, the imposition of non-interest-bearing reserve requirements of the order of magnitude the United States had in the past would have given rise to new kinds of distortions and efforts at evasion since, with the exception mainly of Germany, most countries other than the United States do not use such a system of high and non-interest-bearing reserve requirements at home. Instead of creating new kinds of distortions, a more efficient way to achieve a kind of international harmonisation would be to do away with those regulations and policies that impose an artificial competitive handicap on the banks' domestic activities. This in fact is the road the United States has now taken. Under the new US Monetary Control Act, which came into force at the beginning of this year, banks in the United States will ultimately be freed from interest ceilings, and reserve requirements will be largely limited to demand deposits, with required reserves on time deposits being ultimately reduced to 3 per cent. and those on deposits by private individuals being abolished altogether. This package should already go a long way towards reducing the artificial biases in favour of offshore banking. On the other hand, it remains to be seen whether the benefits resulting from this new Act to US domestic monetary management will not be eroded by the new offshore facility in the United States, which will also be open to the foreign affiliates of US firms and may blur even more the distinction between the domestic and the international money and credit circuits.

As regards the prudential aspects of offshore banking, the situation is perhaps somewhat less serious, since in most offshore centres there is some kind of banking supervision, and, in fact, the so-called Concordat reached in 1975 by the Basle Committee of Banking Supervisors and alluded to in Signor Monti's paper, did help to close some of the gaps in this area. I should perhaps stress in this context, since Signor Monti mentions this point, that contrary to the blown-up articles in the economic press the new US disclosure requirements by no means thwart the objectives of this Condordat. The basic objective of the Concordat was to make sure that no banking office located within the countries represented on the Committee escaped supervision, and not to prevent overlapping of supervision by parent and host authorities. In fact, in some areas, such as the monitoring of the solvency of legally independent subsidiaries, the Concordat even expressly provided for an overlapping of the supervisory responsibilities of parent and host authorities. Of course, as regards the supervisory authorities covered by this agreement, the new US regulation may carry the overlapping too far, but this does not invalidate the Concordat; instead, the problems to which the new US reporting requirements may give rise belong more to the sphere of banking secrecy.

Moreover, the membership of the Basle Committee is limited to the Group of Ten countries including Luxembourg and Switzerland. Several of the offshore centres are therefore not formally committed to the Concordat. There has been a problem in the United States of branching-in of banks set up expressly for this purpose in offshore centres. The new US disclosure requirements might be the only way to achieve a certain amount of supervision over these banks. While the situation is of course very different with regard to the affiliates from banks in the Group of Ten countries, it would be impracticable for a law to discriminate according to countries. However, some differentiation may perhaps be made in the spirit of application of this law.

Apart from its limited geographical coverage, the Concordat has two other weaknesses. Firstly, even though the offshore centres are completely willing to adhere to the Concordat, they may not have the necessary staff and expertise to implement sufficiently tight supervision. And, secondly, even when the supervision in the offshore centres is fully up to the standards of the parent authorities of the banks concerned, certain regulations such as minimum capital ratios, risk exposure limits and so on can only be effective if they are imposed on the internationally consolidated position of a banking company as a whole. It is for these reasons that the central-bank Governors, in their press communiqué of April 1980 on the Euro-market, strongly endorsed an initiative of the Committee of Banking Supervisors that the banks' international business should be supervised on a fully consolidated basis. This measure, too, should help to eliminate some important artificial biases in favour of international banking, since it means that the prudential rules and ratios to which banks are subject at home will apply also to their total internationally consolidated positions.

There is, however, one problem connected with this approach. Since rules differ from country to country, for example with respect to minimum capital requirements, the extension of the domestic rules to international business might put banks of different parent countries on an unequal competitive footing. This means, and here one cannot but be in full agreement with what Signor Monti says on page 21 of his paper, namely that in the longer run efforts will have to be made by the countries adhering to the consolidation principle to reach a certain harmonisation of national regulations in this area.

Let me then deal briefly with the second respect in which the banks' international business cannot be considered as a natural extension of their domestic business, namely their rôle in providing development finance, which in practice engages the banks in very long-term commitments. Needless to say, the flow of financial credits on market terms to lesser developed countries is a good thing as long as these countries are able to transform these capital imports into a higher level of investment that will ultimately increase their export capacity and/or their scope for import substitution. If this condition is fulfilled, a growing external debt volume will not burden the country's future but will, on the contrary, increase future income growth. And although the increase in indebtedness may be for the foreseeable future an irreversible process, this will be "alright" as long as the individual credits are properly served and can be refinanced in good faith. In fact, it appears that some of the countries, such as Brazil and South Korea, that had in the last ten years been the largest takers of bank credits, were also the ones to experience the highest growth rates. Moreover, in the past, because of the high rate of increase of international dollar prices, the real interest cost of international bank credit was very low and mostly even negative, which meant that the productivity of the investments financed with these credits did not even have to be very high to make the borrowing worthwhile.

Nevertheless, there are instances in which the borrowing proceeds were not used for investment, but rather for financing private or public consumption, or in which the investments, if anything, increased the import dependence without raising export capacities. Moreover, more recently the international financial position of broad groups of countries has been severely impaired by two exogenous developments. Firstly, the second wave of oil price increases and their consequences for balances of payments, unemployment and inflation in the industrial countries. And secondly, the sharp rise in dollar interest rates, combined with the exchange-market strength of the dollar, which meant that real interest rates became all of a sudden rather high, and this not only on new credits but, because of the technique of floating interest rates, on a large proportion of the total debt outstanding.

As a result of these two developments, there can be little doubt that the external payments situation of a number of countries has become rather precarious and that the risks involved in international lending, both as regards new credits and credit outstanding, have increased. Since at the same time it is of vital interest for the world economy that the international banking sector should continue to act as a major source of credit to the developing countries, this throws up the question of who would act as the lender of last resort in case banks got into trouble in their rôle as providers of capital to Third World and other countries.

In this connection, in view of the mix-up there has been in the press and which on pages 18-19 seems also to affect Signor Monti's paper, I must start out by stressing that the division of responsibilities in the field of banking supervision is not necessarily the same as that in the field of lender of last resort function. In fact, in a number of countries the prime responsibility for banking supervision is vested with authorities outside the central banks that have no opportunity to act as lender of last resort. The Concordat reached in 1975 by the Basle Committee of Banking Supervisors related only to supervision with no implications for the lender of last resort responsibilities, and the same is true for the consolidation initiative, or the new US disclosure requirements.

In the international field, the lender of last resort problem is a very complex one. In the domestic field the central bank, in the case of a liqudiity crisis, can normally extend aid in domestic currency, i.e. in the currency the supply of which it controls itself. In the international field, however, support will more often than not require foreign currency, i.e. a currency which the central bank concerned cannot create itself. It should therefore be clear that in the international field the exercise of the lender of last resort function will require close co-operation between central banks. Moreover, it is very difficult to say in advance exactly what form and proportions such a crisis, if any, could assume. Instead of elaborating on a rigid and complicated scheme that could take care of all contingencies, it is probably better to remain flexible. What is needed are close contacts between central banks, and a broad agreement on the principles, both of which already exist.

Moreover, the same applies with regard to the announcement of specific rules for emergency assistance to troubled banks, and I think Governor Wallich's argument, which Signor Monti quotes on page 20 of his paper, has a lot of merit. The form, the price and the extent of such assistance, if any, will depend on a large number of circumstances, and it would not only be impossible but next to foolish to try to establish in advance and publish a kind of menu list allowing for all these possibilities. The danger would not only be relaxation of some of the necessary caution by the banks, which Governor Wallich in the aforementioned quotation has mainly in mind, but the fact that everything is already worked out and provided for might also sound to the debtor countries very much like an invitation to go ahead and default on their debt service obligations.

To end with a note of agreement, I can personally fully endorse what Signor Monti says on page 21 about the desirability of broadening and improving the international banking statistics. Efforts in this direction are under way, but quick progress is difficult to achieve, since it means co-operation by the authorities of the offshore centres and/or increasing reporting burdens on the banks themselves.

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"INTERNATIONAL BANKING: ITS MARKET AND INSTITUTIONAL STRUCTURE"

Antonio Monti

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"INTERNATIONAL BANKING: ITS MARKET AND INSTITUTIONAL STRUCTURE"

Antonio Monti

Antonio MONTI

Recent Trends in International Banking

Paper prepared for the Ente Einaudi Conference on
"International banking: its Market and Institutional Structure"
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Introduction

When I was asked to speak about international banking, the first question that came to mind was "What do we mean by international banking"? Can we consider it as something completely different from domestic banking or is it really the same business in a wider context?

On looking at the past development of what is today called "international banking", my first reaction was that international banking in itself (apart from some peculiar technicalities) is more a geographical expression - as the name itself says - than a particular type of activity.

As a matter of fact international financial intermediation developed pari passu with international trade, helping the latter to increase its possibilities and scope and enabling economic operators all over the world to deal with their problems more efficiently.

In other words, in the course of their development, domestic banks have to cope, sooner or later, with problems that go beyond national frontiers. In following their customers' foreign activities, they begin to deal with foreign correspondents and counterparts, thus becoming engaged in "foreign banking". Usually their next step, prompted by the need , which sooner or later arises, is to establish themselves abroad in one way or another in order to tackle the problems that confront them in the course of their business. They become in this way "international banks".

What I have just said can be accepted as a fair description of what happened to the banking systems of the industrialized nations, and sounds very much like a smooth and normal development.

Yet today few areas of economic and financial research attract greater interest and draw larger audiences than international banking (i.b.). This is true when one looks at i.b. from both theoretical and institutional viewpoints.

What has happened is that i.b. has lately found itself at the crossroads of a number of separate developments occurring, at both micro and macro economic levels, in many fields of domestic and international economic activity. It has been shaped in its present form by the 1974 energy crisis and ensuing recycling problems, by the abandonment of the fixed exchange rate regime, by the radical reshaping, two years back, of the overall design of U.S. monetary policy and, last but not least, by the fast changing nature of the whole concept of banking.

In this new framework I think that the international financial community can feel reasonably satisfied with their achievement of adjusting to new problems and solving them to the best possible extent.

It can doubtless, on the other side, be convincingly argued that i.b. has in turn provided forceful feed-backs on many of these developments under whose influence it has of lately been shaping. How often for instance have eurobanks been accused, rightly or wrongly, of fostering, if not creating, exchange rate instability and inflation?

Evolving international banking structures

Let us now consider the development of i.b. and possible future trends.

When, in the aftermath of World War II, more and more commercial banks felt impelled to move beyond traditional correspondent relationships in order to do their business overseas more effectively, the emphasis was almost exclusively on wholesale banking. The thrust of this postwar international expansion was first prompted by the worldwide spread of the activities of multinational non-financial companies. These being mostly from the U.S., the first banks to branch out of national boundaries were understandably the large North American money center banks. Adding momentum to this dash for overseas markets was the growing burden of administrative restrictions variously affecting the U.S. financial system (Regulation Q, Interest Equalization Tax, reserve requirements, restraints on capital outflows, prohibition of interstate branching and the separation of commercial and investment banking). All these forces pushed U.S. banks abroad in search of a less constrained financial environment. Thus, offshore markets began gradually to take shape.

Although with a time lag, European and Japanese banks followed the American lead and with increasing speed as the oil crisis of 1974 was adding new and voracious borrowers in the offshore markets in the form of sovereign entities looking for balance of payments adjustment finance.

I would however like to point out here how, in my view, the internationalization of the world's major banking systems was in many instances an evolutionary phenomenon governed by market or institutional developments (when not by purely imitative behaviours) rather than the outcome of a well thought-out strategic effort. Many banks, that is, found themselves transformed into international banks as a consequence of their uncoordinated responses to a set of changes affecting their traditional environment at home. The need thus never arose for managerial separation of domestic from overseas activities, since the latter were naturally generated by the former with which a close relationship was of necessity maintained.

As a matter of fact the moment at which a bank is ready and, in my opinion, compelled to become geographically international is very uncertain.

It depends on many variables whose influence changes, often quite dramatically, over time: the bank's <u>relative size</u>, its <u>management</u>, the economic and foreign <u>policies</u> pursued by the government at home, the type of <u>clientele</u> it has developed and so on.

The real difficulty is how to maintain at any point in time the right balance between the "domestic" and "foreign" components, in other words to keep within the limits and the modes justified by the structure of its activity , avoiding both to over-expand abroad and to choose the wrong medium for going international. For instance in recent years branching abroad has indeed been a very fashionable exercise, sometimes regardless of economic realities and mainly for reasons of prestige.

Now things are changing and on the whole banks have become much more wary in this respect. Many bankers consider that the best policy would be to reduce the expansion and even to go back to more cautious attitudes . This does not mean that in the former period banks always did the wrong thing. Most of the time, they behaved correctly on the light of the factors existing at that time. But some of these factors no longer exist, others have changed and banks now have to consider what kind of presence on international markets is most appropriate.

The changes that the market has undergone are indeed important and basic. As stressed before, in previous years foreign banking was mostly wholesale both on the funding and on the lending side, retail banking being regarded as a heavily regulated and protected industry requiring massive start up costs. It was thus left entirely to local banks. But things changed rapidly in the second half of the '70s.

First of all, the ever increasing competition among lenders in offshore markets rapidly brought gross unit profits down to unprecedented levels, often leaving only just enough to cover operating costs. Banks located in offshore centers tried to counteract what they thought to be a transitory borrowers' market by temporarily increasing their financial leverage in an attempt to protect their profitability. This strategy proved feasible only up to a point, given the deterioration of the international financial environment under the all important profile of the risk/return trade-off.

It became thus increasingly apparent that, for the intermediate future at least, no hope could reasonably be entertained for an internal build up of financial resources sufficient on the one hand to bring about the desired equilibrium between foreign assets and capital base and to appease the growing concern of banking supervisors as to the breadth and mix of bank portfolios on the other. The only feasible alternatives to a substantial recourse to fresh equity capital were thus a slow-down in the rate of growth of foreign banking activities or a radical redefinition of growth priorities.

Secondly, the well publicised difficulties incurred by both internationally indebted multinational companies and countries prompted banks to scrutinise their past expansion strategies, often found wanting in many respects. It was first of all realized that in too many cases not enough weight had been assigned to the important variable of portfolio diversification. Then, the review of international operations led some institutions to consider the idea of specialization of banking services on a geographical, sectoral and functional sense. This in turn imposed major innovations in the organizational structures of many banks.

Moreover, as wholesale i.b. began looking more and more problem ridden, banks started feeling increasingly uneasy about international exposures on whose growth they had little or no direct control, as happens with large subsidiaries and especially with the so called consortium banks. Coupled with the fact that, due to the experience gained in the course of the last decade, it appeared that most things a consortium bank does can be done by at least some of its partner banks - and more effectively at that - this development seems to suggest, although with noteworthy exceptions, big question marks as to the future viability of some international banking consortia (witness the recent acquisitions, although for different reasons, of such banks by one of the partners). 1/

However the most interesting and novel feature in the field of i.b. is probably the fact that overseas retail banking is starting to look appealing to many banks. The reasons lie not only in the growing disaffection with wholesale banking but also in more positive circumstances. First of all, the rapid development of financial technology in the field of electronic funds transfer promises to gradually transform retail banking from a labour to a capital intensive industry with the ensuing productivity gains. Secondly, many financial innovations introduced at the retail level in the U.S. (money funds, "advanced" credit/debit cards and travellers' cheques, money transfer services, etc.) increasingly look ready for the export markets. An additional source of interest

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1/ See for instance: M. Blanden, "Why banks choose to work together", The Banker, March 1981, pp. 93-99.

here is that in many instances non-banks or quasi-bank financial entities are leaders in this field: have a look at the recently unveiled international strategies of Merryli Lynch and Visa International, among others. Thirdly, recent and prospective institutional developments inspired by deregulation will liberalise and "deprotect" many important domestic banking markets (in the EEC and in the U.S. in particular) and a growing number of banks are deploying their facilities to profit from these changes. Many recently concluded or attempted takeovers by foreign banks of going banking concerns located in the U.K., Spain and the U.S. have been largely inspired by such calculations. Of course all this is likely to have far-reaching repercussions on the internal structures of banks. Some of them are for instance creating international retail departments in order to support their worldwide strategies for the personal markets of the '80s. But the consequences of this process might prove to be even more far-reaching.

Relationships between domestic and international banking

It is conceivable for instance that establishing a firm foothold in an important domestic retail market may significantly add to a bank's overall strategic options. The more so when the international monetary system is gradually evolving towards a multiple reserve-currency standard. It has thus been noted that:

> "Ensuring a stable dollar deposit base and source of access to dollar credits is an important reason for non-U.S. banks to establish themselves in the United States... Simply put, liability management in a particular currency is more efficiently accomplished by operations in that currency's home market... Because most of their operations are conduced in dollars, American banks will attach relatively less importance to securing currency bases by opening offices in the home markets of foreign currencies. Nonetheless, the argument does apply: deposit bases in important (key) currency countries can provide relatively low-risk sources of these currencies." 2/

2/ J.M. Gray and H.P. Gray, "The Multinational Bank: a Financial MNC?", Journal of Banking and Finance, Vol. 5, N° 1, March 1981, p. 46.

As foreign currency sources become more stable and diversified, their use for domestic purposes will probably start growing. This has already been apparent in a number of countries, notably in Italy, where plentiful foreign exchange finance has been used to fund foreign trade. In the U.K., after the removal of exchange controls in October 1979, the offer of retail dollar deposits has been met with a fair degree of success (see The Economist, June 13, 1981, pp. 78-79).

But the opposite process (i.e., lending abroad with funds raised domestically) could also, balance of payments difficulties notwithstanding, pick up substantially once foreign outlets increase in scope and penetration.

The steadily increasing involvement of non financial companies in foreign goods and services markets will also promote this development by compelling banks to service their clients on an integrated basis. The preference of supervisors for assessing the soundness and solidity of banks on the basis of consolidated financial statements points in the same direction. This too will predictably push bank managers to go on thinking and acting more and more in terms of global problems.

This is all food for thought and discussion - whether the trends outlined will materialise and to what extent remains to be seen. The process is just beginning and the rethinking on the part of bankers is still at a very early stage.

This said, one may guess that domestic and international banking will, this time as a result of a conscious and conscientious effort, become more and more integrated and any attempt to draw a dividing line between the two - already hardly a legitimate exercise - will cease to have any meaning.

In this new set-up, in this turmoil of initiatives and rethinking, in this total reshaping of international financial intermediation, there is a definite need for a clear and equitable framework for the attribution of the lender-of-last-resort and supervisory roles in the context of i.b. in the face of increasing <u>risks</u>.

<u>Devising an overall regulatory framework for international banking</u>

The growth of external lending of international banks in both absolute and relative terms is a well documented fact. Commercial banks' loans to non-oil LDCs, which stood at some $ 35 billions at the end of 1974, had reached the $ 200 billion mark by the end of 1980, with an annual compound rate of increase of almost 30%. This has meant that many banks are now threatened by heavy concentration of country credit risk and that serious strains are developing in their capital positions.

To have an idea of how the degree of concentration of the aggregate portfolio of foreign assets of banks has been worsening over the last few years, consider that the external claims of banks of countries reporting to the B.I.S. towards only 16 LDCs, amounted at the end of last year to almost 45% up from 35% at the end of 1975 (see Table 1). No wonder than that many LDCs are correspondingly beginning to experience high and rising debt service ratios which make them risky debtors in the eyes of international lenders while at the same time increasing the worries of national monetary authorities. To this we must add the additional danger of the foreign exchange risk which, due to the present volatility of the markets, has undergone a dramatic increase. The support for the establishment of lender-of-last-resort facilities in i.b. has thus been rising rapidly from both the private and the official sectors of the international financial community: surprisingly,

Table 1 - Stock of Gross External Debt of Selected LDCs towards Commercial Banks

(billions of US$)

Foreign claims of commercial banks located in the B.I.S. reporting area on: (1)	end 1975	end 1977	end 1979	end 1980
(a) Twelve non-oil LDCs (2)	30.7	48.0	82.4	110.0
(b) Four high absorbers oil exporting LDCs (3)	20.1	34.5	59.9	73,7
(c) All countries outside the reporting area (excl.int. organizations and offshore banking centers)	144.6	225.0	320.6	421.3
	. . . .	. . . . %	. . . .	. . . .
(d) row (a)/row (c)	21.2	21.3	25.7	26.1
(e) row (b)/row (c)	13.9	15.3	18.7	17.5
(f) row (d) plus row (e)	35.1	36.6	44.4	43.6

(1) The B.I.S. reporting area is made up of the G-10 countries plus Austria, Denmark, Ireland and Switzerland.

(2) Argentina, Bolivia, Brazil, Chile, Colombia, India, S.Korea, Philippines, Taiwan, Thailand, Turkey and Ivory Coast.

(3) Algeria, Mexico, Peru and Venezuela.

Source: Bank for International Settlements.

however (or, maybe, not really so surprisingly), not much progress has so far been made.
Although, in the aftermath of the banking crises of 1974-1975, central banks of the Group of Ten and Switzerland seemed to accept the principle of parental responsibility (according to which the primary duty for supporting the establishment of foreign banks rest with the regulatory authorities of the country in which the parent bank has its registered office) the issue remains nonetheless confused. It is known that some central banks are having second thoughts or appear to believe that this rule should not be considered legally binding.

Thus in 1979 the U.S. Federal Reserve Board, in approving the International Banking Act of 1978, was in effect reserving for itself the right to ask parent banks of branches in the United States to report consolidated accounts on the ground that such information was needed for proper supervision of their U.S. activities. Foreign central banks have challenged this Federal Reserve ruling on several grounds and are considering this legislation to be in open contrast with the guidelines agreed upon in 1975.

There also exists agreement in principle among national authorities that responsibilities for support and supervision need to be differentiated according to whether the foreign bank has set up shop abroad with a branch, an agency or a subsidiary, but no clearcut decisions have so far been made. Even more clouded remains the problem of consortium banks and of financial institutions in which a foreign bank has a majority stake.

On the whole one cannot disagree with what one commentator has recently suggested:

> "The legal, moral and commercial relationship between foreign branches, foreign subsidiaries and parent banks are now in a state of considerable confusion. This situation has arisen because regulatory authorities have tried at one and the same time to insulate foreign banks from the potential financial difficulties of their parent insitutions while seeking to ensure that these same parent institutions come to the assistance of their foreign offspring should help be needed." 3/

3/ R.S. Dale, "Prudential Regulation of Multinational Banking: The Problem Outlined", National Westminster Bank quarterly Review, February 1981. p. 19.

What appears even more worrying is the lack of any publicized set of rules and procedures for the provision of liquidity in case temporary difficulties should be experienced by some component of the international banking system.

Moreover central banks appear to be against the disclosure of any agreed plan for emergency assistance on the grounds that this might lead to undue reliance being placed on it on the part of international banks:

> "...there are dangers in trying to define and publicize specific rules for emergency assistance to trouble banks, notably the possibility of causing undue reliance on such facilities and possible relaxation of needed caution on the part of the market participants...". 4/

This uncertainty surrounding the scope and the division of responsibilities among national authorities generates legitimate doubts concerning the efficiency and speed with which any such scheme could be designed and/or implemented, should the

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4/ H.C. Wallich, "Central Banks as Regulators and Lender of Last Resort in an International Context", FRB of Boston, 1978.

need arise. It should thus be apparent that if the banking system is to be more closely involved in the recycling process, the national authorities will have to play a clearer and more constructive part in the background.

A parallel effort should be made to improve the coordination on the part of national authorities in the field both of reporting international financial data and, more to the point, of harmonising accounting standards and managing practices that bear on external lending activities (capital ratios, balance sheet consolidation etc.). Such an effort should include geographical areas which, although of growing importance as centers of offshore finance, are not yet fully covered by euromarket reporting systems. Besides, the growing number of private placements of unpublicized international bond offerings, which in the case of some debtors seriously undermine the coverage of external debt statistics, should be brought under the reporting net of both the national authorities and of the international organizations.

All this, and here lies the difficulty, should be done in such a way as to safeguard the soundness of the system, which on the whole has proved useful and efficient. It is also necessary to ensure that competition among international banks (domestic and foreign) is not hindered by binding regulations which could disrupt the mechanism. The cautiousness with which the authorities of all countries deal with the problem is therefore understandable.

This is a very broad outline of many problems which would need volumes to deal with properly and exhaustively. I have raised, I am afraid, many questions and given no answers. But if I have helped to prepare the ground for further discussion of this very important subject I think I have fulfilled my task.

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"LUIGI EINAUDI"

8

"INTERNATIONAL BANKING: ITS MARKET AND INSTITUTIONAL STRUCTURE"

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PRELIMINARY FIRST DRAFT

INTERNATIONAL BANKING: CURRENT ISSUES IN PERSPECTIVE

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I. Introduction

Few contemporary financial developments are as striking as the growth of international banking in the 1960's and 1970's. That growth is impressive by whatever measure you use to assess it. Between 1966 and 1980, the "net size" of the Euro-currency market as measured by the B.I.S. increased from 17.4 billion dollars to 575 billion dollars, or an annual rate of increase of 28.4%. Over the same period the foreign assets of the world's deposit banks increased, by the I.M.F.'s reckoning, from 51.8 billion dollars to 1711.3 billion dollars, or again by 28.4% per annum on average. Net new international bank lending has been estimated to have risen by some 25& per annum over the seventies to reach 165 billion dollars in 1980. This compares with "only" 29 billion dollars of net new bond financing for the same year.[1)]

The growth of the international activities of banks has been part of a profound transformation in banking competition and in the structure of international financial markets in the postwar period. The rise of European and offshore centers has challenged the predominant position in which New York emerged at the end of the second world war. Banking competition has become truly international with the Euro-currency market becoming "the" international money market - and the main money market for several national banking systems. Bank lending across borders has supplanted bond financing as the main private source of medium and long-term capital internationally. As a consequence the share of foreign assets in bank portfolios has risen substantially with banks coming to assume an ever-increasing role in the financing of current account imbalances, particularly those of developing countries.

These developments have entailed new opportunities for banks, but also new problems and policy issues. They challenge conventional analyses of banking centered on the domestic model. Among the questions in need of explanation, three figure importantly: the continued predominance of the dollar in spite of the "multinationalization" of banking competition; the sources of the more rapid growth of international as compared with national banking activity and the question of whether that growth constitutes credit creation and/or credit substitution; and the reasons why it is bank credit rather

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1) Unless otherwise indicated, the sources of figures in the text are: International Financial Statistics, various issues, and Bank for International Settlements Annual Report, various issues.

than, say, bond financing, that has become the major source of private international lending.

Recent developments in international banking have also presented policy makers with some real and some imagined challenges. The "unbridled" growth of Euro-markets has given rise to a state of proposals for international controls. National regulations on domestic banking and on the access of residents to international financial markets, undertaken for marcroeconomic purposes, have seriously distorted the competitive positions of national sectors of the international banking industry. And the perceived increase in country risk, coupled with the large indebtedness of a few borrowing countries and the increased role of banks in the financing of international payments imbalances, has called into question the adequacy of lending margins and the stability of the international financial system.

The purpose of this paper is to put these developments in perspective and to analyze a number of the policy issues of current concern. The next section provides some background and a historical perspective on the postwar development of international banking. The third section inquires into the reasons for that development while the last section focuses on policy issues of current concern, notably on the dilemma posed by the need to shift certain categories of risk back to banks while preserving the stability of the international banking system.

II. Recent Developments in Historical Perspective

International banking is, of course, not a recent phenomenon. It is probably almost as old as "modern" banking in the development of which international money transfers, money changing, and the financing of trade have figured prominently. After all, many modern banks were established by merchants engaged in foreign trade. The role of banks in international financial and capital markets has, however, changed markedly in the last two decades, with banks playing an increasingly important role in the international transfer of resources over time, in addition to providing a variety of financial services on an international scale.

Broadly speaking, London emerged as "the" international capital market in the second half of the 19th century and retained this position until the first world war. Most international transfers of resources, beyond short-term trade financing, took the form of bond issues. Foreign bond issues were concentrated in London to tap both British savings, the main source of capital at the time, and the financial expertise of the City which sold a substantial part of these bonds to foreign investors. Foreign bonds were also issued, but to a much lesser extent, in European financial centers, notably in France and Germany. London lost its pre-eminence after World War I, with New York beginning to emerge as an important international financial center, a position it was well nigh to monopolize for some fifteen years after the second world war.

The pre-eminence of New York as the center of the international capital market in the late forties and until the early sixties is not surprising. Together with the Swiss capital market, which also developed as an important international financial center, the U.S. money and capital markets were the only financial markets free of rigid regulations and exchange controls. As importantly, the United States economy was the main source of net international lending to the rest of the world's war-stricken industry. And, of course, the United States had the only "broad, deep, and resilient" financial market at the time.

At a somewhat superficial level, at least three forces combined to erode (at first, modestly) the dominant position of the United States in international capital markets in the late fifties and early sixties: a decline in real terms in the current account surplus of the United States from its 1957 peak and the concomitant appearance of other national sources of net international lending, the return to (non-resident) convertibility of the world's major currencies in 1958, and the restrictions imposed on U.S. residents' international capital transactions, beginning with the Interest Equalization Tax (IET), adopted in 1964 retroactive to 1963, and followed by the 1965 Voluntary Foreign Credit Restraint Program (VFCR) and the 1968 Foreign Direct Investment Program (FDIP). In terms of financial markets, the relative decline of New York was reflected, first, in the growth of Euro-currency (especially the Eurodollar) market, which came into its own in the sixties after a modest start in the late 1950's, with its main center in London, but with Paris, Frankfurt, and Zurich, among other cities, also playing an important role. The short-run Eurodollar inter-bank deposit market was supplemented in the late sixties and early seventies by the rapid development of medium-term Euro-currency financing in the form of syndicated bank loans to a variety of borrowers, though mainly from industrial countries. Finally, Eurobond issues came into their own after 1963 and the IET, and since the early seventies have become as important a source of bond finance as the more traditional foreign bond issues. The share of bond finance in international lending and borrowing, however, has declined significantly relative to bank loans and deposits in the last fifteen or twenty years as compared with earlier periods.

The spectacular growth of international banking and the concomitant increase of the foreign relative to domestic component of banks' balance sheets is documented in Tables 1 and 2. By any of the measures included in Table 1, the growth has indeed been spectacular: average annual rates of growth of both stocks (columns 1-5) and flows (6-7) range from 23.4% to 45.6% over the 1966-1980 period and the two sub-periods 1966-1973 and 1973-1980. The growth over the first of the two sub-periods is perhaps not surprising as the initial asset base was low; it is more remarkable in the second sub-period. The growth in the internationalization of banking is also reflected in the ratio of foreign in total assets of deposit banks in Table 2. The figures of course measure gross shares and not net foreign lending or borrowing. The very high share of the U.K. of course reflects London's central place in the Euro-currency market. Though the share of

Indicators of International Banking and Lending Growth

	(1) Euro-currency Assets Total	(2) Euro-currency Claims on Non-Banks	(3) Euro-currency Market Net Size	(4) Deposit Banks Foreign Assets	(5) Deposit Banks Foreign Liabilities	(6) Net New International Bank Lending	(7) Net New International Bank Lending to Non-Oil LDCs
	Billion of U.S. Dollars						
1966	20.3	2.8	17.4	51.8	61.3	n.a.	n.a.
1973	187.6	38.7	132.0	354.5	384.7	31	10
1980	751.2	193.5	575.0	1711.3	1777.8	165.0	41*
	Average Annual Rates of Growth (%)						
1966-1980	29.4	35.4	28.4	28.4	27.2	n.a.	n.a.
1966-1973	37.4	45.6	33.6	31.6	30.0	n.a.	n.a.
1973-1980	21.9	25.8	23.4	25.2	24.4	27.0	26.5**

Notes: - * 1979, ** 1973-79

- Sources: Columns (1) - (3), B.I.S. Annual Reports.

  Columns (4) - (5), I.M.F., International Financial Statistics

  Columns (6) - (7), B.I.S. and I.M.F., International Capital Markets, Occasional Paper , Sept. 1980.

- Columns (4) and (5) refer to IMF "world" aggregates (all countries).

Table 2

Percentage Share of Foreign Assets in Total Assets of Deposit Banks: Selected Countries

	U.S.	U.K.	GE	FR	IT	CA	JA	NE	BE	SW	DK	AU
1951	0.8	n.a.	1.2	n.a.	n.a.	n.a.	n.a.	6.9	7.5	2.4	2.1	n.a.
1960	2.2	n.a.	2.6	n.a.	4.0	n.a.	2.6	18.4	11.1	5.3	4.9	1.4
1970	2.6	46.1	8.7	16.0	12.6	19.8	3.7	27.0	36.6	7.0	6.7	10.7
1973	3.4	51.2	6.5	22.5	16.7	18.8	2.6	29.9	41.3	9.6	7.8	16.4
1980	13.4	64.7	9.7	31.5	9.5	21.0	4.3	36.2	52.5	13.2	24.8	23.3

Notes: 1) Calculated from IFS tapes, end-of-period figures.

2) Country codes: Federal Republic of Germany (GE), France (FR), Italy (IT), Canada (CA), Japan (JA), Netherlands (NE), Belgium (BE), Sweden (SW), Denmark (DK), Austria (AU).

3) Earliest available data (where not available in 1951): U.K.: 13.7 (1964). FR:13.6 (1969). IT: 2.3 (1957). CA: 15.4 (1964). JA: 1.5 (1953). AU: 1.7 (1953).

foreign assets is comparatively low for U.S. banks, its growth from 1973 to 1980 is substantial. The relatively low share in the U.S. reflects, on one hand, the very large size of the "internal" capital market in that country and, on the other hand, fails to reveal the concentration of foreign banking in the hands of a few large American banks and their foreign branches. For smaller, more open economies, the growth in the international portion of bank activities is striking, reflecting heavy participation in Euro-markets in the absence of broad and deep national short-term financial markets. The exceptions are Japan and Germany, where national markets are perhaps more important, authorities have discouraged direct participation of banks in the Euro-markets, resulting partly in the shifting of these activities abroad.

To gain some perspective on the rising importance of the international transactions of banks, the growth rates of Table 1 may be compared with those shown in Table 3. The latter are annual growth rates of world aggregates as calculated by the I.M.F. The only world aggregates that come close to growing at rates roughly comparable to those of our "International Banking Indicators" are world reserves (when gold is valued at market prices) and the value of exports for the last sub-period, 1973-1980. The increase in the value of oil exports contributes significantly to this last finding.

Before turning to some explanations in the next section, four features of the recent expansion of international banking are worth noting here. First, the currency composition of international bank lending is still dominated by the U.S. dollar, in spite of a slight decline in its role. As an indication of that currency's continued importance, the foreign currency assets of European banks reporting to the B.I.S. were denominated in December 1972 for 74% in dollars, 15% in Deutsche Mark, 6% in Swiss francs, the remainder being made up of various other currencies. By December 1980, the respective shares of the three main currencies were 69%, 16%, and 7%.

Second, the second half of the 1970's was marked by a decline of international bond financing relative to international bank loans as a source of capital. Table 4 provides some relevant data for the period 1974-1980 (earlier data is hard to obtain on a comparable basis). The "arithmetic" reason for the decline in bond financing is readily apparent: after a rapid initial expansion in new bond lending, the latter stabilized at its (high)

Table 3

Average Annual % Growth Rates of Selected "World" Economic Series

	(1) Total World Reserves (Gold at market prices)	(2) Total World Reserves (Gold at 35 SDR an ounce)	(3) World Money	(4) Consumer Prices World Index	(5) Value of Exports (World)	Memorandum Items (6) Deposit Banks Foreign Assets	(7) Deposit Banks Foreign Liabilities
1950-1980	9.6	6.9	8.5	6.2	12.3	n.a.	n.a.
1966-1980	18.2	12.0	11.5	9.2	14.3	28.4	27.2
1966-1973	16.4	11.1	10.2	5.6	9.2	31.6	30.0
1973-1980	19.9	12.8	12.9	12.7	25.2	25.2	24.4

Notes: Source: International Financial Statistics, World Tables. Based on end-of-period figures.

Table 4

International Bank and Bond Financing, 1974-1980

(Billions of U.S. dollars)

	1974	1975	1976	1977	1978	1979	1980
Net new international bank lending	50	40	70	75	110	130	145
Net new international bond lending	11	20	30	31	30	29	29
Total new bank and bond financing	61	60	100	105	140	159	174
Percent of bond financing	18%	34%	30%	29%	21%	18%	17%

Notes: 1) This table is adapted from I.M.F., International Capital Markets, Occasional Paper 1 (Sept.1980), Table 13, p.29. Data for 1980 are taken from B.I.S., Fifty-First Annual Report (1981).

2) Total new bank and bond financing contains a minor amount of double counting.

1976 level while new bank lending kept expanding rapidly.

Third, the increasing role of banks of industrial countries in financing balance-of-payments deficits(particularly those of developing countries and subsidiarily Eastern bloc countries) in the 1970's has received much attention recently. Coupled with an increased perception of country risk and an apparent decline in profit margins on lending, this development has been the source of much concern, though it has also been welcomed as a major contribution in solving the recycling problem attendant on increases in oil prices after 1973. The flows involved are illustrated in Table 5 which is reproduced from the IBRD's World Development Report. The figures for the middle-income developing countries reveal clearly the large increase in their current account deficit after 1973 and 1979, the relative decline of official development assistance (ODA) in financing these deficits, and the large absolute increase in financing through commercial loans since 1970. Table 6 documents the impact on the outstanding stock of debt of all non-oil developing countries which increased from 97.3 billion in 1973 to 370.1 in 1980 or at an average annual rate of 21 per cent. The debt to private creditors increased by 23.7 per cent over the same period, that to financial institutions by 26.7 per cent. As a result, the share of claims of private creditors grew from 49.6 per cent to 57.9 per cent of the developing countries debt. Financial institutions, which accounted for 71.4 per cent of private claims on developing countries in 1973, account for 84.5 per cent of that total by 1980.

Finally, this internationalization of banking competition has been accompanied by a change in the structure of the international banking industry.[1)] That industry was dominated, in the late fifties, by a few large U.S. commercial banks and some specialized European banks. By 1970, many more U.S. commercial banks as well as European banks and consortium banks had become important international market participants. By 1980, the participants included a large number and variety of large commercial banks from several countries, what Crane and Hayes call "internationalized investment and merchant banks", in addition to a few middle Eastern banks

1) The trends in the industry and the figures given in this paragraph are culled from a talk by Dwight B. Crane and Samuel L. Hayes,III, "The Evolution of the International Banking Industry, 1960-1980", at the Graduate Institute of International Studies in February 1981.

Table 5

Oil-importing developing countries' current account deficit and finance sources, 1970–80

(billions of 1978 dollars)

	Oil importers									
	Low-income					Middle-income				
Item	*1970*	*1973*	*1975*	*1978*	*1980*	*1970*	*1973*	*1975*	*1978*	*1980*
Current account deficit[a]	3.6	4.9	7.0	5.1	9.1	14.9	6.7	42.8	20.4	48.9
Financed by:										
Net capital flows										
ODA	3.4	4.1	6.6	5.1	5.7	3.3	5.3	5.3	6.5	7.9
Private direct investment	0.3	0.2	0.4	0.2	0.2	3.4	5.1	3.8	4.6	4.5
Commercial loans	0.5	0.6	0.8	0.9	0.7	8.9	13.7	21.0	29.4	27.1
Changes in reserves and short-term borrowing[b]	–0.5	–1.1	–0.7	–1.1	2.4	–0.8	–11.7	12.7	–20.1	9.5
Memorandum item:										
Current account deficit as percentage of GNP	1.9	2.4	3.9	2.6	4.5	2.6	1.0	5.5	2.3	5.0

a. Excludes net official transfers (grants), which are included in capital flows.
b. A minus sign (–) indicates an increase in reserves.

Note: Reproduced from World Bank, World Development Report for 1981.

Table 6

Non-Oil Developing Countries: Long-Term External Debt, 1973–81 [1]

	1973	1974	1975	1976	1977	1978	1979	1980	1981
				In billions of U.S. dollars					
Total outstanding debt of non-oil developing countries	**97.3**	**120.6**	**147.1**	**176.5**	**216.7**	**272.7**	**322.8**	**370.1**	**425.2**
By type of creditor									
Official creditors	49.1	59.3	69.3	81.2	97.8	117.8	134.8	155.8	180.0
Governments	36.9	44.2	50.4	58.5	68.9	81.6	92.1	106.0	121.4
International institutions	12.2	15.2	18.8	22.7	28.9	36.2	42.8	49.8	58.6
Private creditors	48.3	61.2	77.9	94.4	118.9	154.9	188.0	214.3	245.3
Unguaranteed debt	21.4	26.0	32.0	37.5	43.1	51.4	60.7	68.2	79.0
Guaranteed debt	27.1	35.4	46.1	57.2	75.8	103.5	127.3	146.1	166.3
To financial institutions	13.1	21.7	29.8	39.2	54.3	73.9	96.1	112.8	127.9
Other private creditors	13.8	13.5	16.1	18.0	21.5	29.6	31.2	33.3	38.4
				In percent					
Total outstanding debt of non-oil developing countries	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
To official creditors	50.4	49.2	47.1	46.4	45.1	43.2	41.8	42.1	42.3
Governments	32.9	36.6	34.3	33.5	31.8	29.9	28.5	28.7	28.5
International institutions	12.5	12.6	12.7	12.9	13.3	13.3	13.2	13.4	13.7
To private creditors	49.6	50.8	52.9	53.8	54.9	56.8	58.2	57.9	57.8
Financial institutions	35.5	39.6	42.0	43.7	45.0	46.0	48.6	48.9	48.7
Other private creditors	14.2	11.3	10.9	10.0	9.7	10.8	9.6	9.0	9.1

Sources: World Bank, Debtor Reporting System; and Fund staff estimates and projections.

[1] Excludes data for the People's Republic of China prior to 1977. For classification of countries in groups shown here, see the introduction to this appendix.

Notes: 1) Extracted and reproduced from I.M.F., World Economic Outlook, Occasional Paper 4 (June 1981), Tables 27, p.132 and 29, p.134.

2) Figures from 1981 are Fund projections.

and consortia.[1] A similar diversification of suppliers and users of funds and of types of products, occurred over the period, as is apparent from our earlier discussion. This internationalization of banking is reflected in the pattern of foreign bank branches and agencies. Foreign bank branches in major European countries, Japan, the United States and the "off-shore centers" grew rapidly between 1961 and 1978, while those located in Africa declined steeply, reflecting the decline of colonial banking. In terms of the home countries of foreign branches, the period saw a particularly significant increase in the branches in a number of major countries e.g. Germany (from 2 to 47), Japan (from 27 to 131), the United States (from 128 to 670), and Switzerland (from 3 to 33).[2]

In summary, the internationalization of banking has proceeded rapidly since the return to convertibility in 1958. New York, though still extremely important as a financial center, has lost its monopoly position. The dollar, though, has kept pride of place among financial currencies. The international capital market has truly become a worldwide one, with banks playing a dominant role. At the same time, bank financing has supplanted bond financing as a major source of international medium- and long-term capital while the short-run Euro-currency markets fulfill the function of main money market for the banking system of several of the smaller industrialized countries. The geographical distribution of the foreign assets and lending of banks has also evolved, with developing countries assuming an important share of international indebtedness, and flows of bank loans playing an increasingly important role in balance-of-payments financing. With rising and volatile interest rates, diminishing spreads, and an increase in perceived country risk, these developments raise a number of issues which will be discussed in Section IV.

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1) See reference in preceding footnote.

2) Ibid.

III. Explanations of International Banking Growth

Many explanations have been offered for the overall growth of international banking and its pattern over the last twenty years. This section reviews briefly some of these. They include historical-episodic explanations of individual developments, broader historical-economic perspectives on the industry's over-all development, and more analytical explanations.

At a somewhat superficial level, it is possible to attribute specific developments to specific events and policies. In this vein, the origin of the Eurodollar market has been attributed to Russian banks' practice of keeping dollar balances in Europe in the mid-fifties; the market's subsequent growth to interest ceilings imposed by Regulation Q in the United States. Similarly, the growth of the Euro-loan and Euro-bond markets has been related to various U.S. controls on capital outflows mentioned above (IET, VFCR, FDIP). The expansion of bank claims on developing countries and the banks' expanded role in balance-of payments financing have been described as a direct consequence of the seventies' oil price increases and the attendant need for recycling OPEC surpluses.

These are of course but partial explanations that do not account for the general growth and spread of international banking. The latter is better seen as part and parcel of the general economic trends that have characterized the postwar period, in particular the "golden 60's". The end of reconstruction and the return to non-resident convertibility in 1958 paved the way for a general expansion of international economic transactions, be they in goods, services, factors of production, or assets. This expansion was reflected both in the development of the activities of multi-national corporations and in a growth rate of international trade (including intra-industry trade) that outstripped significantly that of domestic production in real terms. It is, in a sense, not surprising that if production of firms should become multinational, their financing should also become more international. In addition, the communications revolution, by facilitating the spread of information and reducing its cost, played a very substantial role in the internationalization of industrial and financial activity. At the same time, the shifts in the geographical location of economic power stimulated the emergence of new international financial centers outside the United States. The increasing political and economic importance of developing countries in turn explains their increasing role as borrowers and lenders in international capital markets. It also suggests that a substantial portion of the future international business of banks may be the export of financial services to this group of countries. The developing countries, in view of their more rapid rate of population growth, may well constitute the most rapidly expanding market for international banking in the future.

This broad perspective, however, leaves at least three questions unanswered at a more analytical level. First, why has the dollar kept its preeminence in international banking in spite of the industry's "multinationalization"? Second, what are the economic reasons for the more rapid growth of the international relative to the domestic banking sector and has the former been additional to, or at the expense of, the latter? Third, why is it banks that have played the dominant role in the expansion of international finance rather than other financial intermediaries or direct lending? The remainder of this section is devoted to these three questions.

The first of these questions is perhaps the easiest to answer. Though business becomes international, it still has to be conducted in a national currency. There are many historical and economic reasons why the dollar should have been chosen as the main vehicle currency in the postwar world: its role as a reserve and intervention currency, the dominant economic position of the United States, the "depth, breadth, and resiliency" of United States money and capital markets, to cite but the main ones. All of these factors contribute to greater liquidity of dollar balances and to lower asset-exchange costs on dollar transactions. As I have argued elsewhere, "the growth in the use of a currency as a vehicle, by enlarging its transactions domain, results in economies of scale and information that further enhance its usefulness and attraction".[1] The monetary capital accumulated in the vehicle-currency role of the dollar has eroded only slowly after the United States lost the monopoly position it enjoyed in international trade and finance in the earlier part of the postwar period. The United States is still the dominant single currency issuer in the international monetary system, and there are still gains to conducting transactions in one, or only a few, major currencies.

The set of inter-related issues that is raised by the second question can perhaps best be clarified by focusing on the growth of the Eurocurrency, and especially the Eurodollar, market. Has the growth of the market constituted an addition to total credit that would not have occurred in its absence, is it a spontaneous engine of monetary inflation, and is it uncontrolable and/or out of control ? Furthermore, has the growth of international credit intermediated through banks occurred at the expense of their domestic loans ? To simplify, the question is whether and to what extent, the expansion of Eurodollar deposits and loans represents credit creation or credit substitution.

The thesis that ascribes a vast inflationary potential to the Eurocurrency market is usually based on the contention that the banking multiplier applicable to a shift of deposits from the U.S. banking system to banks outside the United States (the Eurodollar market or system) is extremely high indeed. The conclusion is based on two arguments. First , as Eurobanks keep scant New York deposits as reserves against their dollar liabilities, the multiplier (equal in a first approximation to the increase of the Eurobanks' reserve ratio) applicable to a "primary" inflow of deposits in the Eurodollar system is extremely high, much higher than the low (because of legally or voluntarily high reserve ratios) multiplier of

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1) A.K. Swoboda, "The Eurodollar Market: An Economist's Point of View", in H.B. Prochnow, Ed., The Eurodollar (Chicago: Rand Mc Nally & Co., 1970).

domestic banking. Second, to the extent that the initial shift of deposits out of New York is made up by the accumulation of New York deposits held as reserves by Eurobanks, no decrease in the balance-sheet totals of the U.S. banks need occur. One consequence is that any increase in the demand for credit in the world can be satisfied by shifts of deposits to the Euro-currency market with hardly any increase in interest rates. In the words of some commentators, the amount of credit in the Eurodollar market is demand-determined.

The fallacies contained in this line of reasoning are numerous. As I have reviewed the Euro-currency credit creation debate in some detail elsewhere[1)], I will confine myself to only a few remarks here. First, shifts of deposits from the U.S. to the Eurodollar banking system are likely to be induced by changes in Eurodollar rates rather than autonomous. For these shifts that are autonomous, as the "Yale school" has emphasized, induced interest-rate (and exchange-rate) changes will in turn provoke further portfolio adjustments which will reduce the value of the multiplier to less than one (to a divisor). In this perspective, one reason why some estimates of the Eurodollar multiplier have turned out to be absurdly high is the unwarranted identification of foreign banks' deposits in New York with the exogenous base (or sum of "primary" deposits) of the Eurodollar system. Another reason is that these estimates identify "created" Eurodollar deposits with the total dollar deposits of non-U.S. banks rather than, more properly, with these banks' dollar liabilities to the non-bank public.

Still, one can guess what the Eurodollar multiplier would be, should there be an autonomous shift of deposits from New York, <u>given</u> interest rates and other relevant variables. To arrive at such a guess it is necessary, at the mininum, to form a rough estimate of the desired reserve ratio of Eurobanks and, more important, of the public's desired ratio of Eurodollar to U.S. dollar deposits. Assuming these desired ratios to be equal to actual (average) ratios, one arrives at estimates of the Eurodollar "initial-deposit multiplier" that range from 1.02 to 1.09[2)]. The value of this multiplier

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1) A.K. Swoboda, "Credit Creation in the Euromarket: Alternative Theories and Implications for Control", Occasional Papers 2, (New York: Group of Thirty, 1980).

2) <u>Ibid.</u>, pp.14-17.

would be even lower if induced interest-rate effects were taken into account.

Alternatively, and still on the hypothesis of given interest rates and stable asset-preference ratios, one can ask how the existence of the Eurodollar market affects the value of the "total dollar multiplier", that is, the multiplier applicable to the U.S. monetary base (presumably under the control of the FED) to obtain the total of dollar deposits of the non-bank public be they held in New York or abroad. Again using naive but reasonable estimates of asset-preference ratios, the answer is that the total supply of dollars, given the U.S. base, is probably between 2 and 9 per cent higher with the Eurodollar market than it would be without it.[1] This higher total reflects the reserve-economizing character of Eurodollar relative to U.S. dollar deposits. It is true, however, that in the more general dollar supply multiplier model an autonomous shift of deposits from New York to the Eurobanks, if it were to occur, would have a significant effect on the total dollar supply. With an oversimple institutional structure of monetary asset preferences and neglecting interest rate effects, a one dollar shift (i.e. a change in asset preferences) could increase the total dollar supply by as much as three dollars. The increase would of course be much smaller if these simplifying assumptions were removed. In addition, the FED could take increases in the preference for Eurodollar deposits and their effect on the "dollar multiplier" into account when setting the rate of growth of U.S. base money required to achieve a target rate of growth of the total dollar stock.

Though the preceding analysis recognizes that the existence of the Euro-currency market may have increased the interest-elasticity of the total supply of dollar deposits, or total credit, somewhat, it denies that it has resulted in an infinite interest-elasticity of these aggregates. If there should be such very high elasticity of supply making for a demand-determined total amount of credit outstanding, it would be the result of inappropriate interest pegging by the U.S. monetary authorities. After all, somebody must be setting the interest rate at which the supply of money or credit becomes infinite. Similarly, an extraordinarily high rate of expansion of monetary aggregates throughout the world should be ascribed

1) Ibid., p.12.

not to the expansion of Euro-currency markets but to the expansion of national monetary bases. That expansion, in turn, can be attributed to excessive domestic credit creation or to inappropriate foreign-exchange intervention practices.[1)]

In brief, on the basis of simple models and rudimentary evidence, one may conclude that the existence of Euromarkets allows, at present, the total supply of dollar short-term deposit balances in the hands of the non-bank public, to be higher than they otherwise would have been, given United States base money, but by an amount that is likely to be well below ten per cent. A shift in deposits to Eurobanks will tend to increase the total supply of dollar balances and the multiplier, but by an amount that remains small as a percentage of the total dollar supply. This, however, leaves the faster expansion of Eurodollar than of U.S. dollar deposits,the question we started out with, to be explained.

In the framework of multiplier analysis, the expansion in the international segment of banking, can be attributed to two sources: increases in the base available for credit expansion in general, and shifts from domestic to international deposits that change the composition of total deposits and, by economizing on reserves, increase the over-all multiplier. Both factors have been at work. The first explains why both domestic and international banking have expanded rapidly, the second that the latter has expanded more rapidly than the former. Why it has is precisely the question which needs to be answered and which multiplier analysis, by itself, cannot answer.

Banks have been able to expand the off-shore portion of their business because they have been able to attract deposits from national markets and re-lend the proceeds at terms more favorable than those available in traditional national credit markets, not because deposits have shifted autonomously or lenders flocked spontaneously to their doorstep. Thus, Eurodollar deposit rates are typically higher than comparable short-term U.S. rates, Eurodollar lending rates lower than comparable U.S. loan rates. The fact that "Eurobanks"

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1) On the role of foreign-exchange reserve accumulation, as a source of world monetary expansion under pegged exchange rates, see H. Genberg and A.K. Swoboda, "Worldwide Inflation under the Dollar Standard", mimeo, Graduate Institute of International Studies, Geneva, January 1977.

have been able to operate profitably within these narrower margins is due to a variety of circumstances. Among these one may mention the large size of transactions and associated reductions in costs, the concentration on well-known names and associated information economies , in brief the wholesale nature of the business. More important in practice, the international sector of banking escapes a host of regulations, such as maximum borrowing rates (e.g. regulation Q) or local "gentlemen's" agreements on minimum lending rates, that encumber the domestic banking sector. The escape from reserve requirements on domestic currency deposits is perhaps the most important example of the cost advantages enjoyed by an unregulated intermediary over a regulated one.

These cost advantages are readily illustrated by a simple example. A bank that earns no interest on required reserves of 10% and borrows at 10% must, in order to break even on its borrowing cost only, lend at 11.11%. If it is subject to a 20% reserve requirement, the break-even lending rate rises to 12.5%. Table 7 gives someillustrative values of the break-even lending rate and break-even mark-up for a few sample combinations of reserve ratio and borrowing rate.[1] Reading across the tables shows how the mark-up increases as the reserve ratio rises for various given borrowing rates. Reading down the columns shows how the mark-up changes as the interest rate changes for a given reserve ratio. Obviously, in a highly competitive market where lending spreads are very low, the competitive disadvantage of even slightly higher reserve ratios is very substantial indeed.

Not only do banks find it profitable to operate internationally for the various reasons mentioned above, they also apparently found it profitable to expand their international business more rapidly than their domestic business over the past two decades. This is not surprising. In the first place, increased familiarity with new forms of an old activity, international

1) Denoting the reserve ratio by R and the borrowing rate by i, the following formulae for the break-even lending rate, L, and the break-even mark-up, M, over the borrowing rate apply:

$$(1) \quad L = \frac{1}{1-R} \cdot i \ ,$$

$$(2) \quad M = L - i = RL = \frac{R}{1-R} \cdot i \ .$$

Table 7

The Cost Advantage of Unregulated Intermediaries

(All figures in percentages)

a) Break-Even Lending Rates

Borrowing rate \ Reserve Ratio	0%	5%	10%	20%
5%	5.00	5.26	5.55	6.25
8%	8.00	8.42	8.88	10.00
10%	10.00	10.52	11.11	12.5
15%	15.00	15.79	16.66	18.75

b) Break-Even Mark-Ups

Borrowing rate \ Reserve Ratio	0%	5%	10%	20%
5%	0	.26	.55	1.25
8%	0	.42	.88	2.00
10%	0	.53	1.11	2.50
15%	0	.79	1.66	3.75

banking in this instance, has led to a lowering of the costs of carrying it out. This is one instance of learning by doing. Second, just as a fall in transport cost leads to an increase in international trade (that is, trade over longer distances), rapidly improving communications and information gathering processes have been steadily reducing the cost of engaging in international borrowing and lending. Finally, the cost advantage to unregulated intermediaries increases with the level of the interest rate as Table 7 clearly illustrates. The reason is that the cost of reserve requirements to banks is the interest foregone on their cash reserves. As interest rates have been rising on average over the past decade, the advantage of shifting business to the unregulated international sector of banking has been steadily increasing[1]. In one sense, one may well ask why, in view of these cost advantages, international banking has not expanded even more rapidly than it has, rather than why it has grown as rapidly as it has.[2]

Whether the expansion of international banking has occurred at the expense of the domestic banking sector is a moot question. Our previous discussion indicates that though international banking has contributed to a substantial increase in gross credit, it has contributed only modestly to a growth in net credit. As the portion of credit intermediated by banks on an international rather than a national basis has risen significantly, one may infer that international credit has substituted for domestic credit to some extent. But why should it matter to non-bank borrowers whether they incur liabilities to a domestic, foreign, or offshore bank, - or whether they borrow in foreign rather than domestic currency, especially if they have the option to cover themselves in the forward market ? It may be that some borrowers have found it more difficult or expensive to obtain credit than would have been the case had the banks not been able to lend abroad. To the extent that this reflects a better (opportunity cost) pricing of banking services, however, this represents a gain rather than a loss in welfare. Furthermore, the average cost of a given amount of aggregate credit has probably been lowered by the gains in efficiency that have been both cause and consequence of the expansion in international banking. It remains true, however, that particular groups of borrowers, or society at large, may have suffered losses (or more

1) It may also be that it has been easier to lend on a floating rate basis in international than in national banking, an advantage in a period of volatile (in addition to rising) interest rates.

2) To cut a long answer short, the supply of international banking services is rising at any point of time, though it has been shifting down over time for the reasons mentioned in the text. These downward shifts take time and are limited by a variety of factors including customary and legal restrictions on the level and kinds of transactions that can be carried out offshore.

generally realized less than potential gains) if the expansion of international banking has been due partly to perverted incentives, as the next section will argue. The cause of the problem, though, is the perverted incentives.

Turning to the third issue raised at the beginning of this section, we may ask why it is banks and not other intermediaries or direct lending that have come to play an ever increasingly important role in international financial flows in the recent past. The easy answer is to invoke the traditional explanations of the role of banks domestically. They are able to make a living as intermediaries and to grow because they reconcile the debt preferences of borrowers with the asset preferences of wealth owners by issuing liabilities that have particularly desirable characteristics. This they can do partly by diversifying the risk of individual loans through their holding of a large loan portfolio. In addition they can reap economies of scale in information that are not available to individual investors. This does not explain, however, the preponderant part taken by bank loans rather than bond financing in private international transfers of resources, particularly to developing countries. Such preponderance does not exist in most domestic markets. Part of the answer may indeed be that banks possess informational advantages over individual, even large, investors. Moreover, nonbank investors may, rightly or wrongly, feel that banks can exercise a degree of "conditionality" (or obtain more senior claims) on foreign borrowers which they themselves could not.

I also suspect, that many wealth owners are willing to lend to banks which in turn hold portfolios which they themselves would not dream to hold (even though they are wealthy enough to diversify). The reason is that they assume that banks will not be allowed to fail, that there is an implicit or explicit government guarantee on their liabilities. The very serious policy issues this raises will be taken up at the end of the next section.

IV. Current Issues

The very rapid development of international banking has given rise to a number of apparently serious policy questions. An (incomplete) list of issues of current concern may read as follows:

1) The need to impose controls on the growth of international banking in order to avoid a worlwide credit explosion.

2) The necessity to control a country's access to international financial markets through banks in order to regain domestic macroeconomic control.

3) The discrimination against domestic borrowers and lenders that the growth of international banking has entailed.

4) The excessive permissiveness in the international adjustment process that has been a consequence of the banks' role in balance-of-payments financing.

5) The exaggerated decrease in lending spreads on international loans, particularly to higher-risk borrowers, and the inadequacy of capital/asset ratios.

6) The distortions in competition and efficiency that result from differential national regulations on bank behavior, both domestically and internationally.

7) The consequences of high and volatile interest rates for the efficient channeling of savings internationally (and nationally).

8) The stability of the international banking system in the face of increasing country risk and the need for improved prudential regulation.

Several of these concerns are, in my judgement, misplaced or improperly identify the symptoms with the disease. The first four items on the list are to some extent among these and I will comment on them only briefly. This will enable me to concentrate on the remaining issues, especially the last, concern over which seems particularly warranted.

If a worldwide credit explosion is to be avoided, the first order of priority is to control the sources of growth in national monetary bases.[1)] These sources are domestic credit creation and international reserve accumulation by monetary authorities. It is true that it would be helpful to avoid expansionary shifts of deposits from the domestic to the foreign sector of banking activity in periods of monetary stringency. To this effect, it would be useful to diminish the relative cost advantages enjoyed by unregulated intermediaries. This can be achieved in two ways: a decrease in the cost disadvantages of regulated intermediaries or an attempt to inflict cost disadvantages on unregulated intermediaries by extending domestic regulations to them. The goal is the same, namely to harmonize implicit and explicit taxes impinging on domestic and international activities of banks. The first way of achieving such harmonization seems, however, preferable. It would be extremely difficult to devise a set of regulations that is not discriminatory among bank activities and countries unless one abolished all existing national regulations and started from scratch. Such universal scheme would also be exceedingly difficult to enforce if only because new ways of carrying out old activities and new geographical locations for such activities would rapidly spring up. Harmonization through de-control of the domestic sector of banking and the paying of interest on reserves of commercial banks seems therefore preferable.

De-control of domestic banking and the payment of interest on bank reserves would have the added advantage of also contributing to solving the third and sixth of the problems listed above. Once cost disadvantages of lending to domestic borrowers are removed, these borrowers should be able to obtain financing at conditions that properly reflect the existing scarcity of capital. Once the relative cost disadvantages placed upon banks located in more heavily regulated countries are mitigated, these banks should be able to compete in international (and their own national) money and capital markets on an equal footing. In this context, it is interesting to note that the

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1) See section III above, and A.K. Swoboda, "Credit Creation in the Euromarket: Alternative Theories and Implications for Control", op. cit.

pressure of market forces has, on the whole, moved authorities towards harmonizing regulation at a low level and de-regulation of domestic activity rather than towards extension of domestic regulation to the international activities of banks. The 1980 adoption of the "Depository Institutions Deregulation and Monetary Control Act" and the establishment of "International Banking Facilities" in the United States can be interpreted in this light.

Turning to the second issue listed above, monetary authorities in open economies have typically found it very difficult to conduct an independent macroeconomic policy, especially under fixed exchange rates. They have often found it convenient to blame their difficulties on international capital flows. As these have been increasingly channeled through banks, the latter's international activities have become the focus of the authorities' frustrations. Undeservedly so, since the source of the problem is the fixing of exchange rates and not international capital flows. That is, even if there were no capital flows, a single country's business cycle and inflation rate would tend to follow the trend of these variables in the rest of the world when the exchange rate is fixed. It is true that temporary divergences are easier to engineer through policy in the absence of capital flows but the basic principle that the adoption of a fixed exchange rate entails the abandonment of monetary autonomy will have out in the end. Furthermore, in the presence of capital mobility, controlling the international business of domestic banks will rapidly lead to substitution of non-banking for banking capital flows.

As for item 4) on our list, concern over excessive permissiveness in international adjustment may well be warranted. Ascribing the problem to the role of banks in the financing of payments imbalances, however, is confusing the symptom with the disease. It is well known that the speed of international adjustment under fixed or managed exchange rates is inversely related to the supply of international liquidity. Inadequate adjustment of deficit countries is thus related to an over-abundance of international liquidity, and more generally of credit, at a macroeconomic level rather than to inadequate behavior of banks at a microeconomic level. There may nevertheless be a kernel of truth in the view that bank lending for payments adjustment purposes has been excessive insofar as incentives for excessive international lending by banks may, as is argued below, well exist.

Easy credit in the aggregate is also partly responsible for the fairly narrow spreads in syndicated bank lending that have been prevailing over the last few years, a symptom of a "borrowers' market". Average spreads (over Libor) which had been quite low in the early 1970's (approximately 0.65 per-cent for industrial countries and 1 per cent for developing countries in 1973) rose sharply after the bank failures of 1974 and in the wake of the oil shock. They remained high in 1975 and 1976 (at roughly 1.35 percent and 1.6 percent for developed and developing countries, respectively). They then began decreasing till January 1980 when they stood at or below their 1973 levels. They have been rising again mildly since then. The fear that these margins are inadequate has been widely expressed in view of a perceived increase in country risk and a concentration of exposure to a few heavy borrowers (e.g., Brazil, Mexico, Argentina, Algeria, Egypt, Indonesia, India, Turkey, Yugoslavia, Korea, Poland). This concentration is indeed worrying; the general level of spreads less so, for a number of reasons. First, the return to banks includes various fees in addition to interest-rate spread. Second, banks often have an average cost of funds well below Libor. Third, rising interest rates have tended to increase the return from loans on the bank's own capital. Fourth, and perhaps most important, an increasing proportion of international bank credit is being extended on a variable interest-rate basis. This reduces substantially the intermediating banks' re-financing or interest-rate risk which the spread was initially designed to cover.

Floating-rate loans, however, are not a panacea in a world of high and variable interest rates. The other side of the floating interest-rate coin is that borrowing countries are facing more stringent debt servicing and re-financing terms, adding to country risk what had been removed from the lending banks' interest-rate risk. The recent sharp rise in *real* interest rates compled with the switch from official to private sources of financing for developing countries has added substantially to their debt-servicing problems. The switch to private sources of finance has resulted in a significant shortening of the maturity of developing countries' debt (from 18 to 15 years between 1973 and 1979) and an increase in the average interest rate on that debt (from 6.7 to 9.3 percent over the same period).[1)] Neither are floating-rate loans a perfect hedge against highly volatile interest rates from the point of view of the lending banks. In the first place, if they can be passed on, highly volatile interest rates increase the financing problems of borrowers and the likelihood of their default. Second, there are limits to the extent they can be passed on if only because loan rates are re-adjusted only at discrete intervals. Lending banks can incur substantial losses between rate revisions in view of the very large recent swings in the cost of short-term money. At a more basic level, the generalization of variable rate lending coupled with large and frequent short-term swings in interest rates has meant that long-term commercial financing has become unavailable in anything but in name.

Narrowing spreads and diminishing capital-asset or capital-deposit ratios have been a main source of preoccupation of the international banking industry. In fact, calls for various measures to improve spreads and capital ratios have come as much from international bankers as from their supervisors. Together with increased country risk and concentration of international bank claims on a small number of large borrowers, these concerns have shifted the focus from regulation for macroeconomic purposes to supervision for prudential reasons. Various insurance schemes, safety nets, and provisions for a lender of last resort in the international field have been proposed. The avowed purposes of such schemes are the avoidance of an international crisis of confidence, the decrease or shifting of country risk, more generally the stability of the international financial and banking system.

To assess the adequacy of such proposals and to clarify the nature of the problem they purport to deal with, it is useful to inquire why the problem has arisen in the first place. Why have the banks been so imprudent as to acquire assets whose return does not justify the risk undertaken - or why is there a danger that they would act imprudently in the future? Why, if spreads have been declining to insufficient levels have the banks not increased their margins or refused to lend? Why, if capital asset ratios have

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1) The figures refer to the average terms of debt commitments for 94 developing as given in I.M.F., "External Indebtedness of Developing Countries", Occasional Paper 3, (Washington, D.C., May 1981), p.9.

become a constraining factor , have the banks not issued additional capital or declined to engage in insufficiently profitable activities? Or why would they not in the future? Excessive competition is one easy answer which the market, for one, does not seem to believe. After all you and I keep lending to banks and buying their shares. On the basis of observed behavior neither the market nor the industry believe that banking is in serious trouble - or, if it is, that it will not be rescued out of trouble. That, I believe, is the crux of the matter. There is a general perception that banks will not be allowed to fail.

This perception acts as a subsidy to banks in several respects. The implicit guarantee on their liabilities enables them to obtain funds at lower cost than they otherwise could. It allows them to invest in assets that are riskier than those their stockholders would choose to hold directly (because, in fact, they are less risky to banks than to other investors). These elements of subsidy are responsible for a number of distorsions in international lending. On one hand, they confer a distorted advantage to bank versus direct finance. On the other hand, they bias international bank portfolios towards higher risk (and return) portfolios.

They also have other distortive effects. In particular, they advantage large bank lenders and large borrowers at the expense of smaller ones. For if one may hesitate to let a large entity fail, one can afford to let a small one do so. New York could not be allowed to default and go into bankrupcy; Yonkers could and was. Chrysler and Studebaker are another example.[1] Similarly, the U.S. authorities might let a smaller institution go into receivership but are unlikely to allow one of the three or five largest American banks to fail- just as they cannot afford to let the effective bankrupcy of a large portion of the Sawings and Loans Associations be recognized. The international counterparts to these examples are obvious. There are several ways in which the banks' claims on, say, Poland can be made good: Western governments can either bail the banks out by taking over their claims (or allowing the banks not to write off their losses immediately) or bail Poland out by lending it the money to re-imburse the banks (on a re-scheduled basis). One further untoward consequence of implicit guarantees to large borrowers and lenders is that it creates

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1) These examples were suggested to me by Michael Mussa.

incentives for brinkmanship. Banks can raise the probability of a bail-out by concentrating their lending on one large borrower who then cannot be allowed to fail since the banks' stake is too high (or by following one large bank who has a large stake in one country). Similarly, borrowers have an incentive to incur very large liabilities to one or a few banks who cannot be allowed to fail.

This analysis is not meant to imply that the problem has yet reached unmanageable proportions or that the world's major banks face bankrupcy. The exposure of individual banks to individual foreign borrowers is well within most banks' capital availability. These borrowers are unlikely to fail (or reschedule) together. As is often mentioned, the record on default on foreign loans has been better on average than on domestic ones, though this may partly be a consequence of the problem just mentioned.[1] What the analysis does point to, however, is the need for removing the distorsions created by the perception that major banks will not be allowed to fail. This is necessary if undue riskiness in their assets is to be avoided and the stability of the international banking system is to be enhanced in the long run.

Herein lies the dilemma of prudential regulation. In order to guard against a crisis of confidence and insure the stability of the international banking system, implicit or explicit guarantees on the soundness of banks are provided to the public. Moral hazard, however, is in the nature of the exercise. Undesired increases in credit creation and the assumption of bad risks are likely to occur and to undermine the very stability of the international banking system which the policy was designed to achieve.

There is no easy way out. Recent moves toward better information, consolidation of balance sheets, harmonization of capital-deposit ratios on a consolidated basis, and clearer assignment of parental responsibility for private

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1) It should, however, be mentioned that the consequences of an actual default of a major foreign borrower are likely to be much more serious than those of a default by a domestic borrower. Recoverability of assets is much more likely in the domestic context.

and central banks all go in the right direction. But this will not suffice to put back the risk where it belongs. Banks should grant credit on a commercial basis; they are entitled to a higher spread if they effectively undertake a higher risk and are held accountable for their mistakes. The bank failures of 1974 led to a reassessment of risk, a rise in spreads, and a restructuring of the industry to the latter's long-run benefit.

This is not to extoll the virtues of bank failures but to point out that it is necessary for them to be conceivable and believed to be capable of occurrence.They might even occasionally have to occur. Neither is it to deny that developing or other countries should be given credit at terms that contain a subsidy element - or even be bailed out. Political, humanitarian, or long-term economic self-interest considerations may well argue in favor of debt relief. However, the latter should be granted explicitely, either through official loans or aid or through an explicit interest subsidy, rather than through an implicit and distortive blanket guarantee on bank assets and liabilities. Removing such distorsions while preserving the stability of the international banking system is the challenge that faces the industry and its supervisors in the 1980's.

10

S O M M A R I O

INTERNATIONAL CAPITAL MARKETS

(external bond issues and syndicated euro-credits by categories of borrowers)

US $ billion; annual rate

	1978	1979	1980	1980			1981	
				I	Q3	Q4	Q1	Q2
OECD countries	53,6	55,1	69.0	59.0	65.6	92.4	62.1	74.6
OECD-based international organisations	3,3	3,8	3.6	3.3	2.6	5.2	2.4	2.3
Non-OECD countries								
Comecon	3,4	4,9	2.7	1.9	2.6	4.4	2.5	2.2
OPEC	11,9	9,0	6.6	5.6	11.1	4.2	3.4	7.3
Other developing	25,3	35,5	28.9	24.1	28.0	39.4	30.8	40.9
International development institutions	3,6	3,8	4.4	5.1	4.3	3.1	2.2	4.6
Other	0,7	3,5	1.2	1.1	1.1	1.6	0.9	0.2
Total	101,8	115,6	116.4	100.1	115.3	150.3	104.3	132.1

Fonte OCDE Financial Market Trends

INTERNATIONAL CAPITAL MARKETS

US $ billion; annual rate

	1978	1979	1980	1980 I	1980 Q3	1980 Q4	1981 Q1	1981 Q2
Euro bonds								
US dollar	6,9	10,2	13.3	13.3	11.4	15.3	14.6	18.2
Deutschmark	6,5	4,8	3.4	3.2	4.2	3.3	-	0.7
Other currencies	1,7	2,3	3.3	2.9	3.5	3.8	4.7	3.2
Total	15,1	17,3	20.0	19.4	19.1	22.4	19.3	22.1
Foreign issues	6,4							
United States	6,4	4,4	2.7	3.2	1.5	3.1	3.0	8.5
Switzerland	7,4	9,5	7.5	6.8	7.3	8.9	8.7	5.5
Japan	4,4	2,6	1.5	1.0	1.5	2.8	2.2	2.8
Germany 1	1,4	2,6	5.0	6.3	3.5	3.6	1.0	0.7
Other countries	1,1	0,9	1.3	1.1	1.7	1.1	1.5	2.5
Total	20,7	20,0	18.0	18.4	15.5	19.5	16.4	20.0
External bonds.								
Total	35,8	37,3	38.0	37.8	34.6	41.9	35.7	42.1
Completed medium- and long term euro-credits	66,0	78,3	78.4	62.3	80.7	108.4	68.6	90.0
Grand Total	101,8	115,6	116.4	100.1	115.3	150.3	104.3	132.1

Fonte OCDE Financial Market Trends

MAIN CHARACTERISTICS OF THE MEDIUM-TERM EURO-CREDIT MARKETS

	1978				1979				1980			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
a) New loans ($ billion at annual rates)	55.0	64.9	64.2	79.9	53,9	69,0	108,7	81,9	63.5	61.2	80.7	108.4
b) Average size of individual loans ($ million)	108	112	100	92	84	82	121	90	87	79	81	99
c) Longest maturity(1) (years/months)	12	12	12	15	15	18	15	15	15/6	15	12	12
d) Average maturity(1) (years/months)	7/9	8/4	8/5	8/11	8/9	9/3	7/9	9/3	8/9	7/8	7/6	7/7
e) Lowest spread(1) (per cent per annum)	5/8	5/8	1/4-3/8	½	1/2	3/8	3/8	-3/8	3/8-½	3/8-½	¼-½	¼-3/8
f) Average spread(2) (per cent per annum)	1.05	1.10	0.90	0.87	0,87	0,76	0,74	0,64	0.67	0.69	0.63	0.75
g) OECD borrowing as a per cent of total	40	50	53	42	27	37	37	42	47	51	51	56

Fonte OCDE Financial Market Trends

RECORDED MEDIUM-TERM EURO-CREDITS

Annual rates, $ billion

Borrowers	1978	1979	1980	1980 1st half	1980 Q3	1980 Q4	1981 Q1	1981 Q2
OECD area	30,4	28,5	40.6	30.6	40.9	60.4	33.6	43.0
Non-OECD countries								
Comecon	3,3	4,9		1.8	2.6	4.3	2.5	2.2
OPEC	10,0	8,6	6.4	5.4	10.9	3.9	3.0	6.7
Other developing	21,9	32,8	27.3	22.6	25.6	38.4	29.0	37.8
International development institutions	0,2	0,3	0.6	1.1	-	-	0.1	0.2
Other	0,2	3,2	0.9	0.8	0.7	1.4	0.4	0.1
Total	66,0	78,3	78.4	62.3	80.7	108.4	68.6	90.0
Memorandum item:								
Total external bond offerings	35,8	37,3	38.0	37.8	34.6	41.9	35.7	42.1

Fonte OCDE Financial Market Trends

INTERNATIONAL AND FOREIGN BOND ISSUES

($ billion at annual rate, not seasonally adjusted)

	1978				1979				1980				1981	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
International issues (of which private placements)	16.6	18.0	14.0	11.8	18,0	22,1	16,6	13,0	8.5	30.2	19.1	22.4	19.3	22.1
Foreign offerings (1) (of which private placements)	19.4	20.7	22.6	19.3	21,6	15,7	20,6	19,9	19.6	17.2	15.5	19.5	16.4	20.0
Total	36.0	38.7	36.6	31.1	39,6	37,8	37,2	32,9	28.1	47.4	34.6	41.9	35.7	42.1

Fonte OCDE Financial Market Trends

Tavola n. 6

INTERNATIONAL AND FOREIGN BOND OFFERINGS

$ billion

	1978	1979	1980	1980 1st half	1980 Q3	1980 Q4	1981 Q1	1981 Q2
			(a) All issues					
International Issues	15,10	17,35	20.05	9.69	4.77	5.59	4.82	5.53
Foreign Issues	20,74	19,98	17.95	9.19	3.88	4.88	4.10	5.00
Sub-total	35,84	37,33	38.00	18.88	8.65	10.47	8.92	10.53
Special placements(1)	1,64	1,60	1.44	0.79	0.49	0.16	0.05	0.17
Total	37,48	38,93	39.44	19.67	9.14	10.63	8.97	10.70
			(b) International Issues by currency					
US dollar	5,85	10,21	13.30	6.63	2.84	3.83	3.65	4.56
Deutsche Mark	6,53	4,77	3.46	1.59	1.05	0.82	-	0.18
Canadian dollar	–	0,47	0.27	0.21	0.06	-	-	0.04
OPEC currencies(2)	0,60	0,38	0.03	-	0.03	-	-	-
Dutch guilder	0,38	0,31	0.55	0.23	0.22	0.10	0.14	0.15
Sterling	0,29	0,29	0.98	0.52	0.24	0.22	0.22	0.10
French franc	0,10	0,37	0.88	0.32	0.17	0.39	0.53	-
Units of account(3)	0,24	0,41	0.09	0.05	0.01	0.03	0.07	0.30
Other	0,11	0,14	0.49	0.14	0.15	0.20	0.21	0.20
Total	15,10	17,35	20.05	9.69	4.77	5.59	4.82	5.53
			(c) Foreign Issues by Market					
United States	6,36	4,37	2.74	1.59	0.37	0.78	0.74	2.12
Switzerland	7,43	9,48	7.47	3.42	1.83	2.22	2.17	1.38
Japan	4,39	2,66	1.54	0.49	0.36	0.69	0.57	0.69
Germany(4)	1,43	2,62	4.95	3.16	0.88	0 91	0.25	0.18
B.L.E.U.	0,36	0,34	0.26	0.10	0.04	0.12	0.05	0.04
Netherlands	0,35	0,16	0.33	0.15	0.10	0.08	0.17	0.09
OPEC currencies(2)	0,16	0,03	0.14	0.04	0.10	-	-	-
Other	0,26	0,32	0.52	0.24	0.20	0.08	0.15	0.50
Total	20,74	19,98	17.95	9.19	3.88	4.88	4.10	5.00

(1) Private placements with monetary authorities and governments.
(2) Bahraini Dinars, Kuwaiti Dinars, Saudi Arabian Riyals.
(3) European units of accounts and special drawing rights.
(4) Includes issues of special DM-denominated United States Treasury bonds, amounting to $ 1.2 billion in 1980.

MEDIUM-TERM EURO-CURRENCY BANK CREDITS*

$ bns

(i) Sectoral analysis

	Total	Major OECD (a)	Minor OECD	Oil exporters	Developing Countries	Of which: Net oil exporters (b)	Of which: Newly-industrialised countries (c)	Of which: Eastern bloc	Of which: Other
1978	58.04	10.92	10.65	9.63	23.67	8.42	8.50	3.04	0.1
1979	72.36	12.77	14.56	7.59	30.16	9.19	10.40	3.95	3.3
1980	73.26	19.38	18.62	7.39	24.60	6.57	10.17	2.59	0.5
1980 QII	18.44	2.20	6.95	2.56	6.33	1.83	2.51	0.41	-
QIII	13.13	2.87	2.75	0.89	5.28	2.07	2.19	0.81	0.5
QIV	26.18	9.81	5.24	1.94	8.48	1.82	3.46	0.67	0.0
1981 QI	21.57	4.77	4.01	1.42	10.43	3.74	3.06	0.89	0.0
QII	16.66	4.79	3.33	0.66	7.55	2.04	3.47	0.13	0.2
1981 April	4.02	0.24	1.60	0.22	1.88	0.65	0.69	0.03	0.0
May	8.68	3.60	0.78	0.13	3.97	1.34	1.73	0.10	0.1
June	3.96	0.95	0.95	0.31	1.70	0.05	1.05	-	0.0

(ii) Selected borrowers

	Major OECD				Minor OECD		oil producing dev. country	Newly industrialised countries		Other ldc
	US	UK	France	Italy	Spain	Scandi/ navia	Mexico	Brazil	South Korea	Philippines
1978	1.60	3.01	1.90	2.73	2.00	5.22	7.11	5.38	1.60	1.34
1979	1.93	0.56	3.03	4.05	4.69	3.47	6.92	4.97	2.81	1.92
1980	2.46	0.83	1.42	6.62	5.60	5.39	5.48	4.61	2.10	1.08
1980 QII	0.32	0.35	0.68	0.66	1.40	2.73	1.68	1.10	0.27	0.03
QIII	0.16	-	0.35	1.53	0.62	0.71	1.71	0.98	0.09	0.25
QIV	1.58	0.14	0.28	2.24	2.29	0.82	1.56	1.94	0.83	0.48
1981 QI	0.08	0.06	2.03	2.30	1.13	2.76	2.73	1.53	0.24	0.19
QII	2.38	-	0.44	1.67	1.19	0.34	1.97	1.33	1.25	0.44
1981 April	-	-	-	0.24	0.58	0.09	0.75	0.12	0.48	0.08
May	2.35	-	0.03	1.10	0.45	0.03	1.20	0.46	0.68	0.22
June	0.03	-	0.41	0.33	0.16	0.22	0.02	0.75	0.09	0.14

*Three years and over; value on the basis of announcement date, not take-up/draw down.

/Norway, Sweden, Iceland, Denmark, Finland.

(a) USA, Canada, UK, France Germany, Italy, Japan, Benelux, Switzerland.

(b) Chiefly Mexico, Malaysia, Peru, Egypt, Tunisia.

(c) Chiefly Argentina, Brazil, South Korea, Taiwan, Hong Kong.

Fonte: Banca d'Inghilterra

Tavola n.°

(i) currency analysis

	Total	$ Euro	$ Foreign	$ Total	DM	Sw Fcs	£	¥	DGl	LxFr	FrFr	CC⊗	Other
1979	33.49	10.47	2.21	12.69	7.17	9.08	0.28	1.67	0.58	0.23	0.45	0.30	1.07
1980	35.51	13.53	1.29	14.82	7.79	7.36	1.17	1.60	0.82	0.29	0.87	0.10	0.70
1980 QII	11.54	6.08	0.38	6.45	1.79	1.83	0.32	0.34	0.21	0.05	0.29	–	0.25
QIII	8.36	2.72	0.17	2.89	2.11	1.71	0.44	0.49	0.32	0.10	0.07	0.01	0.22
QIV	9.29	3.74	0.40	4.14	1.59	2.14	0.22	0.42	0.13	0.08	0.48	0.02	0.08
1981 QI	7.89	3.49	0.10	3.59	0.25	2.03	0.31	0.59	0.45	0.04	0.43	0.06	0.15
QII	10.01	4.74	0.72	5.47	0.47	1.81	0.66	0.97	0.23	0.06	0.09	0.20	0.06
Apr	3.18	0.86	0.35	1.21	0.23	0.58	0.38	0.42	0.09	0.04	0.09	0.16	–
May	2.21	0.93	0.17	1.10	0.06	0.43	0.29	0.23	0.08	0.01	–	–	0.02
June	4.62	2.97	0.20	3.17	0.17	0.80	–	0.33	0.07	0.01	–	0.04	0.04

(Minor currencies: £, ¥, DGl, LxFr, FrFr, CC⊗, Other)

(ii) issue type analysis

	Total Str	Total Conv	Total FRN	$ issues Str+	$ issues Conv	$ issues FRN	DM issues⁰ Str	DM issues⁰ Conv	Sw Fc issues Str	Sw Fc issues Conv	Sw Fc issues FRN	Minor currencie Str	Minor currencie Conv	Minor currencie FRN
1979	25.96	3.14	4.37	7.37	1.05	4.28	6.84	0.33	7.23	1.76	0.09	4.52	–	–
1980	27.21	3.52	4.79	8.30	2.07	4.45	7.59	0.20	6.19	1.00	0.17	5.13	0.25	0.17
1980 QII	9.71	0.62	1.22	5.05	0.38	1.03	1.73	0.06	1.63	0.19	0.02	1.24	0.05	0.17
QIII	6.40	0.77	1.19	1.26	0.49	1.14	1.97	0.14	1.48	0.18	0.05	1.55	0.10	–
QIV	6.03	1.58	1.68	1.48	1.05	1.60	1.59	–	1.64	0.42	0.08	1.32	0.11	–
1981 QI	6.46	0.61	0.82	2.49	0.28	0.82	0.25	–	1.74	0.30	–	1.99	0.04	–
QII	6.63	1.27	2.12	2.78	0.81	1.88	0.47	–	1.34	0.36	0.10	2.04	0.10	0.13
Apr	2.16	0.40	0.61	0.48	0.30	0.43	0.23	–	0.42	0.10	0.06	1.03	–	0.12
May	1.15	0.60	0.46	0.34	0.32	0.44	0.06	–	0.22	0.18	0.02	0.52	0.10	–
June	3.32	0.27	1.04	1.96	0.20	1.02	0.17	–	0.70	0.07	0.02	0.49	–	–

(iii) borrower analysis

	OECD Total	OECD Of which: USA	Japan	UK	International Institutions/ Total	Of which: EIB	IBRD	Other borrowers Total	Of which: Dev ctry	Oil exp	East bloc
1979	24.66	5.30	3.92	1.38	5.92	1.98	1.28	2.88	2.28	0.27	0.08
1980	26.49	5.06	3.69	1.69	6.88	1.98	2.68	2.14	1.55	0.18	0.05
1980 QII	8.44	1.73	0.70	0.67	2.22	0.60	1.04	0.88	0.65	0.05	0.05
QIII	5.86	0.70	1.07	0.49	1.78	0.40	0.88	0.72	0.55	0.05	–
QIV	7.17	1.48	1.33	0.41	1.70	0.76	0.30	0.42	0.25	0.09	–
1981 QI	6.50	1.52	0.77	0.07	1.08	0.32	0.23	0.32	0.13	0.10	–
QII	6.75	1.09	1.23	0.30	2.03	0.29	1.03	1.23	1.13	0.10	–
Apr	1.78	0.19	0.27	0.18	0.94	0.04	0.50	0.46	0.46	–	–
May	1.85	0.17	0.59	0.03	0.10	0.04	0.04	0.26	0.16	0.10	–
June	3.12	0.73	0.37	0.10	0.99	0.21	0.50	0.52	0.52	–	–

*Completed issues (public and private, foreign and euro) with maturities of three years and over, but excluding Canadian borrowers foreign dollar offerings in New York.
/Market borrowing.
⊗Composite currencies (SDRs, EUAs and ECUs).
0There are no FRNs denominated in deutschemarks.
+Includes all fixed rate issues (except those convertible into equity).

Fonte: Banca d'Inghilterra

Euro-currency bank credits

publicly-announced in period, in millions of dollars

	1978	1979	1980	1981 Jun	1981 Jul r	1981 Aug p	Jan-Aug 1981	Jan-Aug 1980
Industrial countries	26 952	27 248	39 100	2 006	47 542	1 365	64 917	20 687
Australia	212	941	2 475	196	—	—	367	603
Canada	5 705	1 845	1 743	—	3 300	—	3 640	656
Denmark	2 242	1 205	1 720	26	101	—	1 027	1 338
Finland	550	92	1 040	—	115	—	376	1 040
France	1 914	2 955	1 745	—	702	—	2 712	1 561
Greece	508	1 009	1 333	14	220	220	1 064	859
Ireland	616	687	237	88	90	—	552	111
Italy	2 485	3 708	6 268	533	120	620	4 151	4 367
Norway	1 517	935	685	71	260	—	427	410
Spain	2 426	4 184	5 457	270	60	78	2 491	2 717
Sweden	1 872	1 263	1 370	50	85	—	1 565	1 208
United Kingdom	3 898	795	1 470	—	122	—	392	1 098
United States	1 206	2 348	6 719	353	42 217	420	43 957	1 133
Other a	3 801	5 281	6 838	405	150	27	2 196	3 586
Developing countries	37 290	47 964	35 054	4 791	3 379	2 813	27 842	21 665
Non-OPEC countries	26 669	35 225	24 009	3 715	2 234	1 987	21 756	13 589
Argentina	1 461	2 965	2 506	140	—	545	1 517	1 620
Brazil	5 634	6 278	4 158	476	666	230	3 436	2 221
Chile	1 045	867	1 322	57	45	497	1 581	585
Korea	2 651	3 258	1 917	716	311	69	1 808	1 133
Malaysia	858	1 168	—	40	—	140	725	—
Mexico	7 250	8 243	5 971	897	616	249	5 839	3 441
Morocco	605	499	420	102	—	—	542	249
Peru	—	596	480	359	174	—	995	335
Philippines	2 073	2 067	1 056	262	—	100	824	476
Taiwan	254	1 063	314	53	—	—	601	64
Other b	4 838	8 221	5 865	613	422	157	3 888	3 465
OPEC countries	10 621	12 739	11 045	1 076	1 145	826	6 086	8 076
Algeria	2 576	1 906	40	—	—	—	—	40
Indonesia	1 118	1 061	1 435	7	—	—	305	859
Nigeria	825	1 373	1 330	320	442	—	1 304	538
United Arab Emirates	726	401	101	—	55	300	363	59
Venezuela	2 054	6 830	6 715	749	348	466	3 223	5 304
Other	3 322	1 168	1 424	—	300	60	891	1 276
Communist countries	3 767	7 325	2 809	152	99	80	1 291	1 840
China	—	3 395	181	—	50	—	50	139
East Germany	642	796	303	100	—	—	400	76
Hungary	700	260	550	—	—	—	550	249
Poland	374	849	800	—	—	—	—	799
Other c	2 051	2 025	975	52	49	80	291	577
International organizations	160	275	429	—	—	—	70	409
TOTAL	70 169	82 812	77 392	6 949	51 020	4 258	94 120	44 601

a includes multi-national organizations *b* includes regional development organizations *c* includes COMECON institutions *p* preliminary
r revised

Fonte: Morgan Guaranty Trust Company
World Financial Markets

New international bond issues

new issues in period, in millions of dollars

	1978	1979	1980	1981 Jun	1981 Jul^p^	1981 Aug^p^	Jan-Aug 1981	Jan-Aug 1980
By type:								
Euro-bonds, total	**14 125**	**18 726**	**23 970**	**3 612**	**2 535**	**1 907**	**17 119**	**15 908**
by category of borrower								
U.S. companies	1 122	2 872	4 107	800	477	455	3 482	2 373
Foreign companies	4 540	7 183	9 032	1 291	1 428	662	6 969	5 819
State enterprises	3 291	4 524	5 839	657	305	477	3 766	4 068
Governments	3 643	2 433	3 045	218	325	23	1 272	2 212
International organizations	1 529	1 714	1 947	646	—	290	1 630	1 436
by currency of denomination								
U.S. dollar	7 290	12 565	16 427	3 370	2 367	1 700	14 631	10 784
German mark	5 251	3 626	3 607	32	33	16	246	2 582
Dutch guilder	394	531	1 043	57	—	—	364	750
Canadian dollar	—	425	279	42	—	—	42	257
European unit of account	165	253	65	43	42	—	117	25
Other	1 025	1 326	2 549	68	93	191	1 719	1 510
Foreign bonds outside the United States, total	**14 359**	**17 749**	**14 521**	**921**	**1 403**	**741**	**8 172**	**9 444**
by category of borrower								
U.S. companies	245	217	307	49	11	23	304	219
Foreign companies	2 110	3 463	3 157	215	568	364	2 438	1 757
State enterprises	3 163	3 284	2 830	246	366	115	2 239	1 693
Governments	5 771	7 663	4 086	226	135	114	1 325	3 079
International organizations	3 070	3 122	4 141	185	323	125	1 866	2 696
by currency of denomination								
German mark	3 789	5 379	4 839	42	144	39	642	3 705
Swiss franc	5 698	9 777	7 617	568	902	464	5 076	4 751
Dutch guilder	385	75	259	23	74	—	253	107
Japanese yen	3 826	1 833	1 088	269	217	215	1 566	502
Other	671	685	718	19	66	23	635	379
Foreign bonds in the United States, total	**5 795**	**4 515**	**3 429**	**985**	**746**	**100**	**4 121**	**1 729**
by category of borrower								
Canadian entities	3 142	2 193	2 136	825	550	100	3 106	870
International organizations	459	1 100	550	—	—	—	—	350
Other	2 194	1 222	743	160	196	—	1 015	509
By country of borrower:								
Industrial countries	**24 964**	**31 886**	**32 732**	**4 057**	**3 911**	**2 135**	**23 284**	**21 205**
Australia	1 218	593	539	89	130	—	345	324
Austria	1 027	1 218	1 859	144	211	86	944	1 243
Canada	4 764	4 197	3 797	1 182	1 045	504	5 666	2 211
Denmark	1 017	752	1 125	41	247	—	461	867
Finland	952	699	392	138	—	—	354	316
France	1 286	2 106	2 820	506	273	100	2 236	1 641
Japan	3 467	5 775	5 309	599	558	737	4 173	2 977
Netherlands	250	832	1 585	43	69	46	300	1 166
Norway	2 751	1 954	892	69	32	—	221	577
Sweden	876	1 530	3 244	50	43	46	1 162	2 058
United Kingdom	1 365	1 181	1 733	25	250	—	609	1 219
United States	2 973	6 767	5 587	849	488	478	3 786	3 764
Developing countries	**4 227**	**3 093**	**2 485**	**630**	**450**	**198**	**2 602**	**1 329**
Non-OPEC countries	2 684	2 675	1 942	630	450	198	2 291	1 109
Brazil	843	930	349	—	14	—	60	292
Mexico	568	363	544	505	301	155	1 583	288
Philippines	170	175	70	—	—	—	30	—
OPEC countries	1 543	418	543	—	—	—	311	220
Algeria	721	208	—	—	—	—	—	—
Venezuela	588	55	398	—	—	—	221	120
Communist countries	**30**	**75**	**65**	—	—	—	**30**	**65**
Hungary	—	—	65	—	—	—	—	65
International organizations	**5 058**	**5 936**	**6 638**	**831**	**323**	**415**	**3 496**	**4 482**
TOTAL	**34 279**	**40 990**	**41 920**	**5 518**	**4 684**	**2 748**	**29 412**	**27 081**

Fonte: *Morgan Guaranty Trust Company / Page 11*

World Financial Markets

Average Spread[1]
(per cent per annum)

Borrowing countries	1977	1978				1979				1980				1981	
	Q4	Q1	Q2	Q3	Q4	Q1	Apr/May	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
OECD countries	0.84	0.82	0.80	0.72	0.69	0.69	0.66	0,67	0,49	0.56	0.57	0.54	0.56	0.54	0.47
Comecon countries	1.05	0.97	0.70	0.74	0.73	0.88	-	0,61	0,57	0.58	0.73	1.17	0.96	0.66	0.62
Other non-OECD countries	1.46	1.22	1.26	1.15	1.03	0.95	0.88	0,76	0,74	0.78	0.84	0.82	1.03	0.82	0.99
General average	1.17	1.05	1.10	0.90	0.87	0.87	0.83	0,73	0,64	0.67	0.69	0.68	0.75	0.70	0.74

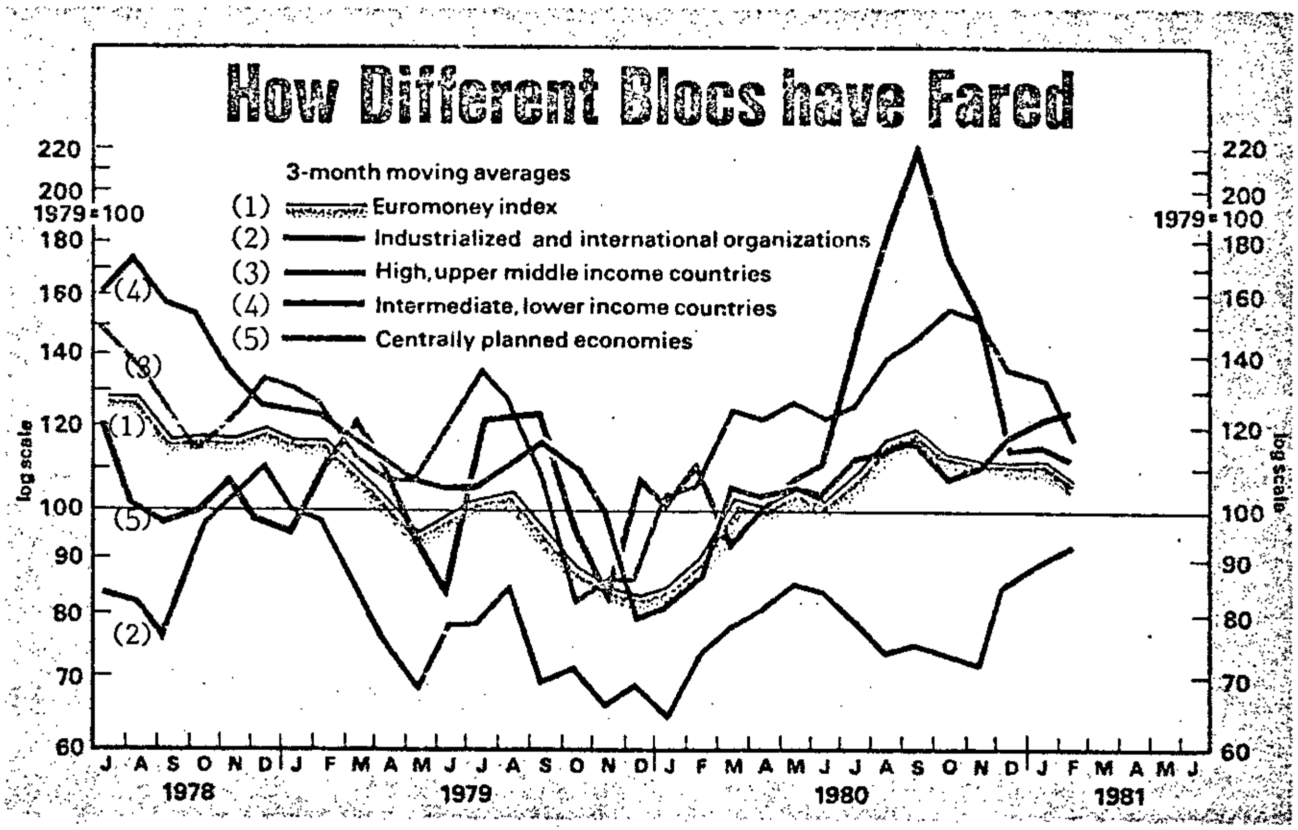
(1) Weighted mean of spreads applied to loans of $ 50 million and over with a maturity of at least three years completed or signed during the period.

Fonte OCDE Financial Market Trends

Grafico n. 1

EVOLUZIONE DEGLI SPREADS PER GRUPPI DI PAESI

(Anni 1978 - 1981)

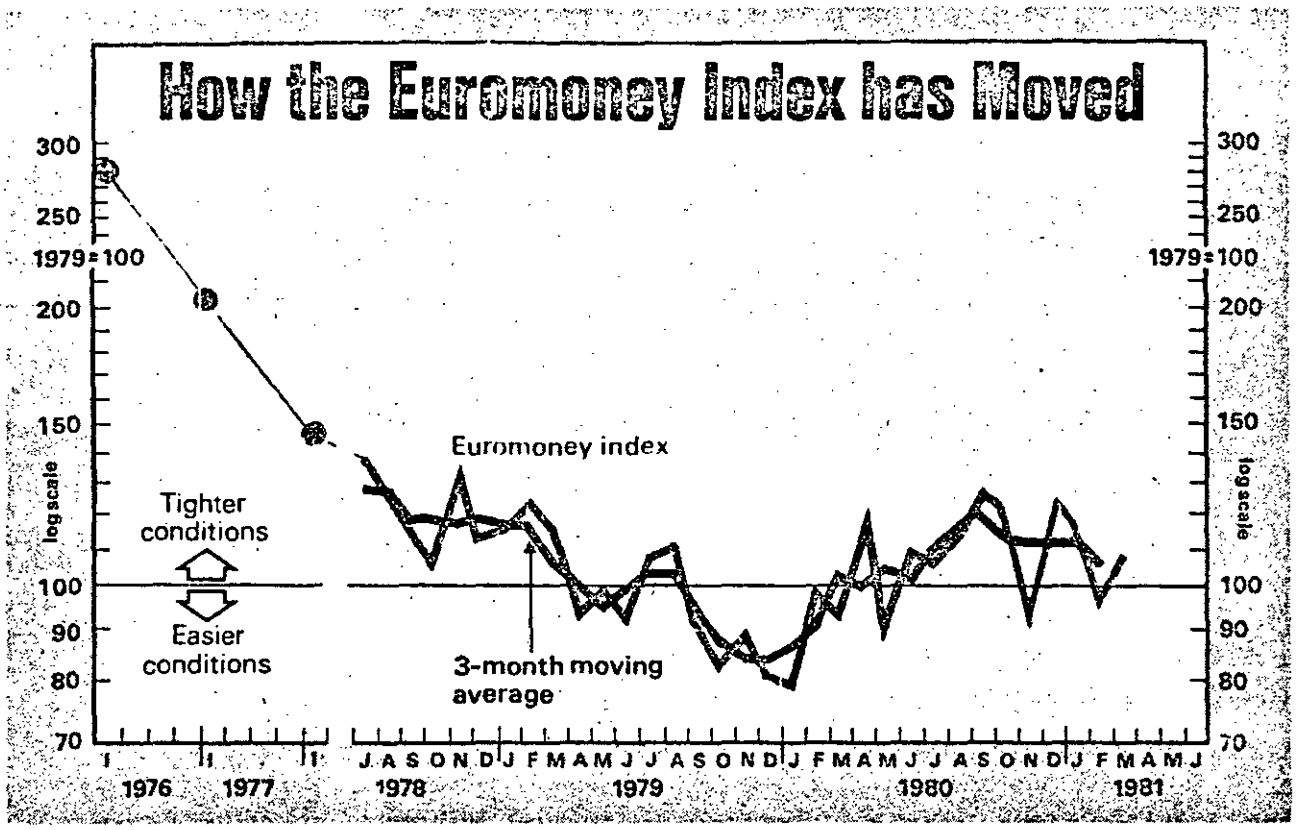


Fonte Euromoney: maggio 1981

Grafico n. 2

EVOLUZIONE DELL'INDICE DI EUROMONEY

~~PER LA VALUTAZIONE DEGLI "SPREADS"~~



Fonte Euromoney: maggio 1981