LATIN AMERICAN BANKING SYSTEM AND THE FINANCIAL CRISIS[1]

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Summary

The internationalization of the financial systems in Latin America is once again a topic of discussion, on both the political as well as economic level, due to the current economic crisis. But above all, the role played by the national financial systems in Latin America is an issue of monetary sovereignty. The process of deregulation and financial liberalization of the 1980s and 1990s, with the resulting bank crises, opened the national banking systems to foreign financial intermediaries. Such processes had specific characteristics in each country. This process culminated with countries such as Mexico having almost 80% of their banks in the hands of international banking institutions that today are in crisis or are now insolvent. In Brazil, only 16.67% of the country's banks are in the hands of foreigners and it has two public banks that account for 25.98% of the assets of the 15 largest banks of the Brazilian banking system. These banks are the Banco do Brasil and Caixa Económica Federal. Meanwhile, in Argentina, despite the country having adopted the Monetary Board a decade ago, with the 2001 economic crisis, public sector banks such as the Banco de la Nación and the Banco de la Provincia de Buenos Aires were strengthened. Foreign banks only control 38.19% of the total assets of the Argentine banking system.

What, then, should be done to deal with a financial crisis so deep and that appears to put a question mark over the development of the Latin American economies?,

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To what degree will the internationalization of the banks and the financial conglomerates be decisive in development financing given the consequences of the crisis in each country? And, what is more important, will it be advisable to re-nationalize the subsidiaries of the foreign banks and to rescue the banks that were lost during the banking crises of the 1990s?

Responding to these legitimate concerns goes far beyond the scope of this study, which is limited to presenting elements that contribute to the debate, through examining the processes of financial concentration and centralization -in which mergers and megamergers are of particular importance- following the breakdown of the national banking systems in the countries of the region. With this in mind, the privatizations are analyzed, placing special emphasis on the international financial institutions that acquired the local banks, on the earnings obtained in each country, and on the percentage of financial assets that they control. Concretely, the effects of the strategy adopted by the large international banks in the banking systems of Argentina, Brazil and Mexico will be studied.

Introduction

In the past three decades, the debate concerning the internationalization of the financial systems of Latin America and its consequences for development has assumed major dimensions. This problem was framed, both on the academic as well as political planes, in the issue of monetary stability. Given the current crisis, the national financial systems have taken on considerable importance in terms of the measures adopted by the governments of the region. Different development strategies are maturing in relation to the possibilities and together with them, the different financing modalities.

Thus, today more than ever, we can assert that the mergers and megamergers in the national financial systems and their linkage with transnational financial conglomerates respond to the structural changes in the productive sphere caused by the major transformations of the social, economic and political order in the framework of the internationalization and globalization of capital. The megamergers of the large transnational banks are the result of the process of financial globalization, made possible by deregulation, liberalization, and financial innovation, intensified by the economic crises. Chesnais states that "… the financial markets are intrinsically unstable, and this characteristic has been further accentuated as a result of the very specific forms assumed by financial globalization… which arose… from liberalization and financial deregulation" (Chesnais, 2003:43).[3] The International Monetary Fund (IMF) itself points out in a study that "… between 1975 and 1997, 158 episodes in which countries experienced substantial exchange market pressures and 54 banking crisis were identified" (IMF, 1998:86). The crises are revealed in different ways, through devaluations, in the stock exchanges, banks, balance of payments, etc. Therefore, it can be argued that the 1990s was not the "decade of hope" nor the "lost decade", but the "decade of the financial crisis" on a global level.

The processes of financial concentration and centralization following the breakdown of the national banking systems took on different characteristics in each country. These financial crises, due to the processes of deregulation and financial liberalization, had uneven results both in Japan as well as in Spain, where the country's own banks were strengthened without the participation of transnational financial conglomerates. Indeed, its private financial groups were strengthened to

[3] In recent years there has been a plethora of studies concerning the growing importance of finances in contemporary capitalism. Among those that should be emphasized, moreover based on a critical theoretical approach, is the continual and important contribution made by the French Regulation School, with which Chesnais has established an extensive dialogue. For a synthesis of issues and authors of this current, see the first chapter of Brumo (2005). Part of the contemporary studies of the authors belonging to this tradition can be found in the publication *Revue de la Regulation* (http://regulation.revues.org)

such an extent that they became transnational corporate conglomerates that expanded beyond their own borders.

In Latin America the banks were acquired by foreign consortia. In Mexico, control of the financial assets remained almost entirely in the hands of foreign financial groups. Argentina and Brazil, after their respective crisis, at least maintained one or two strong and dynamic public banks. In this study, we will demonstrate that the deregulation and liberalization of the financial systems caused the financial crises in emerging economies, such as Argentina, Brazil, and Mexico. Among these countries differences exist in terms of the way in which the mergers were carried out within their respective financial systems. The mergers that took place in each country and the formation of a system of foreign banks that dominate the financial assets of Latin America, involved an increase in the profitability of each of the home offices of the purchasing banks.

I. From the financial crisis to the reforms and vice versa

The past few decades will pass into the annals of economic history as the years of the bank crises and stabilization policies, with the resulting loss of control over financial assets on the part of the national financial systems in the Latin American region. We could argue the common thread in the different banking crises experienced by these countries was the process of deregulation and financial liberalization, but it is also necessary to add to this highly unstable dynamic, the need of the financial conglomerates to expand their controls and securitize a large part of their financial operations.

At the beginning of the 1990s, the IMF predicted a promising future for Latin America for having introduced the reforms that were imposed on the region and for having established macroeconomic stability as a priority. The countries of the region were often characterized as the “best pupils”, in order to underline their efficiency in the application of such changes. From the IMF’s point of view, Latin America had benefitted to a great extent from the reduction in the foreign debt through the Brady Plan. For the region, its history of debt moratorium seems to have been confined to the past and it appeared headed for the road the growth as had been the case with the Asian countries (International Monetary Fund, 2005:1).

For three decades, one of the most important features of the economic history of Latin America has been the increase in the trend to generate continual financial crisis. The alternative presented for handling the crises was the reforms based on the famous stabilization plans of the IMF, which were quite frequent in the region as of the mid-1970s. Three major objectives of these reforms can be identified: a) to disarticulate the development model implicit in the strategy of import substitution; b) to deprive national companies of their prerogatives, supposedly to open the road to the greater productive efficiency that would accompany competition; c) to “smoothly” expand control over the productive and financial assets of the transnational conglomerates.

Thus a strategy was launched to diminish the participation of the state in the productive sector and to expand the openings, first of all, for foreign direct investment, which ended up buying the financial assets of already established companies, and secondly, once the foreign debt was renegotiated and paid off with the Brady Plan, the so-called emerging economies were allowed to return to the capital markets. Simultaneously, the financial reform was launched, a sine qua non condition for allowing the autonomy of the central banks, deregulation and the liberalization of interest rates, the privatization of private, national, and local commercial banks and, perhaps most importantly, the opening of the capital account. It should be emphasized that the financial reforms in the region took place in the context of the "first, second, and third generation" reforms of the Washington Consensus.

The immediate consequences of the deregulation and liberalization of the financial sector were the bank crises in several Latin America countries. The Mexican crisis was pinpointed by the then managing director of the International Monetary Fund, Michel Camdessus, as the first global crisis of the 21st century in the monetary circuits. The "tequila effect", as many called it, threatened the dollarization project in Argentina and led to the Brazilian financial crisis. The supposed benefits of deregulation and financial liberalization were put into question in Southeast Asia, South Korea, Russia, and Turkey (1997-1998), which precipitated the end of the convertibility project in Argentina (2001).

The Mexican crisis (1994-1995) spilled over into the region, with the crises of Brazil and Ecuador (1999), Argentina (2001), Brazil and Uruguay (2002), following in its wake. These financial turbulences, coupled with the foreign exchange and international debt crises of the 1970s and 1980s, halted economic development and overshadowed the democratic changes in government, due to the vulnerability of the external sectors. The crisis in Southeast Asia occurred following a period of high growth and this allowed for a very quick recovery. On the opposite end, in Latin America, the period following the crisis was marked by stagnation and volatility.

What took place in the 1990-2008 period can be synthesized in the following points: a) the end of the hyperinflation of the 1980s; b) the renegotiation of the foreign debt via the Brady Plan; c) the beginning of the economic reforms; d) the decrease in the fiscal deficits; e) the inflow of considerable amounts of foreign capital to the region, and f) a growth mainly based on primary export products, whose prices increased in the world market. All of this enabled Latin America to post sustained growth of 5.8 percent from 2002-2007. (ECLAC, 2008).

The region's economy grew "… between 2003 and 2008 at an average rate of close to 5% annually, which implies per capita GDP growth above 3% in annual terms (ECLAC, 2008)." The economies of Brazil, Argentina, and other countries resumed their growth, due to a large extent to the good prices for their export products and the efforts of applying heterodox and less restrictive policies. At the end of 2005, several countries were even able to make advance payments to the IMF, which allowed them to move away from the contractionist policies of the Washington Consensus. The Mercosur, the Unasur, and the proposal to create the Banco del Sur, led Ecuador, Venezuela, and Bolivia to seek integration processes different from those of the Free Trade Agreement of the Americas (FTAA). An example of this is the Bolivarian Alternative for Latin America and the Caribbean (ALBA).

To summarize, the debt crisis of the 1980s was followed by a financial reform, which caused intermittent bank crisis in the 1990s and the resulting financial fragility. Of particular importance was the internationalization of the local financial systems as a result of the acquisition of national banks on the part of foreign financial conglomerates. The level of concentration and of internationalization of the financial systems of the countries of the region will be decisive in determining the strength or weakness of each country to face the current recession.

II. Main foreign financial corporations in Latin America

Today, the inhabitants of Latin America carry out daily operations in financial companies such as BBVA, Santander, Citigroup, HSBC, and ScotiaBank. This intervention on the part of international banks was made possible by the process of financial privatization carried out in the 1990s. In the opinion of Calderón and Casilda (2000): “Rather than playing the traditional role of working alongside non-financial firms as they further their internationalization process (providing financing and financial services to such firms), in Latin America Spanish banks have aggressively expanded their core activity —commercial banking— with a view to building a presence in as many markets as possible.”

The two Spanish banks with the greatest presence in Latin America in terms of the amount of their financial assets are BBVA and Santander. In 2004, the assets of these two institutions topped 150.20 billion dollars, very much above the corresponding figures for Citigroup (62.50 billion dollars), HSBC (35.06 billion dollars), and Scotiabank (13.57 billion dollars). U.S. and British banks have been more timidly positioned in Latin America in comparison with their Spanish peers. In the 1990s, BBVA and Santander invested close to 10 billion dollars in the region. In 2008, together, they controlled more than 290 billion dollars in financial assets in the region. In 2004, they obtained earnings of 2.33 billion dollars, which by the first half of 2008 had risen to more than 3.23 billion dollars.

According to the figures obtained in the course of research, between 2006 and the first half of 2008, the five above-mentioned conglomerates considerably increased the amount of their assets in Latin America. These bank conglomerates hold strategic positions in order of importance by country. In 2008, BBVA held more than 122.63 billion dollars in Latin America; of that total, 59.2% corresponds to Mexico. Santander controls more than 180.11 billion dollars in financial assets in the region, of which 23.74% are in Mexico. The figures corresponding to Citigroup are almost 116.23 billion dollars and 45.51%, respectively. In Mexico, HSBC and Scotiabank have 30.07% and 37.75% of their assets, respectively. Brazil is the country in which Santander has most of its assets in the region (43.76%). Citigroup and HSBC maintain a presence in Brazil with 18.69% and 50.22%, respectively, of the total amount of their investments in Latin America. Chile is in third place, where Santander has 24.93% and BBVA 9.58% of their respective totals in Latin America.

When comparing these relative holdings in the countries, the decrease in the percentage share corresponding to Mexico in the financial assets that the five conglomerates maintain in the region is clear. The decline was more pronounced in the case of Citibank, in which the percentage fell from 67% of the bank's assets in Latin America in 2006 to 46% 2008, what means that it fell by 32% in a year and a half.[4]

The cases of Brazil and Chile are very different. Brazil went from representing 35% of Santander's assets in 2006 to 44% in 2008.[5] A similar phenomenon occurred in Chile in regard to Citibank, with the country's percentage share rising from 5% to 27%.[6]

Another key variable for an analysis of the Latin American financial system and its relationship with international banks is the earnings that the latter obtain in the region. BBVA obtains from Mexico 57.93% of its total earnings in Latin America. From Venezuela the corresponding figure is 24.59%, which is somewhat surprising because in that country it controls fewer financial assets than in Chile, where it only obtains 2.07% of its earnings. The internationalization of the banking systems in Latin America goes hand in hand with the profitability provided by this region.

III. The Latin American financial systems following the banking crises of the 1990s: Argentina, Brazil, and Mexico

[4] It is still premature, since the timeframe for the data is very short, to make a diagnosis about what these movements signify. However, it is necessary to consider the possibility that the country that was important for banks' foreign direct investment in 1990s has experienced a pronounced change in its situation. The relative "lack of interest" in Mexico as a market to invest in on the part of the big conglomerates, acquires dramatic dimensions if we consider that that country is precisely the one that most internationalized its financial system. If the capital investments of the foreign banks stay away from Mexico, or at least fail to flow in same proportion as previously, how will access to the funds required for any recovery and economic reactivation strategy to face the current crisis be guaranteed?

[5] What was initially the Banco Real, with domestic capital, was purchased by the Dutch bank ABN-Amro in 1998. In the same year, that bank acquired Bandepe, in 2001 it purchased Paraiban and in 2003, Sudameris. By October 2007, the consortium formed by Santander, the Royal Bank of Scotland (RBS) and the Belgian-Dutch financial institution Fortis purchased the operations of ABN-Amro, which implies that currently Banco Real is more a company of the Santander Brasil group. The merger of ABN and Santander in Brazil were approved by the Administrative Council of Economic Defense (CADE) and by the Banco Central do Brasil, which explains the higher percentage of assets of the Spanish bank in the country during the 2008 fiscal year.

[6] At the end of 2007, the shareholders' meeting of the Banco de Chile, which was then the country's second largest bank, approved its merger with Citibank.

The process of deregulation and financial liberalization resulted in the national financial systems being intertwined through the international financial and monetary circuits. Meanwhile, the monetary market became a single market, which facilitated the positioning of the large foreign banks in the region. In the framework of the successive financial crises of the 1990s, the majority of the banks passed into the hands of the large foreign consortia by means of mergers and megamergers. The region's financial assets, close to a trillion dollars, passed into the hands of the main international banks once they were "cleaned up" by the respective local governments.

In 2004, the total amount of assets of the main banks of Argentina, Brazil, and Mexico totaled more than 660.30 billion dollars and net earnings more than 8.78 billion dollars; that is, more than 10% of total assets[7]. This should be considered along with the characteristics of the recovery of the national private banks and public banks in each of these countries. For example, in Argentina the two main banks are the Banco de la Nación, which controls financial assets to the tune of almost 18.53 billion dollars, and the Banco de la Provincia de Buenos Aires (almost 7.42 billion dollars). The public banks, with these two banks, control in total more than 25.97 billion dollars, more than a third of total financial assets. Although Argentina was one of the nations that was a symbol of the privatizations in the 1990s and that experienced the cruelest financial and economic crisis, once the crisis was overcome, the country began to grow, with the public banks key to the economic revival.

Mexico's main commercial banks are in private hands. The four largest banks are owned by transnational Spanish megaconglomerates. BBVA and Banco Santander together account for almost 115.37 billion dollars in assets. If Citibank-Banamex and HSBC are added to the total, the result is that the four groups reach the impressive figure of 204.54 billion dollars.

Foreign penetration of the Mexican financial system was much deeper than in the case of Argentina and Brazil. Eight of the ten largest banks of Latin America operate in Brazil and the country has two solid public banks.[8] The Banco do Brasil[9]

[7] In this section, we are dealing with the 15 largest banks of each country, taking into account each of their total assets.

[8] Brazil is home to 10 of the 15 largest banks of Latin America. These banks' assets total 1.40 billion dollars. According to data from *América Economía* no. 67, October 2008, the value of assets, based on capital ownership, can be broken down as follows: a) public banks (423.18 billion dollars); b) private banks with national capital (736.40 billion dollars); and c) foreign owned private banks (241.00 billion dollars).

[9] It should be emphasized that the Banco do Brasil is a mixed venture, although the National Treasury of Brazil is its holding company. Its current equity structure is divided as follows: a) National Treasury (65.3%); b) foreign capital (11.5%); c) PREVI, retirement fund for bank employees (10.5%); d) individuals (5.7%); e) corporate investors (4,5%); and BNDESPAR (2,5%). See the bank's institutional information at www.bb.com.br.

holds close to 258.86 billion dollars and Caixa has more than 164.32 billion dollars. The first bank with foreign capital in Brazil was the fourth largest, if the combined total of ABN-Amro and Santander assets is considered. If calculated individually, the amount of their assets would place them in sixth and seventh place, respectively. If we compare the amount of assets in the Brazilian banking system and what is held by the foreign banks, it turns out that the latter have had much less penetration than in the other countries of the region, especially in comparison with Argentina and Mexico. This was because few foreign financial conglomerates were willing to face the oligopolized competition of the large Brazilian national banks, and those that did so, have little influence in credit decisions with their local clients.

In synthesis, total banking system assets of the three countries are distributed as follows: in Mexico 77.66 percent of deposits correspond to foreign banks and 22.34 percent to local private banks. In Argentina, state banks account for 49.36 percent of the total; local private banks, 12.45 percent; and private foreign banks, 38.19 percent. In the case of Brazil 28.24 percent correspond to state banks, 55.09 percent to local banks, and only 16.67 percent to foreign banks.

In Mexico, as a result of the crisis of the mid-1990s and the way in which the problems in each bank were revolved in the framework of the financial liberalization, domestic financial investors were losing control of the commercial banks. Mexican banks are controlled by the top ten banks on a world level, such as Citibank, HSBC, Bank of America, JP Morgan, and the Spain’s two more important banks (BBVA and Santander).

The situation in Argentina is very different, where, as has already been pointed out, the first and third largest banks are state banks.

Grupo Santander arose from the mergers with Banco Central, Banco Hispano American, and Banco Español de Crédito. Santander has been strengthened with its entry into Latin America, since in 2004 it controlled close to 464 billion dollars. In 2000, the home office purchased Banco Serfín in Mexico for almost 2 billion dollars, Banespa in Brazil for 7 billion dollars and Banco Santiago for 675 million dollars. In addition, Santander owns Banco Río de la Plata in Argentina and Banco Santa Cruz de la Sierra in Bolivia. It has also purchased other banks in Venezuela, Colombia, and Uruguay. Santander’s expansion in Europe through the purchase of Abbey strengthened its assets by 30%. However, this decreased the percentage of its assets in the Latin American region. This diminishes its company risk given the possibility of financial problems in Latin America. The strategy that the bank will follow will be to position itself in a short period of time among the top ten banks on a world level thanks to the future purchase of other banks in Europe and the United States. In 2005, Santander Central Hispano was number 10 in the list of The Banker (2006ª: 224), controlling close to 954.47 billion dollars in assets.

The situation of the financial systems in Latin America, in light of the results of the financial reform, is different from the experiences in other countries. For example, in Southeast Asia, and even in Japan and Spain, the financial reform followed a road different from that laid out in the Washington Consensus. In Japan and Spain, when their respective banking systems entered into a crisis, the banks merged with the help of the state and the central bank. This led to the strengthening of the banks within the country and to their expansion abroad. Today, three Japanese banks are among the top ten banks on a world level -Mitsubishi UFJ Financial Group, Sumitomo Mitsui Financial Group and Mizuho Financial Group-, which in 2006 together held financial assets to the tune of almost 3.62 trillion dollars.

However, foreign investment in relation to the financial systems has not behaved as was expected with deregulation and financial liberalization. For example, if we consider the domestic savings rate in relation to the gross domestic product (GDP) there are differences among the three countries that are the subject of our study. The trends following the banking and financial crisis in each of the countries and their degree of foreign penetration, show that the domestic savings rate in Argentina is much higher than in the case of Mexico and Brazil. In 2002-2004, the Argentine savings rate was of 23.4%. In Brazil (1999-2004) the corresponding figure was 21.2%. In Mexico (1996-2004) it was 21.4%, but it has diminished as the degree of foreign penetration of the country's financial system has intensified.

IV. Conclusions

The major mergers and megamergers were factors in financial globalization that represented large-scale and extensive interests. In 2006, the top ten commercial banks on a world level controlled financial assets for a total of almost 12.88 trillion dollars (The Banker, 2006), while 15 years earlier the corresponding figure was of close to 3.06 trillion dollars. The large non-financial corporations in 2006 held more than 3.00 trillion dollars in assets, more than the triple the figure from 14 years previously of 870.48 billion dollars (The Fortune, 2005). Financial globalization, capital flows, and the conception of a development subordinate to the large conglomerates, further defined and helped not only the deregulation of the financial system but also reforms that were articulated, at least in Latin America, in the framework of the Washington Consensus.

Latin America's profitability, despite the deep financial crises of the 1990s was a constant in the region. Correa (2004: 295) indicates, based on data from ECLAC that "… profit sharing from foreign investment averages more than 36% of these annual flows, while interests on the foreign debt paid annually represent 7.4% of its total balance. At the same time … financial services indispensable for direct and portfolio investment flows as well as for the placement of private and public debt bonds have been provided mainly by foreign financial institutions."

To the extent that the financial conglomerates on a world level increase their presence in Latin America, their power will be strengthened. New acquisitions of national banks will increase their supply of financial services in Latin America. The profitability that these financial groups or banking megaconglomerates obtain is vital for their strengthening and competition on a global level. This left certain Latin American countries extremely weakened in terms of obtaining financing for sustained and equitable economic development. The financial strategy of a national project was lost in the process.

The degree of internationalization of the banking systems in Latin America has been uneven. Brazil and Mexico are the polar opposite examples in which the internationalization of the banks followed markedly different paths. The foreign banks in the region's banking systems are subsidiaries of international financial conglomerates. Therefore, the country's economic growth and the granting of credit to national companies becomes a secondary objective. Profitability in a system of international financial accumulation leads the subsidiary banks to channel their profits to their home offices. In response to the financial crisis in the Latin American countries, today there are banks that can place obstacles in the way of the alternatives for dealing with it. For example, by transferring considerable capital flows to the home office, provoking greater uncertainty and destabilizing the country's exchange rate. In this context, it would be worthwhile to rescue the foreign banks and re-nationalize, to some extent, the banking systems of the Latin American region.

What we have sought to do in this study was to present elements for the debate on the different development models that are again making their rounds throughout the region, in light of –or in the shadow of- the challenges posed by the current crisis. The pursuit of this goal must take place through a detailed examination of the processes of concentration and financial centralization following the collapse of the national banking systems in the countries of the region, and of the analysis of the privatizations, with special emphasis on the international financial institutions that acquired the local banks, on the earnings that they extract in each country, and on the percentage of financial assets that they control. In a word, emphasis must be placed on the consequences that the strategy adopted by the major international banks has had on the banking systems of Argentina, Brazil and Mexico.

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