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Abstract

The recent international financial crisis has dramatically revealed the shortcomings and potential dangers of bank globalization and deeper financial integration. While the lack of supervision and adequate legal frameworks has been largely acknowledged as a main problem, the effects of regulation on the development of international banking activity and financial stability are still a matter of controversy. This article investigates the conditions under which the globalization of the domestic banking sector unfolded in Brazil and Mexico during the years of dizzying expansion of foreign finance that culminated the international debt crisis of 1982. It shows how the regulatory framework for international banking and foreign capital in Brazil created a model of intermediation that was considerably less vulnerable to crisis than in Mexico, with a more lightly regulated institutional base. These findings provide insights into historical discussions about the implications of financial regulation and capital controls for the development and expansion of foreign finance and whether the risks underlying international banking are necessarily inherent to the process of financial globalization.

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Introduction

The relationship between international banking and financial fragility has gained a prominent place on academic and policymaking debates since the global financial crisis of 2008. The attention is largely driven by the dramatic surge of international finance and foreign banking activities observed in the years that preceded the outbreak of the crisis and the salient role of cross-border financial linkages in the transmission and propagation of banking problems at an international level afterwards.¹ While previous research had been largely focused on the benefits of the international diversification of large banks in the industrial world and its contribution to sustainable financial development,² the wave of financial crises of the last decade has raised serious concerns about its potential perils. As a result, a growing body of literature has developed as to improve our knowledge of the circumstances under which global banking and deep international financial integration can lead to an increase in the likelihood of crisis and an exacerbation of its effects in both developing and developed countries alike.

The role of supervision and regulation of national and international banking activities and cross-border capital flows had moved to centre stage within these discussions. As the problems of wrong incentives and flawed banking practices became apparent, scholars have looked into history and past episodes of financial turbulence to understand the dynamics of crises and the institutional and regulatory conditions of more stable and resilient banking systems across time and space.³ Because the supervisory framework and the presence or absence of specific legal provisions determine the rules and options available for financial intermediation, they have a fundamental influence on shaping the business models adopted by the banks and the underlying risks and vulnerabilities. Yet, the form and extent that regulation should take and the ways through which it conducts to prudent banking behaviour and financial stability, as well as whether this results in a sub-optimal development of the banking sector and lower economic growth, remains a matter of disagreement and examination.

This article addresses this debate by looking at the early years of modern financial globalization, the period of the great expansion of international banking that led to the Latin American debt crisis of 1982. After the markedly contraction experienced during the Great Depression, international banking activities began to recover with the end of World War II and entered into a period of remarkable growth since the early 1960s. Between 1950 and 1963, the number of US and European banks with operations overseas and their network of foreign offices increased gradually, and in the following years the process of bank internationalization accelerated and became a widespread phenomenon both in scope and scale.⁴ With the expansion of the Euromarkets and the lift of capital controls that followed the end of Bretton Woods in the early 1970s, the number of foreign banks in the world's financial centres, notably in London and New York, along with the volume of international businesses and their weight in banks' balance sheets and domestic economic activity grew significantly, resulting in a rise of cross-border banking transactions and heightened international financial integration.⁵

Until now, scholars have largely focused on institutions and financial regulation in industrial creditor countries when analysing the shortcomings of international banking in the lead-up to the 1982 crisis.⁶ This article takes a different approach and examines the situation in debtor countries, namely Brazil and Mexico, the two largest international borrowers and major economies of the developing world

¹ See World Bank (2018), Claessens (2017), Demirgüç-Kunt, Evanoff, and Kaufman (2016), among others.

² Kose, Prasad, Rogoff, and Wei (2009) and Kose, Prasad, and Taylor (2011).

³ Some recent works are Turner (2014), Dimsdale and Hotson (2014), and Calomiris and Haber (2014).

⁴ See, for instance, Moffitt (1984), in particular Chapter 2, pp. 41-70, and Brimmer and Dahl (1975).

⁵ Pecchioli (1983) and Llewellyn (1980).

⁶ Altamura (2017), Mourlon-Druol (2015), and Schenk (2005, 2014).

back then. The study of the debtors' experiences makes immediate sense since, while the banking sector of industrial countries came out of the turbulent years of the debt crisis without major damage, many of the defaulting countries suffered from severe financial problems or full-fledged banking crisis.⁷ Moreover, as scholarship on the Latin American debt crisis of 1982 has demonstrated, many domestic banks underwent a process of international expansion during the years that preceded the crisis, and the involvement with foreign finance was at the heart of increasing financial fragility in some countries.⁸ Finally, to the extent that these problems and the regulation of international banking varied among the debtor countries, they provide with valuable comparative case studies for understanding the different risk and dynamics underpinning bank globalization and financial fragility.

The article analyses the different regulatory and supervisory environments for Brazilian and Mexican bank participation in global financial markets in connection with their exposure to the 1982 crises. How were the funding and lending strategies of their international businesses different? What were the consequences of sovereign debt payment problems on their financial and solvency position? I answer these questions by drawing on a combination of recently disclosed archival records as well as secondary sources. I build up on recent research on the problems and outcomes of Mexican international banking,⁹ and reconstruct the distinctive features of the model of intermediation in Brazil by analysing the large corpus of legislation enacted by financial authorities, notably the central bank, and the balance sheets of the banks. My account relies on published and some insightful unpublished work, such as dissertations and policy reports, by contemporary Brazilian scholars as well as the coverage provided by the domestic business and financial press. Finally, the analysis is also based on data from the central banks' annual reports, *Revista Bancaria Brasileira*, the Report of Assets and Liabilities of US Branches and Agencies of Foreign Banks of the Federal Financial Institutions Examination Council (FFIEC 002), Lloyds bank archive and the Bank of England's Task Force collection.

Notably, while the debt crisis inflicted a major blow on Mexican banks and nationalization became the option adopted by the government, no bank failure or systemic meltdown were observed in Brazil. Indeed, this article shows that, despite a larger number of domestic financial institutions involved with foreign finance and arguably greater international presence both in scale and scope, the Brazilian banking system was considerably less vulnerable to the crisis than its counterpart in Mexico. I argue that the regulatory and the legal framework for foreign capital in Brazil was fundamental in creating a model of intermediation with lower risks than the one developed in Mexico, with a more lightly regulated institutional base. Although heavy bureaucratic and capital control procedures might seem to imply negative consequences for financial development and cross-border banking integration, this study suggests that that is not to be assumed and that the relationship could also go the other way around. It also reveals the potential benefits for mitigating risks and looking after financial stability, at least in this case of Brazilian international banking in the wake up of modern financial globalization.

The article begins with the historical context of the internationalization of banking in both countries and its different dimensions. It then analyses the models of intermediation, with a detailed account of the interaction between the regulatory framework set by Brazilian financial authorities and the domestic economic and financial factors driving the decision of the banks when engaging in foreign finance, stressing the differences with respect to the conditions of Mexican international banking. The third section looks specifically at the foreign agencies and branches of Mexican and Brazilian banks and the nature of their activities and the different risks and vulnerabilities underlying their businesses. Section four analyses the exposure of Brazilian and Mexican banks to the debt crisis and the

⁷ Laeven and Valencia (2008) and Sundararajan and Baliño (1991).

⁸ Alvarez (2017) and Diaz-Alejandro (1985).

⁹ Alvarez (2019).

repercussions of the defaults on their liquidity and solvency position along with the extent to which this represented a threat to the stability of the domestic banking systems. Last section concludes.

The Historical Context of International Banking

Although largely concerned with large banks and the banking systems of the world main economies, developing countries were also part of the internationalization trend and Brazil and Mexico were no exceptions. Figure 1 plots the evolution of the external position of the banking system in both countries, namely cross-border liabilities to foreign financial institutions, in terms of domestic economic activity. In Brazil, the involvement of domestic banks with foreign finance took up in the late 1960s with the introduction of Resolution 63, a legal statute enacted by financial authorities in August 21, 1967 to permit financial institutions to borrow abroad and on-lend these funds domestically. Between 1969 and 1982, Resolution 63 obligations grew from US\$ 433 million to US\$ 16.4 billion, which represents an average pace of expansion of about 32.1 percent per year. In terms of the GDP, these banking foreign liabilities passed from 1.2 percent in 1969 to an average of 3.2 percent in the period 1972 and 1979, and then they gradually climbed up to 5.7 percent in 1982 as Figure 1 shows.

<< Figure 1 around here >>

Along with Resolution 63, a series of major reforms were passed between 1964 and 1967 to restructure the Brazilian financial system and strengthen its performance in the national economy.¹⁰ Most notably, there was the creation of the Brazilian Central Bank in 1964 with the promulgation of Law 4.595, which also set up a system of specialized banking with different types of financial firms with separate markets and intermediating functions, such as commercial banks, investment banks, saving and loans associations, housing credit companies, among others.¹¹ Banco do Brasil, the large Federal bank that had officiated as the nation's central bank up to that moment, would keep a monetary authority status and become a member of the National Monetary Council.¹² Among all these entities, only commercial and investment banks along with Banco do Brasil were permitted to engage with foreign finance under the Resolution 63 device, with commercial banks coming to account for the bulk of them with as much as US\$ 12 billion or three quarters of the total obligations in 1982. With balance sheets for US\$ 59.8 billion, commercial banks were the most prominent financial intermediaries in Brazil – commonly the leaders of larger financial conglomerates, and they have increased their participation in the GDP from 17.1 to 22.2 percent between 1968 and 1982.¹³

The restructuring and internationalization of the Brazilian banking system emerged and developed within the Plano de Ação Econômica do Governo (PAEG), a four-year economic program launched by the military government upon the arrival of Castello Branco to the presidency in 1964. Designed to accelerate economic growth and redress the balance of payment problems that had affected the country, the stimulation of foreign capital inflows and external indebtedness policy were central elements of the PAEG.¹⁴ Prior to Resolution 63, two other measures had been implemented to provide domestic borrowers with devices for the incorporation of foreign capital, though none of these contemplated the domestic banking sector. On the one hand, there was the short-lived Instruction 289, enacted in 1965 and revoked in 1972, which allowed Brazilian firms to borrow directly from foreign companies. On the other hand, and most importantly, there was Law 4,131 of 1962, amended and reinforced after the coup through Law 4,390 in 1964, which ruled the borrowing activities of the

¹⁰ For an complete account of the financial reform see Welch (1993), pp. 67-90, and Simonsen (1974).

¹¹ World Bank (1984) and Bäer (1986), pp. 13-19.

¹² See Franco (2017) and Armijo (1989), pp. 328-384.

¹³ Welch (1993), pp. 152-180.

¹⁴ Lara Resende (1990).

private and public sector with foreign banks, and would serve as the main mechanism for the inflow of foreign capital and external indebtedness during the period leading to the debt crisis of 1982.¹⁵

As in Brazil, domestic bank involvement with foreign finance also grew in Mexico during this period, though it started later and experienced a much quicker development. Figure 1 displays how the foreign liabilities of the domestic banking system passed from 0.7 percent of the Mexican GDP or US\$ 717 million in 1975 to 8.7 percent or 10.2 US\$ billion in 1982. This represents an expansion in terms of domestic economic activity four times quicker than their Brazilian counterparts over the same years and twice as fast as that of the entire period between 1968 and 1982. Like for the Brazilian government, foreign capital and external indebtedness were also central to the development strategy of the Echeverria and Lopez Portillo administrations between 1970 and 1982 and so was the banking sector, which, after some years of financial disintermediation in the first half of the decade, was reformed into a system of universal banking in 1975-76 and equipped with new financial instruments with the purpose to improve its performance and financial capacities.¹⁶ However, the channels through which foreign capital could flow into the country were not laid down by Mexican authorities as in Brazil, and there were no statutes either regarding the performance of international financial intermediation by the domestic banking sector. Indeed, the operations of Mexican banks in the global capital markets developed in the absence of institutionalized mechanisms or an overarching legal framework circumscribed the external borrowing activities of the domestic private and public sector.

An additional dimension of the internationalization of the Brazilian and Mexican banking systems concerned the operations of foreign financial institutions in the countries. While the presence of foreign banks in Brazil had gently increased since the 1940s, the financial reform of the mid-1960s introduced some internal restrictions to the inflow of foreign capital into the banking sector. To settle and operate in the country, foreign banks were required from an authorization of the newly founded Brazilian central bank, which was to decide on each particular case based on a reciprocity criterion and the legal treatment that the financial authorities of the foreign country would apply to Brazilian banks willing to do business there. Despite the restricted regulatory environment, a number of big international banks, such as Chase Manhattan, Bank of America or Deutsche Bank, arrived in Brazil during the post-reform period and became regular players in the Brazilian banking market.¹⁷ Once authorized to settle and operate in the country, apart from some additional limitations with respect to the opening of new agencies or branches, foreign banks received equal legal treatment than any other local institution and were allowed to conduct banking activities in accordance to Brazilian banking norms. They could, therefore, participate in international business and conduct cross-border operations under Resolution 63 in the same terms than their Brazilian counterparts, accounting for about a quarter of the total Resolution 63 liabilities of the commercial banking sector in 1982.¹⁸

The context of international banks' participation in Mexico during this period was different. Since the enactment of the Law of Banking Institutions in late 1930s, which induced most foreign banks to close their offices in Mexico, a series of norms were passed to forbid the participation of foreign ownership in Mexican financial firms. With the exception of Citibank, which had been operating in the country since Porfirian times and was granted authorization to conduct full branch facilities and commercial banking activities, the rest of the foreign banks willing to have a physical presence in Mexico were only allowed to open a representative office. Representative offices, however, could not perform banking

¹⁵ As of end-1982, Law 4131 accounted for US\$ 36.7 billion or 52.8 of Brazil's total external debt. Banco Central do Brasil, Boletim Mensal, Vol. 19 – N° 04, Table 6.7, pp. 348-9.

¹⁶ See Alvarez (2019), pp. 67-70.

¹⁷ Bäer (1986), pp. 20-55 for a documented review of foreign participation in the Brazilian financial system.

¹⁸ Biasoto Junior (1988), Table III.8, p. 203.

activities and their only way to conduct domestic businesses was by leveraging the network of corresponding banking relationship with local banks. Likewise, in terms of international banking activities, they could facilitate transactions between parent banks in their home countries and a Mexican bank but could not undertake cross-border operations by themselves. In this context, although the number of representative offices in Mexico expanded vigorously in the 1970s,¹⁹ the extent of international banks' financial operations was more limited than their counterparts in Brazil.

A Contrasted Model of International Financial Intermediation

The sanction and enactment of Resolution 63 in August 1967 empowered Brazilian banks with the possibility of leveraging in foreign finance and external resources to expand their domestic lending operations. As of 1968, domestic deposits from the public were the single largest funding source of the commercial banking system accounting for about 70 percent of their resources, but they came to loose prominence over the following years as their weight in total liabilities declined sharply to 53 percent in 1973 and down to 27.9 percent by 1982 (see Figure 2). Conversely, although limited in scale during its early years, Resolution 63 obligations significantly increased their importance in the funding base of the banking sector throughout the 1970s and in the early 1980s: their share in total liabilities climbed from around 5 percent of in 1970 to 9 percent by 1978 and up to 20 percent as of end 1982.

Underlying the declining relative importance of the deposit base of the Brazilian banking system was a problem of rising inflation and the relative interest rate of fundraising instruments. As of the early 1970s, demand or sight deposits accounted for as much as 85 percent of the total deposits with commercial banks, but this were non-interest bearing accounts and became thereby negatively affected by the prolonged inflationary process experienced by the Brazilian economy during those years. The balance of 15 percent were mainly term deposits - essentially *Certificados de Depósitos Bancários* (CDB), which became subject to the so-called 'monetary correction' after the introduction of indexing by the financial reform of the mid-1960s and could therefore adjust their yield according to past inflation as to enhance its attractiveness.²⁰ Figure 2 shows, however, a buoyant behaviour for the real rates of CDB with average positive levels of about 5 percent before 1974 and between 1977 and 1978, close to zero in 1975-1976 and highly negative in the early 1980s at a time when inflation accelerated and temporary ceiling on nominal rates were introduced by financial authorities. In a context where domestic savers had other investment possibilities available for domestic savers, notably the high performing Readjustable Obligations of the National Treasury (ORTNs), it seems therefore that to increase the term deposit banks had to offer better yields, but their willingness to pay more for domestic deposits so depended on the cost of the alternative funding options.²¹

<< Figure 2 around here >>

As an alternative to limited domestic funding, the Resolution 63 opened access to international liquidity and the large Eurocurrency markets. Through this statute, domestic banks negotiated foreign loans with international banks at LIBOR or prime rate plus a risk premium or spread and a flat commission, which then on-lent to a local borrower by passing on the interest rate and other charges on the foreign loan along with associated taxes and the commission of the repassing institution. The

¹⁹ See Maxfield (1990), p. 98-103.

²⁰ Introduced in 1964 it was Brazil's first indexed credit instrument. These were bonds of one or two years' maturity whose whole were adjusted monthly according to the three-month moving average of the wholesale price index, lagged three months (Baer and Beckerman, 1974).

²¹ In this spirit, Brazilian banker Gastão E. de Bueno Vidigal objected in 1977 that "banks sight deposits [did] not raise satisfactorily (...) and term deposits [were] only attracted at very high interest rates." "*O custo do dinheiro e o lucro dos bancos*" in de Bueno Vidigal (1981), pp. 125-128.

law also required to repass not the foreign exchange but its equivalent in domestic currency, “obliging the borrower to settle it through a currency parity clause” and clearly stating in the contract that it “assume[d] the risk arising from exchange rate variations.”²² Within this regulatory framework and pricing scheme, foreign loans appeared as an appealing alternative source of funds for the banks when confronted to the prospects of increasing domestic resources by offering higher CDB nominal rates. The corollary of this was that the sub-loans of Resolutions 63, even after including the previously mentioned costs and the adjustment for devaluations, were often cheaper than credit lines funded with domestic savings and resulted therefore more attractive to banks’ customers. Figure 3 plots the evolution of the effective monthly rate – including commission, taxes, foreign exchange correction and other associated costs – for working capital financing through the discounting of commercial papers or ‘*descontos*,’ which was the main lending instrument of commercial banks funded with domestic resources, and Resolution 63 credit lines as reported by the Brazilian business magazine EXAME. It shows that, after a brief period of tabulated domestic interest rates in 1979 and 1980, the cost of money through ‘*descontos*’ hiked up when the government freed the deposits and lending rates in the late 1980 while simultaneously introducing credit growth limits, with Resolution 63 funding becoming the cheaper option as the spread between them increased from there on.

<< Figure 3 around here >>

The increasing reliance of Brazilian banks and final borrowers on Resolution 63 funding developed within an economic policy program increasingly oriented toward the inflow of foreign exchange. As part of its ‘*política de administração da dívida*,’ Brazilian authorities would regularly modify the regulatory framework and conditions for the international and domestic operations of the banking sector to stimulate or discourage recourse to foreign funding. Table 1 lists some of the most important legal normative on Resolution 63 operations enacted by Brazilian authorities between 1967 and 1982, which the extent to which they controlled and regulated the terms and conditions for these transactions. In early 1968, the central bank resolved to secure currency coverage for the repayment of Resolution 63 obligations, and in 1974 it allowed the borrowing banks to place the proceeds of the foreign loan not repassed to a ultimate borrower as a deposit with it, for which it assumed the foreign exchange risk and the financial charges due to the foreign creditor.²³ In October 1972, compulsory deposits with the central bank were introduced on Resolution 63 funds which lasted until February 1974, but during the rest of the period these funds were not subject to reserve requirements or subsidized credit programs as domestic sight deposits, providing the banks with more flexibility of usage and allocation.²⁴ In 1979, the Brazilian government temporarily forbade new emissions of CDB by commercial banks, and in 1980 and 1981 introduced restrictive quantitative ceilings to the expansion of domestic credit but this explicitly excluded Resolution 63 sub-loans,²⁵ which, along with the suspension on the prohibition on States, municipalities and public enterprises to borrow through this device, encouraged recourse to foreign capital by both domestic banks and the non-banking sector.

<< Table 1 around here >>

Like in Brazil, the increasing recourse by Mexican banks to external finance also developed in a context of domestic fundraising difficulties and a relatively more favourable cost of foreign banks’ credit lines and Eurocurrency liquidity.²⁶ Important differences existed, however, in terms of the fundraising

²² Resolução n° 63 of 21/8/1967 and Circular n° 180 of 29/5/1972 respectively.

²³ Resolução n° 83 of 3/1/1968 and Circular n° 230 de 29/8/1974 respectively.

²⁴ Resolução n° 236 of 19/10/1972 and Resolução n° 279 of 7/2/1974.

²⁵ Resolução n° 605 de 02.04.80 and Resolução n° 669 de 17.12.80 respectively.

²⁶ See Alvarez (2019), pp. 40-45 and 70-75.

mechanisms and financial intermediating strategies. While Brazilian banks' Resolution 63 funding consisted of Eurocurrency loans to domestic offices, their Mexican counterparts borrowed abroad mainly through their network of international banking offices. As of end-1983, the agencies and branches of Mexican banks overseas were responsible for about 70 percent of the foreign loans from international banks, and, as previously research has demonstrated, these consisted essentially of interbank funding transactions, with the remaining 30 percent representing lines of credit to the head offices or branches in Mexico. One major difference between these two funding schemes related to the maturity of the liabilities of the borrowing banks to their international lending counterparts, which were mainly short-term wholesale financial obligations in the case of Mexican banks, but had much longer tenor under Brazilian Resolution 63 operations. These credit lines arranged by Brazilian banks were regular syndicated or direct Euroloans granted by international banks to developing countries within the petrodollar recycling process and their maturity ranged from two to over ten years.

The setting of maturity guidelines by Brazilian financial authorities, and the determination of certain conditions for the international operations of the banks, was a main feature of the Resolution 63. As of 1972, the central bank resolved that the tenor of the foreign loan could not be less than two years, increasing the limit to five and six years in June and September 1972 and up to eight and ten years in June and July 1973 respectively, before bringing it down to five years again in September 1974. Over the following years, Brazilian authorities would continue to amend the regulation and modified the minimum according to the needs of foreign exchange and the country's external debt repayment profile, but progressively imposing longer tenors to up to ten years.²⁷ Moreover, in May 1972 the government introduced additional fiscal incentives for even longer maturities by allowing a "reduction of, or exception from, the 25 per cent withholding tax on interest and commissions if the maturity exceeded at first ten years," raising it to up to twelve years in July 1973 and down to eight years in September 1974.²⁸ In addition to this, the central bank would also determine minimum grace periods, which would range at different times from six to 18 month depending the maturity of the loan, as well as minimum periods between instalments of usually three months. The regulation also imposed an upper limit to the engagement of commercial bank on Resolution 63 indebtedness, which was initially set at two times its paid-in capital and free reserves and then increased to four in 1980.

Along with the maturity and payment schedule of the external debt operations, the Brazilian government also stipulated some requirement for the repass loans. The law prescribed that only companies engaged in industrial and commercial activities were eligible as final borrowers, excluding service industries in the financial sector such as investment brokers or insurance companies, and that the funds were to be used for working capital or fixed investments. The banks could repass the entire amount to one borrower or divide it among several companies under the condition of having no more that 10 percent their capital and free reserves in sub-loan to a single borrower. Importantly, the maturity of the sub-loans could not exceed that of the foreign loan with a minimum term of six months. Commercial banks were by designed of the Banking Law of 1964 as a source only of short-term financing, and Resolution 63 sub-loans were an additional instrument to serve this purpose. At maturity, the bank could rollover at the sub-loan with the same client or lent to a different borrower, although there was no need for it to remain outstanding for the entire life of the foreign loan.²⁹

²⁷ See Wellons (1977), 307-313 for a review of the regulation on the terms and maturity of Resolution 63 operations. Also Davidoff Cruz (1984), pp 123-149.

²⁸ Wellons (1977), p. 309.

²⁹ Since 1972 banks were required to allocate the non-repassed amount of the foreign loan to treasury bonds (LTN) and since 1974 they could also be deposited it in the central bank who would covered the financial costs.

The intermediating rules of Resolution 63 led to an international business model with a balance sheet structure that was fundamentally different from the one that developed in Mexico. While Mexican banks funded long-term foreign loans with short-term liquidity from the international interbank and money markets (Alvarez 2015), in Brazil the maturity transformation went the other way around: banks borrowed abroad at medium and long term but lent at shorter term domestically. As a result, the level of risks underlying the international operations of the banks and the vulnerabilities were considerably different. In both cases the banks had an external liability to foreign banks, but the more volatile and short-term nature of Mexican banks wholesale obligations made them more vulnerable to potential funding problems in the international capital markets. On the other hand, while the portfolio of Mexican banks that resulted from these foreign operations consisted of long-term external loans home country borrowers, their counterparts in Brazil had shorter-term domestic loans, which means that the exposure to sovereign debt payment problems was also different. Moreover, while in Mexico there were not gearing ratios circumscribing the international lending operations of the banks, Resolution 63 regulation did not permit the banks to lend more than ten percent of their capital and reserves to any one borrower. This, along with the provision that allowed for splitting the foreign loan into several sub-loans to different borrowers, served to encourage a diversification of risk.

The system under which Brazilian banks developed their international businesses contrasts starkly with the lightly supervised and *laissez-faire* environment of their counterparts in Mexico. In Brazil, Resolution 63 and the broader external borrowing operations of domestic agents were subject to the regulatory framework of Law 4131 of 1962. This law had established the basic statute for foreign capital and ruled the inflow and outflow of resources in Brazil, and it created a register for the financial transactions of Brazilian residents with their counterparts overseas, the Foreign Capital Control and Registration Office (FIRCE).³⁰ FIRCE, which became a division of the central bank upon its foundation, was responsible for reviewing the documents submitted by the banks on Resolution 63 and authorizing the operations. Additionally, each month the Banking Inspectorate (ISBAN) would review a list from each banks of action on foreign loans and corresponding sub-loans. By contrast, the internationalization of Mexican banks unfolded in a context of lack of legal provisions or supervision since, as Mexico's Director of Public Credit Angel Gurria acknowledged, "Mexican authorities had never regulated, controlled or required the registration of any form of Mexican private sector contracted debt with foreign entities."³¹ This absence of the government policies and regulation left considerable space for the banks to develop forms of intermediation that they found the most convenient as far as the operations fell within the law and the consent of financial authorities. This resulted, however, in the type risks that Brazilian Resolution 63 sought to restrain and protect from.

The Network of Agencies and Branches Abroad

Along with the expansion of cross-border transactions under Resolution 63, the internationalization of the Brazilian banking sector also involved the creation of agencies and branches overseas as in the Mexican case. As of the beginning of the 1970s, apart from Banco do Brasil that, as the main financial agent of the Federal government and instrument of its external commercial policy had been developing a large and widespread network of foreign banking offices, only Banco Real and Banespa had a direct presence abroad. This situation would however quickly evolve over the following decade as an increasing number of banks opened their own international facilities, and by the end of 1982 18 leading Brazilian public and private banks had agencies and branches overseas.³² In Brazil, the opening

³⁰ Acronym for the Portuguese name Fiscalização e Registro de Capitais Estrangeiros.

³¹ Gurria (1988), p. 78. See also de Sousa (2011).

³² See Andrade and Gonçalves da Silva (1982) and Penido de Freitas (1989) for a detail documentation of the expansion of the external network of Brazilian banks and Alvarez (2019) for Mexico.

of foreign offices by a domestic bank was subject to minimum capital and reserve requirements and formal authorization by the central bank,³³ as opposed to Mexico where the international expansion of the banks was overseen by the secretary of finance under no specific limitations or requirements.

Although more geographically diversified for Banespa and Banco Real, the presence of Brazilian banks abroad, as their counterparts in Mexico, was largely concentrated on international financial centres. The United States, and in particular New York with its large dollar money market, was their main destination and, to a lesser extent London, which had become the epicentre of the international Eurocurrency market. As of 1982, all Brazilian and Mexican banks with international presence were operating in New York and some of them had additional banking offices in Los Angeles, Miami or San Francisco, with a total of 25 and 10 US agencies and branches respectively as of year-end. Furthermore, four out of the six Mexican banks and four out of the 18 Brazilian banks operating in the US had also a branch in London. The new offshore financial centres or booking outposts of the Caribbean, namely the Cayman Islands and the Bahamas, were also among their destinations, and all six Mexican banks and 12 Brazilian banks were present there as well.³⁴ The arrival of Mexican and Brazilian banks to the US, London and the Caribbean was part of a broader international trend of strong expansion of foreign banking presence in the world's main financial centres over the period.³⁵

Table 2 lists the Brazilian and Mexican banks in the United States and London along with the year they began banking activity in these marketplaces and their volume of business as of June 1982. The table shows the relatively larger and more aggressive involvement of Mexican institutions in the US banking market during the 1970s and early 1980s and also, though to a lesser extent, in London. By the time Bancomer and Banamex set up business in the US in 1974, Banespa and Banco Real, the two major international Brazilian banks with the largest US involvement, were already operating there, but by mid-1982 the assets of these two Mexican banks doubled those of their Brazilian counterparts. At an aggregated level, the 10 US agencies of Mexican banks reached US\$ 2.9 billion in assets, an amount 45.9 percent higher than the US\$ 1.9 billion of the 19 Brazilian banks in June 1982. In London, the assets of Mexican and Brazilian banks were about US\$ 2.1 and 1.3 billion respectively, which also indicates the relatively faster pace with which Mexican banks, especially Banamex, Bancomer and Serfin, expanded their operations in the UK given the fact that they set up business there some years later than Brazilian banks. Overall, the size of the average Mexican banking office in the US and London was 2.3 and 1.2 times larger than that of the Brazilian counterpart respectively. Although beyond the scope of this article, the extent of the US and London activities of monetary authority Banco do Brasil should be also underlined here, since the volume of its assets was significantly larger than that of the whole network of private and state Brazilian commercial banks as can be observed in table 2.

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A main reason why the US and London were appealing destinations for Mexican and Brazilian banks, as well as for many other foreign banks, was direct access to international wholesale liquidity. In the case of Mexican banks, as previous research has demonstrated, money markets instruments and interbank transactions represented virtually the totality of the resources of the agencies and branches in the US, which was then used to fund international loans to customers back in their home country.³⁶

³³ In 1971, the minimum was established at Cr\$ 100 or US\$ 20 million with only eight banks over this requirement, but this restriction was to be softened over the following years (Penido de Freitas 1989, 116-5).

³⁴ Andrade and Gonçalves da Silva (1982) and Penido de Freitas (1989).

³⁵ Baker and Collins (2005), United States General Accounting Office (1979), Terrell and Key (1977), and Dale (1983).

³⁶ Alvarez (2015).

As for Brazilian banks, information provided by their US banking offices to the Federal Financial Institution Examination Council (FFIEC) in the 002 Call Report shows a similar balance sheet structure and financial intermediation model for Banespa. As presented in Table 3, borrowed money from financial institutions, federal funds and interbank deposits accounted, respectively, for 54.4, 16.6, and 10.1 percent of the US\$ 653 million in total liabilities as of June 1982, or as much as 84.1 percent when added together. On the other side, the loan portfolio represented about US\$ 491 million or 75.1 percent of total assets, of which about three fifth consisted of commercial and industrial credits and the remaining two fifth was lending to financial institutions. Like any international bank, the overseas banking offices of Brazilian banks could lend to non-financial and financial borrowers in Brazil under the statute prescribed by the law, and Banespa was using these channels to finance São Paulo private companies and public sector projects as part of the development strategy of the state government. Data collected by Freitas de Pinedo shows that as of December 1982 Resolution 63 loans and syndicated or direct credits under Law 4131 represented an estimated of 21.2 and 20.7 percent of the portfolio of the network of its agencies and branches overseas. The balance consisted of an additional 19.4 percent of export and import finance to Brazilian customers and 42 percent of claims with non-Brazilian borrowers, while on the liability side as much as 92.6 percent were interbank facilities.³⁷

The extent of the reliance on wholesale funding and engagement on recycling into international loans seems to have a less prominent feature for the other Brazilian banks with foreign presence. In the case of Banco Real, the second largest Brazilian bank in the US after Banespa and the first one to have set up business there in 1964, borrowed money and interbank deposits accounted for about 38.9 percent of their total US resources in mid-1982, and it had no liabilities to the federal fund markets. On the contrary, during the last two years the bank had been commonly placing more liquidity in federal funds than what it borrowed from it, becoming therefore a net lender instead of taker of funds in the market.³⁸ Notably, liabilities to and assets with the head office and related institutions represented 41.8 and 20.4 percent of the balance sheet respectively, meaning that the level of inter-office transactions was important and that a substantial part of the resources came from internal sources. By that time, Banco Real had developed an extensive foreign banking network as part of its internationalization strategy and was not only operating in the US and London but in many other countries as well. Rather than focusing on raising wholesale funding to fund sovereign loans, the international businesses of Banco Real included an important component of retail banking activity, especially in Latin America with 23 out of a total of 37 overseas banking offices dispersed all over the region.³⁹ Banco Real, along with Banespa, accounted for the lion's share of the foreign banking offices of Brazilian banks and as much as 53 and 90 percent of their assets and liabilities in the US and London.

<< Table 3 around here >>

³⁷ It should be noted that the data from Freitas de Pinedo is consolidated for Banespa and Banco do Estado do Rio (Banerj). However, at that time, the international banking offices of BANERJ consisted of two agencies created in 1981 in New York and Grand Cayman, while Banespa had developed a network of 16 overseas agencies and 11 representative offices across 19 countries since the opening of the first office in New York in 1969. In December 1982 Banerj New York agency had US\$ 73.5 million in assets and, although there is no information on the activities of the Cayman office, the international network of Banespa must be indeed accounting for the large majority of the remaining 97.3 percent of the consolidated assets reported by Pinedo de Freitas. The author also reports data on the liability structure, with interbank facilities accounting for as much as 73.7 percent of the funding base. Freitas (1989), Table 3.8, p. 180.

³⁸ Between June 1980 and June 1982, the third quarter of 1981 was the only one in which Banco Real had a negative net position in the federal fund markets as reported to the FFIEC.

³⁹ Pinedo de Freitas (1989), Table 2.4 and 2.5, pp. 98-99.

The scale and scope of international financial intermediation was considerably more limited for the remaining 12 Brazilian banks that were operating overseas by mid-1982, and there were also important differences on the legal standing of their offices. Together, they accounted for 47 percent of the Brazilian banking assets and liabilities in the US, with five of them, including large domestic actors like Bradesco and Banco do Estado do Rio, starting businesses in the first half of 1982 and 1981, while most of the other banks arrived during the last years of the 1970s and 1980 (see Table 2). Notably, unlike Banespa and Mexican banks whose US offices had agency license and could thereby only operate in the wholesale markets, many of these banks had branches and this allowed them to take deposits from the public and engage in broader retail banking activity in the US. Banco Safra, for instance, had a branch in the US since 1973 with assets for US\$ 181 million, and as much as 90 percent of its funding base consisted of public deposits. For the group of banks arrived in 1981-82, all of which had branch statute, total deposits accounted for about a quarter of aggregated liabilities, and only a quarter were interbank facilities and the balance came also from the general public. On the other hand, in the other banks settled up to 1980, four of which were agencies and two branches, deposits from the public were virtually non-existent and interbank facilities like borrowed money and federal funds had a more preponderant role in the funding base. As in the case of Banco Real analysed above, internal funding appears also to have an important role since liabilities to head offices and affiliated institutions accounted for as much as 28.8 percent of the total and had no claims with them, a pattern also observed, although to a lesser extent, for the group of banks arrived in 1981-82 (see Table 3). On the assets side, the loan portfolio accounted for as much as 70 percent of the consolidated claims of these offices although there were considerable differences across banks. For Comind and Banco Safra, the third and fourth largest Brazilian banks in the US with similar volume of assets, lending presented 25.6 and 87.5 percent of their balance sheets respectively, while Bradesco had granted no credit yet and the value for Banco Economico was 31.8 percent and as much as 93.8 percent to Banco Itaú.

Although there is no systematic individual bank data on the UK offices of Mexican and Brazilian banks as in the US, archival records from the Bank of England indicate similar differences in London. A report on the role of foreign banks in London prepared by the Financial Statistics Division shows that in end-June 1982 Mexican banks obligations to the UK monetary sector and banks abroad reached US\$ 2 billion or 77.5 percent of total liabilities, while foreign currency lending to their parent country was US\$ 1,5 billion or 60 percent of the assets. However, the data for Brazilian banks, which is also provided at a consolidated level and includes Banco do Brasil, shows that UK and cross-border interbank obligations reached US\$ 3.9 billion or 61.2 percent of total liabilities and international loans to final borrowers in Brazil US\$ 1.5 billion or 23.7 percent of their total assets.⁴⁰ These figures demonstrate that there was also lower reliance of Brazilian banks on the interbank market as source of funding in London when compared to their Mexican counterparts, but, most remarkably, the much lesser extent to which they were engaged in providing external lending back to their home country.

It seems, therefore, that the role of foreign agencies and branches as instruments for channelling foreign capital into the country, which was a salient feature of Mexican banks' international intermediating model, was less prominent in the case of Brazil. Figure 4 plots the ratio of international lending by the network of foreign offices of Brazilian banks under Resolution 63 and Law 4131 to total Resolution 63 borrowing by the domestic banking sector between 1972 and 1982. It shows the extent to which international financial intermediation by the domestic banking system was largely conducted from Brazil under Resolution 63 rather than through the network of agencies and branches overseas. They grew from zero to 6 percent in 1975 and then reached a peak of 16 percent by 1979, but falling during the following year at the precise time were number of Brazilian banks with foreign banking

⁴⁰ Bank of England archive, File 13A195/2, "Role of Foreign Banks in London," 14 November 1982.

offices doubled. Contrary to Mexico, where a system of virtually fixed nominal foreign exchange rate between 1977 and 1982 led the banks to downplay currency risks when arbitraging between domestic and foreign markets, the regime of mini-devaluations and monetary correction in Brazil implied a continuous assessment of the upwards adjustments in cost of external funding. In this regard, a fundamental difference was that, while Resolution 63 operations benefited from foreign exchange guarantees by the Brazilian central bank in the terms explained in the previous section, the fundraising operations of the foreign offices abroad were not covered by similar schemes. Thus, although a foreign office offered the possibility to raise Eurocurrency liquidity at LIBOR or prime rate plus an interbank spread of 1/8-1/4 in moments of no-financial distress while cross-border Resolution 63 loans were charged a country risk premium of 1-2.5 percent, the risks behind them were considerably different.

<< Figure 4 around here >>

The Impact of the Crisis on International Banking

The outbreak of the Latin American debt crisis of the 1982 represented a major blow to foreign finance and international banking activities within and between countries after years of growth and dizzying expansion. The debt-servicing difficulties of large global debtor countries, including both Mexico and Brazil along with several other developing economies, created significant tensions in the world capital markets and disturbed access conditions to international financing. While on the one hand, the flow of syndicated or direct bank lending to the developing world was severely disrupted, it also affected the Eurocurrency wholesale markets and international interbank transactions.⁴¹ The uncollateralized nature and cumulative structure of these operations made the market quite sensitive to troubles or adverse shocks as the Herstatt crisis of 1974 had demonstrated.⁴² Indeed, during the meetings of the Eurocurrency standing committee in the late 1982, BIS official Alexandre Lamfalussy would report on the “shrinkage of interbank positions and a halt in the cross-border interbank market” as well as the “increasing tiering among banks and banking systems.”⁴³ Unlike normal automatic renewals of interbank deposits and low spreads, funding risk could quickly build up at times of financial tension.

The new international conjuncture and funding strains that unfolded in the financial markets harmed the borrowing operations of financial and non-financial institutions from debtor countries. In Mexico, as recent work has demonstrated, the network of agencies and branches of the six domestic banks that were operating abroad encountered major difficulties in securing their liquidity and solvency position, suffering indeed from a progressive withdrawal of interbank deposits throughout the last quarter of 1982.⁴⁴ Funding risk and the leakage of short-term wholesale credit lines was also an issue in the Brazilian case, but it was not a uniform and generalized problem as among Mexican banks and it mainly concerned the Banco do Brasil. Internal computations by the FRBNY and Brazil’s international creditor banks estimated a loss of about US\$ 3.5 to 4 billion in the interbank market during the second half of 1982, of which Banco do Brasil’s foreign agencies and branches accounted for between US\$ 2.5 and 3 billion or as much as three fourth of the total amount.⁴⁵ As for the remaining fourth, it

⁴¹ Cline (1984) and Guttentag and Herring (1985, 1986) respectively.

⁴² Saunders (1987) and Giddy (1981).

⁴³ FRBNY's archive, Box 108406, Notes on the G-10 Governors' Meeting held at the BIS, November 8, 1982 and FRBNY archive, Box 108406, Sam Y. Cross Chronological Files August to December 1982: notes on G-10 Governors meeting held at the BIS, 27 September 1982. ‘Tiering’ occurs when, instead of having uniform interest rates applicable to all participants, there is a differentiation in the spread according to the nature and the nationality of the borrowing bank.

⁴⁴ Alvarez (2018).

⁴⁵ FRBNY archives, Box 108406, Brazilian Agency Problems. See also Langoni (1985, p. 85).

corresponded largely to Banespa as its foreign agencies and branches came also to experience some in the aftermath of the crisis, and to a much to a lesser extent the other 13 Brazilian banks overseas.⁴⁶

Figure 5 plots the evolution of the interbank deposits and money market liabilities of the US agencies and branches of Brazilian banks vis-à-vis their Mexican counterparts between 1982 and 1985. The chart shows the most dramatic impact of the crisis on the wholesale funding base of Mexican banks, which dropped by 25-30 percent after the moratorium declaration of August 20 and continued at that level until the first quarter of 1983 when they started to recover as a result of the agreement subscribed with creditor banks to maintain interbank deposits at pre-moratorium levels.⁴⁷ Brazilian banks, by contrast, were still able to increase their wholesale funding base up to September, but it started to decline from there on with a drop of 11 percent in the last quarter of 1982 and throughout the following year accumulating a loss of 30 percent by end-1983. Banespa and Banco Real were responsible for about two thirds of this fall - 46.6 and 19.2 percent respectively, with the balance being accounted for by the other banks with the exception of Banco Auxiliar, Banco do Estado do Nordeste and Banco Safra for which wholesale interbank liabilities actually increased over this period. As in the Mexican case, an arrangement to restore interbank deposits at mid-1982 levels started also to be negotiated in late 1982, but agreement was only reached towards the end of 1983 and to keep them at the level they had by that time. Notably, the outbreak of the crisis did not prevent new Brazilian banks from entering into the US and succeeding to raise wholesale funding. Bamerindus and Bandeirantes opened banking offices in the US during the very last quarter of 1982 and, along with Banco do Estado do Parana and Banco do Estado do Rio Grande which arrived later, were capable of accessing money markets and increasingly taking interbank deposits as can be observed in Figure 5.

<< Figure 5 around here >>

The different extent to which the crisis affected the funding risk of Mexican and Brazilian banks is also evident in the balance sheets and wholesale market operations in London. Table 4 displays the net position of the London branches on the foreign currency businesses, and in particular in particular the interbank net position as a percentage of total interbank liabilities by maturity band, around the time of the outbreak of the crisis on August 20, 1982. It shows the significant shortening of the interbank funding base of Mexican banks with liabilities of less than three month doubling from 30 to 59.8 percent between August and mid-November, as opposed to their Brazilian counterparts for which no major changes are observed. The relatively heavier concentration of net liabilities in the short-term and net claims over the long-term demonstrate the much faster degree of maturity transformation that had been performed by the Mexican branches, and its substantial increase in the immediate aftermath of the crisis. By contrast, the maturity structure of the Brazilian branches appeared not only less disturbed by crisis but also marginally mismatched beforehand, which would also be an indication of a relatively less prominent involvement with borrowing in the interbank markets to fund long-term international loans with respect to Mexican banks as the previous section has discussed.

<< Table 4 around here >>

The direst financial terms experienced by Mexican banks in the international wholesale markets was coupled with a relatively worst position to face liquidity problems and secure the financial situation. On the one hand, although certainly important in both cases, the funding structure of the foreign agencies and branches of Mexican banks was relatively more heavily concentrated on interbank credit

⁴⁶ See FRBNY archive, Central Records, C261 Brazil – Banco Central do Brasil 1981-82: Office memorandum 'Money Market Lines for BANESPA and Banco do Brasil', 24 December 1982.

⁴⁷ See Alvarez (2019), pp. 173-178.

and money market facilities than that of Brazilian banks as the previous section has demonstrated. This meant that, for instance, unlike the branches of Brazilian banks with access to retail deposits in the US, the Mexican agencies were less well-endowed to raise non-interbank dollar funding, making thereby their liquidity position more heavily vulnerable to shifts on the market. Importantly, none of the Brazilian or Mexican agencies or branches in London and the US had access to discount window of the Bank of England and the Fed respectively, and, with the exception of the New York Branch of Banco do Estado do Nordeste, benefitted from FDIC coverage either. On the other hand, because of the highest degree of maturity transformation and larger involvement in sovereign lending, the capacity of Mexican banks to reduce their portfolio and adjust the balance sheet position was also more restricted since they were long-term loans to borrowers in payment difficulties or illiquid claims.

Indeed, the direct exposure of Mexican and Brazilian banks to the external debt payment problems of their home countries was also significantly different. By end-1982, outstanding syndicated or direct loans to the Mexican government or private sector in the hand of the foreign agencies and branches of Mexican banks reached US\$ 4.27 billion, an amount representing over five times the capital base of the parent banks. In the case of Brazil, aggregated data from the central bank shows that external debt owed to Brazilian banks and Banco do Brasil reached US\$ 7.8 billion in end-1982, of which US\$ 6.9 billion or 88.7 percent were Resolution 63 and Law 4131 loans granted from the offices overseas and the balance consisted essentially of trade-finance facilities.⁴⁸ Although larger in absolute terms than the corresponding claims of their Mexican counterparts, relative to the capital base of parent banks they represented about 76.3 percent, a level almost 7 times lower than in Mexico. In terms of assets however, foreign loans to Mexico accounted for about 15 percent of the total assets of the banks, while the corresponding figure for Brazilian banks stood at 8.5 percent. This shows the relative extent to which a potential default or serious debt payment disruption by Mexico and Brazil could undermined the solvency position of their major domestic banks and that the larger vulnerability of Mexican banks was related to poorer capitalization levels vis-a-vis their counterparts in Brazil.

Along with the problems arising from the agencies and branches overseas, another source of potential vulnerability for Brazilian banks steamed from the Resolution 63 operations that they had undertaken from their offices in Brazil. By end-1982, Brazilian banks' currency loans under Resolution 63 accounted for about US\$ 11.9 billion or 3.2 times the level of their interbank obligations (US\$ 3.7 billion),⁴⁹ and the possibility of obtaining new credits or rollover the current ones had virtually disappeared with the disruption of international lending that followed the outbreak of the crisis. This, however, did not create the same liquidity pressures and funding risks that the retrenchment of the interbank wholesale market could potentially generate since they were not short-term obligations but have a much longer maturity structure as discussed in previous sections. Moreover, because the loans funded under the Resolution 63 scheme had shorter-term than the foreign obligation that originated them, the banks could reduce the portfolio and adjust the balance sheet to the retrenchment of international lending provided the availability of foreign exchange in the country to reimburse the creditor banks. Also, unlike in the case of Mexican banks where the maturity mismatch on their external position was to get more deeply accentuated as sovereign loans started to be restructured at longer-term while the interbank credit lines used to fund them remain short-term, Resolution 63 obligations were folded in the rescheduling of Brazilian external debt. This meant not only that their

⁴⁸ Lloyds Bank archive, Book 9246, File Brazil: Table III. External debt by type of lender and Table IV. Total external debt due to foreign commercial banks.

⁴⁹ Total interbank debt in end-1982 was US\$ 6.3 billion of which BB accounted for US\$ 3.43 billion. Lloyds Bank archive, Book 9246, File Brazil: Brazil – Interbank deposits 1983.

repayment was stretched out but also that the banks secured new loans as part of the negotiations and agreements subscribed with the international financial community to manage the crisis.

It should be clear by now that the way in which Brazilian banks engaged with international finance created considerable less vulnerabilities to the debt crisis and shifts in the world capital markets than their Mexican counterparts. Yet not only had they conducted their foreign businesses through lower risk borrowing and lending strategies and better care of the maturity structure, but they were also less leveraged on short-term external debt. In June 1982, the US\$ 6-6.5 billion of interbank liabilities of the foreign agencies and branches of Mexican banks represented 5-5.4 times the capital base of the parent banks at an aggregate level and, although interbank deposits progressively fell, the ratio continued to increase over the rest of the year as the Mexican peso depreciated.⁵⁰ In the case of Brazilian banks, the US\$ 3.7 billion of short-term interbank debt in end-1982 represented three quarters of the consolidated capital base of the parent banks, although Banespa and Banco Real stood out with leverage levels over that level but lower than the Mexican average as can be observed in Figure 5. Interestingly, the ratio of Resolution 63 debt to total capital is at or below two for most banks, which was the long-standing limit established by the central bank regulation before it increased up to 4 in mid-1980. Banespa and Comind are the banks that had leveraged the most on this instrument to financial the expansion of domestic lending, but this did not create the same kind of risks and vulnerabilities than to short-term interbank indebtedness as the previous discussion has explained. The systemic implications were also potentially more damaging in Mexico because the six banks under troubles represented up to three quarters of the domestic banking since as of 1982, while the counterparts in Brazil were much less compromised and accounted for a market share of three fifths.

<< Figure 6 around here >>

Conclusions

This article has looked at the way the international expansion of domestic banks and engagement with foreign finance took place in Mexico and Brazil during the leading up to the debt crisis of 1982. While Brazil had an interventionist approach and financial authorities were closely ruling and monitoring the external borrowing activities of domestic banks, in Mexico there was less regulatory institutional base and *laissez-faire* stance. Moreover, the government and financial authorities did not even have a register about external indebtedness by the private sector. By 1982, although the Brazilian banking system was arguably more involved and integrated with the international financial system in terms of the volume of operations and the number of institutions concerned, the financial condition of its international banks proved more solid and resilient to the shock that represented the debt crises.

Important differences existed in the strategies used by domestic banks to intermediate foreign capital with local borrowers. In Brazil, most of the foreign finance was raised through the head offices or branches in Brazil according to a law that established terms and other financial conditions on the external credit and its relending. In Mexico, foreign agencies and branches were at the forefront of bank's international activities and intermediation with local borrowers with no guidelines or regulations. While the foreign liabilities of Brazilian banks consisted of medium- and long-term international loans, those of their Mexican counterparts were essentially short-term interbank credit lines. However, leading Brazilian banks also had offices in the major international financial centers,

⁵⁰ In end-1982, the estimated coefficient is 6.3 computed as the ratio of US\$ 5.2 billion of interbank deposits with the foreign agencies of Mexican banks agreement to US\$ 820 million of aggregated capital for the six parent banks. By that time, the banking sector had already been nationalized and as part of the agreement creditor banks could maintain their interbank deposits with any of the six banks with agencies and branches abroad, which were all owned by the Mexican state and thereby represented the same level of risk.

such as New York and London, and they were also involved in wholesale funding, but the scale and scope of their operations was smaller both in absolute and relative terms. Moreover, with the exception of Banespa that seem to have performed a similar business model to Mexican banks, the other banks most heavily involved in foreign operations through overseas agencies and branches, such as Banco Real and Banco Safra, were less relying on wholesale liquidity for funding and were not necessarily involved in sovereign lending. Overall, Brazilian banks were better matched in their foreign businesses than their Mexican counterparts and were less exposed to external debt and funding risk.

The outbreak of the Latin American debt crisis in August 1982 disrupted the flow of capital to debtor countries and affected the funding lines of the foreign agencies of their domestic banks. In the case of Mexico, its leading domestic banks did not only had significant amounts of Mexico's external debt relative to their capital, but their external liquidity position was seriously damaged. The foreign agencies confronted a shortening of their interbank credit lines and a rise of spread, and they suffered from a progressive leakage of their interbank deposits. Brazilian foreign agencies were also affected by a deterioration of their wholesale funding lines, but this concerned mainly Banespa – and monetary authority Banco do Brasil, and the extent of the deterioration was less dramatic than for Mexican banks. The foreign agencies and their head offices in Brazil were better match in their external assets and liabilities and this seems to have help avoid the serious problems Mexican banks encountered. While the regulatory system and supervision by Brazilian financial authorities had a fundamental role in this outcome and the more stable situation of its banks, the Mexican government decided eventually to nationalize the banking system soon after the outbreak of the debt crisis.

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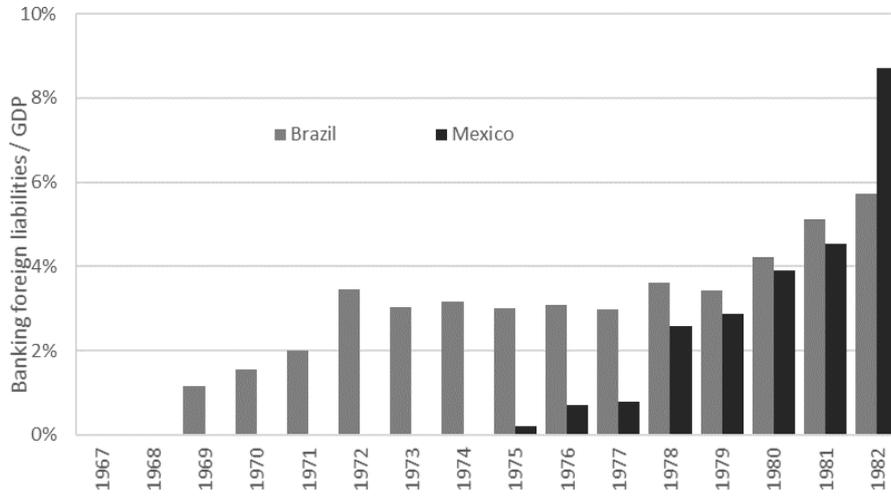
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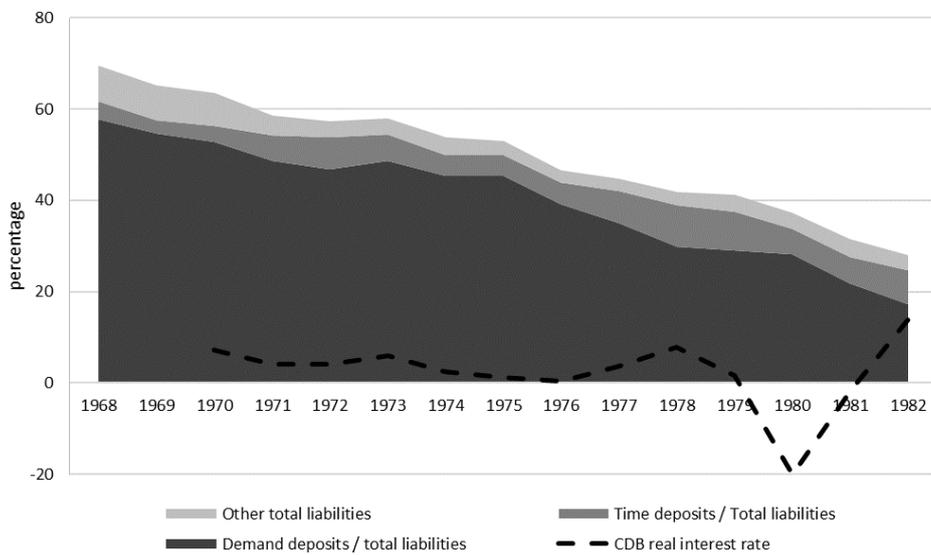
TABLES AND FIGURES

Figure 1. Foreign banking liabilities in Brazil and Mexico, 1967-1982



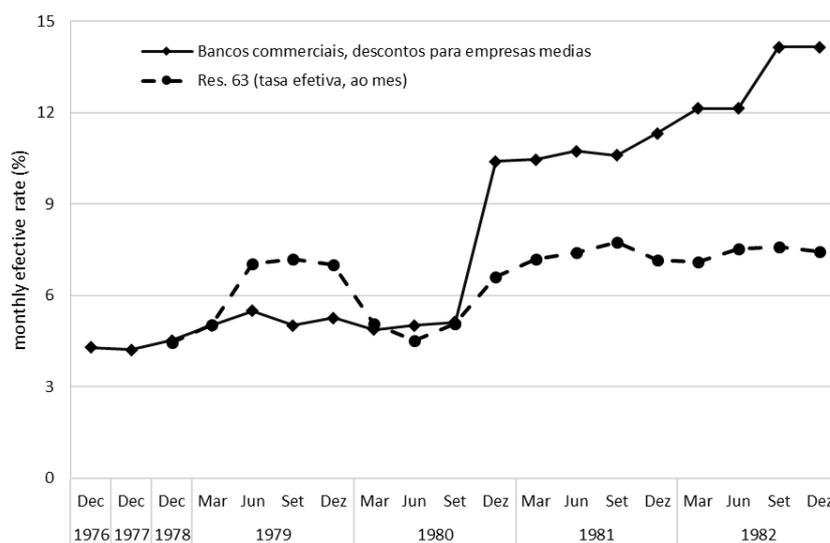
Source: Boletim Banco Central do Brasil (several issues) and Banco de Mexico Annual Reports.

Figure 2. Deposit structure of the Brazilian commercial banking system, 1968-82



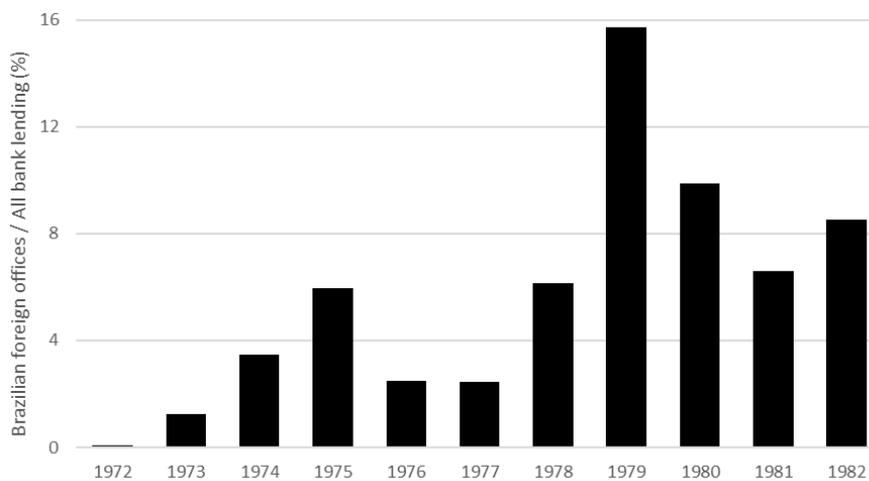
Source: Boletim Banco Central do Brasil (several issues) and ipeadata.

Figure 3. The domestic and foreign cost of money in Brazil, 1977-1982.



Source: Revista EXAME (several issues).

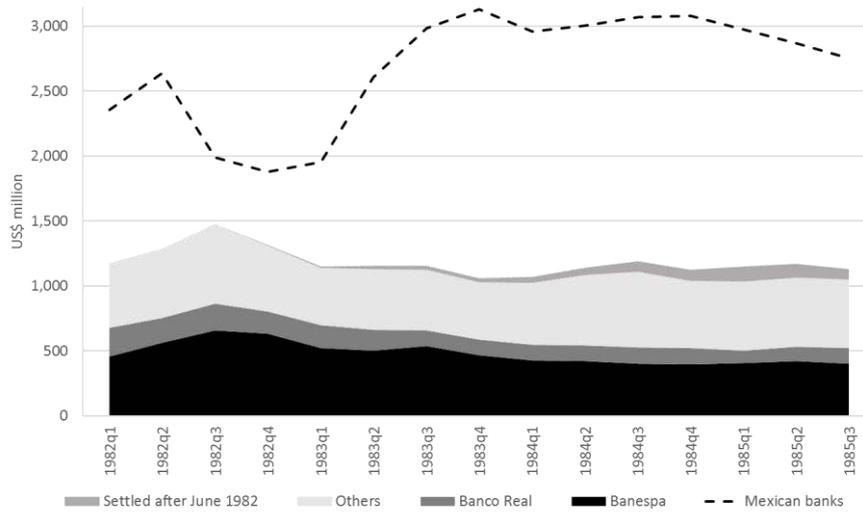
Figure 4. Share of Brazilian foreign offices lending to Brazil, 1972-1982



Note: Ratio between Resolution 63 and Law 4131 lending by the foreign network of Brazilian banks to total Resolution 63 borrowing (excludes the operations of Banco do Brasil foreign agencies).

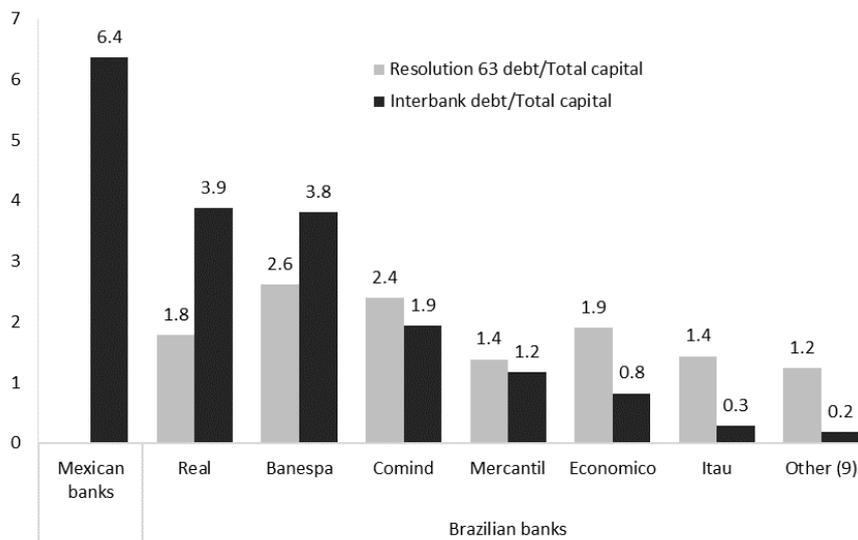
Source: Data from Davidoff Cruz (1984), Pineda de Freitas (1989).

Figure 5. Interbank funding of Brazilian and Mexican banks in the US.



Source: FFIEC 002 Report.

Figure 6. Brazilian and Mexican banks leverage on foreign funding



Note: Other (9) includes Bradesco, Banco Nacional, Unibanco, Nordeste, Bandeirantes, Banerj, BCN, Banco Safra y Banco Auxiliar.

Source: Revista Bancaria Brasileira, Multiple Bank Bulletin and Lloyds Bank Archive.

Table 1. Main legal norms regulating Resolution 63 operation between 1967 and 1982

Norm	Date	Description
Resolution 63	21/08/1967	Banks allowed to borrow abroad and fund domestic loans with local borrower. Banks submits a form to the central bank for verification of the interest rates and approval. Monthly reports to the central bank on the repasses and the amount in local currency.
Circular 96	25/08/1967	Banks report the balance sheet with passed operations to bank inspectorate (ISBAN).
Resolution 83	03/01/1968	The central bank assures foreign exchange coverage for debt repayments.
Resolution 112	12/02/1969	Ceiling on foreign loans to two times the capital and reserves of the borrowing bank.
Resolution 222	29/05/1972	Minimum tenor of foreign loans increased to 10 years
Circular 180	29/05/1972	Loans can only be repassed in national currency with foreign exchange correction clause. Loans can be repassed to industrial and commercial companies and not financial ones. Repasses to the same company cannot exceed 10% of the capital and reserves of the bank. Repass contract to establish the intended use of the credit and the borrower bear exchange risk. Allow for multiple sub-loans at shorter term than the external obligation (6 months minimum).
Resolution 236	19/10/1972	Introduction of 25% deposit requirement of foreign borrowing . Central bank covers exchange risk of the deposit up to the time of its liberation.
Resolution 265	31/08/1973	Increase on the deposit requirement from 25 to 40%.
Resolution 279	07/02/1974	Revokes the compulsory deposits of Resolutions 236 and 265.
Resolution 261	19/07/1973	Increase of the term for the amortization of foreign loan to 12 years.
Resolution 539		Banks can not repass to the public sector
Resolution 532	18/04/1979	Re-introduction of 25% deposit requirement of foreign borrowing .
Resolution 595	16/01/1980	Increase on the deposit requirement from 50 to 70%. Ceiling on foreign loans increase to 4 times the capital and reserves of borrowing bank.
Circular 648	05/08/1981	Allow banks to repass again to the public sector
Resolution 710	04/12/1981	Minimum tenor for repass loans reduced to 3.
Circular 708	24/06/1982	Allow for interbank repasses among financial institutions authorities.

Source: Banco Central do Brasil.

Table 2. Brazilian and Mexican Banks in the US and London, June 1982

	United States				United Kingdom			
	Total Assets	Offices			Year of arrival	Total Assets	Offices London	Year of arrival
		NY	CL	FL				
Brazilian Banks	1,994	14	3	2		1,308	3	
Banespa	653	A	AA	A	1973	507	B	1970
Banco Real	403	B	A	A	1964	664	B	1977
Comind	184	A			1978			
Banco Safra	181	B			1973			
Banco de Credito Nacional	93	B			1981			
Banco Mercantil SP	87	A			1974	137	B	1977
Banco Nacional	86	A			1977			
Banco Itau	84	A			1979			
Banco Economico	60	B			1980			
Unibanco	50	A			1980			
Banco do Estado do Rio	47	B			1981			
Banco Auxiliar	32	B			1982			
Banco do Estado do Nordeste	24	B			1982			
Bradesco	10	B			1982			
Banco do Brasil	2,498	B	AA	A	1969	3,874	B	1970
Mexican banks	2,909	6	4			2,122	4	
Bancomer	1,381	A	A		1974	523	B	1970
Banamex	739	A	A		1974	888	B	1978
Multibanco Comermex	420	A	A		1979	310	B	1979
Banca Serfin	261	A			1978	401	B	1979
Banco Internacional	106	A			1981			
Banca Somex	1	A			1981			

Note: assets are in million US\$; NY (New York), CL (California), and FL (Florida); A (agency) and B (Branch).

Source: FFIEC 002 Report, The Banker Magazine, Bank of England Archive.

Table 3. Asset and liability structure of Mexican and Brazilian banks in the US June 1982, million US\$

	Mexican Banks	Brazilian Banks				
		Banespa	Banco Real	Banco Safra	Other banks settled Up to 1980 In 1981-82	
Liabilities	2.909,1	653,4	403,4	180,6	551,1	205,5
Deposits	639,0	86,6	72,0	166,4	19,3	29,4
of which non-interbank	8,9	20,9	32,5	161,3	6,5	7,0
Borrowed money	1.068,8	342,7	117,9	2,1	114,6	54,0
Federal Funds	644,7	108,2	0,0	0,6	248,2	70,0
Head office and affiliates	210,1	58,9	168,4	6,1	158,6	48,7
Other	346,7	57,0	45,0	5,5	10,4	3,6
Assets	2.909	653,4	403,4	180,6	551,1	205,5
Deposits	10	14,4	20,8	124,7	33,1	28,4
Loans	1.906	490,6	226,9	46,2	458,9	140,2
Federal Funds	261	1,6	21,0	0,0	32,4	28,0
Head office and affiliates	360	100,4	82,3	0,0	0,0	0,0
Other	372,7	46,5	52,3	9,7	26,8	8,9

Note: Mexican banks include Bancomer, Banames, Serfin, Somex, Comermex and Internacional; Other settled up to 1980 includes Comind, Economico, Itau, Mercantil de SP, Nacional and Unibanco; Other settled in 1981-82 includes Auxiliar, Bradesco, BCN, Nordeste, and Banerj.

Source: FFIEC 002 Report.

Table 4. Maturity analysis of the London branches of Mexican and Brazilian banks, 1982

	Net position				Interbank business			
	Mexican agencies		Brazilian agencies		Mexican agencies		Brazilian agencies	
	18-Aug	17-Nov	18-Aug	17-Nov	18-Aug	17-Nov	18-Aug	17-Nov
Less than 8 days	-5.8	+0.6	-3.4	-1.5	-11.8	-3.6	-6.7	-4.1
8 days to less than 1 month	+2.1	-13.5	-2.1	-2.1	-2.9	-51.6	-3.2	-2.0
1 month to less than 3 month	-14.2	-27.8	-4.1	-4.6	-41.1	-72.2	-5.1	-6.6
3 months to less than 6 months	-14.1	+1.1	-1.1	+0.4	-40.1	+0.3	-3.1	-0.6
6 months to less than 1 year	+2.0	-0.1	+2.5	+1.4	-0.2	-2.0	+0.9	+0.6
1 year to less than 3 years	+7.0	+7.1	+4.1	+3.8	+2.0	+4.6	+2.6	+2.2
3 years and over	+23.6	+30.4	+4.6	+5.9	+10.8	+11.8	+3.1	+2.3

Source: Task Force, Bank of England Archive.

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