



WORKING PAPER 60

**MEASURING EUROPEAN FINANCIAL INTEGRATION
Flows and Intermediation
in Greece, Ireland and Portugal**

A report prepared for the European Commission, DGII

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A Review Focusing on Flows and Intermediation
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MEASURING EUROPEAN FINANCIAL INTEGRATION

A Review Focusing on Flows and Intermediation in Greece, Ireland and Portugal

Executive Summary

The impact of the single financial market process was expected to be greatest in the peripheral countries. This report, which concentrates on Greece, Ireland and Portugal, examines the process of financial integration. It focuses on the degree to which financial portfolios have become internationalized, and on the efficiency and internationalization of the institutional financial sector.

There has been rapid structural change

Much has changed in the financial systems of the smaller peripheral member states in the past decade. In the case of Greece and Portugal there has been a very rapid structural transformation of the financial sector. Ireland's financial system has changed too, though it had already been more lightly regulated than the others.

Driven as much by domestic and global pressures as by the single market

These changes have been driven only partly by the single market process. To some extent they would have happened sooner or later, given the demonstration effect of financial liberalization worldwide, and the diminishing effectiveness of the old controls. The removal of exchange controls has certainly had an impact on gross capital flows; but the single passport has had a much smaller effect.

Net integration was already established (except in Greece)

When examining flows and portfolio structures, we distinguish between net and gross financial integration. The former implies relatively easy financing of balance of payments disequilibria; the latter would involve substantial cross-holding of foreign financial assets. Savings and investment correlations show that net financial integration was already fairly well advanced in Ireland and Portugal before the single market process got under way, but has only recently begun to be established for Greece.

Gross integration is higher for Ireland

Our proposed measures of gross financial integration - notably a measure of "home preference" in the national financial portfolio - suggest a clear ranking of countries: Ireland being more integrated and continuing to integrate faster than Portugal, or especially Greece. The role of international banking business is important here, but remaining restrictions on the portfolio allocation of insurance companies and pension funds is a factor, especially for Portugal.

Towards a single world market - not just EU

The internationalization of financial portfolios and financial intermediation is not synonymous with a specific focus on the EU. Use of the US dollar is widespread, and financial transactions with non-EU countries such as the US and Switzerland get at least their fair share. The process should be seen as one of integration in a single world financial market as much as in a single EU market.

Interest margins widened before narrowing: the large borrowers benefit most

The Cecchini report held out great hopes for consumer benefits in the single financial market. Recent trends in bank spreads in the countries under review suggest a mixed picture. Interest rate decontrol in Greece and Portugal at first led to a substantial widening of margins, and only subsequently has there been a contraction. Such evidence as is available suggests that the narrowing of margins has chiefly benefitted the large or low risk borrowers, while high risk or small borrowers could even have suffered from the process.

Modest foreign entry allows concentration to persist

Foreign penetration into domestic banking and insurance markets has not been vigorous, confirming the belief that much of banking and insurance requires a local presence. Even in Portugal, where vigorous entry from Spanish banks had been expected, the early moves have not borne much fruit and have been partly reversed. In Greece new entrants have been mainly local and have sheltered under the umbrella of the high-cost large banks. Nevertheless, local competitive pressures in certain sectors of these industries have been strong, especially in Portugal where a scramble for market share has raised some prudential concerns, in addition to resulting in what seems likely to become once more a rather highly concentrated banking sector.

Tax distortions remain an important factor

As regulatory distortions have diminished, so the importance of tax distortions has increased. Taxation of interest income from short-term financial instruments in Greece has changed several times, but is still quite discriminatory and has led to tax-driven financial innovation. This may have distracted from more socially productive forms of financial innovation. There have been similar, but less severe, problems in Ireland and Portugal. Much of Ireland's rapid financial internationalization has itself been driven by intermediaries doing mostly offshore-type business in the tax-advantaged environment of the Dublin International Financial Services Centre (IFSC).

A reading guide

The report begins with a chapter reviewing the EU-wide experience and setting out the analytical framework for assessing financial integration. (Including the co-movement of wholesale asset prices, which, along with legal considerations, is an aspect which has been excluded from the present study of the peripheral countries). While the first chapter does include some original material, it is mainly a review of published studies.

Chapter 2 summarizes the main features which have been identified for the three countries under review, and can be read on its own. The main work of the report has been to assemble statistical and qualitative information about developments in the three countries, Greece, Ireland and Portugal. The findings are presented as concisely as possible in three country chapters, which are written to a common plan, covering macroeconomic aspects, banking, insurance and the remainder of the financial sector.

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1 DIMENSIONS OF FINANCIAL INTEGRATION IN EUROPE

Introduction

Integration of financial services has been at the heart of the Single European Market process. Not only have capital flows been fully liberalized throughout the Union, but a "single passport" regime is being put in place whereby financial services providers may trade into any part of the union on the basis of their home country license. Already in place in banking and (recently) in insurance, the single passport was expected by some to lead to an explosion of cross-border financial service provision. Despite the dazzling growth of internationalization, it is clear that finance has retained a domestic dimension. The aim of this paper is to quantify the degree of integration that has occurred and to assess the prospects for the future.

The subject is a broad one, and we have delimited it in three important respects. First, we do not directly examine the legal and regulatory changes which have been of crucial importance in influencing the process of financial integration, only their consequences. Second, we touch only briefly on the issue of whether the co-movement of wholesale asset prices (interest rates and equity prices) is consistent with financial market integration. That is a topic which has its own literature. Third, we focus on three peripheral countries, Greece, Ireland and Portugal. However, in this introductory chapter an overview of EU-wide developments is provided.

Our objective has been primarily to collect information rather than to argue for particular propositions. Nevertheless, a number of features emerge naturally from the analysis, among which the most striking include the following three observations.

First, integration of global financial markets is episodic: it comes in surges, especially as new markets and products become established, and can be interrupted by retreats, linked to the business cycle and to specific confidence factors.

Second, there is little preferential EU financial integration: the process is one of international rather than continental integration. Furthermore it has been driven by domestic and international forces as much as European ones. In particular the single passport has had relatively little effect so far.

Third, increased competition in peripheral countries has affected wholesale interest rates more than retail. Depositors and large or mobile borrowers have benefited most. Some small borrowers may even have suffered.

1.1 Characteristics of the Financial Sector in European Countries

Over the centuries, finance has traditionally been an international business in Europe (Kindleberger, 1993) and it was chiefly the displacement of gold and silver with inconvertible paper currencies in the late 19th and early 20th Centuries that resulted in national segmentation of financial markets (Eichengreen and Flandreau, 1994). Subsequently, the increasing differentiation of national taxation and regulatory regimes affecting the financial sector drove national financial practice and institutions further apart, and this was reinforced by the imposition of exchange controls on a more or less systematic basis by the 1930s.

The restoration of current account convertibility in the late 1950s for most European countries was the start of a reversal in the process of segmentation. With rapid growth in international trade and the financing of such trade by international banks, the effectiveness of regulatory barriers began to erode. The distorting effect of many financial sector regulations tended to increase as their effectiveness declined. Recognition of this process led to the progressive dismantling of many of the more distorting regulations - a pattern which was observed not only in Europe, but even more so in the United States, other industrial countries and eventually worldwide.

The Single European Market project, insofar as it affects the financial system and financial flows, can be seen as a formalization of this more general trend. It is unlikely to have been as readily accepted had there not already been a well-established move in the direction of liberalization. The Single Market project both uses the market forces which have the effect of accelerating financial liberalization and directs these forces in such a way as to limit the potential for destructive regulatory competition, with the expectation of allowing the European financial market to achieve a balanced move to free internal competition.

When we speak of the European financial market, we have in mind both a set of institutions and a pattern of claims and flows of funds. The national characteristics of the institutions are

very visible: from currency notes to the large commercial banks that are among the most substantial commercial enterprises in each of the Member States, the financial sector represents a major part of each national economic heritage. The European regulatory tradition has had the effect, in all of the Member States, that economic concentration is quite considerable, with just a handful of large institutions dominating each sector in each country. Economies of scale and scope have tended to contribute to this effect, but are not so pervasive as to prevent the persistence of small institutions, serving regional or niche markets; there may also have been a technologically-driven reduction in the degree to which economies of scale and scope exist.

The financial assets and liabilities which are held and traded in the European financial market include claims of and on financial institutions, as well as financial claims directly held on non-financial entities on each other. Equity shares and bonds are of central importance in the fixed financial structure of enterprises, and these need not be held by financial intermediaries. Likewise trade credit represents a very large pool of financial obligations between non-financial firms, and on which comparatively little analysis has been performed.

It is no longer possible to distinguish neatly between different types of financial sector enterprise, though the traditional distinctions are still recognizable in the more fluid environment which now prevails. Some firms are mainly principals. These include institutions such as banks and insurance companies which offer financial assets which are claims on themselves and in turn acquire financial claims on others. Others are mainly agents, such as brokers who arrange to find counterparties for a financial transaction, or fund managers of portfolios whose beneficial ownership remains with others. Service companies such as organized stock and other markets represent another rapidly evolving type of financial sector firm. Other increasingly important activities combine these functions, such as the investment banker who brings a bond issue to market and underwrites it, or the market-maker, whose stock of assets will tend to be a fraction of his turnover.

The relative importance of different financial institutions is not to be measured solely or even mainly by the size of the assets which they manage. Fund managers, for example, add comparatively little value on average to the funds at their disposal. In contrast, general (non-

life) insurance companies provide a much more important risk-pooling and service function than would be suggested by the size of their portfolio.

Perhaps the best single overall measure of the economic importance of the institutional financial sector in the economy should be its contribution to GDP, or equivalently its net value added. Data on this are presented in Table 1.1, which displays rather dramatic differences between countries.¹ The lowest figures are for Denmark, where the contribution of financial institutions has slipped below 2 per cent of GDP in 1991-92; the highest figure is for Luxembourg at around 13 per cent of GDP in recent years. Apart from Portugal and Spain, these shares have tended to decline since the mid-1980s. Bearing in mind that these figures do include the profits of financial institutions, which can fluctuate sharply, and can also be strongly influenced by explicit taxation and the costs of regulation (implicit taxation or quasi-fiscal burden) it is also worth examining the sectors' share of employment. For financial institutions other than insurance institutions this employment share varies between 1.6 per cent of GDP (Portugal) and 8.5 per cent (Luxembourg).²

The most important financial institutions are the banks, commonly defined as entities which accept deposits, make non-marketed loans and transmit funds. Theoreticians debate what it is that makes banks special, and it is hard to say which of:

the liquidity of their deposit liabilities, many of which are withdrawable on demand,

the credit appraisal function which is entailed by the making of non-marketed loans,
or

the money transmission function through paper or electronic means

¹Measurement of bank value added is complicated by the SNA convention of treating interest flows as a distribution. Strictly following this approach implies that banks' contribution to GDP equals their factor payments less their total interest margin: giving a small or negative net figure. For present purposes it is better to add back the interest margin as is done in the figures provided here.

²The figures for Greece do not take account of the recent sweeping changes in the Greek National Accounts which have had the effect of almost doubling the estimated contribution of the financial sector. There is also a break in the UK series after 1986 reflecting reclassification.

that has allowed banks to maintain a key role in European economies. Undoubtedly, there is scope for increasing competition from money market funds for the former (as has happened in the US), and non-bank giro facilities and credit cards are important competitors for money transmission. Despite increased reliance on bond and corporate paper financing by large and well-established firms, it does seem that lending is the key defining characteristic in the market-place. Indeed, some US research has shown that it is the borrowers rather than depositors who bear the incidence of implicit taxation from reserve requirements, suggesting that in general borrowers do not have close substitutes available to them for the services provided by the banks. From a legal point of view, the Second Banking Framework Directive defines 13 types of banking business,³ and effectively provides that a credit institution authorised to carry on any of these activities in any Member State may do so throughout the EU. The function of the banking system extends from virtually the smallest retail transaction up to money-market activities on the largest possible scale, though not all banks are involved at all levels.⁴

Although most financial institutions are involved in the reduction of risk for customers, this is the primary business of insurance institutions. In particular, they offer risk reduction in respect of verifiable and diversifiable customer-specific risks. Distinction is usually drawn between life or long-term companies on the one hand, specializing in long-term risks primarily related to mortality, and, on the other hand, general insurance focusing on such shorter-term risks as motor vehicle, fire, theft, marine and aviation, employer and producer liability and the like. Some companies do both, either as a single "composite" company, or within a group structure.

³Deposit taking and other forms of borrowing; lending; financial leasing; money transmission services; issuing and administering means of payment (credit cards, travellers' cheques and bankers' drafts); guarantees and commitments; trading for own account or for account of the customer in money market instruments (cheques, bills, credit deposits, etc.); foreign exchange; financial futures and options; exchange and interest rate instruments; securities; participation in share issues and the provision of services related to such issues; money broking; portfolio management and advice; safekeeping of securities; credit reference services; safe custody services.

⁴Useful surveys of the recent empirical and theoretical literature on banking are in Davis (1994b) and Van Damme (1994).

Two further important institutional distinctions in insurance are captive insurance companies, and reinsurance. The former institutionalize the self-insurance arrangements of large corporations. The latter represent the wholesale laying-off of insurance risks assumed by insurance companies. Because neither type of institution sells policies to the general public, they are not heavily regulated. A consequence is that data availability on their activities is not as comprehensive.

Ownership of insurance entities is frequently in mutual rather than corporate form, especially for life companies, but the incidence of government ownership is rather lower than is the case with banks. Because the contracts sold by insurance companies typically involve a premium payment in advance, they tend to manage substantial funds. This is especially true of life companies. As a result of the experience gained in the management of their own funds, many insurance companies have diversified into fund management, and the tax privileges which they have received in some countries have given them a further competitive advantage in this field. Wide variations in the degree of regulation and in the tax treatment of insurance premiums and insurance funds has led to considerable variation in the relative importance of the insurance industry in different EU countries (Tables 1.1, 1.3).

Fund management on an agency basis, or through unit and investment funds, is also carried out by specialized fund management companies, often subsidiaries of banks or insurance companies. The biggest volume of business here relates to pension funds (Table 1.4), but other personal and corporate funds are also managed. The degree of prudential regulation of such funds varies substantially. The sub-class of UCITs, which are freely tradable throughout the EU, represent only a segment of this market, which tends to be quite heterogeneous. Though the sums are large, from an important point of view they tend to exaggerate the economic importance of the institutions concerned in that the fund managers are, for the most part, not carrying out money-transmission functions and are not insuring customer specific risks. Even the degree of credit appraisal and company analysis typically carried out by fund managers is far smaller than that conducted by banks in respect of their borrowers.

Organized stock markets add to the liquidity of equities and bonds and provide a degree of consumer protection. They do this through their regulatory structure and through physical and

technological infrastructure. That a rather small share of corporate funding actually comes through the stock market has been commented on in recent years. For instance, Corbett and Jenkinson (1994) present evidence that bonds and new equity accounted for less than one per cent of net sources of finance for the corporate sector in Germany, 1970-89; the corresponding percentages for the UK, Japan and the US were all under ten per cent.

Most stock exchanges consist of computer systems for trading and for settlement, together with brokers and sometimes dealers and market-makers. The degree of distinction between brokers and dealers varies between different markets, as, in order to provide an adequate service to clients, brokers will often be forced by market pressure to buy or short-sell stock on their own account. There has been much discussion in recent years about the relative advantages of quote-driven and order-driven markets (cf. Pagano and Roell, 1990); but in each country both types of transaction are common, when one considers the totality of trading in shares. Typically, at least for equities, the very small and very large deals tend to be processed on an order-driven and brokered basis, while medium-size transactions go through the quote-driven market.

1.2 Expected Consequences of the Integration Process

Integration has many aspects: the geographical pattern of flows (including consumption, savings and investment), the composition of portfolios and the international correlation of interest rates and service prices. Although this study focuses mainly on flows, portfolios and service prices, it should be made clear from the start that interest rate and asset price convergence are at least equally important. After all, in a fully integrated, competitive and efficient financial market, the possibility of arbitrage can ensure that common prices prevail even without equilibrating flows. And if prices for equivalent assets are both common and at the lowest possible level, then it would seem that no further economic efficiency gains can be made. Furthermore, economic theory does not make strong predictions as to the magnitude of international flows or the portfolio composition that would prevail in a fully or partially integrated market.

Nevertheless, a number of studies have adopted the analysis of flows and portfolio composition as an indicator of internationalization of finance and of the potential gains from

trade. We may distinguish between net and gross financial integration. The former implies relatively easy financing of balance of payments disequilibria; the latter would involve substantial cross-holding of financial assets.

Among the methods of measuring net integration are those based on fluctuations in national saving, investment and consumption. Such macroeconomic studies are based on one of two ideas: first (Feldstein-Horioka) that an efficient international capital market should remove the necessity for any correlation between fluctuations in a country's saving and its investment, and second (Obstfeld) that international capital mobility should so insure country risks that aggregate consumption growth rates would be highly correlated across countries.

Studies examining gross integration have analyzed the composition of institutional portfolios, focusing on the degree to which the risk-reduction opportunities available from international portfolio diversification have been realized. The volume of international financial transactions also provides some information here.

Even if the analytical framework for assessing them is not a strong one, there is a clear interest in descriptive observation of changes in the scale and pattern of international capital flows and in the degree to which portfolios have become internationalized, just as one is interested in the scale, growth and pattern of international trade in goods. Likewise, it is of interest to observe the structures of international trade in financial services, which may be associated with capital flows or not, depending on the nature of the service being provided and the exact contractual method employed to deliver the service.

Pitfalls in Interpreting Flow and Trade Statistics

But trade in all services, and perhaps especially financial services, is a phenomenon whose definition is rather uncertain, because the location of the service provider is often not clear-cut. The same is true for capital flows and portfolio structures, where the multiplicity of contracts, and of parties to individual contracts, means that nationality is often ambiguous. International statistical conventions exist as to how to deal with these ambiguities, but they are not fully adhered to in available statistics.

Even accepting the international conventions, the ease with which funds can now be moved between different jurisdictions, even while remaining within the umbrella of a single financial group, implies that substantial gross flows may occur for legal or taxation reasons without any net capital flow whatever occurring. This must be taken into account when assessing the importance of large or growing measured international capital flows.

Furthermore, there is no presumption that the legal residence of the financial institution involved in a contract corresponds to the location in which the value-added (including employment and profits) of the financial service involved will take place. For example, how much real difference does it make to the nature of the transaction whether a life insurance policy is offered to an Irish resident:

- (a) by an Irish bank acting as agent for a UK-based insurance company;
- (b) by a UK-owned insurance company incorporated in Ireland;
- (c) by the Irish branch of an insurance company incorporated in the UK; or
- (d) by a UK-based insurance company by mail-order?

There may certainly be differences of regulatory and tax treatment, and relating to the enforceability of the contract, but we need to be circumspect about the importance which may implicitly be attached to statistical differences which arise out of only slight differences in the economic nature of the transaction. While the companies' freedom to choose between the different methods of selling can be important for facilitating a competitive outcome (for example in reducing the set-up and capitalization costs of separate incorporation), once that freedom is available, the actual choice may be of little consequence.

1.3 Quantifying the Benefits

The potential benefits of the move to a single financial market can be divided into three. First, and this is a pre-requisite for the others, those coming from the liberalization of capital markets. Second, benefits of the opening up of competition between providers of financial services through the "single license" principle. Third, the benefits of the single currency.

So far as liberalization of capital markets is concerned, the gains are through equalization of rates of return, and improved portfolio diversification. We return to these issues below under the heading "Internationalization of Finance". The single currency would provide risk

reduction and transactions cost benefits, but it is beyond the scope of the present study.

The potential benefits of the single market in financial services *per se* were considered in the 1988 European Commission Study *The Costs of Non-Europe* (Cecchini Report). This study thus focused on the prices of financial services, as opposed to convergence of wholesale or money-market interest rates, though it assumed achievement of a competitive EU-wide single financial market.

The central estimates presented in the Cecchini Report of the potential consumer gains have been widely quoted. They implied that GDP could increase by 1.5 per cent (or about one-third of the total projected GDP gains resulting from the single market) as a result of the liberalization of financial services. The methodology adopted by the report was straightforward, and although its potential weaknesses are clear, no alternative estimates have commanded much attention. What the report did was to identify reasonably homogeneous products in each of banking, insurance and securities business (seven for banking, five for insurance and four for securities) and to obtain prices for these products from major suppliers in each of eight of the Member States (Belgium, Germany, Spain, France, Italy, Luxembourg, Netherlands and UK). The potential gains from the single market were simply computed by assuming that the price of each product would fall to the average of the four lowest prices prevailing for that product. The data indicated that each country was the cheapest for at least one product, and (apart from the Netherlands) the dearest for at least one other product. As a result the average price level of financial services had the potential to fall in each country by a percentage amount varying from 9 per cent (Netherlands) and 13 per cent (UK) to 29 per cent (Italy) and 34 per cent (Spain).

The project has not been systematically replicated, but it has been extended to the EFTA countries, including the three new EU members (Cf. Chakravarty, Gardener and Teppett, 1994). The estimated mean potential saving for the EFTA countries ranged from 0.6 per cent to 2.3 per cent of GDP (with 0.6 per cent, 0.8 per cent and 1.6 per cent respectively for Finland, Sweden and Austria).

As to whether such gains will actually be realized, commentators have expressed doubts both

as to the speed of convergence and to the ability of the single market to deliver the degree of competition implied by the Cecchini methodology (Vives, 1991)

Possible Costs: Centralization

One concern about the single market process has been the degree of centralization it might generate. Not all EU countries still have a motor assembly industry, a fact that results from the globalization of this business, and the economies of scale that are involved. But is the same likely to be true of financial services? This question has been widely debated, but there is no agreement on whether international financial liberalization and (in particular) the single market process should lead to a substantial centralization of financial services in just a few particular countries. Certainly the improvements in telecommunications mean that distance *per se* represents a much smaller barrier to such centralization than it did in the past. But the econometric literature has more or less consistently failed to find evidence of strong economies of scale in banking above a certain level of business. To take this finding at face value would imply that only small centripetal cost pressures exist. Nevertheless, there are reasons for supposing that the failure to identify scale economies may be partly attributable to the complexity of the banking firm's production function, as well as the variety of product mixes in different large banks. Indeed, the variation between unit costs for banks of the same size is larger than the average variation between size classes.

The evidence for economies of scope in banking (i.e. the potential for cost-reduction by increasing the range of products) is also controversial. Some banking futurists assume diseconomies of scope in arguing that unbundling of banking products and processes will be the trend of the future, with individual products and processes exhibiting the economies of scale that are hard to detect in multi-product banking firms. If so, then a degree of centralization could indeed occur, but in specialist niches rather than in general banking as we know it today.

The importance of local information must not be neglected in these matters. Banking practitioners stress the importance of customer loyalty, at least at the retail level, and detailed knowledge of local business conditions is also essential if bad lending is to be avoided. Accordingly, at least some part of banking is certain to remain a "non-traded service", with

local presence necessary. But it is less clear whether local ownership can also be assured by such considerations. The experience of local savings banks in most EU countries suggests that a process of ownership consolidation may be unavoidable (Revell, 1991a).

The same general types of considerations apply to insurance at the retail level, though the degree of local information required is arguably less. Local information is also essential in stock-broking, but may not be very important for fund management.

Possible Costs: Increased Risk

Because of the importance of information and uncertainty, there are further dimensions to this issue. For instance, critics of the process of financial liberalization and free entry have argued both that interest margins could increase and that the system may become riskier and more prone to damaging collapse. Theoretical considerations suggest that a greater degree of fragmentation and anonymity of the banking market will result in each bank adding precautionary margins to its lending rates because of the increased proportion of each bank's loan applicants that are actually uncreditworthy and have previously been refused accommodation at another bank (Broecker, 1990). Although there is not much empirical evidence available to support the increased margins hypothesis, there is plenty of evidence of increased systemic risk following liberalization. This is increasingly being attributed to the loss of franchise value. If banking is highly profitable, existing banks have a franchise value, the loss of which will be avoided by their management through prudent policies. But if there is free entry to banking, bank failure is less costly and bank management can afford to take greater risks.

1.4 Evidence of Internationalization

Episodic Integration

There can be no doubt of the increased degree of internationalization in world financial markets over the past two decades. This is evidenced by the sharp increase in international capital movements and cross-border holdings of financial assets of all types (Table 1.5), the greatly increased volume of cross-border transactions, the increased sophistication of the foreign exchange market and the increased availability of derivatives substantially allowing separation of currency, interest and credit risk. To some extent this is a reflection of the

increasing complexity of financial systems generally and the increased financial depth even in domestic financial systems. Nevertheless, many dimensions of international financial business have grown faster than the domestic.

One-by-one, different market segments, whether by country or by type of instrument, have seen a major surge, sometimes in response to a regulatory change or liberalization (as when the Japanese government removed constraints on the holding of foreign assets in 1980, resulting in a more-than-doubling of institutional holdings in a few years, cf. Bisignano, 1994). Sometimes the surge has been apparently in response to changing fashions and perceptions, as with the rapid growth in developing country equity funds since about 1989. There have also been reversals, as with ECU bonds, and with developing country equity funds.

There has not been as uniform a growth in net capital flows of industrial countries as there has been with gross flows. Net capital flows must equal current account imbalances and considerations of conjunctural macroeconomic balance (rather than an autonomous shift in investor's perceptions regarding the profitability of capital investment in other countries) can be the driving force behind changes. The US fiscal deficit and the fiscal deficit associated with German unification have been the most conspicuous macroeconomic factors of this type in recent years.

Full Integration: Transactions Data

Despite these growth trends, internationalization has not developed to the extent that the international capital market is fully integrated as between the industrial countries. One may distinguish between the position that has been reached in transactions, in net flows and in gross positions. The volume of international financial *transactions* may certainly be approaching what could be expected under full integration. For example, Tesar and Werner (1992) provide a number of measures of the turnover of foreign holders' portfolios of stocks and bonds, showing that turnover is equal to or greater than domestic holders' turnover.⁵ The

⁵Although some allowance may need to be made for the fact that institutional investors account for a higher share of foreign asset holdings than of domestic asset holdings, and they tend to trade their portfolios more actively.

huge turnover in the foreign exchange market and in international financial derivatives (cf. Figure 1.3, based on data in Goldstein et al. 1993) is also evidence of the same type.

Net Integration

When it comes to net flows, there is some evidence for an increase in the degree of capital mobility. Here (apart from studies of interest rate convergence) the Feldstein-Horioka methodology of estimating the correlation between national investment and national savings rates continues to be the main technique in use despite major conceptual ambiguities. A widely-quoted application is by Feldstein and Bacchetta (1991). They note that the coefficient of the national savings rate in a regression of the national investment rate (what they call the "retention rate") remains significant on relatively recent data. Their data is from 1960-86 for 23 OECD countries, and they run cross-sectional regressions on the average data for sub-periods no shorter than seven years: the correlation on annual data tends to be weaker.⁶ They find a tendency for decline in the retention rate in the more recent sub-periods, but it remains significant. The retention coefficient for the nine EU countries included in the study is lower than that for the 14 non-EU countries, suggesting higher capital mobility in respect of EU countries, though not necessarily referring to within-EU capital mobility. Obstfeld's (1994) recent updating of the Feldstein-Bacchetta calculations to 1990 shows no tendency for a reduction in the retention rate - rather the opposite.

Before concluding that these high savings-investment correlations argue for a surprisingly low degree of international capital mobility, we should bear in mind the well-known observation that even within national economies the bulk of corporate investment is financed by corporate savings, thus the apparent segmentation in the international capital market may be no more than a reflection of segmentation in the domestic capital market also.

As to the other noteworthy implication of simple theoretical models of optimal national consumption, namely that consumption growth rates in different countries should be highly correlated in an integrated world capital market, the evidence is no stronger. The average

⁶Working with cross-sections also eases one of the biggest conceptual problems, namely that common disturbances may influence both national savings and national investment even if international capital markets are completely open.

correlation between consumption in industrial countries and the world average 1973-88 is only 0.32; for the EU-12 it is a little higher at 0.41, but still well short of unity (Tesar, 1995; see also Bayoumi and MacDonald, 1994). But here too it is important to bear in mind that the permanent-income-rational expectations theory of consumption on which the method is based is generally rejected in single country studies in favour of some form of liquidity-constraint hypothesis. So the low international correlations may derive from failure of the underlying theory of consumption rather than of capital mobility.

Gross Integration

Turning finally to stocks, it is noteworthy that, despite a substantial growth in capital flows, institutional portfolios still display a marked degree of "home-country preference" (French and Poterba, 1991). Table 1.6 shows data for twelve OECD countries which on average have 86 per cent home assets in their total portfolio (the range is from 74 per cent to 95 per cent). The six EU countries in the table average 81 per cent. Given the small share that each country represents in total OECD financial wealth, this means that portfolio decisions in each country are disproportionately weighted towards domestic assets. That there should be such a preference is not surprising given the importance of local information as a prerequisite in credit decisions. It does not necessarily imply the persistence of international barriers *per se* but may simply reflect a correlation between the locations of informed lenders and their borrowers. There is considerable debate as to the overall magnitude of unexploited potential gain from international portfolio diversification. Assuming historical return means and covariances of traded financial assets leads one to calculate a substantial potential from further diversification of national financial portfolios. But simple intertemporal models suggest that aggregate consumption can be smoothed almost as well by adjusting the timing of investment as by holding an international portfolio (Tesar, 1995)

1.5 Interest Rates

We will have comparatively little to say in this paper about international interest differentials. A large and rather controversial literature exists which distinguishes between nominal and real, *ex ante* and *ex post*, and attempts to construct adequate measures of each. Figure 1.5 plots the standard deviation across the EU of quarterly money market rates 1980-94, and shows a gently downward trend suggesting a gradual convergence of these rates, if the

disturbances of 1992-93 are neglected. Local demand and supply of funds, including that generated by fiscal and monetary policy, are obvious potential influences on the interest rates in each country. The influence of local factors will diminish to the extent that international arbitrage is effective, and a definition of a completely integrated financial market with a single currency would be the absence of distinct money market rates in different countries.

Among the potential contributing factors to differences between countries in money market rates are the risk of exchange rate change, regulatory barriers to capital mobility, taxes and quasi-fiscal impositions on money-market participants, as well as differences in the credit and liquidity risks of the instruments traded in each market. Of these the risk of exchange rate change is surely the largest, and it is the most widely studied, with many papers arguing that observed interest differentials between low inflation countries are weakly correlated, if at all, with expectations of exchange rate change. A recent authoritative survey of this literature (McCallum, 1994), provides a revisionist view, and something of a return to the earlier orthodoxy (uncovered interest parity) which implied that interest differentials would approximate expected exchange rate changes.⁷ Indeed, it seems likely that the decline in variance observed in Figure 1.5 is attributable more to convergent inflationary and exchange rate prospects than to any other factor.

It is possible to abstract from exchange rate risk by comparing on-shore and off-shore interest rates for interbank deposits denominated in the same currency. Here a considerable degree of convergence is evident during the 1980s, even before full implementation of capital liberalization. For example, while explicit or implicit exchange controls have been influential in causing a wedge between on-shore and off-shore interest rates during times of crisis, there has been only a very small gap between the two in tranquil times, as is evidenced, for instance, in the charts and tables presented by Obstfeld (1994) for France, Germany, Italy, Japan and Ireland, January 1982 to April 1993.⁸ Thus, even before France, Italy and Ireland fully liberalized their capital account, such controls as existed did not ensure a steady

⁷A key aspect of McCallum's view is that current econometric tests fail to take account of the systematic actions of the monetary authorities in leaning against the wind.

⁸Frankel (1991) presents data on a larger number of countries, but ending in 1988. His forward rate series for Ireland does not appear to be correct.

lowering of domestic interest rates. By 1987, only small or rare deviations remained. Between early 1987 and April 1993, the mean differential for France and Germany was less than 10 basis points, for Italy less than 50.

1.6 Banking

The scale and complexity of changes in international banking over the past decade resists any brief summary. Here, we limit ourselves to describing the main quantitative trends in the volume of cross-border claims, in banking margins, and in ownership of banks.

Banking Flows

Trends in international banking are calculated from returns provided to the BIS by banking authorities worldwide. The compilation allows one to examine not only the scale of international business done by the banks of each country, but also the banking business done with banks abroad by (non-bank) residents of each country.⁹ Figures 1.4 (a)-(f) display the major features of these developments for the EU-12 countries and for the three new members and Norway. The main impression is of less dynamism in non-bank claims on and borrowing from banks across international frontiers than might be expected given the rapid growth in other aspects of international finance. Indeed, much of the growth in international banking assets and transactions has been of an interbank character. Arguably the business with non-banks is of greater importance, although it should be borne in mind that the nonbanks include not only governments but also financial institutions not classified as banks.

Figure 1.4 (a) shows the cross-border banking business of each country's non-banks, expressed as a percentage of GDP, 1985-93. (The same data in billions of dollars is given in Figure 1.4 (b)). For the EU-12 as a whole, the stock of cross-border credit to non-banks averaged about 7 per cent of GDP in 1985 and reached almost 9 per cent in 1993, having dipped below 6 per cent in 1988. Deposits grew from about 4 per cent of GDP in 1985 to over 7 per cent in 1993, with much of the growth happening in one year: 1989. The most rapid growth has been experienced by Ireland and the Netherlands, both of which saw

⁹Note that the nonbanks include governments.

nonbank deposits more than doubling to over 20 per cent of GDP.¹⁰ The UK and Germany also saw substantial increases, especially in deposits. On the other hand, several countries have exhibited relative declines, notably Greece, Denmark and Portugal.

Figures 1.4 (c) and (d) show corresponding data for four EEA countries. Here, although there is growth in dollar terms throughout, there is no uniform increase in percentage of GDP before 1991.

Turning to data arranged according to the residence of bank, and including interbank business, a completely different picture emerges (Figures 1.4 (e) and (f)). Here the average is dominated by fluctuations in the business of international financial centres in Luxembourg (with international bank assets amounting to more than twice GDP) and the UK. Most other countries have experienced relative growth (especially Ireland, reflecting its emergence as a financial centre also), some of them very rapid. Exceptions here are deposits with Italian banks, and lending by Danish banks. (Declines in the figures for the EEA banks likely reflects liberalization of domestic banking markets in those countries as well as subsequent solvency difficulties.)

The international trade in banking services, as distinct from flows of funds, is an element of the current account of the balance of payments of each country. Estimates for EU countries have been prepared by Eurostat for exports and imports of banking services, distinguishing between trade within the EU and outside. These data are shown in Table 1.7, and they display a sharp increase over the decade to 1992.

Bank Margins

Examination of bank profit and loss accounts helps to throw light on the degree to which competition is eroding margins and the cost of banking generally. It should be borne in mind, however, that liberalization of the financial sector has also implied the removal of taxes and quasi-taxes on the sector which had previously constrained the sector's profitability.

¹⁰The very high figures for Irish borrowing reflect the Irish Government borrowing from foreign banks.

Accordingly, in countries where financial repression had been severe, one observes an increase in bank profitability despite the potential for greater competition.

In discussions of increased internationalization of banking, there has been a tendency to attribute all of the cost and margin differentials between countries to non-competitive behaviour such as expense preference, and to quasi-fiscal burdens. To be sure, the OECD data on bank profitability for some 13 countries (including 7 of the EU-12 and 9 of the EU-15) displays wide variations in gross income as a percentage of total assets even within the EU (from 1.9 in Belgium to 4.6 in Italy, 1992).¹¹ which are substantially matched by correlated variations in operating expenses (1.2 in Belgium to 2.4 in Italy).¹² This correlation is at least consistent with expense preference (Conti and Maccarinelli, 1993). But, despite some convergence in recent years, the average product mix of banks in different countries differs quite widely, notably in the share of low-margin wholesale business in the total. This makes cross-country analysis of the profitability and cost structure of banks problematic.

The liberalization of banking has also resulted in an increase in the complexity of the products supplied and this complicates the interpretation of changes over time in average cost structures. Finally, the fact that recognized loan-losses are counter-cyclical and do not appear in the accounts when the loans are made tends to distort the time-pattern of bank accounts.

Notwithstanding these considerations, the unweighted average gross operating income (net interest plus non-interest) of banks in the seven EU-12 countries has remained in the vicinity of 3½ per cent of total assets, and there is comparatively little evidence from this aggregative data of a squeeze on bank margins. There is only a slight decline from 3.70 in 1982/83 to 3.45 in 1992 (a squeeze of less than 7 per cent). This decline is itself entirely in interest income: non-interest income actually rose from 0.91 to 1.02. As to the use of this margin, staff costs accounted for 1.66 in 1982/83, falling to 1.36 in 1992, but other costs rose from 0.79 to 0.84, resulting in a negligible change in the banks' net income from 1.24 to 1.25.

¹¹For the wider sample the range is from 1.3 in Japan to 5.9 in the United States. The countries in the sample are France, Germany, Italy, Spain, UK, Belgium, Netherlands, Switzerland, Finland, Norway, Sweden, Japan and the US.

¹²And 0.9 in Japan and 3.8 in the US.

Strong competitive pressures within EU banking systems would tend to lead a reduction in margins and in operating costs. Staff costs have declined since 1982-83 in each of the EU countries in the data set, apart from Italy. The average fall in staff costs accelerated in the latter part of that period to a rate of about 0.04 per cent of gross assets per annum, an annual measured productivity gain of over 2.5 per cent. This was about the same as in the three Nordic countries in the sample, and contrasted with the experience in Japan, Switzerland and the US, the latter two of which saw increasing staff costs. Furthermore, the greatest declines in the OECD data set have been in EU countries (though they had the highest staff costs to begin with). Even over ten years, however, there has been no change in the identity of the three countries with the highest staff costs. Furthermore, interest margins have not declined in all countries: Spain and Italy saw increases - surely reflecting the reduced incidence of quasi-fiscal burdens.

To summarize, the international data shows clear evidence of downward pressure on staff costs in EU and Nordic banking systems in the 1980s. The cost savings have generally been passed through to the interest margin, which has fallen by rather less than 0.25 per cent since the mid-1980s (Figure 1.6).

An alternative way of looking at bank margins is to calculate the mark-up above and below interbank rates for quoted lending and deposit rates. This has the advantage of measuring the price directly, but raises questions about how representative the quoted deposit and lending rates are. Gual and Neven (1993) provide data for six EU countries from 1984 to 1991, and show that the quoted deposit and lending rates are rather sticky, with the result that sharp movements in money market rates tend to result in almost equivalent movements in the mark-ups. Thus when money market rates fall suddenly (as in Netherlands in 1988-89) neither lending nor deposit rates move by as much, with the result that the mark-up on loans increases, while that on deposits decreases. The large degree of variability over time of these mark-ups tends to mask any long-term trends, and although one could agree with Gual and Neven's conclusion that Spanish banking had become more competitive, there are no other clear-cut conclusions.

Ownership trends

Three major trends in regard to ownership of banks have been privatization, de-mutualization and cross-border alliances. Although the third of these is the more obviously relevant, the other two partly reflect the more competitive and market-oriented nature of the financial services industry and also influence the degree to which the third can happen.

Since the mid-1980s, banks in the larger EU countries have been active in acquiring stakes (often majority stakes) in domestic non-bank financial institutions including insurance, stock-broking, and fund management. There have also been many bank mergers between banks in the same country. Gual and Neven (1993) present data for deals between 1984 and mid-1991 which indicate that the total value of deals amounted to more than 10 per cent of the capital and reserves of the banking system in Denmark, Spain, France and Italy. More than a half of the transactions (by number or value) were domestic in nature.

So far as cross-border alliances are concerned, the pattern is a bit different. Firstly, a disproportionate number of the cross-border deals have involved target companies in Southern EU countries. As had been expected, the acquisition of stakes has been more common in retail markets than in wholesale, probably because the barriers to entry for a foreign entrant tend to be less in wholesale markets, notably because of the need in retail markets to establish a distribution network. Few of the deals involve foreign control of a bank. According to the Bank of England's (1993) analysis, about one-half of the cross-border alliances in wholesale markets involved the acquisition of stock-brokers and fund managers, where local knowledge is of particular importance.

For the retail market, joint venture companies, formal cooperation agreements and cross-shareholding arrangements have allowed banks in different countries to gain a cross-border toe-hold. This has been especially the pattern for Spain, which had early been identified as a likely target market. French banks were among the most active purchasers, and Credit Lyonnais' alliances are noteworthy in that more than half of them involved outright acquisition or a majority stake. Some of these positions are expected to be divested in the near future because of that bank's difficulties.

Because relatively few cross-border alliances involved control of a bank passing to foreigners,

the market share of foreign-controlled banks in EU countries evolved rather slowly in the late 1980s. According to incomplete data collected by Gual and Neven (1993), this share increased by less than about two percentage points in France, Italy, Spain, Belgium, and Portugal, and it fell in Germany and the UK.

The share of privately-owned banks in the total assets of the EU banking system varies systematically from North to South. At end-1988, the UK and Ireland displayed the highest shares at 85 and 80 per cent respectively; Belgium, Netherlands and Denmark had shares between 60 and 66 per cent; France, Germany and Spain lay between 25 and 55 per cent; while Italy, Greece and Portugal had shares of less than 15 per cent.¹³ The UK, Belgium and Ireland were (along with Luxembourg) the only countries where foreign banks held more than 20 per cent of the banking market, and these shares appear to be relatively stable (Revell, 1991b, Gual and Neven, 1993).

Mutual or public ownership is some defence against foreign takeover, and as Revell (1991a,b) observes, preservation of a substantial mutual or public-owned banking sector in many countries has been seen as a covert means of protecting the banking system against foreign domination. Nevertheless, there are strong pressures in favour of corporatization and privatization of these institutions.

So far as nationalized commercial banks are concerned, privatization plans have been announced in all of the Member States where they have existed. The program in Portugal is the most far-reaching, but even there not all of the nationalized commercial banks are being privatized yet. The rationale for having publicly owned specialized credit banks has weakened, with the elimination of subsidies and of regulatory discrimination as between different financial institutions. Many of these specialized banks have been re-positioning themselves, often within a grouped structure.

The small size and limited access to new capital which has characterized the mutual savings

¹³Finland and Sweden both had around a 45 per cent private share, while Austria's private share was less than one per cent.

bank sector has threatened their long-term viability and growth in an environment where they are increasingly open to competition from commercial banks. In response to this threat, there has been a strong merger movement. The number of savings banks has dropped precipitously in many countries, with consolidation into larger regional banks becoming the norm. For example, the number of savings banks in France is expected, within a few years, to be less than one-tenth of the number in 1983. It has also become possible in several countries for mutual savings banks (and other institutions) to move towards a corporate structure, either by having the mutual society own a separate corporate entity, or by de-mutualization. As private corporate entities, such institutions could more readily become subject to takeovers or get involved in cross-border alliances.

The impact of liberalization on concentration within countries is theoretically ambiguous. Available data, limited though it is, suggests that trends since 1987 have been towards slightly greater concentration in France, Germany, Spain and Italy, arguably the countries that had deregulated most since the early 1980s; and some reduction in concentration in Belgium, Netherlands and UK (Gual and Neven, 1993).

1.7 Insurance

As noted above Insurance is a sector which has achieved widely different degrees of market penetration in different EU countries (Table 1.3). This has been due to a variety of historical and institutional factors, including the differing degrees to which government provides close substitutes for the products of the insurance market, as well as the differing fiscal incentives that prevail. Because of the declining importance of these influences, and particularly the general decline in government provision, the relatively rapid expansion recently experienced in several countries (especially Italy, Spain, Greece and Portugal, each of whose life insurance markets experienced annual real growth in excess of 20 per cent per annum during 1985-92) is thought likely to continue. Indeed, the strong negative correlation between the cost differentials identified by the Cecchini study and premium income as a share of GDP (Figure 1.7) provide further support for such a view.

The process of internationalization of EU insurance markets has been a long-drawn-out affair. Freedom of establishment has been effective for many years now, and foreign-controlled

companies have a worthwhile share of the market in most Member States (Table 1.8). But although foreign companies have not had to incorporate in the host country, they were still subject to national prudential regulations. To the extent that these regulations were at the root of the cost differentials between Member States, freedom of establishment could never have eliminated these costs. Nevertheless, the real threat of entry will have served to limit cost inefficiencies or exercise of monopoly power.

The 1980s were marked by a considerable number of takeovers and alliances in the insurance business, and many banks established insurance subsidiaries. Although early expectations of a thorough integration of banking and insurance have not been realized, the closer relationships that have been established are not likely to be reversed. At the same time as this domestic market re-positioning was taking place, there have been numerous cross-border acquisitions of shares, most of them in the form of a takeover (more than 50 per cent control). Of 155 European transactions logged by Dickinson (1993) (on which we rely heavily in this section) for the period 1984-90, the most frequent target countries have been Spain (32) and Italy (24), the most frequent bidders have been from France (44) and Switzerland (25). These data confirm a pattern noted for other sectors also, namely the perceived potential for change in Southern Europe, and the importance of non-EU countries in the process of increased internationalization. Cross-border activity has been less pronounced in life insurance, a fact that has been attributed to the relatively ample potential for growth in this sub-sector in most countries, so that few companies experience a need to seek new markets for expansion.

Cross-border sales of insurance products are now technically free following the coming into effect of the Third Insurance Directives. But it is not thought likely that there will be a substantial growth here. For one thing cross-border sales of re-insurance and wholesale risks have already been freed,¹⁴ and the remaining retail risks do require a local presence for claims settlement, as well as for avoidance of adverse selection. Furthermore, life insurance benefits from tax incentives in all EU states, and at present the applicability of these incentives to policies purchased abroad is not generally assured. Nevertheless, by eliminating costly and unnecessary regulation, these Directives should help to reduce national differences in

¹⁴Table 1.9 provides estimates of trade in insurance services.

insurance costs.

1.8 Other Financial Markets

Stock and Other Securities and Derivatives Markets

European securities markets have also experienced dramatic liberalization, driven mainly by domestic legislation and regulatory changes rather than the single market process. The diversity and complexity of the developments here are beyond the scope of this review, but it is clear that geographical concentration is most acute in this segment.

Although the value of domestic securities quoted on the London and Frankfurt exchanges are almost the same, and Paris is not far behind, the London shares are more actively traded. There has been considerable international competition between different financial centres for transacting internationally traded securities. Indeed, close to 50 per cent of all trading in the equity of firms located in the EU takes place outside the home country (Goldstein and Mussa, 1993) with the technical sophistication of London's SEAQ trading system allowing it to capture an early lead (Pagano and Roell, 1990), though some of its gains have been recovered by the national markets from which it had taken business (cf. Table 1.10). London has also retained a dominant position in the foreign exchange market and in derivatives markets.

US experience suggests that more than one centre of organized financial markets in widely traded instruments can survive; however (despite the hopes of several EU cities), it is clear that not more than two or three can be international financial market centres in Europe. Stock markets in other centres will survive as specialists in the shares of national companies below world rank, and possibly in government bonds as long as national currencies persist.

Fund Management

Despite some degree of convergence in international practices, there are still wide differences in the degree to which funded pension exist in Europe. One of the main driving forces here is the degree to which retirement income is provided for through social security. In Germany, Italy and France, where social security pensions offer high replacement rates, even at high incomes, there has been relatively little development of funded supplementary pension schemes, and much of what does exist has been either unfunded, or only notionally funded

through provisions on the employer's balance sheet. As a result, the accumulated assets of pension funds in France, Germany and Italy in 1991 were between 4 and 6 per cent of GDP. At the other end of the scale, pension funds in Denmark, the Netherlands and the UK amount to between 60 and 76 per cent of GDP.¹⁵ Pension fund assets in most of these countries almost doubled as a share of GDP during the 1980s.

For the present, cross-border sales of pensions is negligible for a variety of regulatory and tax reasons. Cross-border investment by pension funds is much more important. Nevertheless, the share of foreign assets in pension fund portfolios remains small. Prudential restrictions which were quite severe in several countries until recently partially explain the small share. Even in the UK and Netherlands, the share in 1991 was only 20 per cent, thus displaying considerable home preference, but it should be noted that these shares have increased very rapidly indeed since 1980 (doubling in the UK, and more than quadrupling in the Netherlands).¹⁶ At most about one-third of UK foreign assets represent claims within the EU.

Outside the pension area, the major internationalization issues relate to cross-border sales of fund management services and international diversification of portfolio holdings. The expectation that the UCITs would be the primary vehicle for such internationalization appears not to have been realized; according to the Bank of England's survey, the freedoms reflected in the UCITs Directive are felt to be quite limited (Thomson and Taylor, 1994). Tax-driven growth in offshore fund management has been a feature of recent years, but the artificial and intra-institutional nature of much of this business has to be recognized.

¹⁵Davis (1995). The figures shown are on his "broad definition," including funds managed by insurance companies and banks, for example.

¹⁶These data are from Davis (1994, 1995). Hoffman (1992) provides somewhat different numbers, with a lower share for Netherlands and higher for the UK. Hoffman identifies Belgium as the country with the highest foreign asset share (around 35 per cent) and he also notes the relatively high foreign share of Irish pension fund assets. Hoffman's figures indicate foreign shares of less than five per cent for Germany, France and Denmark). In all seven EU countries discussed by Hoffman, foreign asset shares are estimated to have increased sharply in the period 1985-90.

2 FINANCIAL INTEGRATION IN THE SMALL PERIPHERAL COUNTRIES: THE OVERALL PICTURE

Introduction and summary

The financial systems of the smaller peripheral member states have seen substantial changes in the past decade. In the case of Greece and Portugal there has been a very rapid structural transformation of the financial sector. Ireland's financial system has changed too, though it had already been more lightly regulated than the others. This chapter offers some broad conclusions as to the most important features of recent developments. We argue that, though there have been dramatic changes, many of these have been primarily domestic in nature, and in particular that the role of the single passport appears to have been modest.

Subsequent chapters, one for each country, describe the evolution of financial flows, the structure and performance of the banking system, the insurance sector and the remainder of the financial system. We do not examine the important question of international convergence of the wholesale prices financial assets (interest rates, stock indices etc.) on which there is a substantial literature but which is excluded from the scope of the study. We have collected data on as comparable a basis as possible to assess the degree to which internationalization has progressed since the mid-1980s, and the degree to which there has been an effect on the efficiency of the financial system. The tables and figures referring to the three countries that come from international sources are included in this chapter, while those coming from national sources are presented in the country chapters.

The trends in the different countries are not parallel. In terms of the volume of international financial business, Ireland is much more involved in the global financial market than the other two. The tax-advantaged Dublin International Financial Services Centre (IFSC), emphasizing what would traditionally have been regarded as offshore business, has added considerable impetus to what had already been a rather open banking regime. Portuguese banking is undergoing a huge ownership transformation which has probably reduced the focus on internationalization in that market, while the continued dominance of the State-controlled banks in Greece makes that financial system still rather inward looking, despite very considerable liberalization.

In terms of gross capital flows, the liberalization of exchange controls has certainly had an

effect, notably in the adjustment of institutionally managed portfolios, though home preference remains significant, especially in Greece. Prudential regulations severely limit the international diversification of insurance and pension fund portfolios in Portugal.

2.1 Deregulation

In 1985, the banking systems of Greece and Portugal operated under a regime of high reserve requirements and binding quantitative credit controls. These had the effect of channelling a substantial fraction of the resources mobilized by the financial system either to the Government itself or to preferred categories of borrower, at low interest cost. Most of the banks were Government-owned or controlled, and in the case of several of these a large volume of doubtful and non-performing assets had accumulated in the loan portfolio. Interest rates were also subject to administrative control, contributing to the net effect that the banking system as a whole was unprofitable and weak in its capital structure. Both financial systems operated behind exchange controls, which indeed were a necessary condition for persistence of such distorting regulatory regimes.

The rapid dismantling of the regulatory banking controls, the liberalization of entry and, at least in the case of Portugal, the privatization of most of the Government-owned banks have brought the Greek and Portuguese financial systems much closer to the norm of more market-driven financial systems which had earlier become established in the rest of the EC. Adaptation of the systems to the new regulatory environment is still under way. At present the most dramatic developments for Portugal have been the ownership restructuring which now promises to result in much greater concentration in the banking system than before. In Greece the largest banks are still Government-controlled, and, while entry by new private participants has been vigorous, modernization and technological convergence rather than changes in ownership structure and competition have been the key features of the Greek financial system changes.

In Ireland, elimination of the formal interest-rate cartel and the abandonment of administrative credit controls were also a feature of the 1980s, but they happened at an earlier stage, and anyway were never as constraining as the interest ceilings and directed credit policy of the other two countries. The fact that the Irish banking system was already technically well-

equipped will no doubt have contributed to the success of the offshore financial centre IFSC established from 1987, though this was undoubtedly driven mainly by tax advantages. With the elimination of regulatory distinctions and exchange controls it is no longer fully possible to distinguish in practice between the offshore and onshore aspects of the financial sector in Ireland, but it is clear that much of the recent growth in the Irish financial sector has related to what must by any account be considered offshore-type business.

Liberalization of Exchange Controls

Although partial liberalization had been in progress for several years, especially in the case of Ireland, the final restrictions on international capital movements were removed only quite recently: December 1992 in the case of Portugal, January 1993 for Ireland, and May 1994 for Greece. The consequences appear to have been most dramatic for Greece, where the very high nominal Drachma interest rates have encouraged borrowers to refinance their bank borrowings in foreign exchange and to borrow directly from abroad. The resulting substantial inflows of funds to Greece are sufficiently large to threaten monetary stability unless sterilized, and are reminiscent of undesired inflows into Spain in the late 1980s, as well as some other well-known cases of liberalizing economies such as Chile in the early 1980s and Mexico until very recently. The policy dilemma posed by these inflows is not the one which was traditionally most feared by the monetary authorities, namely that speculative outflows would destabilize exchange rate policy and force depreciation. In fact, although the Greek removal of exchange controls was accompanied by considerable market turbulence for some weeks, and although the Irish removal was followed within a month by devaluation, it seems fair to say that removal of exchange controls has been less traumatic than had been feared by many.

Role of the EU

To what extent have EU developments contributed to these developments? This question is, in a sense, the theme of the present report, and in general our findings suggest that, while the effect of the removal of exchange controls has been very significant, the single passport programme has so far had comparatively little effect - and this situation is unlikely to change dramatically. Most of the changes in the financial systems of these countries have been driven by domestic policy and this in turn has been influenced by worldwide regulatory and

technological developments, and by the more generalized move to market-based financial systems. The EU single market process is itself more a reflection of these global trends than a setter of the trends.

Thus we may distinguish between (on the one hand) the indirect impact of the single market process through its role in creating a perception that regulatory reform was needed and (on the other hand) the actual impact of the single market legislation in the market-place. The indirect role may have been important, though the demonstration effect of financial liberalization in many other countries not only those within the EU (for example, the Nordic countries, USA and Canada), and the diminished effectiveness of the existing controls were probably of greater collective importance.¹ Most of the liberalization in Ireland had taken place before the single financial market was close to realization.

2.2 Gross and Net Integration

When examining flows and portfolio structures, we distinguish between net and gross financial integration. The former refers to net capital flows and specifically to the financing of current account payments deficits and surpluses. Net integration implies a relatively easy financing of such disequilibria. Gross capital flows and substantial cross-holding of foreign financial assets will normally be optimal for reasons of risk-sharing, corporate control, and competitive intermediation, even where there is no net macroeconomic imbalance to be financed. A trend towards gross integration would be reflected in a reduction in home preference, and in an increase in the share of gross capital flows in relation to GDP and other measures of the size of the economy and the domestic financial asset stock.

Net Integration

Over the past couple of decades, substantial capital inflows to Ireland and Portugal, notably including borrowing undertaken by government and official agencies, have served to liberate

¹For instance, in the case of Greece, such documents as the 1980 Harissopoulos Committee report from the Bank of Greece were already calling for modernization of the banking system.

national investment from the bounds that would otherwise be established by national savings. Savings and investment correlations show that net financial integration was already fairly well advanced in Ireland and Portugal before the single market process got under way. This has applied both on the average of several years and in terms of year-to-year fluctuations. To this extent, an important degree of capital market integration has already been available to these countries before the single financial market process took hold. For Greece the story is rather different, the year-to-year correlations between saving and investment suggests a limited degree of capital mobility. Only in the past half-decade or so does this constraint appear to have been broken.

Table 2.1 presents the internationally comparable data of the capital account of the balance of payments in our three countries. These are discussed in the country chapters, but a glance shows the substantial but diminishing importance of official flows in balancing the current account position.² The often-neglected role of the commercial banks in this regard is also evident. Note also the large errors and omissions items for all three countries: continuing discrepancies in the balance of payments statistics seriously hamper analysis in this area.

Gross Integration: flows

In order to examine gross international flows fully we would need a more detailed breakdown of the components of the balance of payments than is available for the period under review. The most ambitious statistical exercise along these lines is contained in the flows of funds statistics collected by Eurostat and available to researchers, though not published in book form. Relevant portions of these data are presented in Table 2.7 for Greece and Portugal. They show the gross acquisition of local financial assets by foreigners and of foreign financial assets by residents. Even without any trend in the balance of payments, i.e. in net capital flows, a deepening of financial integration would be expected to generate an increase in gross flows. Such an increase is evident as early as 1988 for Portugal, but not for Greece. Unfortunately, comprehensive data for later periods are not yet available, but the indications are that portfolio flows have accelerated in Portugal, while FDI inflows may have declined (Tables 2.1, 4.5).

²The data on funds raised in international markets (Table 2.6) largely reflects these activities.

Home Preference

The disproportionate portfolio share of assets issued by resident entities is widely documented. Naturally, liberalization of exchange controls has led to some change in this position for the peripheral countries, in particular reflecting the behaviour of financial institutions who may in practice have been more affected by the controls than were non-institutional investors. At the same time, home preference has persisted. Indeed, the sharp fall in international bond prices during 1994 meant a poor performance for funds investing heavily in long-term dollar securities, and continued high domestic interest rates, especially in Greece, limited the outflow of funds seeking high returns in the short-run.

We have constructed an index of "home preference", designed to approximate the degree to which total financial asset portfolio of the non-bank sector is not invested, directly or indirectly, in foreign securities. Because it includes both the official external reserves, and gross foreign financial assets of the banking system, the index is much lower than would be computed if based only on the direct holdings of foreign assets in non-bank portfolios (a point which is often neglected in the literature). Year-to-year fluctuations in the index can be significantly influenced by movements in the official external reserves, a factor which has been of importance in Greece. The increasing internationalization of the banking system and the growth in gross foreign asset holdings, matched by closely substitutable foreign assets, also has an important impact on our index (especially for Ireland).

Other measures are possible, but the chosen index of "home preference" is instructive. It suggests a clear ranking of countries: Ireland being more integrated and continuing to integrate faster than Portugal, or especially Greece. The role of international banking business is important here, but remaining restrictions on the portfolio allocation of insurance companies and pension funds is a factor, especially for Portugal. The index reaches its lowest value for Ireland, at a mere 0.24, a figure to which it has fallen sharply in recent years. For Portugal, the home preference index is 0.41, and in Greece, much higher at 0.74 (Tables 3.1, 4.2 and 5.1). There is plenty of scope for further internationalization especially in the latter two economies.

The internationalization of financial portfolios and financial intermediation is not synonymous

with a specific focus on the EU. Indeed, while data is very sketchy in this area, it is evident that use of the US dollar is widespread, and that financial transactions with non-EU countries such as the US and Switzerland get at least their fair share. There is little evidence of an increasing share of EU or of EU currencies in portfolios of foreign assets held. For example, the claims of Irish banks in foreign exchange on EU residents fell from 85 per cent of the total in 1985 to 59 per cent in 1993; and the share of DM and sterling in their foreign exchange liabilities to nonresidents fell from 56 per cent to under 30 per cent (Table 5.2). In inward FDI too, though for Greece and Portugal some three-quarters comes from the EU and this is somewhat higher than recorded for Greece in 1987-88, the EU's share for Ireland has fallen to about 13 per cent in 1991-92 (Table 2.5).

Thus, the financial integration process is as much towards a single world market as towards a single EU market.

2.3 Cost of Financial Services

The Cecchini report held out great hopes for consumer benefits in the single financial market. Recent trends in bank spreads in the countries under review suggest a mixed picture. Interest rate decontrol in Greece and Portugal at first led to a substantial widening of margins (as was to be expected given the degree of implicit taxation of the banking system that had been built in to the old regime), and only subsequently has there been a contraction reflecting increased, though still imperfect, competition (Figure 3.1, 4.1).

All three countries tend to have rather high intermediation costs which are gradually being reduced. A prior expectation regarding the impact of financial integration on the cost and availability of financial services under these circumstances is that (i) large and evidently credit-worthy borrowers and (ii) large depositors would benefit but that others could actually suffer. The reason for this view is that banks have substantial overhead costs which have tended to be recovered, in the pre-liberalization era, from all classes of customer. Liberalization allows both depositors and credit-worthy borrowers to shop around for better rates in the single market. This will force local banks to quote more aggressively for such business, thereby leaving the overhead costs to be recovered disproportionately from the other customers.

So far the evidence, such as it is, is consistent with this view.³ In Greece, the contrast is most marked between foreign currency lending rates and Drachma lending rates. According to market participants, competition has driven down spreads by much more than in the Drachma market. In Ireland and Portugal, quoted interest rate series appear to document the divergent experience of small (or less creditworthy) and large corporate borrowers, in each case amounting to a recent widening of the spread differential of as much as 200 basis points (Figure 4.2, Table 5.3).

Spreads tend to be correlated with movements in the interbank rate. This was already remarked by Gual and Neven (1993) for the countries they studied, and it is a feature of the data for our three countries also. Essentially, this is due to the fact that both retail lending and deposit rates are still slow to adjust to movements in interbank rates. This point needs to be borne in mind before jumping too hastily to conclusions about trends in spreads based on the potentially reversible experience of a few quarters.

An alternative indication of financial intermediation costs is obtained by analyzing the profit and loss accounts of the banks. The relevant data (Table 2.2 - the figures for Ireland are not fully comparable), which allows account to be taken of the shift to non-interest charges, tends to support the qualitative picture we have described.

Nonbank financial institutions

Insurance, pension fund, mutual fund and other financial services remain much less developed in Greece and Portugal than in Ireland and in other more prosperous parts of the EU.⁴

As regulatory distortions have diminished, so the importance of tax distortions has increased.

³Available interest rate data is somewhat unsatisfactory. For instance, in Greece and Ireland there is no assurance that the rates correspond to actual effective rates charged on average; the series represent posted rates against which unknown reductions may be made in practice. Even in Portugal there is no published data on interest rates charged domestic borrowers for foreign currency loans.

⁴Though there is a degree of convergence, as shown for insurance in Table 2.3. It does not now seem possible to get any quantified picture of aggregate trends in insurance market costs on a comparable basis for these countries over the past decade.

increased. Taxation of interest income from short-term financial instruments in Greece has changed several times, but is still quite discriminatory and has led to tax-driven financial innovation, which may have distracted from more socially productive forms of financial innovation. Indeed the development of mutual funds in Greece, and to some extent in Portugal also, has been substantially tax driven, rather than reflecting a substantial widening of the range of financial instrument types. There have been similar, but less severe, problems in Ireland: tax advantages for resident savers long contributed to a very substantial development of the insurance sector in Ireland, and its growth has been slowed by the substantial removal of these advantages. Note also that, in a graphic case of what is known in the fiscal literature as tax competition, much of Ireland's rapid financial internationalization has itself been driven by intermediaries doing mostly offshore-type business in the tax-advantaged environment of the IFSC.

Concentration in the financial sector

Foreign penetration into domestic banking and insurance markets has not been vigorous, confirming the belief that much of banking and insurance requires a local presence. Even in Portugal, where vigorous entry from Spanish banks had been expected, the early moves have not borne much fruit and have been partly reversed. Neither in banking nor in insurance do the statistics show any strong trend towards increasing market share for branches or agencies of foreign-owned companies (Tables 2.4, 3.3, 4.5). (However, in insurance there has probably been an increase in the degree of foreign ownership of locally incorporated companies which is not captured in official statistics). Nevertheless, local competitive pressures in certain sectors of these industries have been strong, especially in Portugal where a scramble for market share has raised some prudential concerns, in addition to resulting in what seems likely to become once more a rather highly concentrated banking sector. Indeed, while the single market process might have been expected to reduce concentration in financial markets, the evidence is mixed. The relative decline of the Government-controlled banks in Greece has led to some reduction in concentration in that market, and the growth of offshore business in Ireland has meant a smaller market share for the main Irish banks. However, in the case of Portugal, the privatization process is being accompanied by a wave of mergers which will result in a quite concentrated banking system. Concentration in insurance is lower than in banking, especially in Portugal.

3 GREECE

3.1 Macroeconomic Aspects

As discussed above, in aggregate net terms, the role of capital flows can be seen as bridging the gap between national savings and investment. Figure 2.1 displays that, in the case of Greece, the gap has been much narrower than the year-to-year fluctuations in saving and investment, suggesting that, looking at a thirty-year horizon, this net bridging role has been rather unimportant in the Greek case. The correlation between saving and investment has been very striking ($R=0.88$) and would be suggestive of a limited degree of capital mobility. Only in the last few years has a rather persistent deficit current account deficit emerged.^{1,2}

Looking at the recent period more closely, Table 2.1 shows that the cumulative current account deficit of Greece during 1986-93 has been in excess of \$14.4 billion. This has been financed by over \$7.0 billion of direct foreign investment (mainly in real estate) and by over \$8.1 billion of other non-government capital inflows (of which almost \$2.0 billion through the commercial banks). Official borrowing has amounted to \$9.2 billion, and the official external reserves have increased by \$6.4 billion. The importance of non-bank non-official capital inflows is an important aspect of the Greek situation (and one that is also evident in Portugal). It should be noted that this includes portfolio investment flows which are not separately identified.³

The role of official flows, both government borrowing and net use of reserves by the central bank, as residual buffers is evident from their rather larger annual variation, by comparison with the other items. These two rows are negatively correlated ($R=0.71$), indicating that they

¹Over the shorter period 1986-93 the correlation between saving and investment is insignificant.

²We follow the practice of most of the international agencies in concentrating on the national income accounting definitions in this context. The Greek balance of payments statistics are prepared both on a transactions basis (used in the national income accounts) and a payments basis. The payments basis accounts, prepared by the Bank of Greece, have generally shown a much lower current deficit in recent years, a fact which is generally attributed to slow repatriation of export receipts at a time of currency depreciation.

³The Bank of Greece data contain an item "entrepreneurial capital" into which much of these flows are categorized. However, it is not possible to make any further breakdown of the data from this source.

substitute for one another.

The flow of funds statistics (Table 2.7) show the estimated gross financial flows in and out of Greece in the period 1985-90. As a percentage of GDP these gross flows declined in the period, and the 1990 flows were lower even in nominal Drachma terms than those of 1985. Thus the flow of funds figures do not suggest an increase in financial integration for Greece before 1990.

Recent liberalization of capital movements

As in the other two countries, liberalization of the capital markets has been a phased process, with significant steps taken in 1987, 1990 (when outward direct investments within the EU were completely freed), and 1991-2 (when most remaining current account controls were removed). Liberalization of all but short-term capital movements from May 1993 was not accompanied by large capital outflows, beyond some investments of mutual funds in foreign bonds and equities.⁴

In May 1994, as the ending of all capital controls approached, there was considerable outward capital movement, but this is thought to have been more a speculation that exchange rate policy would change than any portfolio readjustment. The scheduled liberalization was brought forward to 16 May 1994 in order to allow this speculation to be confronted immediately. The fact that outward movements were replaced by inward later in the year, and the fact that longer-term interest rates were not affected suggests that the outward movements were related more to a speculation that exchange rate policy would be weakened than to any structural portfolio adjustment. About one-quarter of official external reserves were spent during the crisis, an outflow that was soon reversed.⁵

⁴This may have been partly due to the relatively onerous reporting requirements imposed by the authorities in order to ensure that investments really were of a long-term nature. Until May 1994, foreign investments had to have a maturity of at least one year, and forward cover contracts at least three months.

⁵And indeed more than reversed: by end-September 1994, official external reserves reached \$12.6 billion, up from \$9.3 in April.

The inward movements that have been occurring in recent months have not yet been fully documented. They are thought to have been primarily in the form of foreign borrowing by Greek enterprises (mainly in dollars and yen) prompted by the high local interest rates and the relative stability of the Drachma (which is announced to have no more than a three per cent devaluation against leading currencies in the year 1995). The opinion of market participants differs as to the nature of this borrowing: private bankers believe that most is flowing through the banking system, but the Bank of Greece believe that a large amount, perhaps one-half or more, represents direct borrowing from abroad (including through parent companies). It is understood that some of the borrowed funds are being invested in the local money market. Only part of the bank-intermediated borrowing is thought to be covered against exchange risk.

Home preference in the financial asset position

Table 3.1 is a compilation of the main financial asset holdings of the non-bank sector, based on data prepared by the Bank of Greece, and on other sources. Without pretending to be comprehensive or rigorous in consolidation it serves to provide a benchmark of the relative magnitudes involved.

There is no standard methodology for constructing an overall financial asset holdings table. Any approach must take account of the risk of double counting (as, for example, when a non-bank financial intermediary holds a claim on a bank). Our approach has been to list the claims on the banking sector and claims on the government (other than those held by the banking sector). In addition we include other marketable securities quoted on the stock exchange, other than unit trusts. Finally, we also include identified foreign asset holdings, both of non-bank financial intermediaries and of the non-financial sector (if known).

Note that we do not include claims of the non-financial sector on non-bank financial intermediaries separately, as the corresponding claims of the intermediaries will largely be included elsewhere in the table. Nevertheless it must be acknowledged that the approach is

only approximate and does not fully eliminate all double counting.⁶

Looking first at the domestic financial assets, and bearing in mind that the "repos" shown represent a securitization of bank holdings of government paper,⁷ the dominance of bank-related assets in the table is evident. But non-bank assets have been growing faster of late.

We propose an index of "home preference", namely one minus the ratio of the identified foreign assets to the sum of the domestic assets and the "residents' deposits with non-resident banks". The measure is clearly only one of a variety which might be constructed, for example by distinguishing between direct and intermediated holdings of foreign assets, or by netting out short-term foreign liabilities of the banking system. Nevertheless, it will serve as a broad indicator of the internationalization of the country's financial portfolio.

For Greece, although the data on institutional holdings of foreign assets (monetary authorities plus banks plus, for 1993 only, mutual funds and insurance companies) and on nonbank holdings of deposits in non-resident banks indicate a growing share of foreign assets in the total during the early 1990s, the index of "home preference" indicates a higher reliance on domestic financial assets in Greece than in either of the other two countries.

3.2 Greek Banking

3.2.1 Recent Developments

The dramatic structural changes in the Greek financial system over the past decade have transformed what was a most distorted regime, with an elaborate structure of controlled interest rates, compulsory redeposits and lending coefficients, into what is now a fairly

⁶Among the double-counting problems which we do not resolve is that share of "residents' deposits with non-resident banks" which relates to the holdings by domestic non-bank financial institutions.

⁷Following the conversion in 1991 of the banks' compulsory holdings of Treasury debt into negotiable bonds, sale of repos emerged as a tax-efficient alternative to deposit finance. The implicit interest rate on repos moves closely with interbank deposit rates. The popularity of repos with the nonbank depositor increased sharply with the very high money market interest rates that became available during the 1992-93 currency crisis.

transparent and market-driven system.⁸

As an illustration of the regulatory changes, in 1985 portfolio and reserve requirements restricted the allocation of 78 per cent of bank deposits, a figure which is now reduced to 9 per cent reserve requirement at the central bank (with average remuneration on those deposits at about 10 percentage points below the market cost of funds).⁹ Interest rates are now completely freely determined by the banks, many of the restrictions on lending rates having been removed as early as 1987, with the final restriction (a floor on the savings account rate) removed in March 1993.

Despite deregulation, the system is still dominated by a heavily-concentrated banking system, whose subsidiaries are important players also in the insurance and fund management businesses. Despite recent losses in market share, the state-controlled banks still retain the lion's share of both deposits (79 per cent at end 1993)¹⁰ and lending (82 per cent), and their operations are still not entirely free of government pressures, and the remaining burden of poor, sometimes government directed, credit decisions of the past.¹¹

3.2.2 Structure

Bank concentration is considerable, a situation which is attributable to, and aggravated by, State-ownership of the largest institutions. The banking system has traditionally been

⁸Cf. Antoniadou and Kouzionis (1989), Papademos (1991, 1992).

⁹The reserve requirements can therefore be said to impose a reserve asset penalty equivalent to almost 100 basis points on credits. In addition, an annual 1 per cent commission is payable to the Bank of Greece on most lending. A further addition of another 100 basis points to the cost of credit is imposed by the turnover tax on bank interest receipts which is added by the banks to the quoted interest rate.

¹⁰Of all deposits in local and foreign exchange and repos.

¹¹These banks labour under a rigid salary structure, and senior management is politically appointed (even to the extent of the top management changing with a change in Government). The strength of the bank employees' union has made it difficult to achieve efficiencies. In addition heavy pension burdens resulting from very generous pension plans (now reformed) add to the operating expenses of these banks.

subdivided into a commercial banking sector and the specialized credit institutions, the former accounting for about two-thirds of assets, and rather less than three-quarters of deposits. Three of the four largest commercial banks are state-owned,¹² and the four-bank concentration ratio in this sector at end-1993 was 82 per cent, if measured on deposits, and around two-thirds if measured on assets or branches. Tables 3.1 and 3.2 provide further information on ownership and concentration. From them we may calculate a five-bank concentration ratio for all bank deposits at 70 per cent.

Because the state controls the largest institutions,¹³ effective concentration is considerably higher than indicated by ratios defined over institutions as if they were independent. The market share of state-owned banks has declined only gradually from 88 per cent in 1985 to 79 per cent in 1993 (measured by deposits). The decline has been due, not to privatization (although a couple of small specialized banks were recently privatized), but to the financial difficulties of some of the state-owned institutions which has inhibited them from competitive pricing and resulted in a gradual but steady drain of business to established and to more than a dozen new private Greek-owned banks. These have doubled their market share since 1985 to about 13 per cent, and most have proved to be extremely profitable, a situation which is evidently a corollary of the high margins being charged by the state-owned banks.

The apparent persistence of high banking margins might have been expected to result in substantial entry and expansion by foreign banks. In the event, the number of foreign banks established as subsidiaries or branches in Greece has remained unchanged at around 20 since

¹²The National, the Commercial and the Ionian - the latter being a subsidiary of the Commercial. The Alpha-Credit and the Ergo are the largest of the private banks, the former being an old-established institution.

¹³A peculiarity of the ownership structure of the banking system is that the controlling interest of the state in so many banks derives largely from its ability to vote the shares of the social security and pension funds who are the registered owners of many of the shares. These shares are quoted and actively traded on the Athens Stock Exchange, and recent liberalization of pension fund investment restrictions apparently open the door to a more flexible management of these funds. Although the existing fund managers have no intention of selling, it may very well be that the days of state-control of the largest banks are numbered even without any formal privatization.

the mid-1980s. It is generally supposed that, as elsewhere, information barriers have prevented the foreign-owned banks from making greater inroads. Most of the foreign banks are specialize in traditional international bank business.¹⁴ Despite the relative decline of the state-controlled banks, the foreign banks have enjoyed only a modest increase in market share of deposits to 8 per cent, and in loans to 6 per cent.

3.2.3 International Asset and Liability Situation

The international banking tables reveal a rather stable evolution of cross-border assets and liabilities of the Greek banks. Expressed as a percentage of GDP Greek banks' foreign *assets* have been consistently the lowest in the EU, and have fluctuated in a range between 4.0 and 6.7 per cent of GDP. The latter figure is the situation at end-1993, and there had been a gradual increase from the low point in 1987. A glance at the table for business with non-banks clearly illustrates that almost all of this credit was interbank in nature.

Greek banks have accepted a much larger volume of international *deposits*; the figure at end-1993 was 24.5 per cent of GDP, though this was below the peak of 26.5 per cent achieved in 1989. Over 90 per cent of these deposits were from nonbanks, with the result that Greece ranks third in the EU, after Belgium-Luxembourg and the UK, for cross-border deposits by nonbanks. The volume of inward interbank deposits may well be increasing since the removal of exchange controls.

So far as the foreign activities of Greek banks are concerned, the National and the Commercial have had branches in emigrant destinations (e.g. France, Germany, South Africa, UK, US), aimed at the Greek element, and very little involvement in the foreign markets. Several of the new private banks have opened offices in London, and one (Eurobank, owned by the Latsis family) is associated with a wider network of the international banking interests of its owners. Another new area for expansion, so far more in potential than in actuality is in the former planned economies of nearby Eastern Europe, especially Romania and Bulgaria.

¹⁴For example, Barclays target the shipping sector. Only Citibank is really active in retail segments, including mortgages.

Subsidiaries or affiliates of Greek banks have already opened in both countries, and more are expected to follow.

3.2.4 Interest Rates and Bank Margins

Quoted rates

Spreads between quoted deposit and lending rates in Greece are higher than anywhere else in the EU. Various reasons may be enumerated. First, the burden of fiscal and quasi-fiscal impositions on the banking system.¹⁵ Second, the fact that quoted lending rates do not take account of discounts for prompt loan servicing, a phenomenon which is not commonly encountered in other EU banking markets. Third, the pricing policy of some of the large state-controlled banks in maintaining high lending rates on performing loans in order to ensure adequate cash flow.

The most relevant interest rates are shown in Table 3.4. The interbank rate may be taken as a reasonable indication of the marginal cost of funds, as this market is quite active, though it is not considered large enough to be a reliable base source of funds. The largest component of the banks' funding sources are savings accounts,¹⁶ and therefore the rate on savings deposits is the most representative deposit rate. Short-term lending by the banks is rather larger than long-term lending and so the short-term lending rate is taken as the most relevant lending rate.¹⁷ Note that the substantial holdings of Treasury bills and bonds implies that

¹⁵These have been greatly reduced but, as mentioned above, still remain relevant. As late as early 1993, the effect of taxes, reserve requirements and other quasi-fiscal impositions on the banking system was estimated at 600 basis points, though a part of this was not included in the quoted interest rates used in official statistics.

¹⁶They represent 73 per cent of private deposits in M3. Other important sources of deposit-type funds outside M3 are repos and foreign-exchange denominated deposits; some of the latter are redeposited with the Bank of Greece where, until recently, they enjoyed a Government exchange rate guarantee.

¹⁷Since the liberalization of interest rates, quoted rates on long-term lending have tended to be about 2 percentage points below short-term rates. Most long-term lending is formally at adjustable rates, but it is not clear with what frequency rates are adjusted in practice.

rates on these instruments are also very important.

Table 3.4 reveals that the spread between the savings deposit rate and the short-term lending rate has jumped from a regulated 5.5 per cent in the mid-1980s to 8.0 per cent at the end of 1987 and to between 10.4 per cent and 11.5 per cent since 1989 (exceptionally it exceeded 13 per cent during the currency crisis of 1994). More recent downward pressure on these rates is reported. The interbank rate reacts more quickly to market forces than either the deposit or lending rates, and we therefore find a negative correlation between the spread of lending rate over interbank and the spread of deposit rate below interbank.

The relative stability of nominal rates on Treasury bills can be explained by the Government's reluctance to borrow domestically at very high rates. Accordingly there has been a tendency for the Government to switch its borrowing abroad rather than see Treasury bill rates rise.

So far, therefore, financial market liberalization appears to have resulted in higher, rather than lower, interest spreads. Nevertheless, heavy reliance on foreign currency by corporate borrowers since mid-1994 suggests the beginnings of a change. Banks report that, for the same borrower, quoted spreads (above cost of funds) on foreign exchange loans are some 300 basis points lower than for drachma loans. A degree of competition may be creeping in through the foreign exchange door.

Bank margins and profitability

Quoted interest rates do not indicate the overall average net interest margins earned by the banks. For this we must turn to bank income and expenditure accounts, though these too may be subject to question, especially in regard to the accrual of unpaid interest on non-performing loans, a practice which was prevalent up until recently in Greece. The OECD statistics provide a long-time series only for the two largest commercial banks (Table 2.2). These show a general decline in net interest margins until 1987, followed by a sharp rise to 1991, thereby confirming the evidence from quoted interest rates of greatly enhanced interest margins since liberalization. Non-interest earnings also grew vigorously, while staff and other operating expenses declined somewhat in relation to the balance sheet total. This has allowed

a substantial increase in before-tax profits, despite higher provisions.

Most of the other banks are highly profitable, a fact that is illustrated by the stock market valuation of the Alpha-Credit bank which is higher than that of the National bank despite the latter having a balance sheet some six times larger.

Nevertheless, it may be noted that the gross margin of the two large banks is a good deal lower than the very high figures recorded by Irish and Portuguese banks, confirming the need for care in drawing conclusions from quoted interest rate data.

3.3 Greek Insurance

That Greek life insurance is very undeveloped has generally been attributed to the generous State pension and social security provisions. Table 2.3 nevertheless shows a vigorous growth in penetration, with per capital premia growing from just \$9 in 1985 to \$67 in 1992, a 33 per cent annual average growth rate. While this is slightly slower than the growth experienced in Portugal, and while provisional figures for 1993 indicate a slowdown in growth to reach just \$70, it is clear that future expansion of this sector will remain strong in the medium term.

The low level of non-life premium income is not as easy to explain, and, at \$72 in per capital premium income, it is less than one-third of the next lowest in the EU, and has been growing much less rapidly than the EU average.

Altogether some 161 insurance companies reported activity in Greece in 1992, of which 56 were branches or offices of foreign companies. The share of foreign firms in total business is about 18 per cent and has not increased from the level it reached many years ago.

As to ownership and concentration, the sector includes private Greek firms, subsidiaries of the State-controlled and other banks, and foreign-owned firms and joint ventures. The market leader in life assurance is a private Greek firm (which is part of a privately owned group with new banking interests), and the four-firm concentration ratio in this line is almost 70 per cent.

As an indication of concentration in non-life, we may take motor as the biggest non-life line. In this line (as in others) the largest company is Ethniki, a subsidiary of the National Bank. It has about 20 per cent of the market, and the four-firm concentration ratio is about 36 per cent. Altogether four of the six largest firms are subsidiaries of State-controlled banks.

The investment funds controlled by the insurance companies are relatively small: less than \$2 billion at end 1993, of which 21.3 per cent are in foreign assets, chiefly bonds.

3.4 Remainder of Greek Financial System

3.4.1 Fund management

There has been a rapid expansion in fund management in Greece over the last few years. As with much of the product innovation in the Greek financial sector in recent years, this has been substantially driven by tax and regulatory considerations, and the lead role has been played by commercial banks who have established subsidiaries for the purpose. The largest share of this market has been taken by mutual funds of the open-ended type, whose resources have been invested in treasury bills, bank intermediated repos, and foreign bonds, among others. Mutual funds experienced their most rapid growth in 1993 and early 1994 (Table 3.5) to a level of well over \$5 billion. The removal of tax advantages (avoidance of withholding tax) in early 1994 has substantially halted the development of this market. The share of foreign assets in the total assets of mutual funds shrank from 17 per cent at end-1992 to about 10 per cent at end-1994, a change which is attributed to the disappointing performance of the US bond market and the US dollar, and to high interest rates at home.

Closed-ended investment companies quoted on the Athens Stock Exchange have not grown as much. By end-1993 the market capitalization of such companies totalled only about \$0.5 billion (Table 3.5).

Mention must also be made of the pension and other social funds, governed by legislation. These include social security and public sector pension funds as well as supplementary funds established by enterprises for their employees. There are over 100 such funds and their total assets were valued at Dr 1.46 trillion (just under \$6 billion) at October 1993 (Table 3.6).

Although these are managed by trustees elected by the beneficiaries, and although considerable liberalization has been legislated, including the possibility of such funds being managed on a commercial basis, the *de facto* situation is that the management of these funds is in the hands of Government nominees and is quite conservative. In the past, pension and social security funds were placed unremuneratively in support of the government's borrowing requirement, and several of the largest funds are seriously in deficit. Between them the funds hold controlling interests in several large companies including the banks earlier described as "State-controlled". They also hold substantial liquid assets, including balances at the Bank of Greece. It is not thought that their holdings of foreign assets are substantial. Now, however, their remaining investments are remunerated at market rates and they will soon, it appears become a force in institutional investment as normally understood. The whole area of pension fund management is clearly subject to considerable flux, and the direction of change is clearly towards a more fully funded and independently managed approach.

3.4.2 Stock market

The Athens Stock Exchange trades some 150 equities with a market capitalization at end-1993 of Dr 3.1 trillion, equivalent to \$12.4 billion or about 18.4 per cent of GDP in that year (15.1 per cent of revised GDP). Thirty per cent of the market capitalization represents banks, though the largest individual company is the Hellenic bottling company, capitalized at about \$1 billion. The market value of fixed interest securities traded was Dr 9.1 trillion at end-1993 and (fed by government borrowing, and by the restructuring of government debt) this figure has grown much more rapidly than equity capitalization in recent years. No foreign shares or bonds are traded on the exchange.

3.4.3 Foreign Direct Investment

Data on inward foreign direct investment are presented in Table 2.5. These figures, which do not include real estate, indicate a fairly steady flow in the order of 0.5-0.7 per cent of GDP per annum, with a jump to 1.5 in 1992. In recent years between 80 and 90 per cent of the flow has come from other EU countries.

4 PORTUGAL

4.1 Macroeconomic Aspects

In the case of Portugal, as for Ireland, the empirical link between aggregate saving and investment is weak. Sizable fluctuations in national savings have not been transmitted to national investment; indeed the best years for investment were in the early 1980s, which was a time of relatively low saving (Figure 2.1). This suggests that the international capital market was not closed to Portugal in an obviously constraining way.

The current account of the balance of payments has been in surplus on average since 1986, with a cumulative surplus of some \$0.6 billion. This has been augmented by a net total of just \$10 billion in foreign direct investment and of almost \$5 billion in portfolio investment. Despite net outflows through the banking system of \$5 billion, this has allowed the resident official sector to repay debt and accumulate foreign exchange reserves. Only in 1992, the year of the currency crisis was there a very substantial outflow of private portfolio capital (in the amount of \$3 billion).

As with Ireland, there has been a very substantial balancing item under the heading errors and omissions, and, except in 1993, the figure has been positive, suggesting unidentified capital inflows.

Available flow of funds statistics for Portugal run only to 1989, and have certain deficiencies. A new series is in preparation. The available data (Table 2.7) confirms a very substantial increase in gross capital movements in 1988 and 1989. Short-term loans and acquisition of equity represent the major elements in the inflow, while foreign currency deposits and acquisition of bills and short-term bonds dominate the outflow. In contrast to the figures for Greece, therefore, the Portuguese flow of funds data suggests rapid progress in financial integration as early as 1988.

The 1992 liberalization of capital movements

While the thrust of exchange controls in the previous few years had been directed to limiting undesired short-term capital inflows, controls on both inflows and outflows were both eliminated during the period September-December 1992. The fact that the final removal of

exchange controls, in December 1992, occurred during the EMS crisis, makes it difficult to be categorical about its short-run effect on capital movements. However, expert opinion holds that the removal actually enhanced credibility of the government's macroeconomic strategy and helped ensure a resumption of portfolio inflows in 1993.¹ This reading appears sound, even if it has to be acknowledged that foreign holdings of government paper have not recovered to their pre-crisis levels.

Table 4.1 shows the pattern of post-liberalization portfolio flows and the stock at end-1994. When compared with the figures in Table 2.7 for earlier years, it appears that there has been a further sharp increase in gross portfolio flows, certainly reflecting gross integration trends. But it may be noted that there has been no great net outflow of portfolio flows in 1993 despite the liberalization.

Banks have been by far the most important agents in these transactions, including the inward flows arranged by foreign branches of Portuguese banks. In 1993 trading in long-term bonds dominated the outward flows, but money market instruments took almost one-half in 1994. The inward flows included quite an appreciable fraction of trading in Portuguese equities. The share of the EU in total outward flows fell from about 85 per cent in 1993 to about one-half in 1994, the fall being largely attributable to a decline in Spain as a destination. The EU share in inward flows jumped from about one-third to over one-half.

Home preference in the financial asset picture

Table 4.2 is a compilation, from various sources, of the main financial asset holdings of the non-financial private sector. Inevitably, as with the corresponding tables for the other countries, it is incomplete and has required a number of arbitrary approximations, notably to avoid double counting. The depth of the financial sector relative to GDP has increased slightly in recent years. However, notably because of the high official external reserves, the index of "home preference" shows only a relatively modest decline.

¹For a discussion which places the liberalization in a historical context, see Macedo (1995).

Table 4.3 provides an end-year picture of the net external position in identified financial assets, as presented by the Bank of Portugal.

4.2 Portuguese Banking

4.2.1 Recent Developments

Apart from three foreign-owned banks,² the entire Portuguese banking system was nationalized in 1975 and operated for the next decade or so in a regime of directed credit and binding credit ceilings, controlled interest rates, heavy reserve requirements and no entry.³ The past decade has seen this regulated regime almost entirely replaced by one which is approximates that in most other member states in respect to openness and deregulation, and where the state's ownership share has declined rapidly from more than 90 per cent to around one-third now. The main stages in this liberalization have been (i) the admission of new banks from 1983 (this required a revision of the constitution), beginning with four private Portuguese-owned banks and six foreign owned. (ii) privatization of the nationalized banks (requiring a further constitutional revision) which began in 1989 and is still in progress; (iii) elimination of interest rate controls (which were removed on lending by 1988 and on deposits by 1992); of credit ceilings in 1990; and of other controls such as on branching and on new products, and the progressive reduction in reserve requirements, which is still in progress and will be phased out by 2007.

4.2.2 Structure

From 1983 the possibility of establishing new private banks (foreign or domestic) was reopened. Since the programme of re-privatization began in 1989 the ownership structure and concentration of the banking system has been in rapid flux. It is likely to experience further important changes in coming months. Almost two-thirds of the State's banking holdings have been sold, and the plan is to retain only the largest bank CGD and about a half of one other.

²These were Credit Lyonnais, Bank of London and South America (Lloyds), and Banco do Brasil.

³Cf. Borges (1992,1993), Macedo (1990, 1993).

the BFE, in State hands.⁴

The emerging position is one in which a few individuals or families hold controlling interests in a large part of the banking system. The system is also becoming quite concentrated. Efficiency and prudential issues evidently arise.

In measuring concentration it is important to distinguish between concentration as measured relative to distinct banks and concentration of control in groups (Table 4.5). For the moment, on either basis, following the privatizations, concentration is not high by European standards. Looking first at concentration based on banks rather than groups, the market leader CGD, has about 23 per cent of the deposit market and the four-bank ratio is about 51 per cent, about the same as in 1987. Looking at the consolidated position, the ratio jumps to 62 per cent.⁵ One of the newly established private banks⁶ is in the top five, the other three⁷ are re-privatized banks.

However, a series of mergers among large institutions is in progress which will result in two large private banking groups challenging the CGD's position as the largest bank. After the merger (and based on the 1994 market shares), the four-group concentration ratio will jump

⁴The CGD was already State-owned before 1975, when it was primarily a savings bank (there is no postal savings bank). The BFE grew out of the State-controlled development bank BFN.

⁵Whether this is larger or smaller than in 1987 depends on whether one consolidates the whole of the government's ownership into one group. Looking at the separate legal entities, C_4 (based on loans) was 53 per cent. But at that time most of the banks were government owned, so if the government-owned banks are taken as a single group, C_4 for 1987 jumps to 97 per cent.

⁶The fifth-ranked BCP. It is expected to acquire a controlling interest in second-ranked BPA during 1995.

⁷BPA, BTA and BESCL in second, third and fourth place respectively ranked by consolidated balance sheet aggregates. As noted, BPA will come under the control of fifth-ranked BCP, while seventh-ranked BPSM is acquiring (from the Spanish bank Banesto) a controlling interest in BTA.

to 78 per cent (based on deposit-type resources).⁸

While the rapid growth of the Portuguese economy during 1986 to 1992 helped the reprivatized banks put any undue legacy of bad and doubtful loans behind them, they still inherit excessive staff levels and costs. The wave of mergers is seen as a basis on which economies can be effected, but it remains to be seen whether this can be done.

Although there is almost a score of foreign-owned banks now operating in the market, their aggregate share is only about 9 per cent of loans and about 6 per cent of deposits.⁹ Some of the foreign banks have been quite unsuccessful, with bad loan-loss experience. Some are active in retail banking, despite the fact that rather high charges were imposed on new banks wishing to open branches. None has more than about a 1½ per cent market share. Most of the foreign banks are EU-based, the largest being the Spanish Banco de Santander; US-based banks have about a one per cent market share between them. Some observers have expressed the opinion that the authorities would resist the sale of a large Portuguese bank to a foreign concern, and it is certainly true that concern was expressed when it was revealed that Banesto had surreptitiously acquired control of the second largest bank, BPA. An alternative interpretation, however, is that the political opposition in that case was to the acquisition by a foreign concern at reprivatization, and that no such reaction would occur in the case of a market transaction.

The foreign presence of Portuguese banks takes four distinct forms. First, there is the network of branches operated by the larger banks in traditional emigrant destinations, especially France, where CGD alone has some 43 branches, but also in South Africa and Canada. Second, a new expansion into Spain: CGD have acquired three banks with a total of 160 branches, mostly in parts of Spain near the Portuguese border; BESCL have also

⁸And C₃ will be 70 per cent, compared with 54 per cent on a group basis today. Concentration ratios based on assets or loans are slightly smaller.

⁹This assumes completion of the divestiture by Banesto of its 50 per cent direct and indirect holding in BPA.

acquired a Spanish bank with a retail network. Third, traditional foreign banking activities (corporate and foreign exchange) in major centres including London, New York, Brussels and Geneva. Fourth a relatively modest presence in former colonies in Africa, and Latin America, and in Macau.

4.2.3 International Asset and Liability Situation

The international banking statistics show Portuguese banks to have had comparatively low cross-border assets up to 1993. The figure has been around 10 per cent of GDP, with a very substantial jump after exchange control liberalization in 1993. In contrast, the cross-border liabilities of Portuguese banks to non-banks have been little below the EU average share of GDP. There has been some recent growth in foreign non-bank deposits with Portuguese banks, but the sums are still very small. Foreign currency deposits by residents have grown rather rapidly since 1993, but remain comparatively small (Table 4.4). The data in this area are potentially contaminated by the treatment of Madeira as a non-resident entity, though the magnitude of the distortion is not likely to be very great.

It is noteworthy that there has been a steady decline in the size of Portuguese non-banks' business with foreign banks over the years, with only a small reversal in 1993.¹⁰

4.2.4 Interest Rates and Bank Margins

The main stylized facts about Portuguese bank interest rates and margins are easily interpreted in terms of the process of liberalization and increased competition. Following the liberalization of bank lending rates, combined with retention of binding credit ceilings in 1988, lending rate margins began to expand, a process which accelerated as the bank privatization process continued. After the lifting of credit ceilings in 1991, allowing competition between banks for lending opportunities, the margins dropped rather sharply, and have continued to drift lower. Product innovation, including commercial paper and syndicated loans priced on an auction basis, has lowered borrowing costs for certain low-risk customers; household borrowers in the mortgage market have also benefitted.

¹⁰Recall that this data includes the Portuguese Government.

These trends can, at least partly, be documented by reference to available statistics on quoted interest rates and on average bank margins.

Quoted rates

Figure 4.1 displays the relationship between the main bank deposit and lending rates 1987-95. The upper panels compare the main lending and deposit rates rate with the interbank rate, while the lower panel shows the gap between lending and deposit rates.¹¹ The qualitative features described above are clearly evident in the plot. The gap between the lending and deposit rates in the figure reached over 1000 basis points during 1990-91, before declining sharply to the vicinity of 600 basis points. These data show no evidence of a narrowing of margins during 1993-94, as is suggested by the banks' accounts (below).

The rate on "discount of commercial bills" ("carteira comercial") is reckoned to be that charged to higher-risk borrowers than the rate on "loans and advances" discussed in the previous paragraph. The gap between these two rates could be taken as the risk premium built in to Portuguese bank lending rates. This gap is shown in Figure 4.2 along with the so-called "Cristal" loan rate on syndicated loans to the best borrowers. The data suggests a widening of the risk margin since 1990, but the volatility of the series casts doubt.¹²

In addition to the regulatory changes already mentioned, bank interest rates will have been influenced by the cost of reserve requirements. Calculating the effect of reserve requirements

¹¹See also Table 4.6. The data are obtained from *International Financial Statistics* and from the series of the Bank of Portugal. There are a number of small breaks in the data series, and slightly different data are obtained depending on the maturity chosen, but the main story is unaffected by these. The figures use the quarterly IFS series, based on 91-180 day loans and on 181 day - 1 year deposits. The table uses 91-180 day maturity for both deposits and lending. In fact, the longer maturity is the most popular, representing over one-half of private time and savings deposits. (It is noteworthy that deposits with maturities of under 180 days now represent about one-quarter of non-bank time deposits, up from less than 2 per cent in 1990.) The interbank rate used is the overnight rate, which is by far the most active maturity.

¹²An econometric study by Catalão (1993) suggests that Cournot-type behaviour is present in these markets and that the gap between interest rates may reflect a lower elasticity of loan demand for those borrowing in the form of discount on commercial bills.

on break-even lending rates is complicated by the fact that the requirements amounted to a two-tier system with a base quantity plus a fraction of deposits. At the end of 1994, the 17 per cent reserve requirements were replaced by a 2 per cent unremunerated reserve requirement. The remaining 15 per cent were converted to bonds, one-third of which bear no interest, the remainder being remunerated at a rate of interest close to market. Assuming a marginal cost of funds in the region of 9 per cent, the implicit tax amounts to about 80 basis points added on the interest that must be earned on other assets. In addition, a stamp duty, recently reduced to 7 per cent of the interest paid, together with a smaller, one-off percentage on the capital value of the loan is payable by the borrower (over and above the quoted interest rate).

Bank margins and profitability

The data on bank profitability (Table 2.2) confirms the pattern of interest rate movements discussed already. There was a definite improvement in profitability and a widening of average margins from 1985 to 1990/91. Indeed, average margins widened by about 2 percentage points in this period. Since then, there has been a narrowing of margins which has continued into 1994. Latest data for the first part of 1994 indicate average interest margins at about 3½ per cent. There is now (as elsewhere) a move to unbundle costs and to make separate charges, which means that some of the decline in interest margins is being compensated for by an increase in other income.

Non-price Competition

The relatively large number of significant banks and the public availability of considerable detail about their operations has allowed the recent emergence of a body of econometric research on various aspects of the competitive behaviour of Portuguese banks, notably the vigorous expansion of branches - whose numbers almost doubled in the four years 1988-92, from 1566 to 2839 (e.g. Cabral and Majure, 1993, Barros and Leite, 1994, Barros, 1995, Pinho, 1995). These studies highlight such elements as the strong increase in branching and advertising expenses as evidence of increased competition in the post-liberalization era, but their models also imply that the banking market remains far from perfectly competitive, and that size confers market power. While the conclusions of this research must be regarded as

tentative, they are consistent with the evidence from aggregate spreads and margins.¹³

4.3 Portuguese Insurance

Rapid expansion has been the key feature of the Portuguese insurance sector, although starting from a low base. Measured in dollar terms, average annual growth in per capita premium income in the life sector 1985-92 was 52 per cent, and in non-life 25 per cent, easily the highest percentage growth rates in the EU (Table 2.3). Nevertheless, by 1992 Portugal still had the second lowest insurance penetration in the EU, and per capital premium income was about one-sixth the EU average in life, and one-third in non-life.

There were some 92 authorized companies in Portugal in 1993, of which just over one-half were branches of foreign firms (all but 3 from EU member states). The market share of branches of foreign firms in the non-life sector has remained below 10 per cent (Table 2.4) and in the life sector has declined from almost 40 per cent in 1989 to below 20 per cent in 1992. In addition to branches, some of the firms established in Portugal are foreign-controlled, and the total market share of foreign-controlled companies is over one-quarter. The entry of foreign firms, especially through subsidiaries and cross-holdings, is considered to have brought considerable technical know-how to the sector.

All domestic insurance companies were nationalized along with the banks in 1975 and, following some consolidation, six nationalized companies dominated the market. These have now been re-privatized (except for the second largest, which is a subsidiary of the bank CGD) and they remain the largest companies.¹⁴ The years following privatization, during which premiums were also decontrolled saw a scramble for market share which involved below-cost

¹³ One interesting aspect of the research is the distinctions which are drawn between the behaviour of different classes of banks, notably as between foreign-owned banks and the rest, but also inasmuch as private banks have expanded branches in rural areas, whereas state-owned banks expanded more in urban areas.

¹⁴ There are strong links with the banking system: in addition to that owned by CGD, three of the reprivatized firms are associated with banking groups, and in two cases have been used as a vehicle for bank acquisition.

selling.¹⁵ During this period the four-firm concentration ratio fell: from 48 per cent in 1988 to 44 per cent in 1993. Subsequently a retrenchment has set in with some of the smaller firms retreating, and considerable evidence of "tariff recuperation". During 1994, the top firms fully recovered their losses in market share.

As perceived by the authorities, the main problems facing the sector now are the excess staff numbers and a somewhat negative public image regarding speed of payments in the non-life sector. Confidence in the solidity of the insurance sector is high.

The investment funds controlled by insurance companies at end 1993 totalled Esc 982 billion, or \$5.5 billion. Because of prudential requirements for currency matching (the so-called congruence conditions) less than 2 per cent of these funds are held in foreign assets.

Firms owned by Portuguese banks that have a foreign retail presence have been selling insurance through the foreign branches, though to date this is a small component of their business. More than one hundred foreign companies have indicated their intention to write business in Portugal under the new freedoms, but there is no evidence of much activity of this sort to date.

4.4 Remainder of Portuguese Financial System

4.4.1 Fund Management

Starting from a very low base there was a spectacular growth in mutual funds in Portugal between 1989 and 1993, by which date they had total funds under management approaching Esc 2.5 trillion, or \$14 billion (Table 4.7). Much of the growth was driven by tax advantages.¹⁶ There was no growth in the value of funds during 1994, partly due to poor investment performance and partly to a reduction in tax advantages. The largest mutual

¹⁵The competition was slow to start, as shown by econometric studies suggesting non-competitive behaviour even after entry was liberalized (cf. Barros, 1994).

¹⁶Especially to the so-called "real estate funds"; though their special advantages were greatly reduced in 1993, following which their importance declined rapidly.

funds are managed by banks. Following liberalization of exchange controls, mutual funds diversified into foreign securities and 11.6 per cent of the total portfolio was in foreign assets by the end of 1994.

Pension fund assets managed by financial institutions or fund managers at end-1993 stood at Esc 744 billion or \$4.2 billion, of which less than 6 per cent was invested in foreign assets. Recent rapid growth in the pension fund market has been partly attributable to the banks making belated funding provision for their staff pension schemes. Bank staff are not included in the general social security regime and their pensions are thus the responsibility of the banks. A further component of the growth is in private pension plans for which relatively substantial income tax concessions are available. About 10 per cent of the pension funds are managed by insurance companies, the remainder by distinct pension fund management companies.

4.4.2 Stock market

In 1994 the Lisbon¹⁷ Bourse traded some 195 equities with an end-year market capitalization of Esc 2.6 trillion, or about \$15 billion, equivalent to about 20 per cent of GDP. The number and value of equities traded increased very substantially in the late 1980s, partly due to privatizations, and the privatization of the banks and certain other large companies has continued to contribute growth to the total market capitalization. At end-1994 banks and other financial institutions accounted for over 69 per cent of the total capitalization, and insurance firms for a further 5 per cent.¹⁸ In response to the growing business the Bourse has streamlined its operations which are now considered technically well-equipped.

As in Greece, the restructuring of public debt has contributed to the enormous growth in the value of public bonds outstanding. The market capitalization of bonds at end-1994 was Esc 4.9 trillion of which all but Esc 1.14 trillion was public debt.

¹⁷The Oporto Bourse closed in 1994; it will be replaced by an options market focused on the domestic market.

¹⁸Though given the scale of cross-shareholdings within the financial sector, these totals include a considerable amount of double counting in terms of distinct financial claims.

Non-resident holdings of quoted securities rose from Esc 268 billion at end-1989 to Esc 794 billion at end-1994 (Table 4.8). This rise masks considerable variation in the holding of public debt, which went as high as Esc 609 billion (end-1991) before falling to Esc 177 billion the following year. Holdings of equities grew rapidly during 1992 and 1993.

4.4.3 Foreign Direct Investment

Data on inward foreign direct investment are presented in Figure 2.5. The figures indicate a very strong upward trend since EU membership until 1991, when net inward flows were of the order of 3 per cent of GDP. That net flows have fallen off somewhat since then is indicated by available data for 1993 and 1994, although these are based on a new methodology and are not strictly comparable to the earlier data. More than a half of the net inward FDI relates to the Finance and business services sector. The EU share in the total has been in excess of 70 per cent, with the UK, France and Spain being the largest sources.

Outward FDI, almost all of it to the EU, also increased sharply to 1991, with again a decline in 1993-94. The finance and business services was by far the most important sector here too.

5 IRELAND

5.1 Macroeconomic Aspects

The fact that Ireland has been closely integrated into the European and international capital markets for many years is exemplified by the huge swings in its balance of payments position, from a deficit of almost 15 per cent of GNP in 1981 to a surplus of almost 9 per cent in 1993. The year-to-year correlation between national saving and investment 1960-93 is insignificant ($R=0.1$) suggesting that availability of national savings has not been a constraining factor in limiting national investment (cf. Figure 2.1).

Official borrowing was especially high during the period of large balance of payments deficits. Although the scale of this borrowing has been greatly reduced, the more recent period of surplus has been marked more by accumulation of private financial claims on the rest of the world than by net repayment of Government borrowing.

Table 2.1 shows elements of the balance of payments during the period 1986-93. Among the features of this table are the relatively modest scale of "direct investment" and the huge outflows (totalling \$10 billion over the eight years - or about 5 per cent of GNP on average) "other capital - other" reflecting non-bank private flows other than those identified in other headings.

The former includes only inward flows of capital associated with grant-aided industrial fixed capital formation. It should be noted that these figures are much smaller than the aggregate of the outward direct foreign investment data to Ireland recorded by other EU countries - an aggregate which goes as high as 11.1 per cent of GDP in 1991, over 20 times that reported in the Irish statistics.¹ The larger figures from the partner country sources certainly include substantial flows into investment companies in the Dublin International Financial Services Centre, where they are analogous to managed portfolio funds.

The latter will likely include both portfolio and direct investment flows. They should perhaps

¹A discrepancy which does not arise in the case of other countries.

be considered in conjunction with the sizable errors and omissions item. These have shown some tendency to be offsetting in magnitude.

Following a string of years in which they partly financed the current account deficit, the banks have been net exporters of funds since 1991. The shortlived effect of the 1992-93 currency crisis is evidenced by the outflow of official reserves amounting to \$3.5 billion in 1992 followed by an inflow of \$3.9 billion in 1993.

Official flow of funds statistics do not extend beyond 1986, and so are of no assistance in the present context. More recent data (Honohan, 1992) provides less detail than is available for the other countries, but does indicate that gross capital flows were already well developed by 1986.

Recent Liberalisation of Capital Movements

Liberalization of capital movements came in several stages. The first substantial relaxation was from 1 January 1988, which, among other changes (including liberalization of foreign borrowing) allowed individual and institutional investors to invest a limited amount of new funds in foreign securities. One year later, all restrictions on the purchase of medium and long-term securities were removed. A third stage in the liberalization took effect from April 1990, and was mainly focused on reducing the administrative burden. From the beginning of 1991 restrictions on the purchase of short-term securities by residents and on the making of long-term loans in Irish pounds to non-residents were relaxed. From 1 June 1991, domestic financial institutions were permitted to operate foreign-currency deposits for residents. A penultimate stage in the liberalization was taken at the beginning of 1992, when, among other things, restrictions on medium-term loans to non-residents, on foreign currency borrowing by residents and on the financing of investments or properties abroad. All remaining exchange controls were removed from the beginning of 1993.

Unlike the experience in Greece and Portugal, the removal of exchange controls has not been accompanied by a substantial private capital inflow. Indeed, the period of gradual relaxation has also been a time of substantial private capital outflow. Some of the outflow has undoubtedly been caused by the liberalization, notably the diversification of institutional

funds. It is less clear that liberalization has been the driving force behind other capital outflows. If it was a matter of a once-off stock adjustment, one would expect such flows to have been more substantial in 1993 than before or since, but that is not the case.

There is no evidence that the final liberalization of exchange controls induced more substantial speculative flows during the 1992-93 currency crisis. The outflows surged as sharply before the beginning of January 1993 as after.

Home preference in financial asset position

Table 5.1 presents a compilation, from various sources, of the main financial asset holdings of the non-bank private sector. As with the corresponding tables for Greece and Portugal, it is inevitably incomplete.²

This data for Ireland (which uses a wide definition of the banking system, covering all credit institutions) indicates a higher share of financial assets in GDP than for Greece or Portugal. There is also an apparently much higher share of foreign assets in the total, largely reflecting the large gross foreign position of the banking system. The index of "home preference fell sharply from 0.65 in 1985 through 0.47 in 1990 to 0.24 in 1993.

5.2 Irish Banking

5.2.1 Overview and Recent Developments

Ireland's integration in the international financial system has traditionally been through the close connections between the domestic financial system and that in the UK. The three largest banks in the Republic of Ireland are equally active in Northern Ireland (one has its head office in Belfast), and each has an important banking presence in London. Ireland's banking system is generally rated as technically sophisticated and the sector has been relatively free of prudential problems.

²The methodological approach is explained in Chapter 3.

5.2.2 Structure

Until recently, it was possible to distinguish a number of classes of bank and near-bank in a fairly clear-cut way, but the situation has become rather more blurred as a result of liberalization of the activities of building societies and the state-owned banks, as a result of the growth of international business through the International Financial Services Centre (IFSC), and as a result of the single EU passport in banking.³ The Central Bank is abandoning, without replacing them, some of the former classifications which it has used in statistical presentations, arguing that it would be hard to defend any dividing lines that could be drawn on the basis of the statistical returns it receives. Nevertheless, it still seems possible to distinguish conceptually between on-shore and off-shore banking, and within on-shore between prime, household, and other business.

The banking system has been fairly highly concentrated, with the two largest banks probably taking over 60 per cent of the domestic market. These two - AIB and Bank of Ireland - are among the largest PLCs in Ireland. These two banks (together with their subsidiaries) are involved in all forms of financial activity, including insurance and stockbroking. Broadly speaking, most of the remainder of on-shore retail banking is operated by eight smaller general or retail banks, each of which has deposit resources of over ECU 1 billion, as well as by half a dozen building societies (home mortgage banks). A larger group of banks and near-banks conduct a wide variety of financial service activities, both on-shore and off-shore, with varying degrees of specialization, but primarily dealing with the corporate sector.

Ownership

In terms of nationality of ownership, the banking system displays a wide variety. The two main banks are publicly quoted on the Dublin and London stock exchanges and are widely

³Twenty distinct banks or banking groups are operating under an Irish banking license. In addition several important categories of near-banks, including building societies and credit unions, are exempt from the requirement to hold a banking license. Ten other banks are operating on a branch basis in Ireland with a license from another EU country; this includes Ulster Bank, the third largest financial institution in the State. A further 29 banks had notified their intention to provide banking services on a cross-border basis by end-1993; this number is understood to have grown to about 50 by end-1994.

held. About 28 per cent of AIB shares are held by non-residents. Of the eight smaller general banks which we have highlighted, three are subsidiaries of foreign banks (though one only 50 per cent foreign-owned); one is a former building society, recently de-mutualized and floated on the Dublin stock exchange; two are state-owned specialized banks, the other two are the savings banks - a mutual (the TSB) and the state-owned Post Office Savings Bank. Apart from subsidiaries of these, the remaining institutions are either foreign-owned, or are part-owned by foreign banks. The nationality of foreign control includes US, Canada, Japan and Australia, as well as EU member states.

Foreign bank presence in Ireland is of long-standing origin. Apart from the presence of British-owned banks dating to the foundation of the State, a wave of establishment of foreign-owned on-shore banks in the late 1960s and early 1970s was succeeded in the early 1990s by the arrival of a group of essentially off-shore banks, resulting from the establishment of the IFSC. Table 5.5 shows that this latest surge has left foreign banks with 37 per cent of total assets of the credit system by end-1994 (up from 24 per cent in 1990); and though they only have 21 per cent of deposits (up from 17 per cent in 1990), these are high proportions by international standards.

International merger and acquisition activity in the sector has been present, albeit at a relatively modest rate. The two largest banks have been active in outward direct investment in banking, directed primarily towards the US.⁴ Of particular interest has been the recent acquisition by AIB of the Northern Ireland-based savings bank TSB. This was designed to enhance AIB's retail presence in Northern Ireland. Inward investment through acquisition of shareholding has also been observed, but this has mainly been related to banks active in offshore business, and Credit Lyonnais's acquisition of a 50 per cent shareholding in Woodchester has been the largest deal focused on the on-shore market. Considering the volume of merger and acquisitions activity that has been taking place throughout the industrial world, one would have to say that the Irish experience is one of relative stability.

⁴Just 50 per cent of the combined balance sheet of these two banking groups relates to Ireland, 29 per cent to the USA and 17 per cent to the UK.

5.2.3 International Asset and Liability Position

Growth of international business

Tables 5.2(a)-(c) display aspects of the growth in international business of those banks with a physical presence in Ireland. This data, which refers only to business booked in branches located in Ireland, is more comprehensive than that published internationally, and merits a closer look. "International business" includes all foreign exchange assets and liabilities, and all claims on or deposits from foreigners. Expressed as a percentage of GNP this has grown from 56 per cent at end 1981 and 59 per cent at end-1985 to 173 per cent at the end of 1993 (Table 5.2a). This growth has exhibited a substantial acceleration as time has progressed, with by far the largest growth occurring in 1993. The share of non-banks in the total of foreign business has always been less than one-half, but has now fallen to one-third. A striking change in the position since 1991 has been the emergence of a substantial net lending position with respect to foreign non-banks reversing a long-standing net debtor position of Irish banks *vis-à-vis* foreign non-banks. In this context it should be borne in mind that the classification "non-bank" includes many financial enterprises, and that no break-down between financial and non-financial enterprises is available in this respect.

The rapid growth is undoubtedly associated with what might be termed off-shore business, though this is not separately identified in the data. By offshore business we mean financial services unrelated to non-financial activities involving Ireland, as when a foreign manufacturing enterprise with no production import or export activities in Ireland conducts business with an Irish bank.

It is noteworthy that, in terms of geographical structure or currency of denomination, there is not an uniform trend toward an increased share of EU in Irish international banking business. Thus in particular the share of the EU in Irish bank claims on non-residents has fallen from over 85 per cent in 1985 to less than 60 per cent in 1993 (Table 5.2b). In currency terms there has been some relative gain by the DM at the expense of sterling, but the growth in US\$ assets and liabilities has been much more rapid, primarily as a result of the currency preference of foreign counterparties (Table 5.2c).

5.2.4 Interest Rates and Bank Margins

Competitive pressure

Competitive pressure on existing institutions from increased internationalization will manifest itself in a number of rather different markets. Thus we may distinguish between prime and less-than-prime customers, and between bank lending and other bank services.

Prime Irish borrowers have long had access to the international capital markets. The international scope of their business, especially (but not limited to) the UK meant that they have always had multiple banking relationships. Less-than-prime borrowers have likely had access to international bank borrowing only to the extent that this was closely related to their import or export business and could be secured by reference to that business. This too is not thought to have changed much, as banks with no physical presence in Ireland are in a weak position to assess credit risks and fear adverse selection.

So far as deposit and fee-based services are concerned, the elimination of exchange controls might seem to have opened the possibility of increased imports of financial services, and certainly this is an area where the banks are most concerned to remain price competitive. In fact, it is widely believed that tax evasion led households and small enterprises to hold bank deposits abroad during the 1970s and 1980s. Successive tax amnesties, together with a considerable reduction in the burden of income tax on interest income from 1993 is believed to have resulted in a considerable reflow of such funds, though by their nature, such flows are hard to identify and quantify with any confidence.

If small depositors have easy access to foreign banks and banking services, while prime borrowers have access to foreign bank funds, a competitive squeeze on local banks can be expected to show up in reduced profitability, costs and in higher lending margins (above the marginal cost of funds) on the less-than prime borrower. Some evidence of this seems apparent in the data collected in Table 5.3 and Figure 5.1. However, forces other than pressure of competition have also contributed to the fluctuations in margins and profitability. The decline in the profitability of the Irish banks in the 1991-2 period relates almost exclusively to heavy loan-losses associated mainly with their business located in the UK and

the US, rather than to their Irish business. Furthermore, unbundling of charges tends to result in a growth in fee income relative to interest charges.

In respect of deposits there is general agreement that the price sensitivity and competitiveness of this market segment increased sharply around the beginning of 1993. The interest rate crisis of 1992-93, during which even modest deposits could earn interest at an annual equivalent rate of 25 per cent or more, combined with the relaxation of taxation on deposit interest, led to a greatly heightened awareness and price sensitivity of a large segment of the deposit base. Since the reduction in taxation had been an anticipatory response by the government to the elimination of exchange controls, we can see this increased competition as indirectly being caused by increased financial integration, even though it was associated with an inflow of retail funds during 1993. The deposit rates shown in Table 5.2 become increasingly unrepresentative after 1993, as banks tended to segment the deposit market by offering the best rates primarily to those who revealed their interest sensitivity by completing the necessary forms for the low-tax regime.

The widening of the spread of lending rates over interbank rates is certainly noteworthy, but could again be somewhat controversial. The banks' lending rate matrix (Prime, AA, A) is a survival from the days when interest rates were administratively controlled. Now each bank publishes its own matrix. Objective criteria establish the rate category applicable to any given customer, but a bank may choose to accommodate a customer at a better rate than indicated by the published matrix. Although there is no disputing the fact that there has been a widening of the spread above interbank of the AA lending rates (applicable to most medium-size enterprises), what is less certain is the extent to which favoured customers have been granted loans at below matrix. Market participants indicate that as much as 30 per cent of AA lending is currently at below matrix rates. A more comprehensive indication would be provided by the average interest margin earned. Published information is too aggregative to help much, but market participants indicate that the average margin earned on AA and A lending over a weighted average of deposit rates has shrunk from 5¼ per cent to 4½ per cent.

Overall, the evidence is consistent with increased competition, though alternative explanations

for most of the evidence is available for those who wish to cast doubt on the degree of increased competition.

5.3 Irish Insurance

5.3.1 Recent Developments

Life and non-life insurance are well-developed in Ireland, which has a high ratio of premiums to GDP by international standards. The Irish Insurance market is one of the more developed in the EU with a higher ratio of premium income to GDP than in other members. Having experienced a tradition of relatively light regulation in the old UK tradition, the Irish industry is regarded as efficient and innovative in product terms. Total premium income written in Ireland in 1993 was £772 million for life business and £1091 million for non-life. Total expenses amounted to £356 million (life) and £155 million (non-life)

Over the years, the savings element in life assurance has been boosted by tax concessions (both in regard to partial deductibility for income tax purposes of premiums paid, and exemption from income tax of the proceeds of insurance policies, and in regard to favourable accounting treatment of insurance company expenses). However, these concessions have now been phased out; in addition, new concessions with regard to the taxation of deposit interest have improved the relative after-tax attraction of bank deposits. Accordingly the relative importance of the savings element in relation to the insurance element has decline sharply in recent years.

The industry has been more preoccupied with this dramatic change in the domestic market environment than with any concerns about increased international competition following the Third Life Insurance Directive. Ireland has no derogations from this Directive, which came into effect on 1 July 1994, and domestic legislation (ministerial order) is expected to be in place before the end of 1994.

5.3.2 Ownership and Structure

The Irish market has been served by both Irish-controlled and foreign-controlled companies

for many years (some of them present on a branch basis). Despite several ownership changes in recent years, including the takeover of two large failed Irish-controlled companies by foreign insurers, the concentration of the market has not increased. Indeed, the dominant firms (Irish Life in life assurance Hibernian in general lines and PMPA in motor) have lost some ground in recent years. The four-firm concentration ratio (measured on total premium income) for life in 1993 was just under 50 per cent, down from 67 per cent in 1986; in non-life it was 42 per cent, down from 46.

The market leader Irish Life having been effectively de-mutualized and floated as a PLC in 1991, the major players are all privately owned companies. There has been little change in the market share of the life companies with their head offices in Ireland at about 80 per cent for life, and some increase for non-life (from 65 per cent to 71 per cent). However, this distinction does not correspond to ownership. Indeed, (apart from Irish Life) almost all of the major companies are partly or wholly owned either by the two main banks, or by foreign financial institutions. The arrival on the scene of the two banks, whose life assurance subsidiaries have acquired a substantial market share (around 12 per cent) in just a few years, has been a notable development.

Irish Life is the only domestic-based company with significant participation in insurance companies abroad. Far from expanding these activities within the EU in recent years, however, it has been downsizing and rationalizing its UK presence in response to unfavourable regulatory and market trends. A repositioning of its activities, in favour of relying on brokers rather than tied agents, could allow it to expand again on a more profitable basis. For somewhat similar reasons, Irish Life has recently announced the sale of its Norwegian subsidiary. The main geographical area of expansion for Irish Life is the United States, which became more open to it following privatization.

5.3.3 Competitive Pressure

Direct sales inward

A long and growing list of companies licensed in other EU states have notified their intention of selling insurance products in Ireland. However, there is little evidence of much activity

of this type. The domestic market is regarded as overcrowded, and market participants feel that newcomers would find little advantage in entering, in particular that they would probably also be fearful of the adverse selection. Recently there have been complaints about some EU companies who had sold insurance in Ireland without having notified the authorities, but it is clear that this is a quantitatively insignificant development.

Direct sales outward

A handful of companies with head office in Ireland have long written insurance outside Ireland (mainly in the UK) but, even for non-life, the total premium income from this source has been less than 5 per cent.

Four companies established in the IFSC with the intention of conducting direct sales of life assurance products abroad have recently been licensed. One of these is Irish-controlled, namely Irish Life International. This is a 65 per cent subsidiary of the domestic market leader, and it plans to sell savings products to high net worth individuals. Its target market is not confined to the EU, and indeed the chief market to be targeted in the initial period is expatriate South Africans, though the UK and other markets will also be targeted. A reasonable expectation would be that funds managed by this company alone could amount to \$1 billion within a medium-term horizon.

The IFSC hosts a large number (about 65) of captive insurance and reinsurance companies conducting what may be described as off-shore business. The insurance regulator does not collect information on the volume of business of reinsurance companies, for which no prudential regulation is in place. The total sums involved are thought to be very considerable indeed.

5.3.4 Breakdown of Asset Position of Irish Insurance Firms

The asset holdings of Irish life assurance companies (and pension funds) over the period 1983-93 are laid out in Table 5.4. The total market value of assets held by life assurance firms affiliated to the Irish Insurance Federation, which includes practically the whole domestic life assurance market, was £11.8 billion or some \$16.7 billion at end-1993, the

equivalent of 36.5 per cent of GDP. The share of Irish assets held in the overall portfolio was less than 20 per cent until the late 1980s. After the liberalization of exchange controls the share of foreign assets increased to 25 per cent of the total. Although this percentage has remained constant since 1991, it is lower than the foreign share of all pension funds, and it is too soon to say whether it will remain stable at the new level.

5.4 Remainder of Irish Financial System

5.4.1 Fund management

Exchange control regulations governing the international portfolio allocation of Irish institutional funds (insurance and pension funds) has been substantially liberalized since 1989. Before then, funds were entitled to retain and manage the foreign portfolio which they had held before the introduction of exchange controls *vis-à-vis* the UK in 1978. Nevertheless, the growth of the funds (strongly encouraged by tax concessions which persisted to the end of the 1980s) meant that the share of foreign assets in the portfolios was shrinking. Prudential limits on foreign asset holdings have now been eliminated and though there are still some matching currency requirements, the fact that the bulk of institutional obligations are not defined in terms of a fixed sum of Irish currency means that these matching currency obligations have little practical impact.

The exchange control liberalization of 1989 resulted in a sharp increase in the share of foreign assets in the total, as shown in Table 5.4. This table includes data separately for pension funds and for the assets managed on balance sheet by the life assurance companies. An attempt has been made also to provide a total figure for life assurance and pension funds adjusting for the overlap between the two. The size of the foreign portfolio share, even before the IFSC began to complicate interpretation of the data, is large by international standards and suggests that "home-preference" is much less pronounced in Ireland than in many other EU countries. Hard information is not available about the national composition of the foreign portfolio, but it is understood that a relatively high proportion is in UK assets.

It is worth noting that there has also been a limited amount of selling of foreign (including

US) mutual funds to domestic wealth holders through domestic brokers.

Funds managed in the IFSC on an essentially offshore basis are now larger than those managed by the on-shore insurance and pension funds, and even the data for the latter is no longer clearly distinguishable in that both existing insurance companies, and some newcomers, have become active in offshore-type insurance and fund management business.

5.4.2 Stock market

The Irish Stock Exchange is a branch of the London Stock Exchange although legislation in the form of a Stock Exchanges Bill is due to be published in 1995 on order to separate the exchanges. Some 62 equities were listed on the Official List at end-1993. In addition to this there were 13 equities on the Unlisted Securities Market, three on the Smaller Companies Market and a further 13 on the Exploration Securities Market. The equities comprising the Official List and USM had a market capitalization at end-1993 of IR£12.2 billion or just under \$17.3 billion, the equivalent of 37.9 per cent of GDP. This was a substantial increase on the previous year, both in nominal terms and as a share of GDP, where the corresponding statistics were \$12 billion or some 24.7 per cent of GDP; the increase reflected price movements more than new issues, which amounted to less than £0.5 billion.

Banks and other financial institutions represent 40 per cent of market capitalization, with the two largest Irish banks, Allied Irish Banks and Bank of Ireland, accounting for almost three-quarters of this figure, having a combined capitalization of some £3.4 billion. Allied Irish Bank, capitalised at £2.0 billion, is in fact by far the largest company quoted on the Exchange, .

The market capitalization of Irish gilts at end-1993 was £15.7 billion, with a turnover of £83 billion which represented an increase of 73 per cent on 1992 - the increase being largely due to the sharp fall in interest rates during the course of the year. There was also a major increase in the turnover of non-Irish securities. Non-Irish equity turnover was £1.25 billion at end-1993 compared with £0.5 billion the year before, an increase from 16% to 21% of turnover in Irish Equities. UK companies account for three-quarters of this amount but trade

in Overseas equities rose almost five-fold over 1993 from £68 million to £314 million.

There has been a growing use of the Irish market as what might, by analogy with shipping practices, be described as an "exchange of convenience" or quotation vehicle for international investment funds.

5.4.3 Foreign direct investment

The official data on inward foreign direct investment are given in Table 2.5. The limitations of these data were discussed in section 5.1 above, as they are confined to grant-eligible flows for new fixed capital formation. The rate of inflow has declined from 1 per cent of GDP in 1985 to less than 0.3 per cent in 1990; followed by some recovery in 1991. The share of inward flows to Ireland over the period which originated elsewhere in the EU is much lower than those observed for Portugal and Spain. The EU share in Ireland's FDI has been less than 30 per cent since 1987 and, with the exception of 1990, has been steadily declining to a low of just under 13 per cent in 1992. US investment is quantitatively far more important in the Irish case, being the source of one half or more of all FDI into the country in the period reviewed.

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Irish Insurance Federation

Irish Association of Pension Funds

Associação Portuguesa das Sociedades Gestoras de Fundas de Investimento

Foundation of Economic and Industrial Research (IOBE), Athens

Table 1.1: *Share of Credit & Insurance Institutions in GDP and Employment*

| | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 |
|------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| % of GDP | | | | | | | | |
| Belgium | 5.56 | 5.97 | 6.08 | 5.81 | 5.55 | 4.73 | 4.98 | 5.04 |
| Denmark | 2.75 | 3.56 | 3.07 | 2.77 | 3.17 | 2.69 | 1.81 | 1.48 |
| France | 4.78 | 5.30 | 5.54 | 5.29 | 5.11 | 4.38 | 4.32 | 4.13 |
| Germany | 5.39 | 5.08 | 4.82 | 4.86 | 4.86 | 4.70 | 5.04 | |
| Greece | 2.19 | 2.24 | 2.19 | 2.12 | 2.20 | 2.18 | 2.01 | |
| Ireland | 5.58 | 5.53 | 5.71 | 6.12 | 5.71 | 5.55 | 6.14 | |
| Italy | 4.88 | 5.19 | 4.56 | 4.55 | 4.59 | 4.96 | 4.89 | 5.69 |
| Luxembourg | 24.35 | 22.59 | 21.32 | 18.07 | 13.34 | 13.27 | 13.87 | 15.01 |
| Netherlands | 5.12 | 5.15 | 4.79 | 4.78 | 5.02 | 4.56 | 4.57 | 4.69 |
| Portugal | 6.11 | 5.78 | 6.12 | 6.04 | 6.88 | 8.46 | 8.46 | |
| Spain | 6.25 | 6.07 | 6.28 | 6.62 | 6.94 | 7.25 | | |
| UK | 12.07 | 13.03 | 3.86 | 3.91 | 4.07 | 4.37 | 4.32 | 4.33 |
| % of Total Employment | | | | | | | | |
| Belgium | 3.88 | 4.05 | 4.11 | 4.11 | 4.04 | 3.99 | 3.93 | 3.86 |
| Denmark | 4.50 | 3.32 | 3.89 | 4.24 | 3.57 | 3.82 | 5.45 | 6.33 |
| France | 2.80 | 2.82 | 2.83 | 2.86 | 2.81 | 2.78 | 2.78 | 2.77 |
| Germany | 3.04 | 2.97 | 3.04 | 3.06 | 3.05 | 3.10 | 3.11 | |
| Greece* | 1.38 | 1.51 | 1.50 | 1.61 | 1.59 | 1.59 | | |
| Ireland | 2.97 | 3.15 | 3.43 | 3.67 | 3.58 | 3.29 | 3.56 | |
| Italy | 1.72 | 1.72 | 1.74 | 1.76 | 1.79 | 1.82 | 1.85 | 1.90 |
| Luxembourg | 6.79 | 7.28 | 7.65 | 8.00 | 8.84 | 8.99 | 9.14 | |
| Netherlands | 3.81 | 3.80 | 3.58 | 3.57 | 3.56 | 3.54 | 3.54 | 3.53 |
| Portugal | 2.06 | 2.01 | 1.89 | 1.83 | 1.75 | 1.67 | 1.66 | |
| Spain | 2.59 | 2.54 | 2.44 | 2.41 | 2.40 | 2.42 | 1.70 | |
| UK | 3.59 | 3.66 | | | | 4.00 | 4.14 | |

* Wage and Salary Earners only

Source: Eurostat, ESA National Accounts, detailed tables by branch (2C)

Table 1.2: Markets for Selected Derivative Financial Instruments: Notional Principal Amounts Outstanding

| Billions of \$US Dollars | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | Percentage Change | |
|---|------|------|------|------|------|------|------|------|-------------------|---------|
| | | | | | | | | | 1986-91 | 1990-91 |
| Exchange-traded instruments | 583 | 725 | 1300 | 1762 | 2284 | 3518 | | | 503 | 54 |
| Interest rate futures | 370 | 488 | 895 | 1201 | 1454 | 2159 | 2900 | 4960 | 484 | 49 |
| Interest rate options | 146 | 122 | 279 | 387 | 600 | 1072 | 1390 | 2360 | 634 | 79 |
| Currency futures | 10 | 14 | 12 | 16 | 16 | 18 | 20 | 30 | 80 | 12 |
| Currency options | 39 | 60 | 48 | 50 | 56 | 59 | 80 | 80 | 51 | 5 |
| Stock market index futures | 15 | 18 | 28 | 42 | 70 | 77 | 80 | 12 | 413 | 10 |
| Options on stock market indices | 3 | 23 | 38 | 66 | 88 | 132 | 17 | 29 | | 50 |
| Over-the-counter (OTC) instruments | 500 | 866 | 1326 | 2423 | 3451 | 4449 | 5347 | 8475 | 790 | 29 |
| Interest rate swaps | 400 | 683 | 1010 | 1539 | 2312 | 3065 | 3851 | 6177 | 666 | 33 |
| Interbank | | 207 | | | | 1342 | 1881 | | | |
| Other | | 476 | | | | 1723 | 1970 | | | |
| Currency and cross-currency interest rate swaps | 100 | 183 | 316 | 434 | 578 | 807 | 861 | 900 | 707 | 40 |
| Interbank | | 35 | | | | 225 | 239 | | | |
| Other | | 148 | | | | 582 | 622 | | | |
| Other derivative instruments* | | | | 450 | 561 | 577 | 635 | 1398 | | 3 |

* Caps, collars, floors and swaptions.

Source: IMF, BIS.

Table 1.3: *Insurance Premium Income per Capita (Gross)*

| US\$ per capita | 1985 | | 1992 | |
|-----------------|------|----------|------|----------|
| | Life | Non-life | Life | Non-life |
| Belgium | 101 | 248 | 375 | 724 |
| Denmark | 241 | 271 | 616 | 711 |
| France | 144 | 277 | 867 | 671 |
| Germany | 215 | 358 | 534 | 848 |
| Greece | 9 | 30 | 67 | 72 |
| Ireland | 280 | 210 | 622 | 580 |
| Italy | 24 | 129 | 179 | 469 |
| Luxembourg | 77 | 243 | 463 | 977 |
| Netherlands | 224 | 252 | 903 | 697 |
| Portugal | 5 | 49 | 94 | 230 |
| UK | 342 | 311 | 1326 | 954 |
| EU-12 | | | 625 | 668 |
| Coeff. Var. | 0.74 | 0.46 | 0.66 | 0.43 |

Source: OECD Insurance Statistics Yearbook, 1985-92 (Paris: 1994)
 Germany: Net premium for life insurance; Greece, 1985: Net premium

Table 1.4: *Institutional Investor Holdings of Foreign Securities*

| % Share | | 1980 | 1985 | 1990 | 1991 | 1992 | 1993 |
|-------------|----------------------|------|------|------|------|------|------|
| Belgium | Insurance companies | 5.5 | 8.2 | 5.2 | 4.2 | 4.1 | |
| Italy | Insurance companies | - | | 13.6 | 12.2 | 13.2 | 12.2 |
| Netherlands | Insurance companies | 6.9 | 22.9 | 20.2 | 20.4 | 22.6 | 26.0 |
| | Pension funds | | | | | | |
| | - Private | 26.6 | 28.1 | 36.6 | 38.2 | 39.2 | 36.9 |
| | - Public | 14.7 | 9.9 | 16.6 | 17.2 | 18.9 | 20.2 |
| U.K. | Insurance companies* | 6.3 | 14.1 | 14.6 | 15.8 | 15.5 | |
| | Pension funds** | 10.8 | 17.3 | 23.2 | 25.2 | 23.8 | |

* Long-term funds.

** Excl. central government

Source: B.I.S. Annual Report 1993/94, p.148.

Table 1.5: *Growth in Net Financing in International Markets*

| \$ Billion | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | Stock at end 1993 |
|----------------------------------|------|------|------|------|------|-------|-------------------|
| Net international bank credit * | 260 | 410 | 465 | 80 | 195 | 165 | 3780 |
| Net Euronote placements | 20 | 8 | 33 | 35 | 40 | 73 | 256 |
| Net international bond financing | 139 | 175 | 132 | 170 | 119 | 184 | 1850 |
| Total | 419 | 593 | 630 | 285 | 354 | 422 | 5886 |
| less double counting | (69) | (78) | (80) | (40) | (74) | (122) | (706) |
| Net international financing | 350 | 515 | 550 | 245 | 280 | 300 | 5180 |

* Defined as: Change in cross-border claims + local claims in foreign exchange - interbank redeposits.

Source: BIS, International Banking and Financial Market Developments, various issues.

Table 1.6: Measuring Financial Openness: Relative Size of Foreign and Domestic Issues

Cumulative flows, %

| | 'Share of OECD 'financial 'wealth | Foreign liabilities/Domestic liabilities | | | | | | Foreign assets/Domestic assets | | | | | | | | | | | |
|----------------------|---|--|---------|---------|---------|---------|---------|--------------------------------|---------|---------|------------|---------|---------|---------|---------|---------|----------|---------|---------|
| | | All assets | | | Bonds | | | Equities | | | All assets | | | Bonds | | | Equities | | |
| | | 1970-79 | 1980-91 | 1970-79 | 1980-91 | 1970-79 | 1980-91 | 1970-79 | 1980-91 | 1970-79 | 1980-91 | 1970-79 | 1980-91 | 1970-79 | 1980-91 | 1970-79 | 1980-91 | 1970-79 | 1980-91 |
| United States | 36.2 | 4.8 | 7 | 5.8 | 11.1 | 26 | 44.6 | 2.8 | 4 | 1.6 | 53.2 | 5.3 | 2.8 | 4 | 1.6 | 3 | na | na | 53.2 |
| Japan | 25.3 | 2.4 | 7.2 | 4.4 | 15.7 | -2.2 | 4.8 | 11.6 | na | na | na | 3.5 | 11.6 | na | na | na | na | na | na |
| Germany | 3.9 | 10 | 18 | 5.6 | 32.3 | 38.4 | 37.7 | 27.1 | 2.9 | 33.9 | 85.4 | 12.8 | 27.1 | 2.9 | 33.9 | 60.2 | 60.2 | 60.2 | 85.4 |
| France | 6.4 | 10.4 | 14.2 | 13.7 | 29.8 | 24.1 | 15.7 | 13.2 | 6.4 | 8.9 | 19.8 | 10.9 | 13.2 | 6.4 | 8.9 | 24.2 | 24.2 | 24.2 | 19.8 |
| UK | 6.8 | 30.7 | 27.4 | 9.3 | 36 | 36.9 | 56 | 25.4 | 1.8 | 19.6 | 106.2 | 30.4 | 25.4 | 1.8 | 19.6 | 70.8 | 70.8 | 70.8 | 106.2 |
| Italy | 4.6 | 5.1 | 5.7 | 0.7 | 2.1 | 9.6 | 4.3 | 7.4 | 1.5 | 0.6 | 18.5 | 5.7 | 7.4 | 1.5 | 0.6 | 8.1 | 8.1 | 8.1 | 18.5 |
| Canada | 3 | 10.9 | 14.7 | 27.2 | 38.4 | 6.2 | 17.2 | 6.9 | na | na | na | 5.9 | 6.9 | na | na | na | na | na | na |
| Netherlands | 1.2 | 15.9 | 21.5 | 34.7 | 31.7 | 72.3 | 58.8 | 29.8 | 6.7 | 17.9 | 152.3 | 18.9 | 29.8 | 6.7 | 17.9 | 163.9 | 163.9 | 163.9 | 152.3 |
| Belgium | 1.2 | 20.2 | 35.7 | 1.7 | 16.4 | 1 | 4.2 | 34.1 | 11.4 | 38.7 | 5.6 | 20.3 | 34.1 | 11.4 | 38.7 | 15.4 | 15.4 | 15.4 | 5.6 |
| Sweden | 1.6 | 8.6 | 14.9 | 12.2 | 27.8 | 0.8 | 6.5 | 11 | 0 | 2.5 | 106.6 | 5.3 | 11 | 0 | 2.5 | 21.3 | 21.3 | 21.3 | 106.6 |
| Spain | 2.2 | 8.9 | 7.8 | 0.2 | 54.1 | 17.5 | 40.9 | 7.8 | 0 | 6.5 | 13.4 | 6.5 | 7.8 | 0 | 6.5 | 7 | 7 | 7 | 13.4 |
| Finland | 0.8 | 11.8 | 18.3 | 51.2 | 50.4 | 2.7 | 6.8 | 12 | 12.7 | 4.8 | 18.2 | 6.8 | 12 | 12.7 | 4.8 | 5.6 | 5.6 | 5.6 | 18.2 |
| Average (unweighted) | | 11.6 | 16 | 13.9 | 28.8 | 19.4 | 24.8 | 15.8 | 4 | 11.3 | 48.3 | 11 | 15.8 | 4 | 11.3 | 31.6 | 31.6 | 31.6 | 48.3 |

Source: Bisignano, 1994

Table 1.7:

Trade in Banking Services

| ECU million | | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 |
|----------------|------------|------|------|------|------|------|------|------|------|------|-------|
| Credit: | | | | | | | | | | | |
| BLEU | Total | 374 | 462 | 604 | 772 | 777 | 1003 | 1709 | 1399 | 1920 | 2036 |
| | % intra-EU | 35.3 | 28.6 | 43.2 | 43.3 | 43.0 | 48.9 | 50.3 | 50.6 | 41.0 | 31.2 |
| Denmark | Total | 5 | 13 | 19 | 21 | 25 | 41 | 48 | 46 | 72 | 115 |
| | % intra-EU | 40.0 | 53.8 | 52.6 | 52.4 | 56.0 | 53.7 | 52.1 | 43.5 | 43.1 | 42.6 |
| France | Total | 445 | 500 | 712 | 1046 | 1553 | 1784 | 3676 | 5532 | 5024 | 10907 |
| | % intra-EU | 14.8 | 15.4 | 27.4 | 22.1 | 31.5 | 31.1 | 31.3 | 38.7 | 51.8 | 54.2 |
| Germany | Total | 409 | 467 | 514 | 705 | 655 | 783 | 828 | 702 | 852 | 957 |
| | % intra-EU | 48.9 | 48.2 | 44.2 | 54.5 | 62.0 | 56.4 | 58.5 | 57.4 | 51.1 | 50.9 |
| Italy | Total | 815 | 895 | 1193 | 805 | 895 | 950 | 1282 | 449 | 806 | na |
| | % intra-EU | 74.8 | 74.7 | 74.8 | 74.8 | 74.9 | 74.8 | 74.8 | 74.8 | 2.7 | |
| Netherlands | Total | 124 | 173 | 195 | 204 | 239 | 280 | 206 | 231 | 140 | 38 |
| | % intra-EU | 41.1 | 43.9 | 22.1 | 36.3 | 45.2 | 31.1 | 30.6 | 25.1 | 42.9 | 102.6 |
| Spain | Total | 51 | 60 | 69 | 88 | 175 | 217 | 301 | 307 | 471 | 758 |
| | % intra-EU | 43.1 | 38.3 | 37.7 | 44.3 | 54.3 | 48.8 | 46.2 | 47.9 | 54.1 | 59.9 |
| U.K. | Total | 1540 | 1910 | 2255 | 2528 | 3436 | 3665 | 4001 | 4049 | 3559 | 4057 |
| | % intra-EU | 29.9 | 30.3 | 31.0 | 28.9 | 27.8 | 25.9 | 34.3 | 35.1 | 36.8 | 31.1 |
| Debit | | | | | | | | | | | |
| BLEU | Total | 242 | 286 | 403 | 514 | 524 | 638 | 1140 | 973 | 1271 | 1238 |
| | % intra-EU | 45.5 | 46.2 | 53.3 | 53.5 | 52.1 | 57.8 | 51.3 | 56.8 | 57.5 | 46.8 |
| Denmark | Total | 9 | 12 | 16 | 18 | 22 | 37 | 54 | 51 | 47 | 44 |
| | % intra-EU | 66.7 | 66.7 | 56.3 | 55.6 | 59.1 | 62.2 | 61.1 | 49.0 | 44.7 | 40.9 |
| France | Total | 540 | 556 | 701 | 1044 | 1657 | 2010 | 3482 | 5650 | 5440 | 11250 |
| | % intra-EU | 31.5 | 30.8 | 34.2 | 28.2 | 35.7 | 30.0 | 31.0 | 40.6 | 53.1 | 58.8 |
| Germany | Total | 90 | 94 | 107 | 108 | 113 | 103 | 183 | 238 | 247 | 259 |
| | % intra-EU | 53.3 | 53.2 | 53.3 | 63.0 | 55.8 | 55.3 | 59.0 | 61.8 | 64.0 | 70.3 |
| Italy | Total | 1170 | 1188 | 1387 | 854 | 912 | 931 | 746 | 466 | 996 | na |
| | % intra-EU | 79.5 | 79.5 | 79.5 | 79.5 | 79.5 | 79.5 | 79.5 | 79.4 | 2.3 | |
| Netherlands | Total | 96 | 134 | 199 | 207 | 165 | 161 | 182 | 175 | 182 | 191 |
| | % intra-EU | 46.9 | 50.7 | 46.2 | 49.8 | 57.6 | 54.7 | 55.5 | 58.9 | 56.6 | 59.2 |
| Spain | Total | 34 | 40 | 39 | 38 | 86 | 94 | 149 | 230 | 300 | 414 |
| | % intra-EU | 26.5 | 25.0 | 38.5 | 44.7 | 46.5 | 44.7 | 32.2 | 35.7 | 44.7 | 26.8 |
| U.K. | Total | na | na | na | na | na | na | na | na | na | na |
| | % intra-EU | | | | | | | | | | |

Source: Eurostat, International Trade in Services (6D)

Table 1.8: *Share of Foreign Firms in EU Insurance Markets*

| % of Gross Premium Income | Life | | Non-life | |
|---|------|--------|----------|--------|
| | 1985 | 1992 | 1985 | 1992 |
| (a) Foreign controlled firms | | | | |
| Belgium | | | 40.6 | |
| Denmark | 7.9 | 9.6 | 13.9 | 34.5 |
| Finland | 0.0 | 0.0 | 0.4 | 0.2 |
| France | 7.8 | 6.7 | 13.4 | 18.3 |
| Germany | 24.8 | 11.4 | 8.1* | 14.3 |
| Luxembourg | 46.6 | | 31.0 | |
| Netherlands | 20.6 | 23.3 | 24.7 | 29.0 |
| Norway | 0.0 | 2.2 | 1.1 | 15.7 |
| Portugal | 36.5 | 29.9 | 18.1 | 25.7 |
| (b) Branches or agencies of foreign firms | | | | |
| Belgium | 10.4 | 7.1 | 14 | 7.2 |
| Denmark | 1.8 | 2.4 | 5.6 | 5.1 |
| Finland | 0 | 0 | 0.4 | 0.2 |
| France | 3.3 | 1.9 | 5.1 | 2.8 |
| Germany | 3.5 | 3 | 4.2 | 2.3 |
| Greece | 20.8 | 24.3** | 14.3 | 18.9** |
| Ireland | 50.4 | 24.8 | 30.4 | 34.4 |
| Italy | 1.7 | 1.4 | 4.3 | 3.7 |
| Netherlands | 9.2 | 5.8 | 7.8 | 6.3 |
| Norway | 0 | 0 | 0.6 | 1.4 |
| Portugal | 30.6 | 18.7 | 8.4 | 7.4 |
| Spain | 11.6 | 6.3 | 9.2 | 7.7 |
| SW | | 0 | | |
| UK | 4.2 | 4.5 | 6.2 | 5.2 |

* 1986; ** 1991

Source: OECD Insurance Statistics Yearbook 1985-92, (Paris: 1994)

Table 1.9:

Trade in Insurance Services

| ECU million | | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 |
|--------------------|------------|---------|---------|---------|-------|-------|--------|--------|--------|-------|--------|
| Credit: | | | | | | | | | | | |
| <i>BLEU</i> | Total | 286 | 313 | 350 | 362 | 421 | 744 | 703 | 1013 | 1006 | 1133 |
| | % intra-EU | 50.70 | 52.08 | 61.14 | 63.26 | 57.72 | 42.34 | 65.15 | 62.39 | 64.02 | 69.37 |
| <i>Denmark</i> | Total | 69 | 74 | 74 | 79 | 84 | 86 | 93 | 121 | 114 | 133 |
| | % intra-EU | 46.38 | 47.30 | 45.95 | 45.57 | 47.62 | 48.84 | 49.46 | 58.68 | 58.77 | 63.16 |
| <i>France</i> | Total | 766 | 903 | 1251 | 1168 | 1029 | 1257 | 1179 | 1219 | 864 | 1313 |
| | % intra-EU | 30.94 | 24.81 | 28.38 | 26.63 | 27.89 | 29.04 | 46.31 | 36.34 | 41.20 | 36.71 |
| <i>Germany</i> | Total | 39 | 64 | 33 | 289 | 457 | 273 | -78 | -461 | -559 | -408 |
| | % intra-EU | -279.49 | -184.38 | -303.03 | 15.92 | 25.60 | -10.62 | 302.56 | 129.72 | 83.01 | 103.68 |
| <i>Italy</i> | Total | 322 | 470 | 442 | 555 | 600 | 486 | 600 | 576 | 1583 | 372 |
| | % intra-EU | 54.35 | 54.47 | 54.52 | 54.41 | 54.50 | 54.53 | 54.33 | 54.51 | 54.45 | 81.99 |
| <i>Netherlands</i> | Total | na | na | na | na | na | na | na | na | na | na |
| | % intra-EU | na | na | na | na | na | na | na | na | na | na |
| <i>Spain</i> | Total | 71 | 97 | 222 | 235 | 282 | 275 | 300 | 364 | 464 | 750 |
| | % intra-EU | 70.42 | 58.76 | 63.51 | 58.72 | 39.72 | 44.36 | 49.00 | 56.87 | 61.85 | 53.07 |
| <i>U.K.</i> | Total | 2034 | 2306 | 3732 | 4718 | 4280 | 2809 | 1458 | 599 | 1087 | 843 |
| | % intra-EU | 13.13 | 15.48 | 11.01 | 9.35 | 10.54 | 17.27 | 19.96 | 46.74 | -5.80 | 13.64 |
| <i>Portugal</i> | Total | 13 | 18 | 15 | 15 | 13 | 18 | 20 | 22 | 35 | 41 |
| | % intra-EU | 76.92 | 72.22 | 73.33 | 73.33 | 76.92 | 72.22 | 70.00 | 81.82 | 80.00 | 80.49 |
| Debit | | | | | | | | | | | |
| <i>BLEU</i> | Total | 308 | 379 | 382 | 438 | 467 | 686 | 547 | 621 | 730 | 854 |
| | % intra-EU | 61.36 | 66.23 | 60.73 | 62.79 | 70.88 | 43.44 | 56.86 | 66.99 | 64.38 | 58.31 |
| <i>Denmark</i> | Total | 136 | 204 | 211 | 214 | 202 | 203 | 200 | 117 | 173 | 211 |
| | % intra-EU | 47.79 | 46.08 | 63.03 | 63.08 | 62.38 | 60.59 | 64.00 | 54.70 | 69.94 | 72.51 |
| <i>France</i> | Total | 886 | 1060 | 1085 | 1070 | 1174 | 1114 | 1392 | 1270 | 952 | 1546 |
| | % intra-EU | 43.68 | 43.40 | 47.28 | 50.09 | 51.62 | 57.90 | 58.55 | 56.54 | 58.09 | 46.83 |
| <i>Germany</i> | Total | 568 | 718 | 783 | 738 | 786 | 935 | 828 | 695 | 893 | 849 |
| | % intra-EU | 31.87 | 32.45 | 40.23 | 39.02 | 37.79 | 41.07 | 39.98 | 41.15 | 54.42 | 56.07 |
| <i>Italy</i> | Total | 443 | 596 | 665 | 661 | 651 | 694 | 847 | 573 | 2175 | 862 |
| | % intra-EU | 46.05 | 45.97 | 46.02 | 45.99 | 46.08 | 45.97 | 45.93 | 45.90 | 45.98 | 50.93 |
| <i>Netherlands</i> | Total | 164 | 282 | 294 | 280 | 239 | 290 | 309 | -33 | 204 | 312 |
| | % intra-EU | 2.44 | 56.74 | 57.48 | 67.50 | 54.81 | 45.86 | 60.84 | 96.97 | 63.73 | 39.42 |
| <i>Spain</i> | Total | 247 | 293 | 360 | 430 | 449 | 468 | 465 | 465 | 574 | 824 |
| | % intra-EU | 36.84 | 33.79 | 61.94 | 63.02 | 42.98 | 52.99 | 51.18 | 61.08 | 74.91 | 59.95 |
| <i>U.K.</i> | Total | 349 | 408 | 387 | 381 | 390 | 498 | 566 | 567 | 570 | 538 |
| | % intra-EU | 42.41 | 37.25 | 44.19 | 44.62 | 43.59 | 44.18 | 53.53 | 52.56 | 52.63 | 26.39 |
| <i>Portugal</i> | Total | 56 | 69 | 78 | 79 | 93 | 101 | 112 | 131 | 147 | 139 |
| | % intra-EU | 46.43 | 44.93 | 51.28 | 60.76 | 63.44 | 68.32 | 68.75 | 68.70 | 72.11 | 73.38 |

Source: Eurostat, International Trade in Services (6D)

Table 1.10 *Relative Importance of Foreign Equity Trading in Domestic Exchanges*

| <i>Million ECU</i> | <i>Domestic Equity</i> | <i>Foreign Equity</i> | <i>Foreign/Domestic (%)</i> |
|--------------------|------------------------|-----------------------|-----------------------------|
| Austria | 7065 | 251 | 3.6 |
| Belgium | 10477 | 3130 | 29.9 |
| Germany | 509408 | 14833 | 2.9 |
| Denmark | 24082 | 488 | 2.0 |
| Spain | 43631 | 14 | 0.0 |
| France | 161662 | 3228 | 2.0 |
| Finland | 11194 | 2 | 0.0 |
| Greece | 4293 | 0 | 0.0 |
| Ireland | 3945 | 0 | 0.0 |
| Italy | 121835 | 53 | 0.0 |
| Luxembourg | 862 | 19 | 2.2 |
| Netherlands | 72251 | 158 | 0.2 |
| Portugal | 3195 | 0 | 0.0 |
| Sweden | 66733 | 58 | 0.1 |
| UK | 391635 | 463063 | 118.2 |

Source: FESE Annual Report 1994.

Table 2.1: *Elements of the Capital Account of the Balance of Payments*

| <i>\$ million</i> | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1986-93 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|---------|
| GREECE | | | | | | | | | |
| Current account | -1676 | -1223 | -958 | -2560 | -3537 | -1573 | -2140 | -747 | -14414 |
| Direct investment | 471 | 683 | 907 | 752 | 1005 | 1135 | 1144 | 977 | 7074 |
| Portfolio investment | | | | | | | | | |
| Other capital | 1937 | 1291 | 946 | 1999 | 2997 | 2826 | 1475 | 3840 | 17311 |
| Resident official secto | 1431 | 759 | 142 | 991 | 1303 | 1398 | -313 | 3468 | 9179 |
| Deposit money banks | 190 | 321 | 143 | 503 | 581 | 175 | -2 | 78 | 1989 |
| Other | 316 | 211 | 661 | 505 | 1113 | 1253 | 1790 | 294 | 6143 |
| Errors & omissions | -82 | 223 | 42 | -539 | -185 | -184 | -853 | -631 | -2209 |
| Overall balance | 270 | 806 | 1148 | -341 | 40 | 1660 | -188 | 3019 | 6414 |
| Reserves | -270 | -806 | -1148 | 341 | -40 | -1660 | 188 | -3019 | -6414 |
| Exceptional items | -380 | -168 | 211 | 7 | -240 | -544 | 186 | -420 | -1348 |
| IRELAND | | | | | | | | | |
| Current account | -822 | -95 | 71 | -509 | 45 | 1445 | 2452 | 3848 | 6435 |
| Direct investment | -40 | 89 | 92 | 85 | 99 | 97 | 102 | 89 | 613 |
| Portfolio investment | 1747 | -207 | 990 | 650 | -199 | -1070 | -3189 | 2451 | 1173 |
| Other capital | 84 | 749 | -881 | -2308 | -1805 | -2229 | -3378 | -2377 | -12145 |
| Resident official secto | -397 | 1696 | -615 | -413 | -197 | -236 | 1140 | -581 | 397 |
| Deposit money banks | 736 | -198 | 461 | -354 | 1097 | -658 | -2444 | -1263 | -2623 |
| Other | -255 | -748 | -727 | -1541 | -2705 | -1335 | -2074 | -533 | -9918 |
| Errors & omissions | -1063 | 350 | 320 | 1145 | 2608 | 2221 | 471 | -96 | 5956 |
| Overall balance | -94 | 886 | 592 | -937 | 748 | 464 | -3542 | 3915 | 2032 |
| Reserves | 94 | -886 | -592 | 937 | -748 | -464 | 3542 | -3915 | -2032 |
| PORTUGAL | | | | | | | | | |
| Current account | 1165 | 436 | -1066 | 152 | -181 | -716 | -184 | 955 | 561 |
| Direct investment | 238 | 476 | 842 | 1653 | 2447 | 1985 | 1185 | 1136 | 9962 |
| Portfolio investment | 404 | 816 | 1814 | 1050 | 961 | 1895 | -3064 | 1048 | 4924 |
| Other capital | -2074 | -604 | -2363 | 1302 | -845 | 656 | 928 | -4229 | -7229 |
| Resident official secto | -525 | -176 | -1510 | -584 | -655 | -483 | -63 | 1862 | -2134 |
| Deposit money banks | -69 | -402 | -1023 | 657 | -456 | 1126 | -450 | -4384 | -5001 |
| Other | -1480 | -26 | 170 | 1229 | 266 | 13 | 1441 | -1707 | -94 |
| Errors & omissions | 156 | 653 | 1640 | 497 | 1160 | 1893 | 979 | -179 | 6799 |
| Overall balance | -111 | 1777 | 867 | 4654 | 3542 | 5713 | -156 | -1269 | 15017 |
| Reserves | 111 | -1777 | -867 | -4654 | -3542 | -5713 | 156 | 1269 | -15017 |

Source: IMF, International Financial Statistics

Table 2.2: *Elements of profit and loss account of banks*

| <i>% of average balance sheet</i> | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 |
|---|------|------|------|------|------|------|------|------|
| <i>Greece (Large commercial banks)</i> | | | | | | | | |
| Net interest margin | 1.35 | 1.27 | 0.68 | 0.83 | 1.19 | 1.49 | 2.19 | 1.54 |
| Gross margin | 3.12 | 3.05 | 2.84 | 2.99 | 3.12 | 3.68 | 4.93 | 3.74 |
| Operating expenses | 2.45 | 2.29 | 2.22 | 2.43 | 2.39 | 2.45 | 2.49 | 2.36 |
| Provisions (net) | 0.33 | 0.32 | 0.25 | 0.24 | 0.36 | 0.50 | 0.82 | 0.29 |
| Profit before tax | 0.34 | 0.44 | 0.37 | 0.32 | 0.37 | 0.73 | 1.62 | 1.09 |
| <i>Portugal (All banks)</i> | | | | | | | | |
| Net interest margin | 2.37 | 2.76 | 3.41 | 3.66 | 4.12 | | 4.97 | 4.11 |
| Gross margin | 3.13 | 3.37 | 4.17 | 4.46 | 4.92 | | 6.10 | 5.45 |
| Operating expenses | 2.17 | 2.24 | 2.26 | 2.27 | 2.30 | | 2.79 | 2.89 |
| Provisions (net) | 0.62 | 0.84 | 1.35 | 1.43 | 1.59 | | 1.79 | 1.58 |
| Profit before tax | 0.33 | 0.29 | 0.56 | 0.75 | 1.02 | | 1.53 | 0.98 |
| <i>Ireland (Large commercial banks)</i> | | | | | | | | |
| Net interest margin | 4.23 | 4.52 | 4.26 | 4.50 | 3.93 | 4.49 | 4.51 | 4.49 |
| Gross margin | 5.19 | 5.67 | 5.39 | 5.75 | 5.23 | 6.14 | 6.19 | 6.30 |
| Operating expenses | 3.05 | 2.84 | 2.99 | 3.12 | 3.56 | 4.93 | 3.74 | 4.21 |
| Provisions (net) | 0.83 | 0.77 | 0.60 | 0.58 | 0.33 | 0.61 | 1.30 | 1.16 |
| Profit before tax | 0.98 | 1.27 | 1.14 | 1.33 | 1.33 | 1.45 | 0.81 | 0.93 |

Source: OECD: Bank Profitability; for Ireland: individual bank annual reports.

Table 2.3: *Insurance premia per capita*

| \$ US | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 |
|-----------------|------|------|------|------|------|------|------|------|
| <i>Life</i> | | | | | | | | |
| Portugal | 5 | 8 | 13 | 22 | 30 | 50 | 66 | 94 |
| Greece | 9 | 14 | 19 | 26 | 31 | 44 | 53 | 67 |
| Ireland | 280 | 341 | 548 | 552 | 629 | 680 | 665 | 622 |
| EC | 152 | 229 | 310 | 388 | 415 | 480 | 543 | 625 |
| <i>Non-life</i> | | | | | | | | |
| Portugal | 49 | 70 | 86 | 100 | 114 | 158 | 183 | 230 |
| Greece | 30 | 33 | 41 | 48 | 47 | 61 | 62 | 72 |
| Ireland | 210 | 318 | 348 | 365 | 352 | 469 | 514 | 580 |
| EC | 231 | 326 | 405 | 456 | 460 | 531 | 572 | 668 |

Source: OECD Insurance Statistics.

Table 2.4: *Foreign Presence in Insurance Sectors*

| % share | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 |
|----------------------------------|------|------|------|------|------|------|------|------|------|
| Portugal | | | | | | | | | |
| <i>Share of foreign control:</i> | | | | | | | | | |
| Life | 36.5 | 40.8 | 45.6 | 51.1 | 50.6 | 30.9 | 33.3 | 27.9 | |
| Non-life | 18.1 | 19.0 | 20.2 | 23.1 | 23.4 | 13.1 | 27.3 | 25.7 | |
| <i>Foreign branch or agency:</i> | | | | | | | | | |
| Life | 30.6 | 34.5 | 39.0 | 38.9 | 38.6 | 22.7 | 24.9 | 18.7 | |
| Non-life | 8.4 | 8.6 | 9.1 | 9.2 | 8.8 | 7.7 | 7.7 | 7.4 | |
| Greece | | | | | | | | | |
| <i>Foreign branch or agency:</i> | | | | | | | | | |
| Life | 20.8 | 18.6 | 20.5 | 22.5 | 22.5 | 23.5 | 24.3 | 23.0 | 23.5 |
| Non-life | 14.3 | 17.2 | 17.4 | 15.1 | 17.1 | 16.8 | 18.9 | 14.0 | 12.0 |
| Ireland | | | | | | | | | |
| <i>Foreign branch or agency:</i> | | | | | | | | | |
| Life | 50.4 | 24.4 | 20.3 | 25.8 | 28.2 | 31.2 | 32.6 | 24.8 | |
| Non-life | 30.4 | 29.5 | 34.8 | 37.9 | 36.4 | 37.5 | 35.3 | 34.4 | |

Source: OECD Insurance Statistics, Greek Insurance Association.

Table 2.5: Selected Foreign Direct Investment Statistics

| percentage | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|------|------|------|------|------|------|------|------|------|------|
| Share of Inward FDI in GDP | | | | | | | | | | |
| Greece | na | na | 0.6 | 0.5 | 0.5 | 0.7 | 0.6 | 1.5 | na | na |
| Ireland | 1.1 | 1.0 | 1.0 | 0.7 | 0.5 | 0.5 | 0.8 | 0.7 | na | na |
| Portugal | 0.9 | 0.5 | 0.8 | 1.6 | 3.2 | 3.5 | 3.1 | 2.5 | 1.8 | 1.6 |
| Share of EU in Inward FDI | | | | | | | | | | |
| Greece | na | na | 50.0 | 55.1 | 70.1 | 87.8 | 86.3 | 83.1 | na | na |
| Ireland | 26.7 | 36.2 | 29.0 | 20.4 | 18.4 | 21.5 | 13.0 | 12.6 | na | na |
| Portugal | 58.0 | 75.5 | 67.5 | 71.0 | 72.1 | 70.9 | 74.6 | 76.1 | 75.4 | 63.5 |
| Share of Finance, Insurance and Business Services in Inward FDI | | | | | | | | | | |
| Greece | na | na | 3.0 | 3.7 | 24.3 | 21.9 | 19.8 | 10.9 | na | na |
| Portugal | 25.0 | 18.1 | 38.9 | 33.8 | 47.7 | 65.5 | 59.1 | 76.2 | 62.1 | 36.7 |

Source: OECD International Direct Investment Statistics Yearbook. For Portugal, 1993-94: Bank of Portugal.

Table 2.6: *Funds Raised on International Markets: Greece, Ireland, Portugal 1988-93*

| <i>US\$ billion</i> | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 |
|--|-------|-------|-------|-------|-------|-------|
| <i>Funds Raised on International Markets</i> | | | | | | |
| Greece | 1.28 | 2.12 | 2.52 | 2.53 | 2.88 | 4.73 |
| Ireland | 1.24 | 3.59 | 2.68 | 3.01 | 2.76 | 3.02 |
| Portugal | 2.85 | 0.56 | 0.52 | 0.92 | 0.68 | 3.37 |
| OECD | 332.3 | 322.4 | 314.3 | 363.4 | 401 | 524.4 |
| <i>International Issues of Bonds</i> | | | | | | |
| Greece | 0.12 | 0.63 | 0.29 | 0.62 | 0.6 | 1.74 |
| Ireland | 0.23 | 1.14 | 0.62 | 0.33 | 1.02 | 1.67 |
| Portugal | 1.5 | 0.05 | na | 0.27 | 0.17 | 2.63 |
| OECD | 172.2 | 202.6 | 164.6 | 228.8 | 247.4 | 337.8 |
| <i>Traditional Foreign Bonds</i> | | | | | | |
| Greece | 0.24 | 0.44 | 0.61 | 1.27 | 1.86 | 2.5 |
| Ireland | 0.34 | 0.23 | 0.35 | 1.43 | 1.18 | 0.95 |
| Portugal | 0.42 | na | na | na | na | na |
| OECD | 41.2 | 35.3 | 43.8 | 43.1 | 49.4 | 70.2 |

Source: OECD Financial Statistics.

Table 3.1 Greece: Financial Assets of Non-bank Domestic Sectors

| Billion Drachmas | 1980 | 1985 | 1990 | 1993 |
|---|------|------|-------|-------|
| Domestic assets | | | | |
| Currency | 210 | 505 | 1162 | 1512 |
| Deposits in drachmas* | 986 | 3423 | 8836 | 11646 |
| Private sector | 841 | 3094 | 8109 | 10556 |
| Public entities | 131 | 294 | 649 | 996 |
| Public enterprises | 14 | 32 | 78 | 94 |
| Repos (private holders) | .. | .. | 49 | 2079 |
| Private sector | .. | .. | 49 | 1894 |
| Public entities | .. | .. | .. | 59 |
| Public enterprises | .. | .. | .. | 126 |
| Treasury bills | .. | 57 | 1311 | 4781 |
| Private sector | .. | 10 | 1017 | 3904 |
| Public entities | .. | 47 | 294 | 877 |
| Government bonds | .. | .. | 769 | 1278 |
| Private sector | .. | .. | 637 | 1124 |
| (of which bonds up to one year) | .. | .. | (145) | (188) |
| Public entities | .. | .. | 125 | 154 |
| Bank bonds | .. | 185 | 594 | 703 |
| Quoted Equities** | 140 | 113 | 2197 | 2806 |
| Total domestic assets | 1336 | 4285 | 14911 | 24805 |
| Foreign assets | | | | |
| Residents' deposits with nonresident banks | .. | 867 | 1805 | 2614 |
| Institutional holding of foreign financial assets | | | | |
| Deposit money banks | 55.3 | 293 | 545 | 1215 |
| Mutual funds | .. | .. | .. | 150 |
| Insurance companies | .. | .. | .. | 95 |
| Monetary authorities | 74.1 | 265 | 812 | 2976 |
| Index of "home preference" | .. | 0.72 | 0.81 | 0.74 |
| Memorandum items | | | | |
| Deposits in foreign exchange, mainly by | | | | |
| "non-resident Greeks" | 190 | 940 | 2240 | 4117 |
| Government securities *** | 271 | 1131 | 6748 | 15329 |
| Stock exchange value of shares and bonds | 181 | 404 | 6322 | 12205 |
| Total domestic assets as % GDP | 65 | 77 | 115 | 120 |
| GDP (revised data) | 2055 | 5543 | 12973 | 20609 |

* Including deposits with the banking sector and the Bank of Greece.

** All the shares of enterprises listed in the stock exchange.

*** Outstanding government securities.

Source: Bank of Greece, Athens Stock Exchange, International Financial Statistics, OECD.

Table 3.2

Structure of Greek Banking System (end 1993)

| | <i>Number of Institutions</i> | <i>Number of Branches</i> | <i>Share in Deposits (%)</i> | <i>Share in Loans (%)</i> |
|--|-----------------------------------|-------------------------------|----------------------------------|-------------------------------|
| Commercial Banks | 40 | 1286 | 65.1 | 47.3 |
| Four largest Greek Banks | 4 | 844 | 53.5 | 32 |
| Other Greek-owned banks | 16 | 363 | 9.2 | 9.5 |
| Branches of foreign banks | 20 | 79 | 2.4 | 5.8 |
| Specialized Credit Institutions | 9 | 431 | 34.9 | 52.7 |
| Agricultural Bank | 1 | 214 | 16.8 | 27.8 |
| Mortgage Banks | 3 | 84 | 3.3 | 8.9 |
| Investment Banks | 3 | 15 | 0 | 8.6 |
| Postal Savings Bank | 1 | 114 | 11.9 | 5 |
| Deposits and Loan Fund | 1 | 4 | 2.9 | 2.4 |
| Total | 49 | 1717 | 100 | 100 |
| Central Bank | 1 | 27 | | |

Source: Bank of Greece

Table 3.4

Schedule of Selected Greek Interest Rates

| Period | Interbank rate (Overnight) A | Savings Accounts Comm.Bnks B | Sight Deposits C | Interest rate on 3-12 month time deposit D | Long-term lending rate E | Short-term lending rate F | Treasury bill rate | | |
|-----------|------------------------------------|------------------------------------|---------------------|---|-----------------------------------|------------------------------------|--------------------|--------------|---------------|
| | | | | | | | 3-month G | 6-month H | 12-month J |
| 1994 Dec. | 17.5 | | | | | 26.4 | 15.75 | 16.50 | 17.50 |
| Sept. | 18.4 | 16.0 | 6.2 | 18.7 | 25.2 | 27.4 | 18.00 | 19.00 | 20.00 |
| June | 27.6 | 16.0 | 5.8 | 20.2 | 25.6 | 29.3 | - | 19.00 | - |
| Mar. | 19.8 | 16.1 | 5.1 | 18.4 | 25.1 | 27.0 | 16.00 | 17.50 | 18.50 |
| 1993 Dec. | 19.9 | 17.1 | 4.9 | 19.2 | 26.7 | 28.4 | 18.00 | 20.00 | 20.25 |
| Sept. | 25.0 | | | 19.4 | 26.4 | 28.3 | 18.00 | 20.00 | 20.25 |
| June | 21.3 | | | 19.2 | 26.9 | 28.7 | 17.75 | 19.75 | 21.25 |
| Mar. | 26.5 | | | 19.5 | 27.1 | 28.9 | 19.00 | 21.00 | 22.50 |
| 1992 Dec. | 28.7 | 18.0 | 3.7 | 19.4 | 26.9 | 28.7 | 19.00 | 21.00 | 22.50 |
| Sept. | 30.7 | 18.0 | | 19.3 | 26.6 | 28.6 | 17.50 | 19.75 | 21.50 |
| June | 22.3 | 18.0 | | 19.5 | 27.0 | 28.7 | 17.00 | 19.50 | 21.00 |
| Mar. | 24.1 | 18.0 | | 20.6 | 27.4 | 28.8 | 17.50 | 20.50 | 22.00 |
| 1991 Dec. | 28.6 | 18.0 | 1.3 | 20.6 | 27.6 | 29.2 | 18.00 | 21.00 | 22.50 |
| Sept. | 20.2 | 18.0 | | 20.6 | | 29.5 | 19.00 | 22.00 | 23.50 |
| June | 17.8 | 18.0 | | 20.5 | | 29.5 | 19.00 | 22.00 | 23.50 |
| Mar. | 21.2 | 18.0 | | 20.7 | | 29.5 | 19.00 | 22.00 | 23.50 |
| 1990 Dec. | 23.3 | 18.0 | | 20.5 | 25.2 | 29.5 | 19.00 | 22.00 | 24.00 |
| Sept. | 19.1 | | | 20.4 | | 28.9 | 19.00 | 20.50 | 24.00 |
| June | 22.2 | | | 19.1 | | 26.8 | 19.00 | 20.50 | 24.00 |
| Mar. | 17.1 | | | 18.0 | | 25.3 | 18.00 | 19.50 | 22.00 |
| 1989 Dec. | 19.3 | 15.0 | | 17.8 | 20.4 | 25.4 | 17.00 | 18.00 | 20.00 |
| Sept. | | | | 17.5 | | 23.7 | | | |
| June | | | | 16.9 | | 22.3 | | | |
| Mar. | | | | 16.5 | | 22.4 | | | |
| 1988 Dec. | 20.9 | 14.5 | | 17.1 | 19.3 | 22.7 | 16.00 | 17.00 | 19.00 |
| Sept. | | | | 17.0 | | 22.8 | | | |
| June | | | | 17.6 | | 23.0 | | | |
| Mar. | | | | 17.6 | | 23.0 | | | |
| 1987 Dec. | 16.0 | 15.0 | | 17.8 | | 23.0 | 17.50 | 18.00 | 19.50 |
| 1986 Dec. | | 15.0 | | 15.8 | | 20.5 | | | |
| 1985 Dec. | | 15.0 | | 15.8 | | 20.5 | | | |

Source: Bank of Greece (B,C); Bank of Greece Economic Bulletin (A,D,F,G,H,J); Bank of Greece Monthly Bulletin (E)

Table 3.5 Greece: *Mutual Funds and Investment Companies*

| <i>Drachma billions</i> | 1991 | 1992 | 1993 | 1994 |
|-------------------------|------|------|------|------|
| Mutual Funds* | 171 | 224 | 882 | 1350 |
| % in foreign | -- | 17 | 17 | 10 |
| Investment Companies** | -- | 72 | 122 | -- |

* Mutual Funds: Value of net assets

**Investment Companies: Market Capitalization

Source: Bank of Greece

Table 3.6 *Assets of Social Funds in Greece: October 1993*

| | <i>Dr billion</i> | % |
|---------------------------|-------------------|-------|
| Deposits | 308 | 21.0 |
| Securities | 958 | 65.4 |
| <i>Bills</i> | 667 | 45.6 |
| <i>Bonds</i> | 141 | 9.6 |
| <i>Bonds (ECU, \$ DM)</i> | 43 | 2.9 |
| <i>Shares</i> | 99 | 6.8 |
| <i>Other</i> | 8 | 0.5 |
| Property | 198 | 13.5 |
| Total | 1464 | 100.0 |

Source: Κοινωνικος Προυπολογισμος, 1994

Table 4.1
Structure of Portfolio Investment in Portugal

| Billion Escudos | Outward Portfolio Investment | | | | Inward Portfolio Investment | | | | Net Asset Position* | |
|----------------------------------|------------------------------|-------------|-------------|-------------|-----------------------------|-------------|-------------|-------------|---------------------|------------|
| | 1993 | | 1994 | | 1993 | | 1994 | | 1993 | 1994 |
| | Debit | Credit | Debit | Credit | Debit | Credit | Debit | Credit | | |
| Total | 1521 | 1100 | 1122 | 1069 | 1157 | 1405 | 1281 | 1145 | 923 | 794 |
| Disaggregated by: | | | | | | | | | | |
| Type | | | | | | | | | | |
| Equities | 61 | 33 | 60 | 51 | 226 | 326 | 312 | 393 | 511 | 558 |
| Investment trusts | 1 | 0 | 33 | 28 | 26 | 20 | 12 | 11 | 31 | 29 |
| Bonds (long-term) | 1165 | 1055 | 567 | 537 | 905 | 1058 | 957 | 741 | 700 | 359 |
| of which: | | | | | 465 | 623 | 551 | 404 | 245 | 116 |
| Public debt fixed rate | | | | | 330 | 315 | 341 | 280 | 75 | 37 |
| Public debt floating rate | | | | | 109 | 121 | 64 | 56 | 380 | 206 |
| Others incl. guaranteed | | | | | | | | | | |
| Money market instruments | 293 | 10 | 462 | 452 | | | | | | |
| Derivatives | 2 | 1 | 0 | 0 | | | | | | |
| Agent | | | | | | | | | | |
| Banks | 998 | 970 | 310 | 269 | 262 | 317 | 447 | 485 | 472 | 484 |
| Foreign banks | | | | | 723 | 883 | 658 | 475 | 317 | 150 |
| Portuguese bank branches | | | | | 120 | 143 | 132 | 128 | 26 | 28 |
| Brokers and securities houses | | | | | | | | | | |
| Holding companies (financial) | 9 | 0 | 0 | 0 | 6 | 7 | 16 | 6 | 11 | 7 |
| Investment trusts | 495 | 119 | 675 | 709 | 39 | 48 | 24 | 37 | 18 | 22 |
| Insurance cos. and pension funds | 15 | 4 | 76 | 45 | 2 | 3 | 2 | 8 | 74 | 93 |
| Non-financial entities | 1 | 1 | 1 | 1 | 3 | 0 | 0 | 0 | 3 | 10 |
| Individuals | 1 | 1 | 51 | 37 | | | | | 1 | 1 |
| Others | 2 | 4 | 9 | 8 | | | | | | |
| Geographical area | | | | | | | | | | |
| EU | 1159 | 1060 | 521 | 540 | 401 | 465 | 684 | 647 | 426 | 460 |
| of which: | 957 | 937 | 295 | 303 | 149 | 152 | 248 | 232 | 44 | 33 |
| Spain | | | | | 189 | 274 | 313 | 314 | 215 | 242 |
| UK | | | | | 262 | 471 | 366 | 232 | 242 | 10 |
| Macau | | | | | 409 | 369 | 113 | 130 | 29 | 18 |
| Offshore Madeira | | | | | | | | | | |

* Not including money market instruments
Source: Bank of Portugal

Table 4.2:

Portugal: Financial Assets of Non-bank Private Sector

| <i>Billion Escudos</i> | 1985 | 1990 | 1993 | 1994 |
|--|------|------|-------|-------|
| Domestic assets | | | | |
| Wide Money M2 | 3084 | 6222 | 9755 | 10669 |
| Cash | 319 | 624 | 753 | 796 |
| Deposits in escudos | .. | 5220 | 8747 | 9386 |
| Deposits in forex | .. | 8 | 116 | 359 |
| Other bank quasi-money liabs | .. | 370 | 139 | 128 |
| Treasury bills [^] | 105 | 781 | 386 | 385 |
| Bonds held by nonbank domestic sectors | 263 | 219 | 1833 | 2126 |
| Quoted equities ^{^^} | 60 | 659 | 958 | 1175 |
| Total domestic assets | 3512 | 7881 | 12932 | 14355 |
| Foreign assets | | | | |
| Residents' deposits with nonresident banks ^{**} | 490 | 635 | 1084 | 1062 |
| Institutional holdings of foreign financial assets | | | | |
| Deposit money banks | 773 | 731 | 2632 | 3345 |
| Mutual funds | .. | 1 | 100 | 275 |
| Pension funds [*] | .. | .. | 45 | .. |
| Monetary authorities | 1023 | 2622 | 3714 | 3296 |
| Index of "home preference" | 0.37 | 0.46 | 0.38 | 0.41 |
| Memorandum items | | | | |
| Banks' short-term foreign liabs | 1157 | 2266 | 3947 | 4600 |
| o/w Emigrants deposits | .. | 1744 | 2252 | 2197 |
| Market capitalization of all shares | 36 | 1257 | 2193 | 2587 |
| Market capitalization of all bonds | 216 | 1416 | 4421 | 4851 |
| Total domestic as % GDP | 100 | 93 | 107 | 111 |
| GDP | 3524 | 8507 | 12112 | 12903 |

Source: Based on data provided by the Bank of Portugal, Bolsa de Lisboa and International Financial Statistics

[^] TBs and CLIP sold by banks.

^{^^} From 1990 adjusted for non-resident holdings, and for approximate scale of cross-holdings (1/3)

^{*} Upper estimate

^{**} For 1985, 90: IFS; For 1993, 94: Bank of Portugal figures (which are higher than IFS for these years)

Table 4.3

External financial position of Portugal

| <i>Billion Escudos</i> | 1993 | | 1994 | |
|---------------------------------|---------------|--------------------|---------------|--------------------|
| | <i>Assets</i> | <i>Liabilities</i> | <i>Assets</i> | <i>Liabilities</i> |
| Total | 7430 | 5612 | 7702 | 6547 |
| Non-monetary deposits | 1084 | | 1062 | |
| In national debt | | 3306 | | 3448 |
| Foreign holdings and securities | | 380 | | 206 |
| Banks: Short-term | 2248 | 1695 | 2733 | 2551 |
| Medium/Long-term | 384 | 222 | 612 | 283 |
| Monetary authorities | 3714 | 8 | 3296 | 58 |

Source: Bank of Portugal

Table 4.4a Portuguese banks deposit liabilities

| End of year | Nonbank Financial Sector | | Non Financial Public Enterprises | | Non Financial Private Enterprises | | Private Individuals | | Emigrants | | Short-term Cross-border | | Long-term Cross-border | |
|-------------|--------------------------|-------|----------------------------------|-------|-----------------------------------|-------|---------------------|-------|-----------|-------|-------------------------|--------|------------------------|-------|
| | Total | Forex | Total | Forex | Total | Forex | Total | Forex | Total | Forex | Total | Forex | Total | Forex |
| 1990 | 109 | 2.2 | 116 | 3.4 | 834 | 4.6 | 4695 | 0.4 | 1745 | 126.5 | 524 | 305.2 | 114 | 106.0 |
| 1991 | 284 | 2.3 | 153 | 2.4 | 1179 | 5.2 | 5850 | 0.3 | 1917 | 102.8 | 807 | 597.2 | 128 | 118.0 |
| 1992 | 415 | 0.8 | 146 | 2.0 | 1470 | 46.8 | 6807 | 5.3 | 2183 | 89.4 | 1055 | 804.0 | 170 | 154.0 |
| 1993 | 804 | 10.4 | 160 | 31.3 | 1536 | 59.0 | 7375 | 25.7 | 2254 | 81.0 | 1695 | 963.6 | 222 | 190.0 |
| 1994 | 943 | 148.1 | 80 | 4.0 | 1660 | 104.6 | 8173 | 250.3 | 2197 | 71.0 | 2551 | 1228.0 | 283 | 234.0 |

Source: Bank of Portugal

Table 4.4b

Portuguese banks cross-border assets by currency

| <i>Billion Escudos</i> | <i>End of year</i> | <i>Short-term cross-border</i> | | <i>Long-term cross-border</i> | | |
|------------------------|--------------------|--------------------------------|--------------|-------------------------------|--------------|----------------------|
| | | <i>Escudo</i> | <i>Forex</i> | <i>Escudo</i> | <i>Forex</i> | <i>Not specified</i> |
| | 1990 | 39 | 593 | 35 | 64 | 11 |
| | 1991 | 18 | 788 | 33 | 92 | 13 |
| | 1992 | 81 | 1050 | 52 | 228 | 25 |
| | 1993 | 1137 | 1110 | 134 | 250 | 36 |
| | 1994 | 1202 | 1530 | 196 | 415 | 20 |

Source: Bank of Portugal

Table 4.5:

Market shares in Portuguese banking, 1987 and 1994

| | <i>Deposits</i> | <i>Assets</i> | <i>Loans</i> |
|----------------------------|-----------------|---------------|--------------|
| 1987 | | | |
| State-owned | 95.2 | 92.1 | 92.9 |
| Foreign | 2.6 | 4.1 | 4.0 |
| Top four banks | 57.6 | 53.9 | 53.9 |
| 1994 | | | |
| State-owned (two groups) | 35.0 | 31.7 | 31.7 |
| Foreign | 6.2 | 9.3 | 8.7 |
| Top four banks | 50.5 | | |
| Top four groups | 62.2 | 60.6 | 62.4 |
| Top four groups (proposed) | 78.1 | 74.9 | 75.3 |

Source: based on data provided by Associacao Portuguesa de Bancos, CGD (for 1987) and bank annual reports.

Note: Comparability of figures is approximate

Table 4.6

Schedule of Selected Portuguese Interest Rates

| Period | | Deposits (91-180 days) | Commercial paper* | Lending rates | |
|--------|-------|---------------------------|----------------------|---------------|----------|
| | | | | Discount** | Loans*** |
| 1995 | Jan. | 8.9 | | 16.1 | 14.9 |
| 1994 | Dec. | 9.3 | 10.3 | 16.3 | 14.7 |
| | Sept. | 9.5 | 10.7 | 17.3 | 15.2 |
| 1993 | June | 9.3 | 14.4 | 17.4 | 15.4 |
| | Mar. | 9.2 | 10.0 | 17.9 | 15.0 |
| | Dec. | 10.2 | 12.0 | 18.2 | 15.7 |
| | Sept. | 10.6 | 11.9 | 19.3 | 15.8 |
| 1992 | June | 12.6 | 13.1 | 20.4 | 16.6 |
| | Mar. | 12.7 | 15.7 | 20.6 | 17.1 |
| | Dec. | 14.0 | 16.7 | 20.8 | 18.9 |
| | Sept. | 14.5 | 15.5 | 21.3 | 19.5 |
| 1991 | June | 16.3 | 16.8 | 22.5 | 19.8 |
| | Mar. | 17.0 | 17.3 | 23.8 | 21.5 |
| | Dec. | 18.2 | 19.0 | 23.9 | 21.2 |
| | Sept. | 17.1 | 18.6 | 24.2 | 21.1 |
| 1990 | June | 17.3 | 19.2 | 24.5 | 21.8 |
| | Mar. | 13.9 | 20.2 | 25.0 | 22.1 |
| | Dec. | 11.8 | 22.0 | 24.9 | 21.8 |
| | Sept. | 11.5 | 21.6 | 24.5 | 21.5 |
| | June | 9.4 | 18.7 | 24.0 | 22.1 |
| | Mar. | 10.9 | 19.2 | 23.2 | 21.5 |

* Short-term commercial paper; before 1991: CRISTAL loans.

** Discount of commercial bills: non-financial private enterprises, 91-180 days.

***Loans and advances; non-financial enterprises, 91-180 days.

Source: Bank of Portugal Annual Reports and Economic Bulletin

Table 4.7: *Assets of Pension Funds in Portugal*

| <i>December 1993</i> | <i>Esc. billion</i> | <i>%</i> |
|------------------------------------|---------------------|----------|
| Deposits | 156 | 21.0 |
| Government securities | 282 | 37.9 |
| Non-government domestic securities | 260 | 34.9 |
| Other (including foreign) | 45 | 6.0 |
| Total | 744 | 100.0 |

Source: Instituto de Seguros de Portugal

Table 4.8: *Assets of Investment Funds in Portugal*

| <i>end-year</i> | <i>Real Estate Funds</i> | | <i>Other Funds</i> | |
|-----------------|--------------------------|---------------------|--------------------|---------------------|
| | <i>Esc.</i> | <i>% in foreign</i> | <i>Esc. bn.</i> | <i>% in foreign</i> |
| 1987 | 18 | 0.0 | | |
| 1988 | 26 | 0.0 | | |
| 1989 | 36 | 0.0 | | |
| 1990 | 45 | <1.6 | 381 | 0.1 |
| 1991 | 116 | <1.9 | 856 | 0.0 |
| 1992 | 437 | 0.0 | 1164 | 0.9 |
| 1993 | 827 | <1.3 | 1648 | 6.0 |
| 1994 | 317 | <0.1 | 2054 | 13.4 |

Source: APFIN

Table 5.1

Ireland: Main Financial Assets of the Non-bank Private Sector

| £ billion | 1985 | 1990 | 1993 | 1994 |
|---|-------|-------|-------|-------|
| Domestic Assets | | | | |
| Wide money M3E | 13.47 | 17.73 | 24.13 | 26.60 |
| <i>Narrow money M1</i> | 2.05 | 3.17 | 3.93 | 4.45 |
| <i>Other bank deposits</i> | 6.87 | 9.37 | 13.34 | 14.76 |
| <i>Other deposits</i> | 4.55 | 5.19 | 6.86 | 7.39 |
| Government savings schemes | 0.76 | 2.00 | 2.84 | 3.39 |
| Government stock held by domestic nonbanks | 4.44 | 5.96 | 6.44 | 6.87 |
| <i>Insurance companies, pension funds and unit trusts</i> | .. | 4.74 | 5.46 | 5.87 |
| <i>Non-financial companies</i> | .. | 0.38 | 0.30 | 0.31 |
| <i>Personal sector (direct)</i> | .. | 0.40 | 0.36 | 0.39 |
| <i>Other</i> | .. | 0.44 | 0.33 | 0.30 |
| Quoted equities | 2.16 | 6.47 | 12.33 | 12.70 |
| Total domestic assets | 20.83 | 32.16 | 45.74 | 49.56 |
| Foreign Assets | | | | |
| Residents' deposits with nonresident banks | 1.59 | 4.22 | 7.66 | .. |
| Institutional holdings: | | | | |
| Credit institutions** | 2.62 | 7.71 | 18.23 | 20.44 |
| Pension funds and life assurance companies* | 1.47 | 4.42 | 10.42 | .. |
| Monetary authorities | 2.27 | 2.89 | 4.28 | 4.04 |
| Index of "home preference" | 0.65 | 0.47 | 0.24 | |
| Memorandum items | | | | |
| Banks' short-term foreign liabs | 5.98 | 12.71 | 20.7 | 23.26 |
| Accumulated foreign assets of nonbanks since 1985 | | 4.30 | .. | .. |
| Total domestic as % GDP | 112 | 119 | 146 | 147 |
| GDP | 18.57 | 26.98 | 31.34 | 33.67 |

* Some estimation involved

** For 1985: licensed banks only

Source: Central Bank of Ireland, Eurostat, Irish Stock Exchange.

Table 5.2a International Business of Irish Banks: 1981-93

| % of GNP | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 |
|--------------------------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| Total foreign business - liabilities | 33.0 | 37.4 | 37.1 | 38.4 | 34.3 | 39.1 | 40.4 | 42.9 | 44.5 | 51.4 | 59.1 | 65.6 | 83.1 |
| of which: Interbank | 16.8 | 18.9 | 19.5 | 20.2 | 15.9 | 22.2 | 24.2 | 26.7 | 28.3 | 31.6 | 38.8 | 44.5 | 59.3 |
| Nonbank | 16.2 | 18.5 | 17.6 | 18.2 | 18.4 | 17.0 | 16.2 | 16.2 | 16.2 | 19.8 | 20.3 | 21.1 | 23.8 |
| Total foreign business - assets | 23.4 | 28.1 | 28.1 | 28.1 | 24.8 | 28.4 | 32.1 | 34.7 | 41.1 | 44.4 | 53.0 | 65.6 | 90.3 |
| of which: Interbank | 13.4 | 16.1 | 15.4 | 15.5 | 13.5 | 15.6 | 18.9 | 20.6 | 27.3 | 29.1 | 36.9 | 43.1 | 56.2 |
| Nonbank | 10.0 | 11.9 | 12.7 | 12.6 | 11.3 | 12.8 | 13.2 | 14.1 | 13.8 | 15.2 | 16.1 | 22.4 | 34.1 |

Source : Central Bank of Ireland

Table 5.2b International Business of Irish Banks by Geographical Area

| % of GNP, total | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 |
|---|------|------|------|------|------|------|------|------|------|------|------|------|
| % of GNP | | | | | | | | | | | | |
| Liabilities | | | | | | | | | | | | |
| Claims of non-residents in forex | 14.3 | 14.9 | 14.2 | 12.6 | 15.8 | 13.7 | 15.6 | 15.8 | 15.9 | 14.5 | 16.3 | 16.6 |
| UK | 2.5 | 2.3 | 3.4 | 2.5 | 3.1 | 4.2 | 4.4 | 5.2 | 4.4 | 4.4 | 8.1 | 21.7 |
| Other EC | 1.5 | 1.9 | 2.1 | 1.0 | 1.3 | 2.2 | 2.9 | 3.1 | 1.8 | 1.4 | 2.6 | 1.6 |
| USA | 0.2 | 0.4 | 0.5 | 0.2 | 0.6 | 0.7 | 0.9 | 1.1 | 0.9 | 0.5 | 0.3 | 0.9 |
| Switz | 0.0 | 0.9 | 0.9 | 0.6 | 0.8 | 1.3 | 1.1 | 1.3 | 1.0 | 2.5 | 2.7 | 4.2 |
| Offshore | | | | | | | | | | | | |
| Claims of non-residents in Irish pounds | 9.3 | 10.0 | 10.5 | 10.8 | 8.1 | 7.3 | 6.9 | 6.1 | 9.0 | 9.8 | 7.7 | 8.1 |
| UK | 0.5 | 0.1 | 0.2 | 0.3 | 0.3 | 0.5 | 0.6 | 0.5 | 0.9 | 0.8 | 0.8 | 1.6 |
| Other EC | 0.9 | 0.4 | 0.5 | 0.7 | 1.2 | 1.1 | 1.1 | 1.2 | 1.9 | 1.5 | 1.3 | 1.4 |
| USA | 0.0 | 0.0 | 0.0 | 0.1 | 0.2 | 0.3 | 0.2 | 0.3 | 0.4 | 0.1 | 0.0 | 0.1 |
| Offshore | | | | | | | | | | | | |
| Assets | | | | | | | | | | | | |
| Claims on non-residents in forex | 10.1 | 9.1 | 9.6 | 9.8 | 9.4 | 9.1 | 10.0 | 12.4 | 15.8 | 16.3 | 16.3 | 22.1 |
| UK | 2.1 | 2.1 | 1.9 | 1.5 | 1.9 | 2.6 | 2.9 | 3.4 | 3.1 | 5.0 | 8.0 | 12.5 |
| Other EC | 0.5 | 1.0 | 1.3 | 0.7 | 0.5 | 1.6 | 1.7 | 3.5 | 3.6 | 4.3 | 5.8 | 13.9 |
| USA | 0.0 | 0.0 | 0.0 | 0.4 | 1.1 | 1.5 | 1.9 | 2.9 | 1.6 | 0.9 | 3.7 | 3.8 |
| Offshore | | | | | | | | | | | | |
| % of total | | | | | | | | | | | | |
| Liabilities | | | | | | | | | | | | |
| Claims of non-residents in forex | 71.1 | 69.2 | 63.7 | 72.7 | 71.5 | 58.9 | 60.4 | 57.5 | 63.2 | 59.2 | 52.2 | 36.1 |
| UK | 12.3 | 10.8 | 15 | 14.2 | 14.1 | 18 | 17.1 | 18.7 | 17.6 | 18 | 26 | 47 |
| Other EC | 7.5 | 8.8 | 9.3 | 5.9 | 5.9 | 9.3 | 11.3 | 11.1 | 7 | 5.7 | 8.4 | 3.5 |
| USA | 1.2 | 1.7 | 2.1 | 1 | 2.6 | 3.2 | 3.5 | 4 | 3.7 | 2.1 | 0.8 | 1.9 |
| Switz | - | 4.1 | 4.2 | 3.5 | 3.8 | 5.7 | 4.3 | 4.6 | 4.2 | 10.2 | 8.6 | 9.1 |
| Offshore | | | | | | | | | | | | |
| Claims of non-residents in Irish pounds | 83 | 91.9 | 90.7 | 89.6 | 80.3 | 77.2 | 76.7 | 72 | 71.1 | 77.8 | 74.6 | 68.8 |
| UK | 4.3 | 1.3 | 1.7 | 2.5 | 3.4 | 5 | 6.1 | 5.9 | 7 | 6 | 8.1 | 13.9 |
| Other EC | 7.8 | 4 | 4.7 | 5.5 | 11.8 | 11.1 | 11.7 | 14 | 15.3 | 11.7 | 12.9 | 12 |
| USA | - | - | - | 0.5 | 1.7 | 3.3 | 1.7 | 3.2 | 3 | 1 | 0.4 | 0.6 |
| Offshore | | | | | | | | | | | | |
| Assets | | | | | | | | | | | | |
| Claims on non-residents in forex | 71.3 | 60.7 | 60.3 | 73.8 | 68.7 | 56 | 58 | 51.4 | 62.4 | 57 | 42.6 | 37.9 |
| UK | 15.2 | 14.1 | 11.8 | 11.3 | 14 | 15.9 | 16.5 | 13.9 | 12.1 | 17.5 | 20.8 | 21.5 |
| Other EC | 3.4 | 6.8 | 8 | 5.4 | 3.3 | 9.7 | 9.6 | 14.3 | 14.3 | 14.9 | 15.2 | 23.8 |
| USA | - | - | - | 3.2 | 7.8 | 9.4 | 10.7 | 12.1 | 6.5 | 3.1 | 9.6 | 6.6 |
| Offshore | | | | | | | | | | | | |

Source: Central Bank of Ireland

Table 5.2c
International Business of Irish Banks by Currency

| IR£ billion | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 |
|---|------|------|------|------|------|------|------|------|------|------|------|-------|-------|
| Liabilities | | | | | | | | | | | | | |
| Claims of non-residents in forex | 1.97 | 2.53 | 2.95 | 3.33 | 2.89 | 3.90 | 4.40 | 5.15 | 6.03 | 6.01 | 6.15 | 8.26 | 12.76 |
| of which: | | | | | | | | | | | | | |
| USD | 0.66 | 1.04 | 1.22 | 1.35 | 0.88 | 1.10 | 1.58 | 1.83 | 2.25 | 1.84 | 1.85 | 2.77 | 5.46 |
| GBP | 0.97 | 0.95 | 1.20 | 1.33 | 1.43 | 1.74 | 1.68 | 2.08 | 2.39 | 2.68 | 2.68 | 2.96 | 2.99 |
| DEM | 0.22 | 0.29 | 0.21 | 0.35 | 0.19 | 0.53 | 0.50 | 0.33 | 0.47 | 0.46 | 0.63 | 0.60 | 1.06 |
| Claims of residents in forex | 0.69 | 0.98 | 0.88 | 1.01 | 0.98 | 1.49 | 1.66 | 2.05 | 2.29 | 3.56 | 5.93 | 6.78 | 7.86 |
| of which: | | | | | | | | | | | | | |
| USD | 0.38 | 0.49 | 0.50 | 0.58 | 0.47 | 0.48 | 0.42 | 0.70 | 0.62 | 0.55 | 1.02 | 1.31 | 1.74 |
| GBP | 0.21 | 0.29 | 0.23 | 0.24 | 0.24 | 0.67 | 0.79 | 0.79 | 0.93 | 1.65 | 1.78 | 1.93 | 1.88 |
| DEM | 0.07 | 0.13 | 0.07 | 0.05 | 0.06 | 0.09 | 0.12 | 0.21 | 0.28 | 0.54 | 1.15 | 1.25 | 1.53 |
| Assets | | | | | | | | | | | | | |
| Claims on non-residents in forex | 1.35 | 1.78 | 2.06 | 2.37 | 2.21 | 2.43 | 3.09 | 3.45 | 5.31 | 6.03 | 7.18 | 10.15 | 16.12 |
| of which: | | | | | | | | | | | | | |
| USD | 0.27 | 0.63 | 0.84 | 0.93 | 0.77 | 0.60 | 1.25 | 0.94 | 2.05 | 1.71 | 2.33 | 4.96 | 9.56 |
| GBP | 0.99 | 0.93 | 1.01 | 1.18 | 1.14 | 1.38 | 1.31 | 1.89 | 2.56 | 3.33 | 3.43 | 2.99 | 3.01 |
| DEM | 0.03 | 0.15 | 0.09 | 0.05 | 0.10 | 0.13 | 0.13 | 0.17 | 0.17 | 0.36 | 0.45 | 0.91 | 1.75 |
| Claims on residents in forex | 1.33 | 1.80 | 1.89 | 1.99 | 1.97 | 2.72 | 3.07 | 3.74 | 3.91 | 4.67 | 6.31 | 7.38 | 9.29 |
| of which: | | | | | | | | | | | | | |
| USD | 0.27 | 0.63 | 0.84 | 0.93 | 0.77 | 0.60 | 1.25 | 0.94 | 2.05 | 1.71 | 2.33 | 4.96 | 9.56 |
| GBP | 0.99 | 0.93 | 1.01 | 1.18 | 1.14 | 1.38 | 1.31 | 1.89 | 2.56 | 3.33 | 3.43 | 2.99 | 3.01 |
| DEM | 0.03 | 0.15 | 0.09 | 0.05 | 0.10 | 0.13 | 0.13 | 0.17 | 0.17 | 0.36 | 0.45 | 0.91 | 1.75 |
| Currency composition of forex business (%) | | | | | | | | | | | | | |
| Liabilities | | | | | | | | | | | | | |
| Claims of non-residents in forex | 33.5 | 41.1 | 41.4 | 40.5 | 30.4 | 28.2 | 35.9 | 35.5 | 37.3 | 30.6 | 30.1 | 33.5 | 42.8 |
| USD | 49.2 | 37.5 | 40.7 | 39.9 | 49.5 | 44.6 | 38.2 | 40.4 | 39.6 | 44.6 | 43.6 | 35.8 | 23.4 |
| GBP | 11.2 | 11.5 | 7.1 | 10.5 | 6.6 | 13.6 | 11.4 | 6.4 | 7.8 | 7.7 | 10.2 | 7.3 | 8.3 |
| Claims of residents in forex | 55.1 | 50.0 | 56.8 | 57.4 | 48.0 | 32.2 | 25.3 | 34.1 | 27.1 | 15.4 | 17.2 | 19.3 | 22.1 |
| USD | 30.4 | 29.6 | 26.1 | 23.8 | 24.5 | 45.0 | 47.6 | 38.5 | 40.6 | 46.3 | 30.0 | 28.5 | 23.9 |
| GBP | 10.1 | 13.3 | 8.0 | 5.0 | 6.1 | 6.0 | 7.2 | 10.2 | 12.2 | 15.2 | 19.4 | 18.4 | 19.5 |
| Assets | | | | | | | | | | | | | |
| Claims on non-residents in forex | 20.0 | 35.4 | 40.8 | 39.2 | 34.8 | 24.7 | 40.5 | 27.2 | 38.6 | 28.4 | 32.5 | 48.9 | 59.3 |
| USD | 73.3 | 52.2 | 49.0 | 49.8 | 51.6 | 56.8 | 42.4 | 54.8 | 46.2 | 55.2 | 47.8 | 29.5 | 18.7 |
| GBP | 2.2 | 8.4 | 4.4 | 2.1 | 4.5 | 5.3 | 4.2 | 4.9 | 3.2 | 6.0 | 6.3 | 9.0 | 10.9 |
| Claims on residents in forex | 20.3 | 35.0 | 44.4 | 46.7 | 39.1 | 22.1 | 40.7 | 25.1 | 52.4 | 36.6 | 36.9 | 67.2 | 102.9 |
| USD | 74.4 | 51.7 | 53.4 | 59.3 | 57.9 | 50.7 | 42.7 | 50.5 | 65.5 | 71.3 | 54.4 | 40.5 | 32.4 |
| GBP | 2.3 | 8.3 | 4.8 | 2.5 | 5.1 | 4.8 | 4.2 | 4.5 | 4.3 | 7.7 | 7.1 | 12.3 | 18.8 |

Source : Central Bank of Ireland

Table 5.3 Quoted Bank Interest Spreads: Ireland 1985-1994

| Range - yearly averages | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992* | 1993* | 1994 |
|--|---------|----------|---------|---------|-----------|---------|---------|---------|---------|---------|
| Loans | | | | | | | | | | |
| <i>Spread above (3-month) Interbank Rate</i> | | | | | | | | | | |
| AAA/Prime rate | 36-51 | (83)-(8) | (31)-52 | 2-29 | (87)-(62) | (24)-15 | 22-55 | 63-98 | 80-107 | 20-28 |
| AA Overdraft | 164-205 | 108-238 | 165-239 | 229-304 | 138-213 | 192-278 | 218-299 | 221-296 | 431-497 | 399-469 |
| A Termloans | 497-509 | 375-388 | 492-517 | 525-529 | 438-438 | 499-503 | 520-524 | 509-521 | 576-611 | 524-524 |
| Demand deposits | | | | | | | | | | |
| <i>Spread below (3-month) Interbank Rate</i> | | | | | | | | | | |
| >£100,000 | 137-145 | 212-247 | 152-185 | 190-215 | 306-331 | 252-331 | 251-326 | 263-345 | 286-424 | 376-518 |

* Note: 1992 and 1993 averages are over 8 and 10 months respectively to avoid the effects of the currency crisis.
Source: Central Bank of Ireland.

Table 5.4 *Asset Breakdown of Irish Life Assurance Companies and Pension Funds: 1987-93*

| <i>£ billion</i> | | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 |
|---|--------------------|------|------|-------|-------|-------|-------|-------|
| Asset Holdings of Irish Life Assurance Companies | | | | | | | | |
| <i>Total</i> | Gilts | -- | -- | 3.33 | 3.11 | 3.42 | 3.22 | 4.28 |
| | Property | -- | -- | 0.87 | 0.97 | 0.93 | 0.74 | 0.80 |
| | Shares | -- | -- | 4.44 | 3.35 | 3.99 | 4.07 | 5.80 |
| | Other | -- | -- | 0.69 | 1.04 | 1.01 | 0.83 | 0.94 |
| | Total | 5.98 | 8.20 | 9.32 | 8.42 | 9.33 | 8.84 | 11.82 |
| <i>Foreign</i> | Gilts | -- | -- | 0.06 | 0.10 | 0.17 | 0.18 | 0.28 |
| | Property | -- | -- | 0.10 | 0.11 | 0.13 | 0.09 | 0.08 |
| | Shares | -- | -- | 1.56 | 1.16 | 1.79 | 1.69 | 2.38 |
| | Other | -- | -- | 0.02 | 0.21 | 0.27 | 0.21 | 0.24 |
| | Total | 1.08 | -- | 1.74 | 1.53 | 2.33 | 2.16 | 2.98 |
| | Foreign as % total | 18.0 | -- | 18.6 | 18.2 | 25.0 | 24.4 | 25.2 |
| Asset Holdings of Irish Pension Funds | | | | | | | | |
| <i>Total</i> | Gilts | 2.36 | 3.01 | 2.88 | 2.93 | 3.11 | 3.56 | 4.62 |
| | Property | 0.31 | 0.31 | 0.68 | 0.79 | 0.72 | 0.70 | 0.72 |
| | Shares | 1.96 | 2.61 | 4.34 | 3.70 | 4.86 | 4.74 | 7.86 |
| | Other | 0.46 | 0.46 | 0.51 | 0.67 | 0.62 | 0.75 | 0.73 |
| | Total | 5.09 | 6.39 | 8.41 | 8.10 | 9.30 | 9.74 | 13.92 |
| <i>Foreign</i> | Gilts | 0.10 | 0.15 | 0.23 | 0.31 | 0.28 | 0.57 | 0.51 |
| | Property | 0.05 | 0.05 | 0.04 | 0.05 | 0.05 | 0.04 | 0.06 |
| | Shares | 0.72 | 1.12 | 1.82 | 1.65 | 2.61 | 2.68 | 4.71 |
| | Other | 0.05 | 0.05 | 0.04 | 0.05 | 0.04 | 0.07 | 0.04 |
| | Total | 0.92 | 1.34 | 2.14 | 2.06 | 2.98 | 3.37 | 5.31 |
| | Foreign as % total | 18.0 | 21.0 | 25.4 | 25.4 | 32.0 | 34.6 | 38.1 |
| Consolidated Total: Life Assurance and Pension Funds | | | | | | | | |
| | Irish | 7.12 | 5.05 | 10.83 | 10.17 | 10.41 | 10.15 | 13.44 |
| | Foreign | 1.56 | 1.34 | 3.18 | 2.98 | 4.27 | 4.47 | 6.70 |
| | Total | 8.68 | 6.39 | 14.01 | 13.15 | 14.68 | 14.63 | 20.14 |

Note: Italicized entries denote some estimation.

Sources: Irish Insurance Federation, Irish Association of Pension Funds.

Table 5.5 *Structure of the Irish Credit System*

| End year, percentage | Share of | | Total Assets |
|------------------------------------|-------------|-------|--------------|
| | Deposits | Loans | |
| | <i>1985</i> | | |
| Total Credit Institutions | 100 | 100 | 100 |
| Total Banks | 71 | 74 | 78 |
| Irish-owned | 54 | 48 | 54 |
| Foreign-owned | 17 | 26 | 24 |
| -subsidiaries | 11 | 17 | 16 |
| -branches | 6 | 8 | 8 |
| Building Societies | 18 | 19 | 13 |
| Other Credit Institutions and POSB | 11 | 7 | 10 |
| | <i>1990</i> | | |
| Total Credit Institutions | 100 | 100 | 100 |
| Total Banks | 68 | 75 | 81 |
| Irish-owned | 53 | 53 | 57 |
| Foreign-owned | 15 | 21 | 24 |
| -subsidiaries | 9 | 13 | 16 |
| -branches | 6 | 8 | 8 |
| Building Societies | 21 | 18 | 12 |
| Other Credit Institutions and POSB | 11 | 7 | 7 |
| | <i>1994</i> | | |
| Total Credit Institutions | 100 | 100 | 100 |
| Total Banks | 67 | 72 | 79 |
| Irish-owned | 46 | 41 | 43 |
| Foreign-owned | 21 | 31 | 37 |
| -subsidiaries | 11 | 18 | 18 |
| -branches | 10 | 14 | 18 |
| Building Societies | 23 | 21 | 14 |
| Other Credit Institutions and POSB | 9 | 7 | 6 |

Note: Irish Permanent included in Building Societies
Non-government business, non-interbank business

Figure 1.1

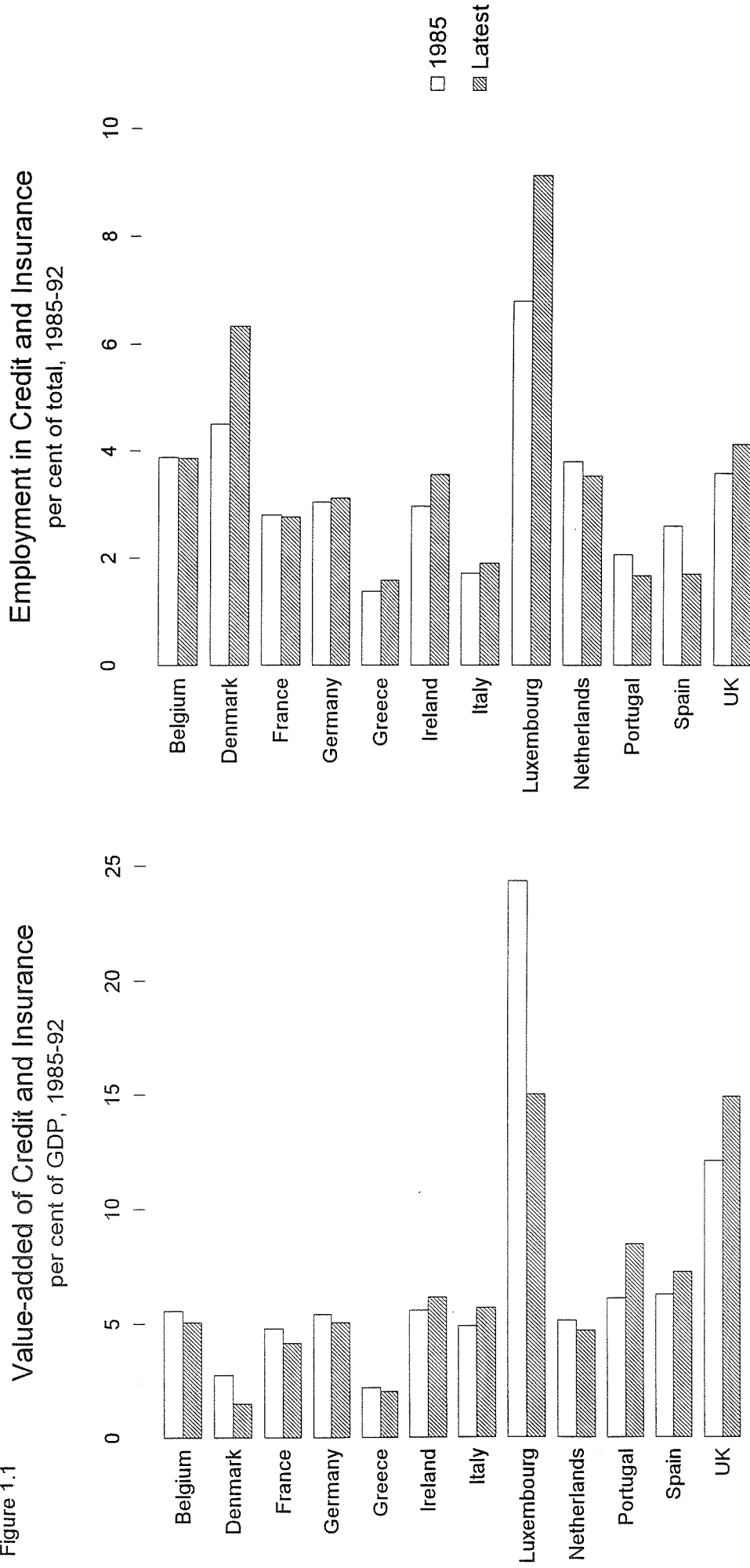


Figure 1.2

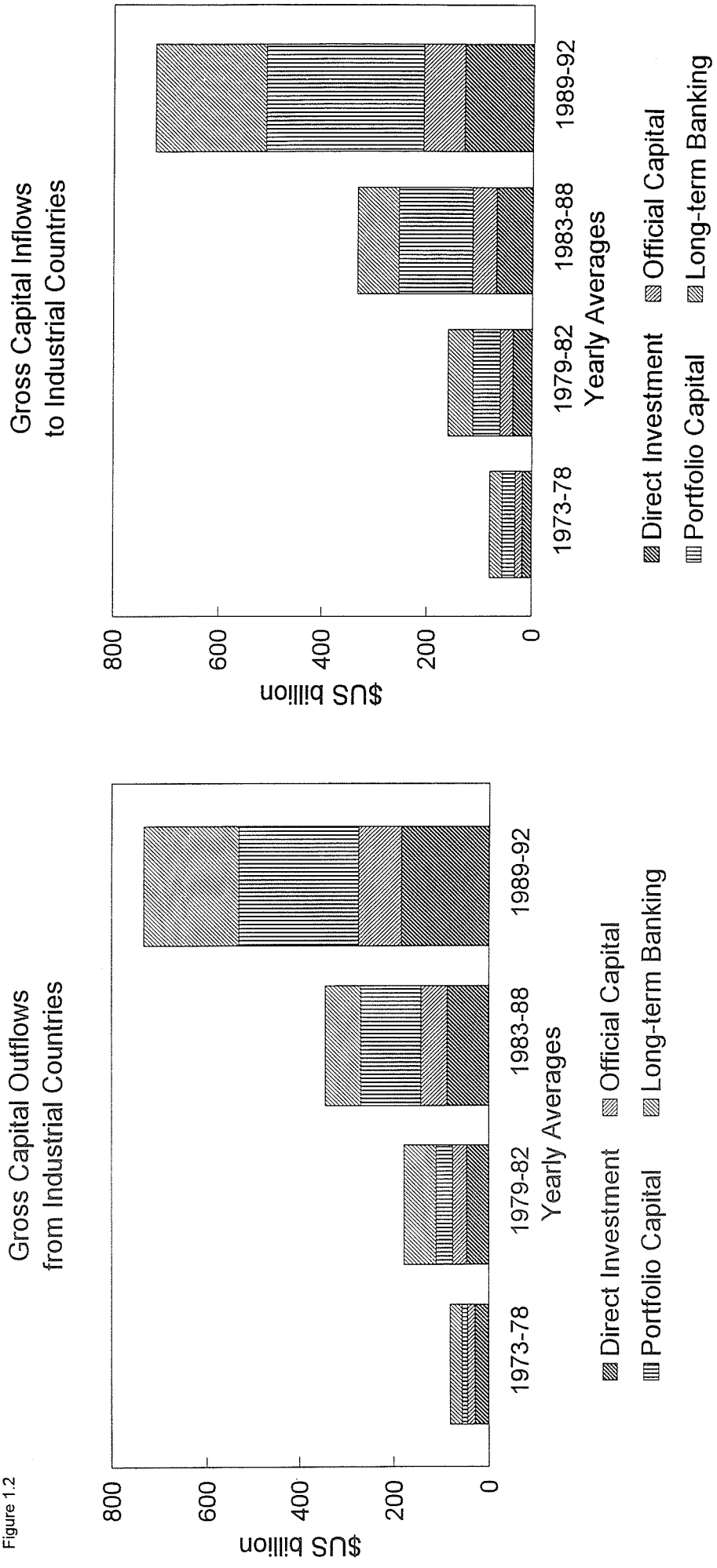
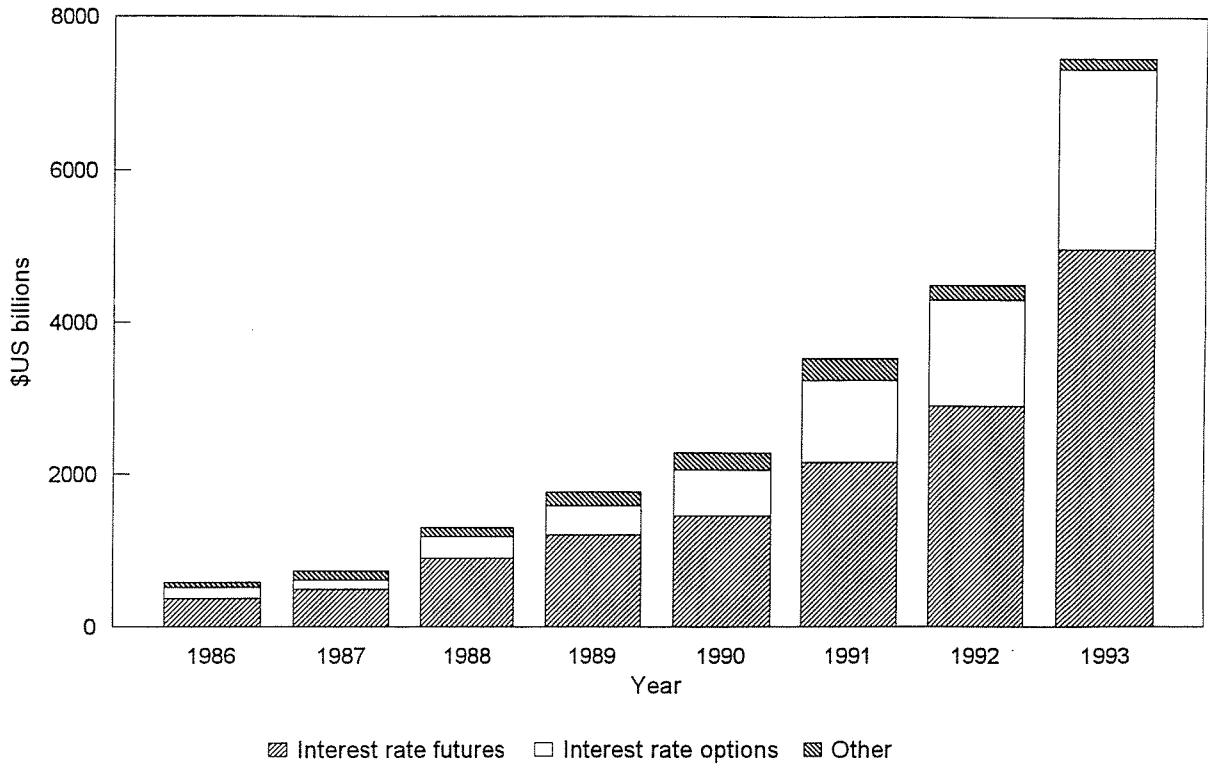


Figure 1.3

Market for Exchange-traded Instruments: 1985-93

Notional Principal Amounts Outstanding



Market for Over-the-counter Instruments: 1985-93

Notional Principal Amounts Outstanding

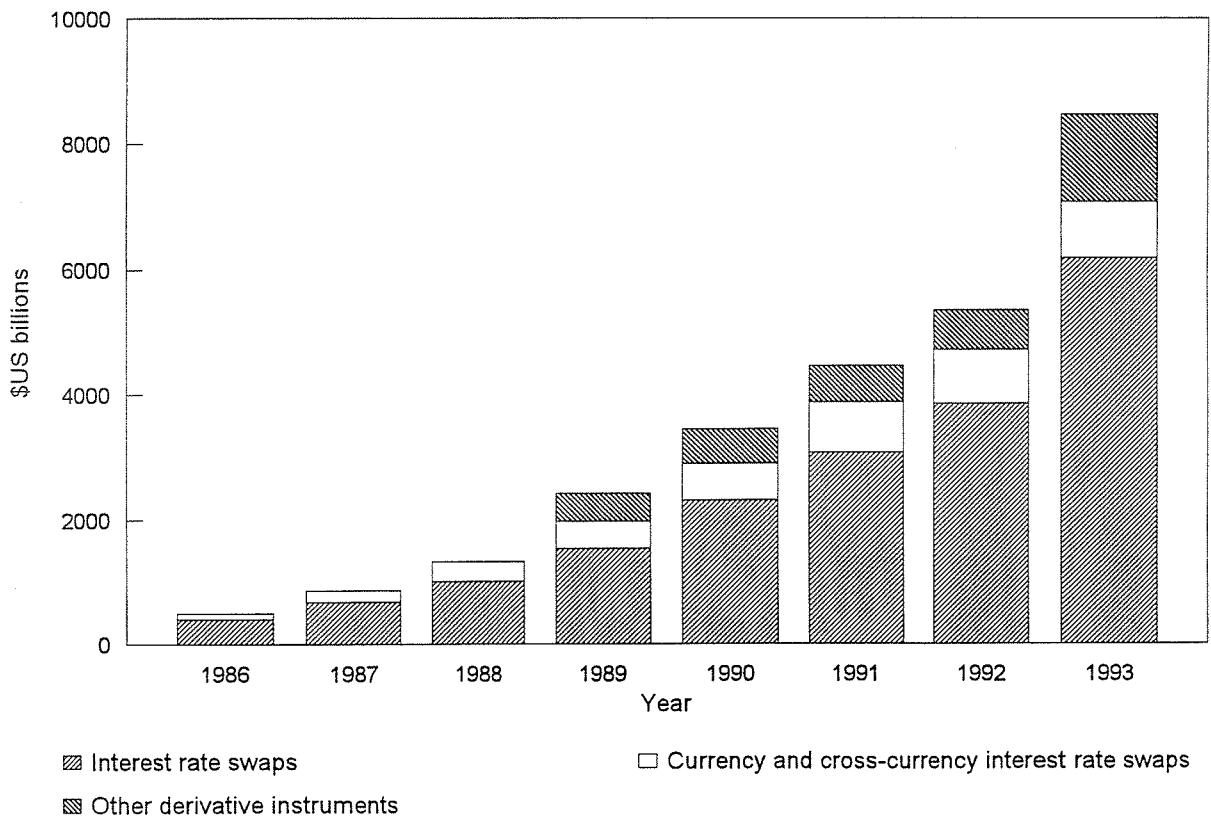


Figure 1.4(a)

Banks' international business with nonbanks (% of GDP)

by residence of nonbank

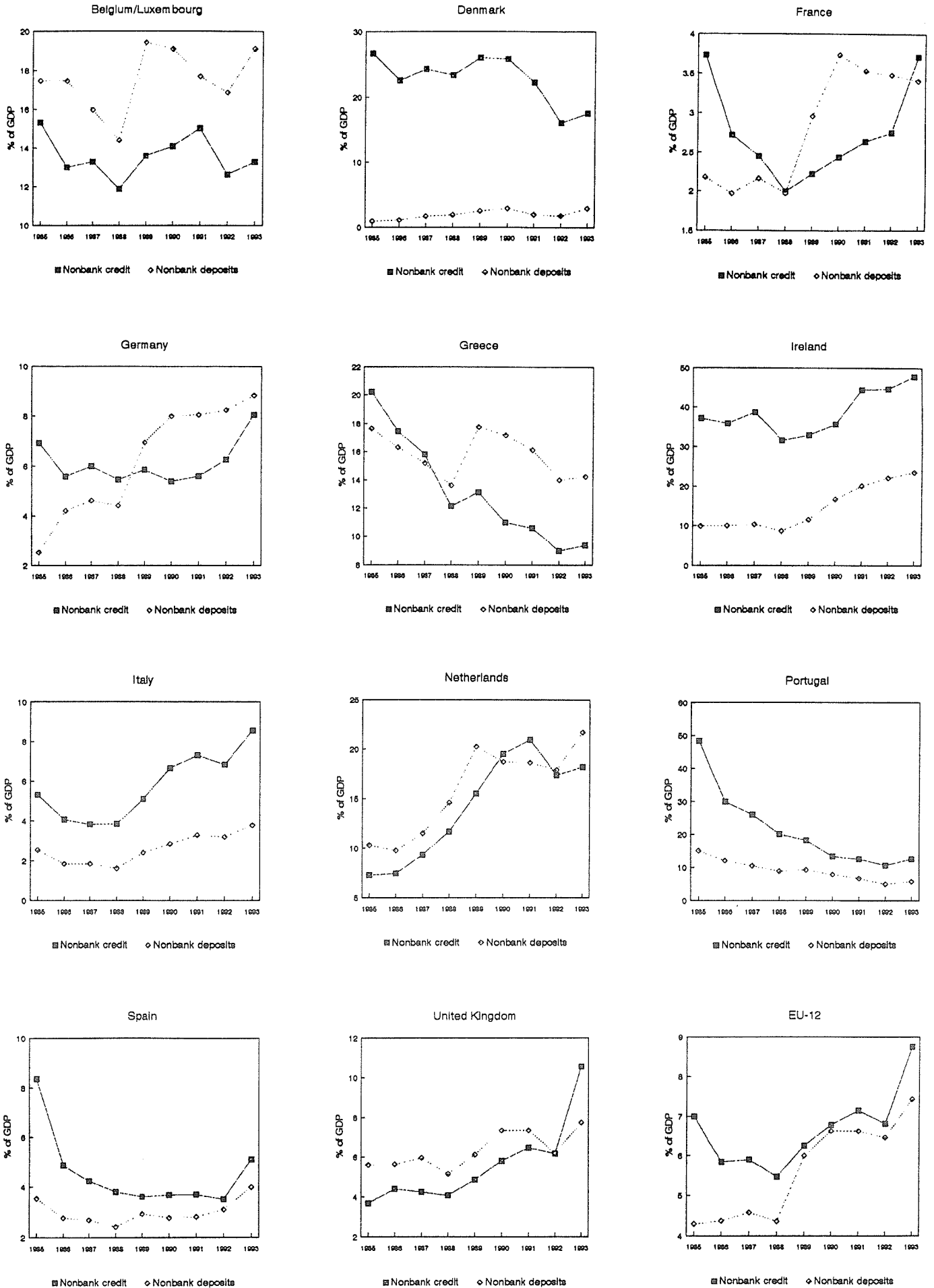
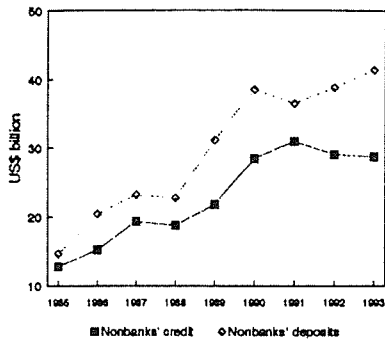


Figure 1.4(b)

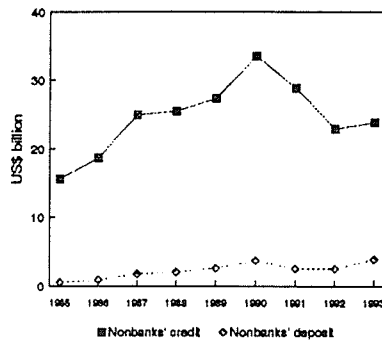
Banks' international business with nonbanks (\$US bn)

by residence of nonbank

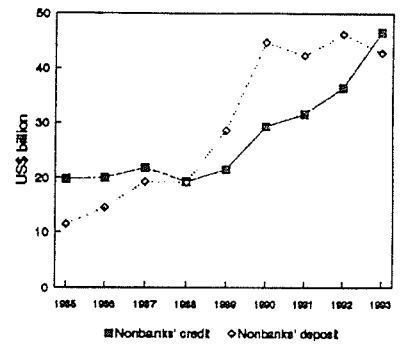
Belgium/Luxembourg



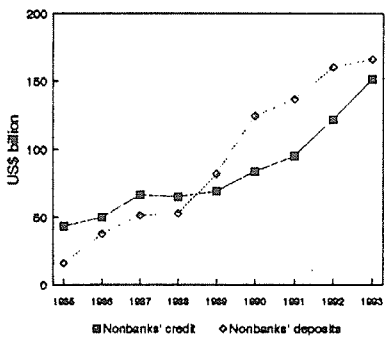
Denmark



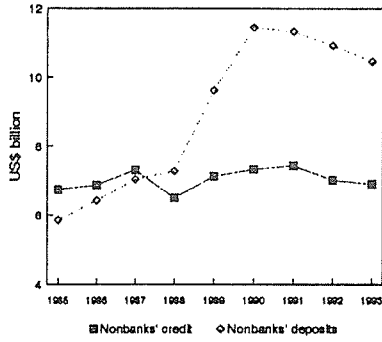
France



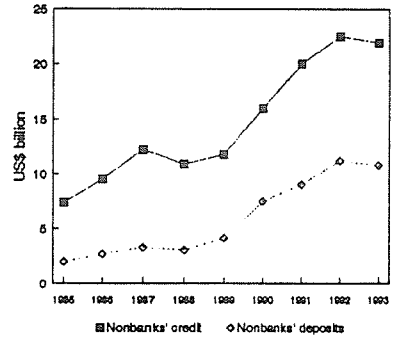
Germany



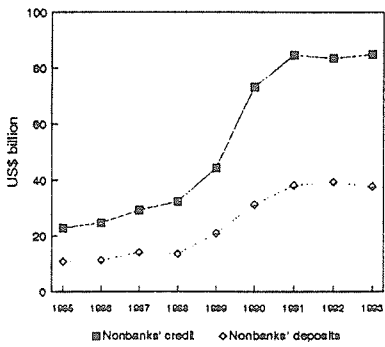
Greece



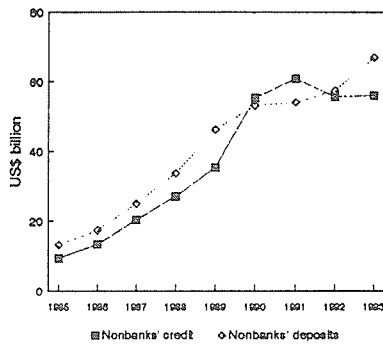
Ireland



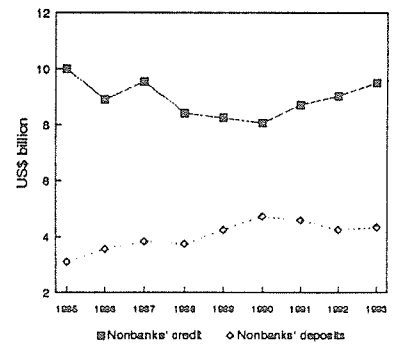
Italy



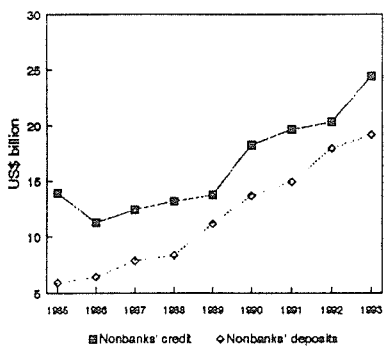
Netherlands



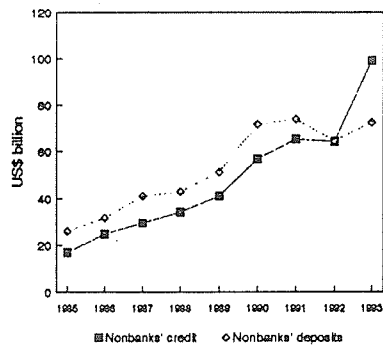
Portugal



Spain



United Kingdom



EU-12

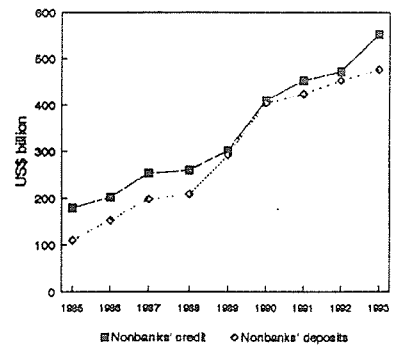


Figure 1.4(c)

Banks' international business with nonbanks
by residence of nonbank

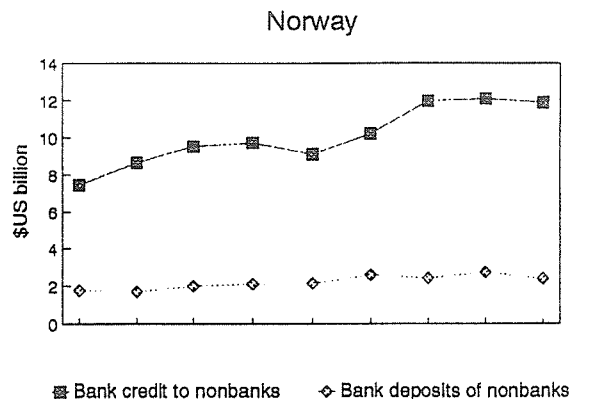
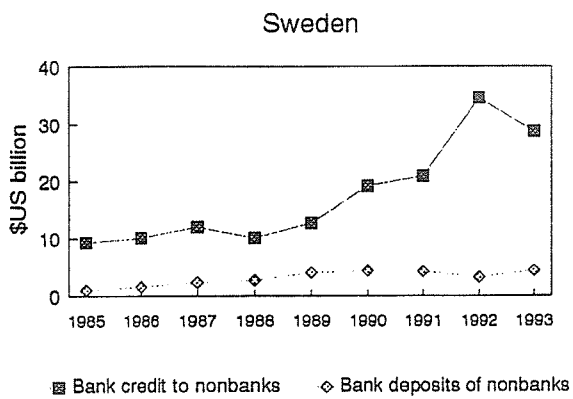
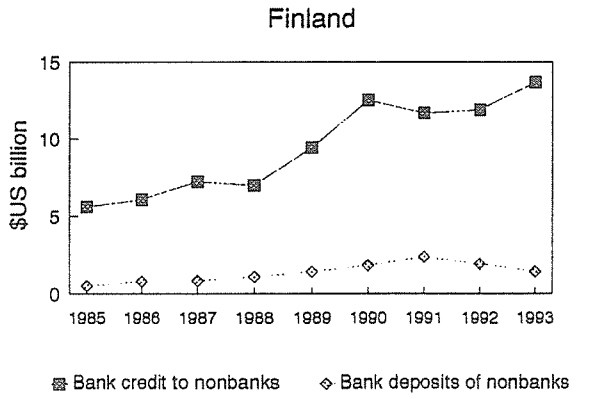
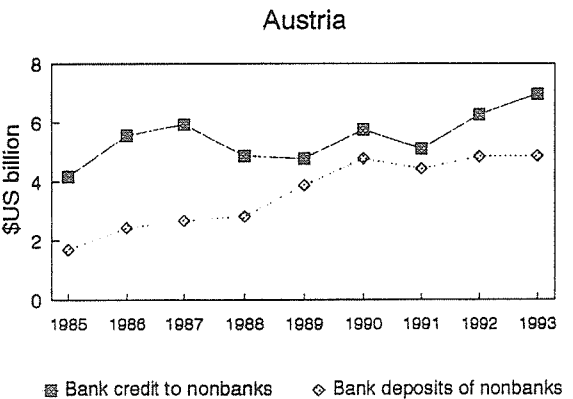
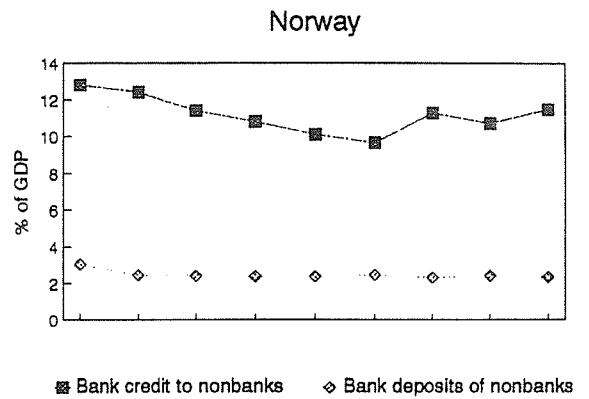
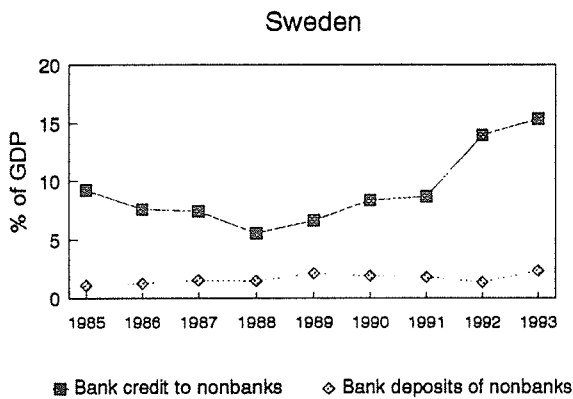
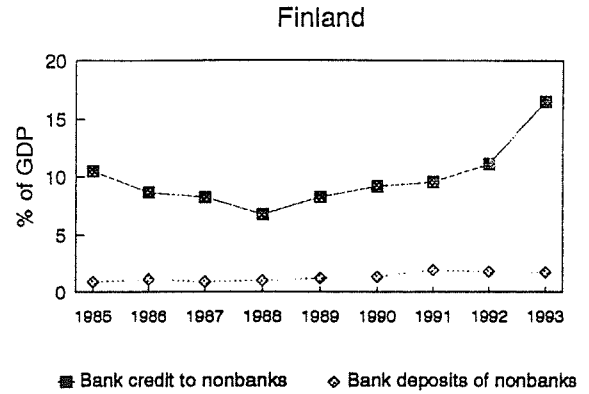
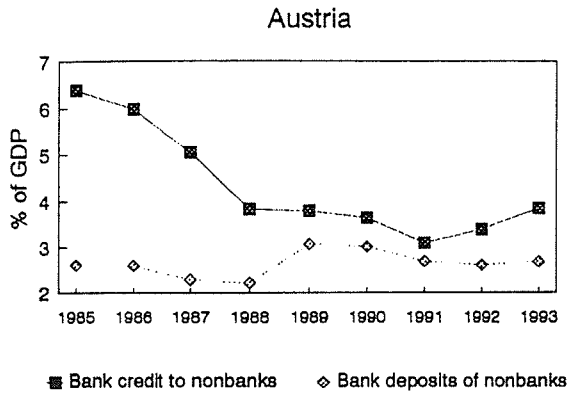


Figure 1.4(d)

Banks' international business

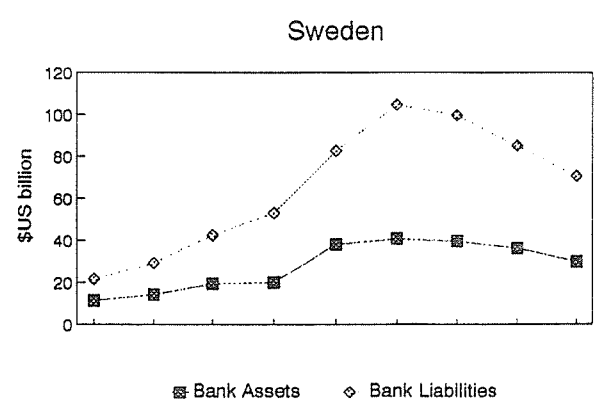
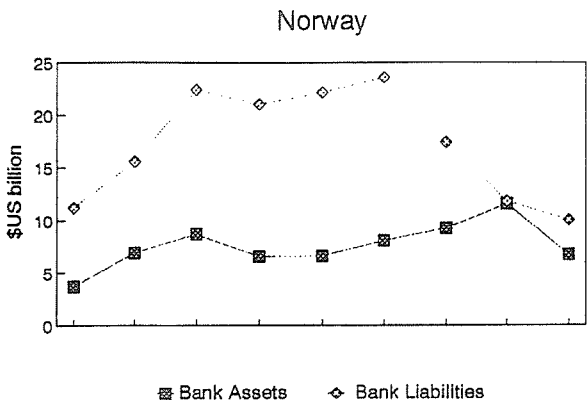
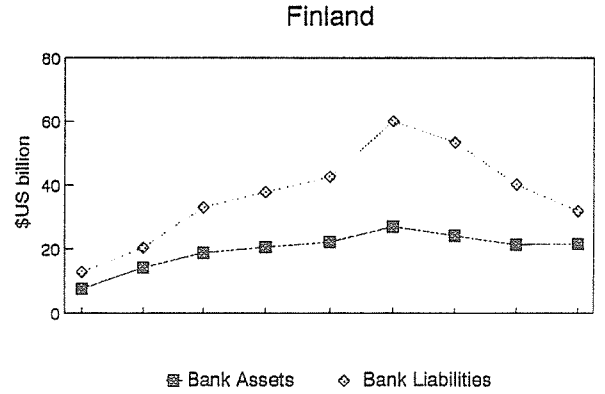
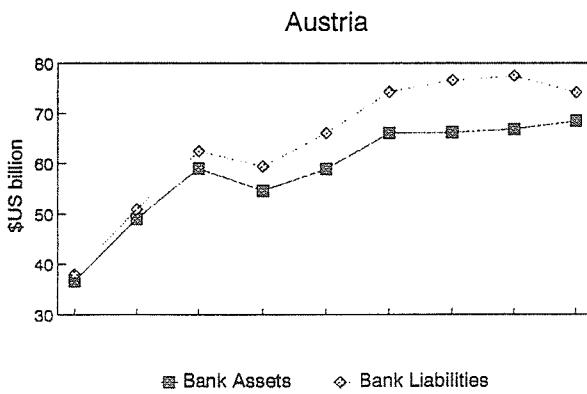
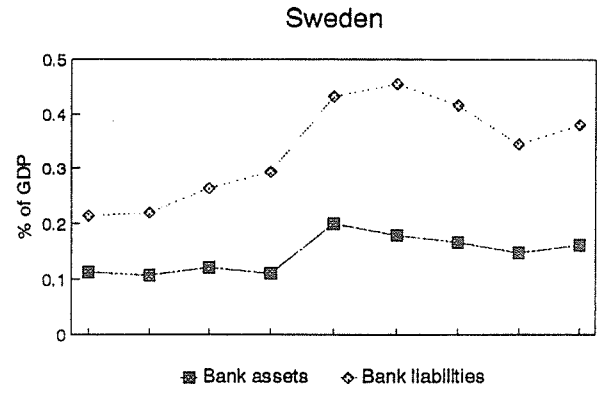
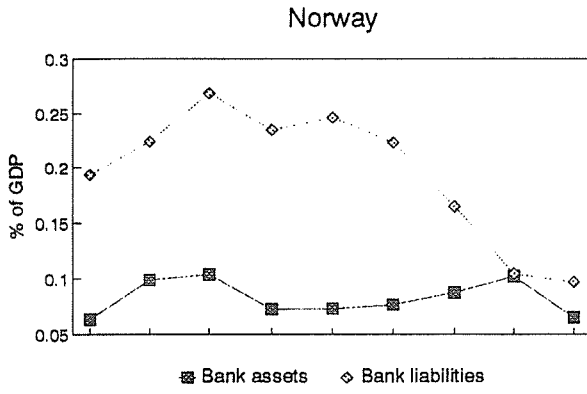
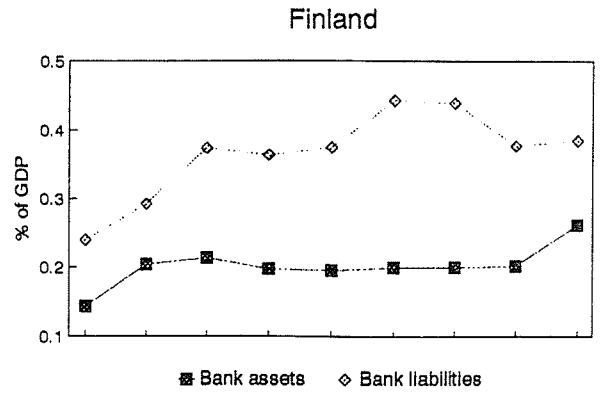
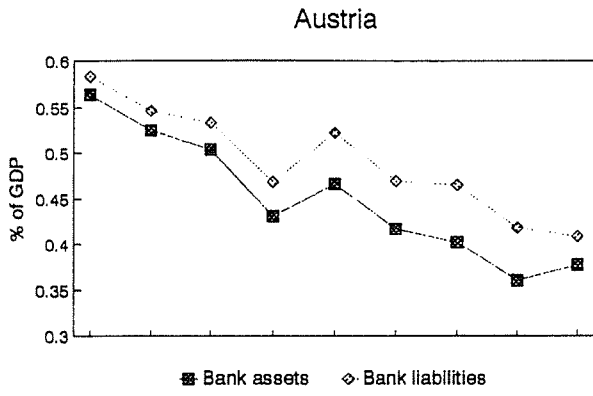
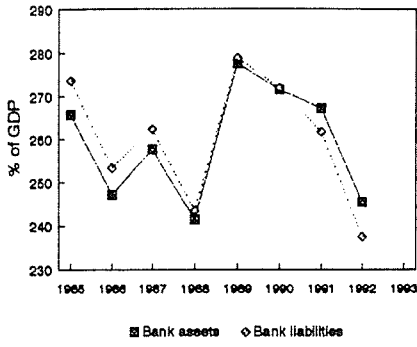


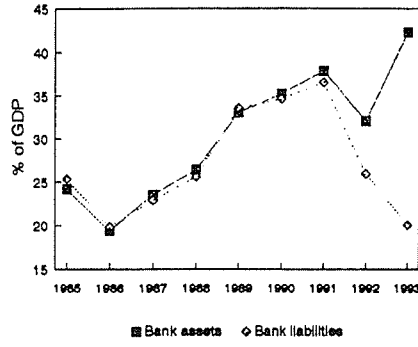
Figure 1.4(e)

Banks' international business (% of GDP)

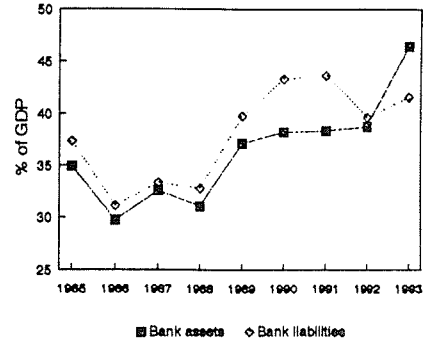
Belgium/Luxembourg



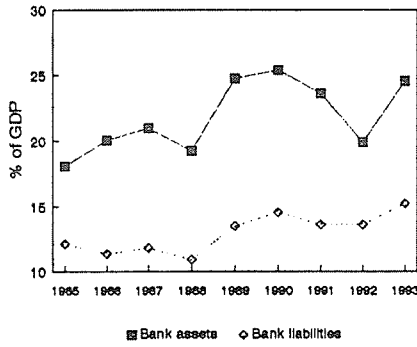
Denmark



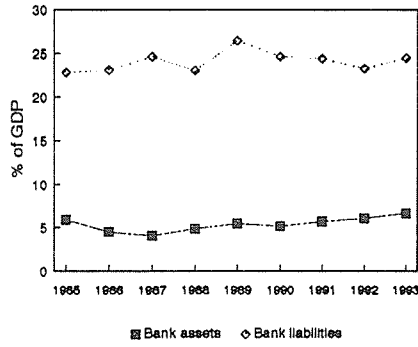
France



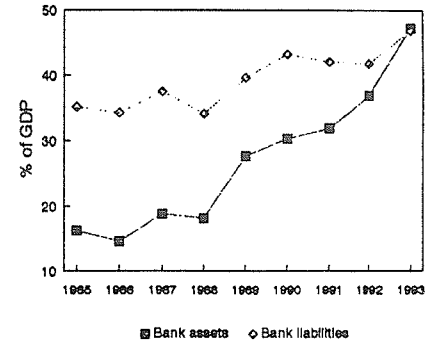
Germany



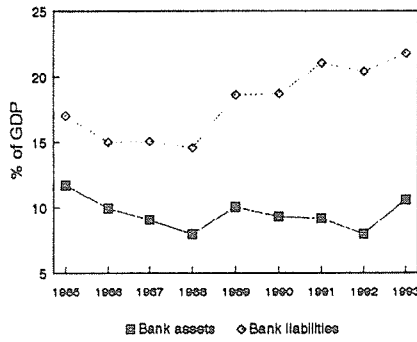
Greece



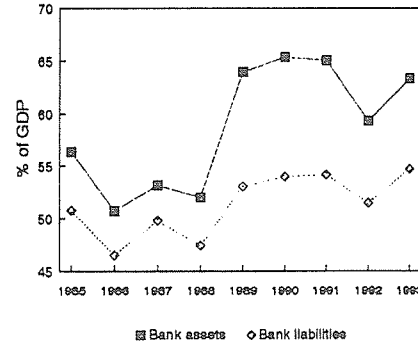
Ireland



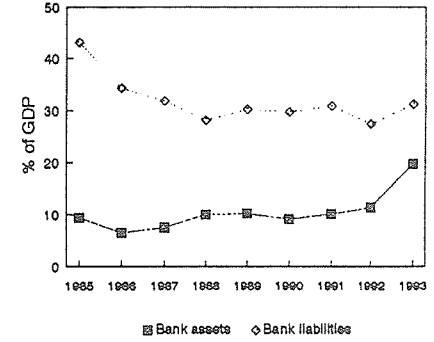
Italy



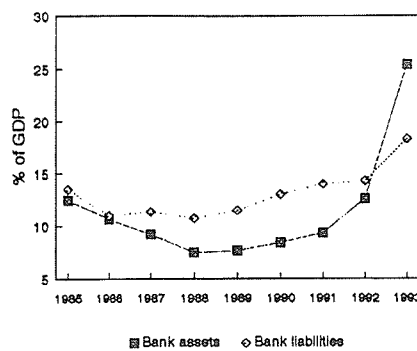
Netherlands



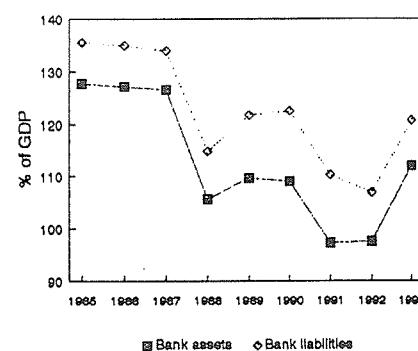
Portugal



Spain



United Kingdom



EU-12

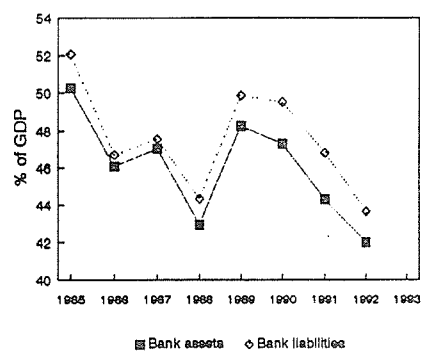
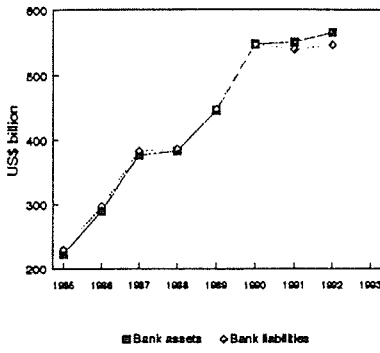


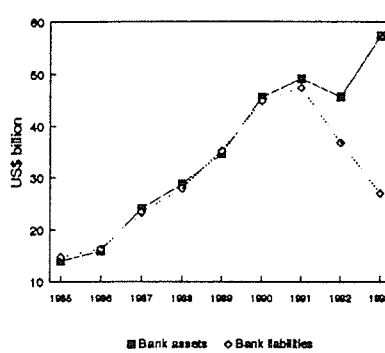
Figure 1.4(f)

Banks' international business (\$US bn)

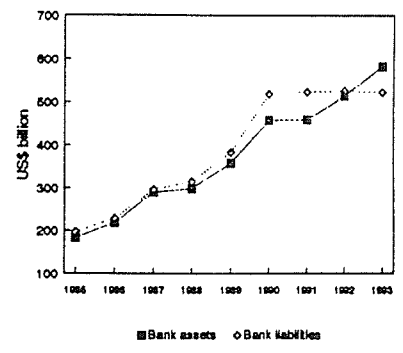
Belgium/Luxembourg



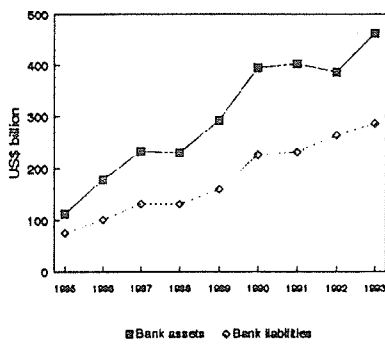
Denmark



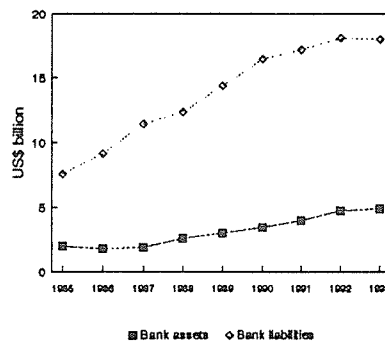
France



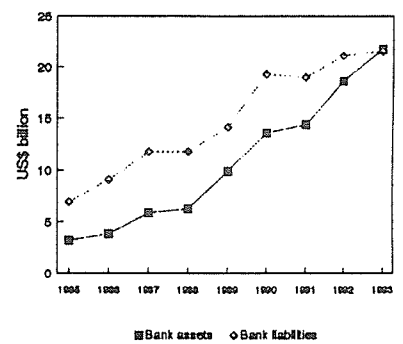
Germany



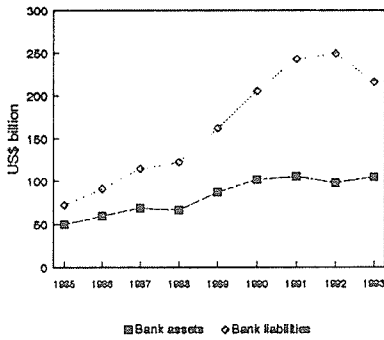
Greece



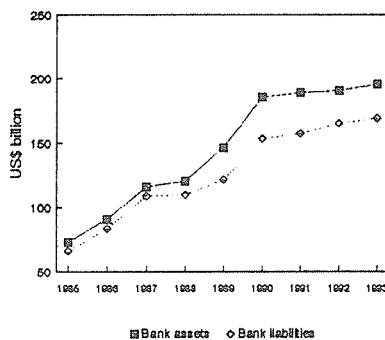
Ireland



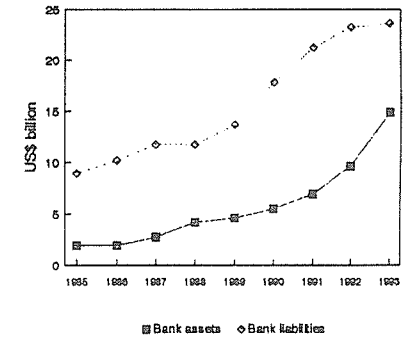
Italy



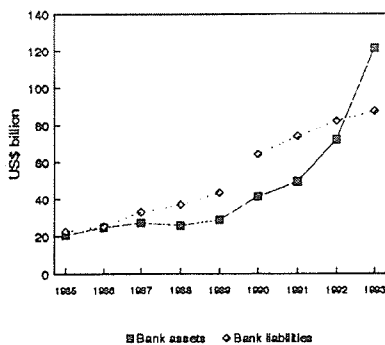
Netherlands



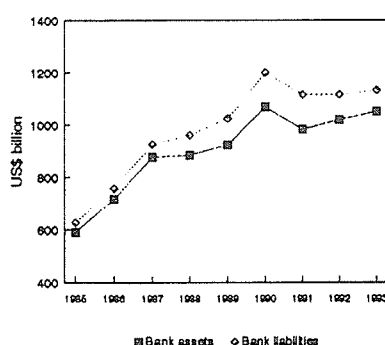
Portugal



Spain



United Kingdom



EU-12

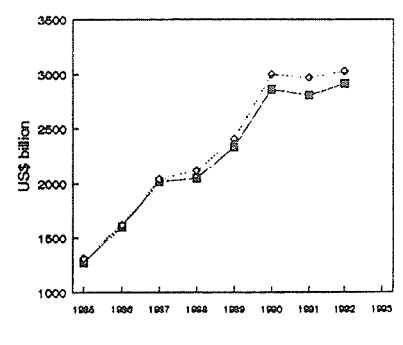


Figure 1.5

Trend in standard deviation of interest rates

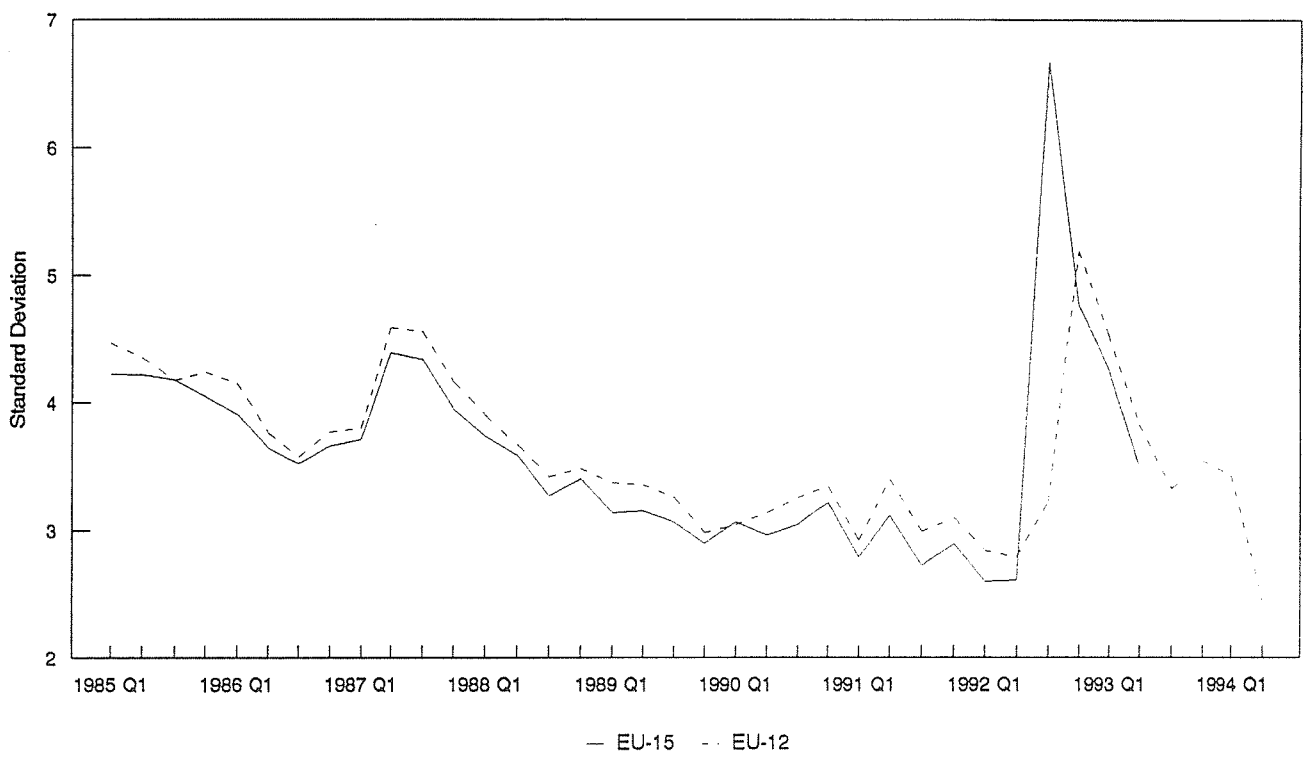
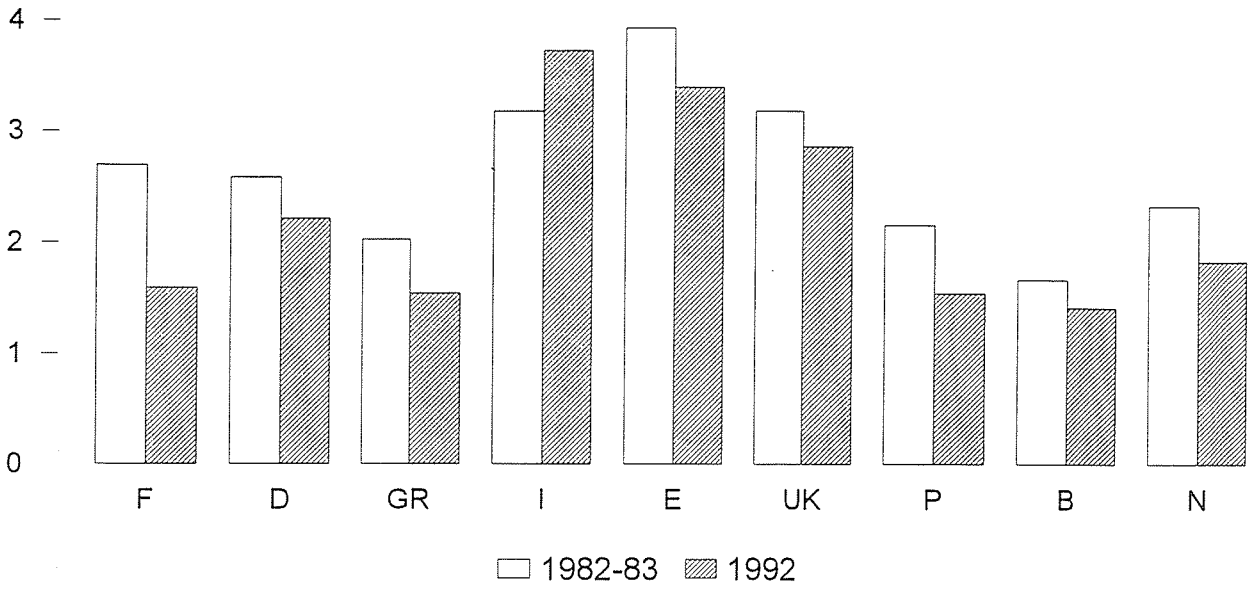


Figure 1.6

Banking: Interest Margin as percent of total assets



Banking: Gross Margin as percent of total assets

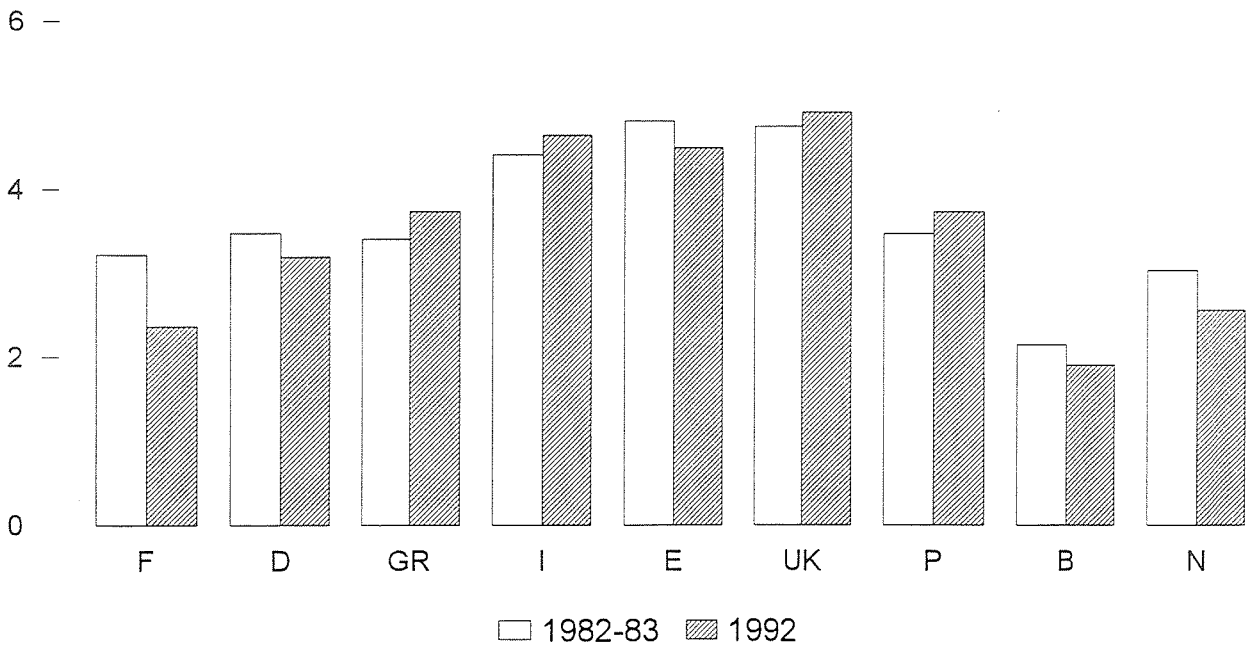


Figure 1.7

Insurance: Costs and Performance

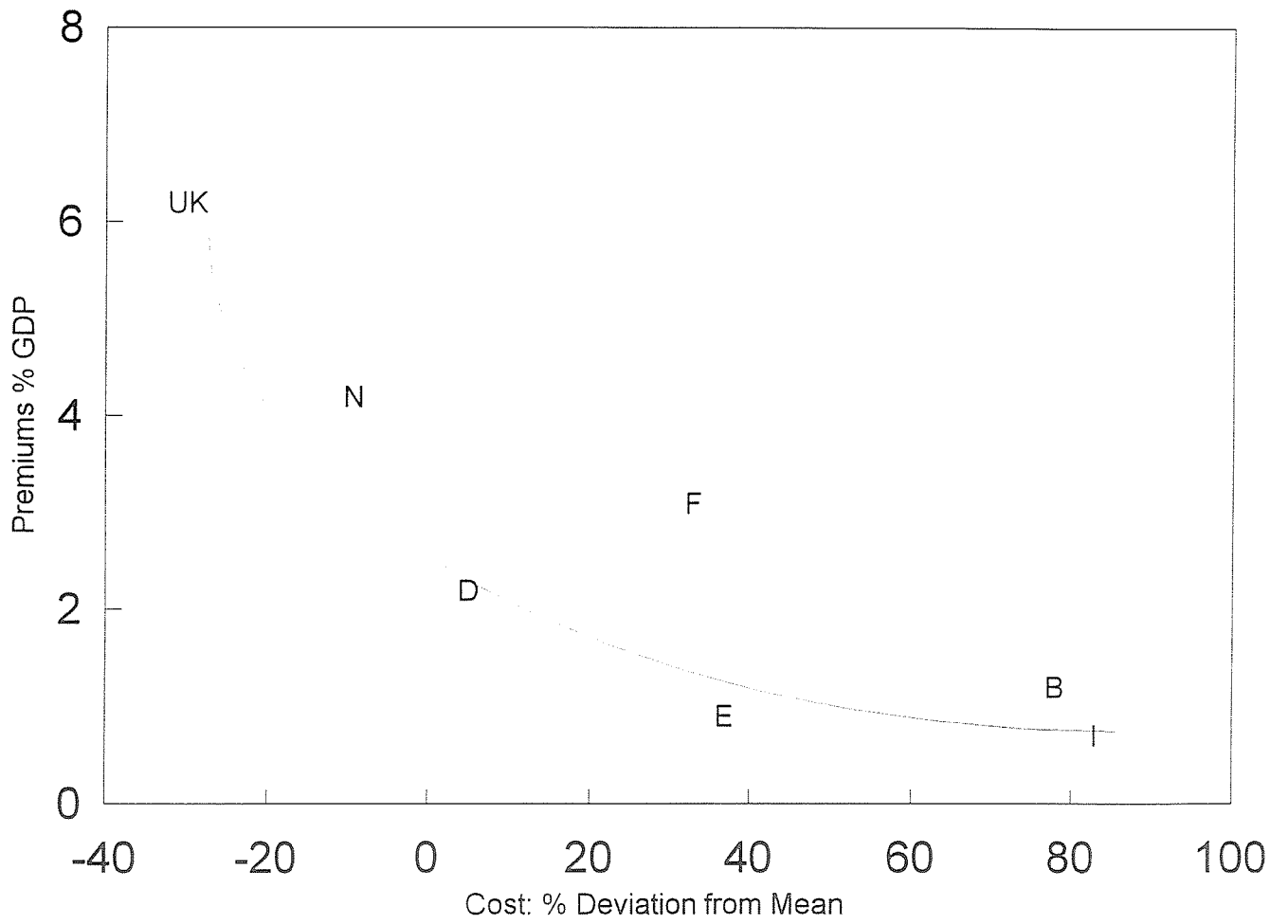
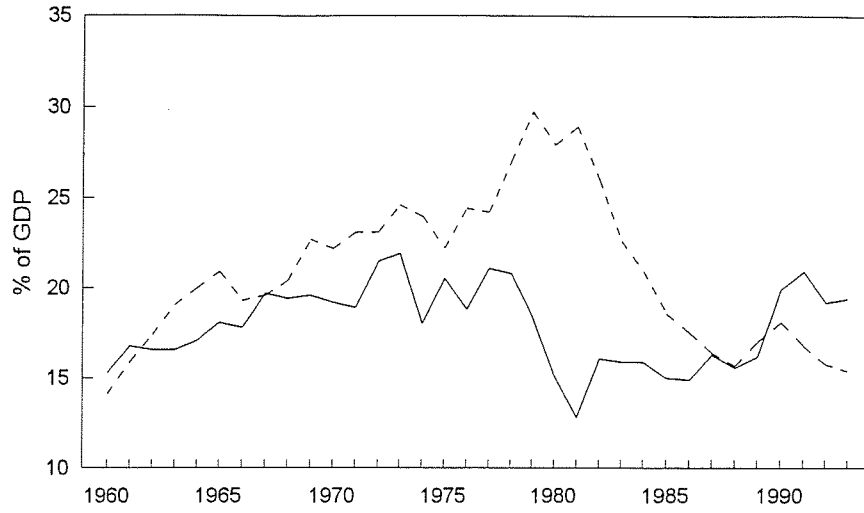
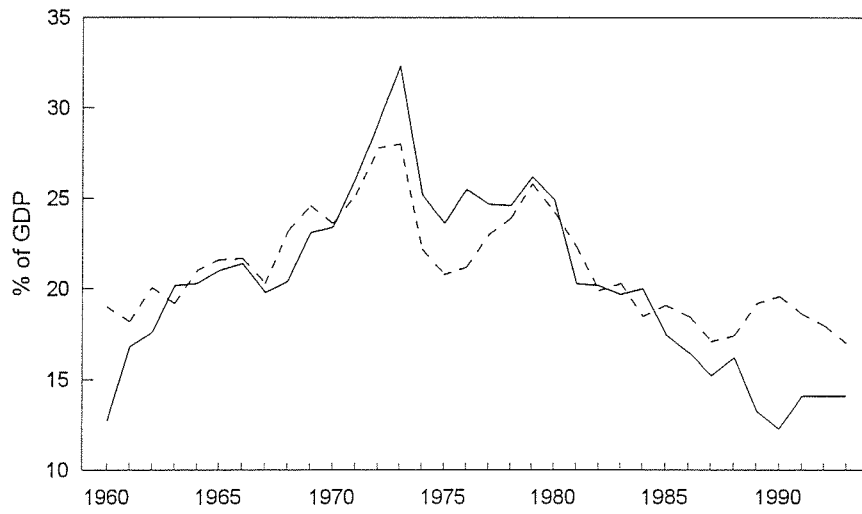


Figure 2.1

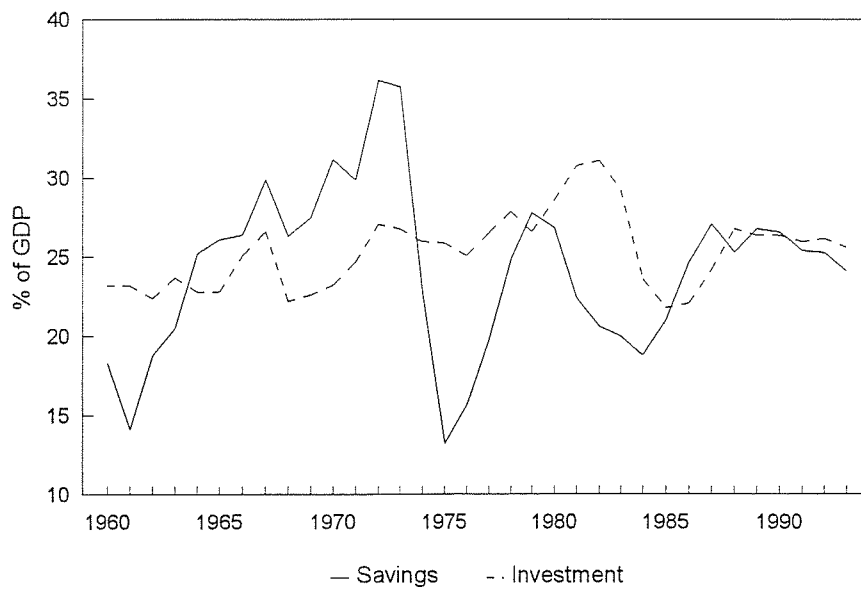
Savings and Investment as percentage of GDP : 1960-1993 Ireland



Greece



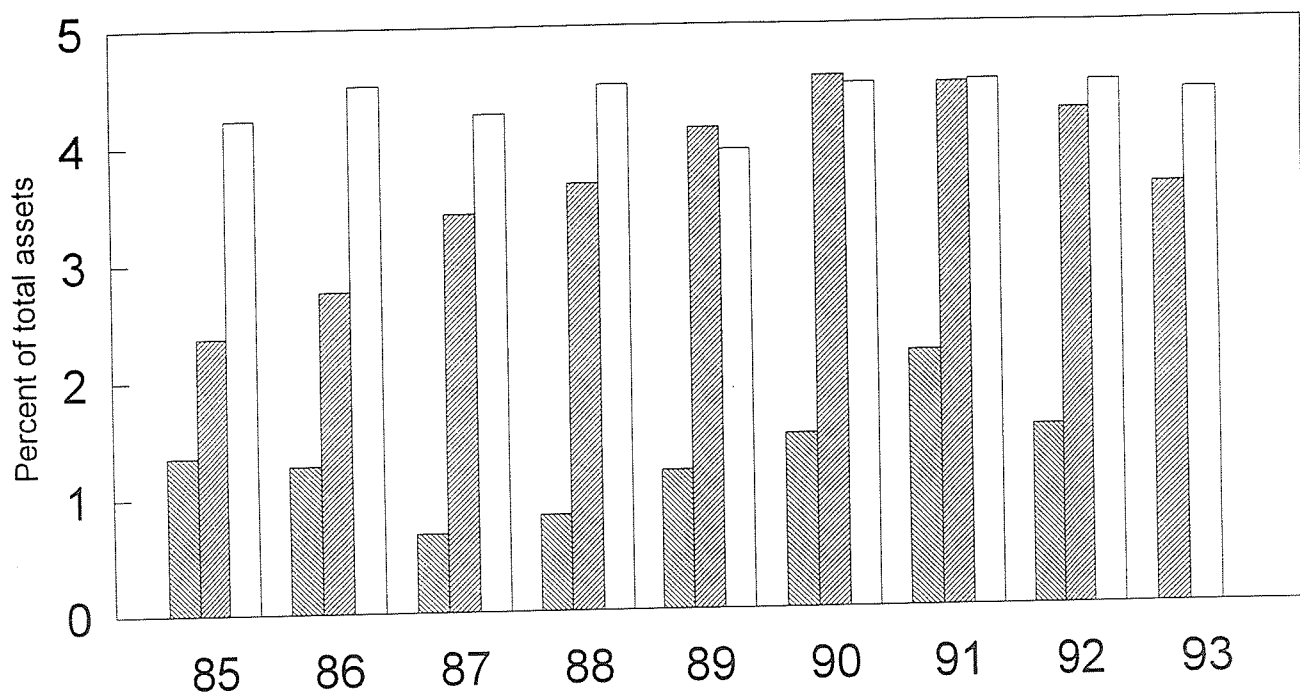
Portugal



— Savings - - Investment

Figure 2.2

Net interest margin, 1985-93



Profit before tax, 1985-93

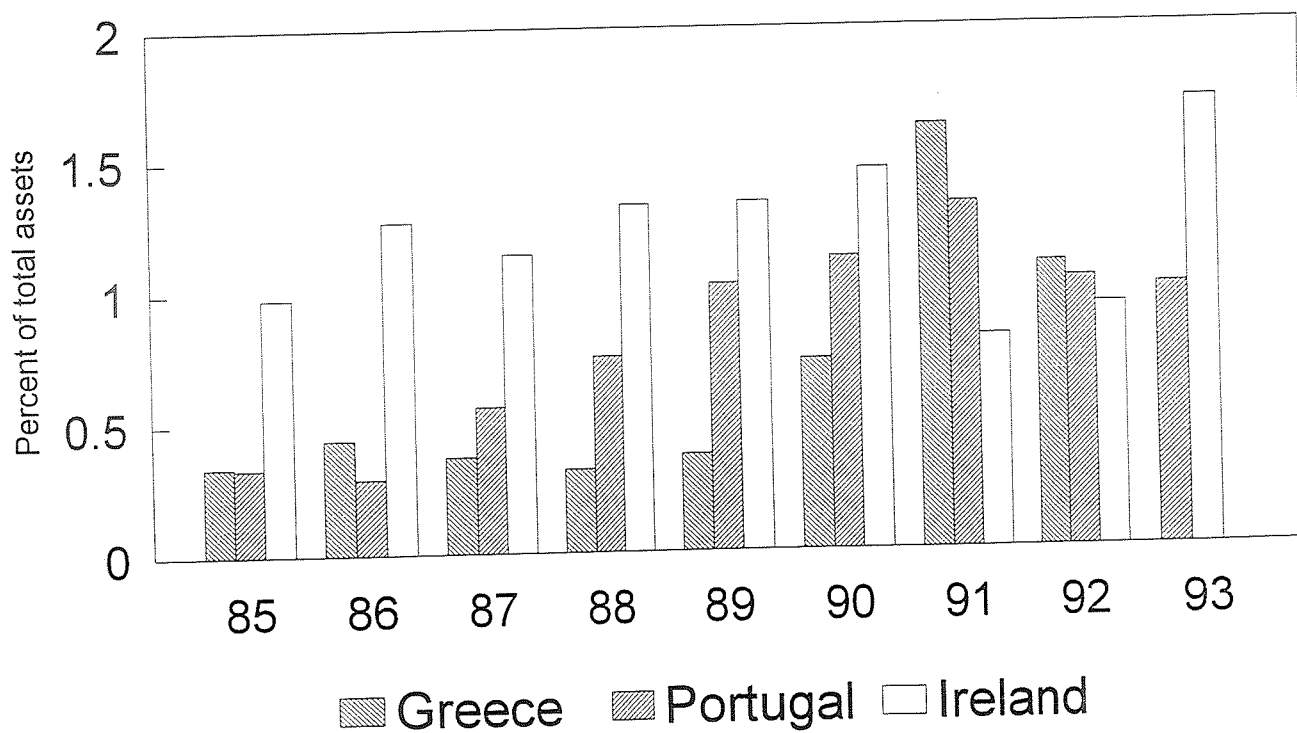


Figure 3.1

Greece: interest spread, 1985-94
Short-term lending less time deposit

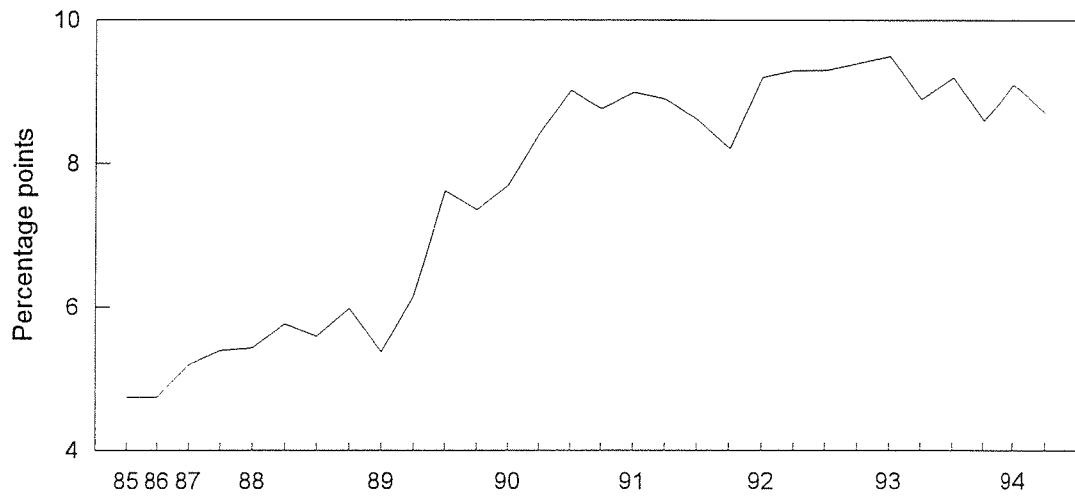
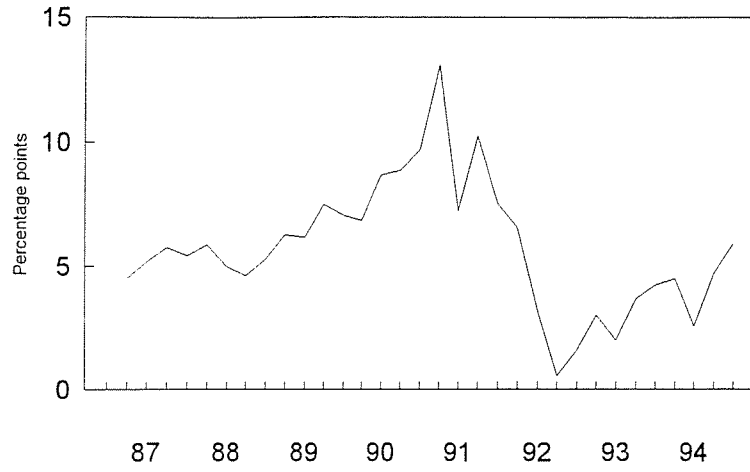


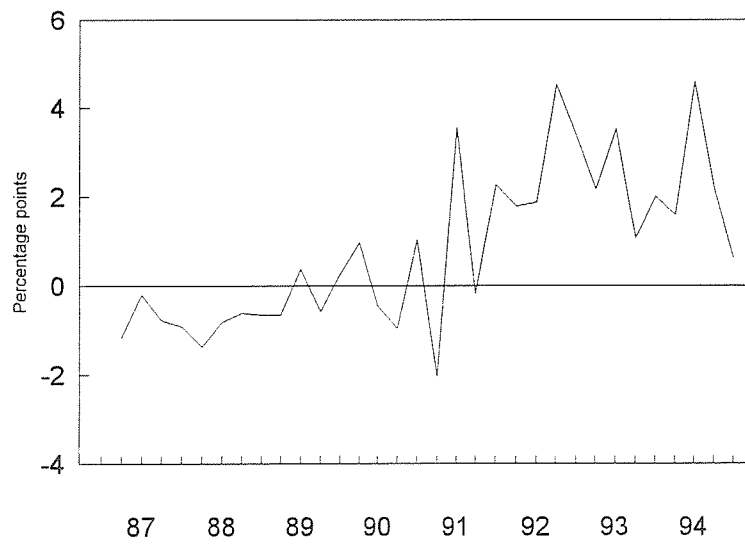
Figure 4.1

Portugal

Lending interest rate spread above interbank



Deposit interest spread below interbank



Lending interest spread above deposit rate

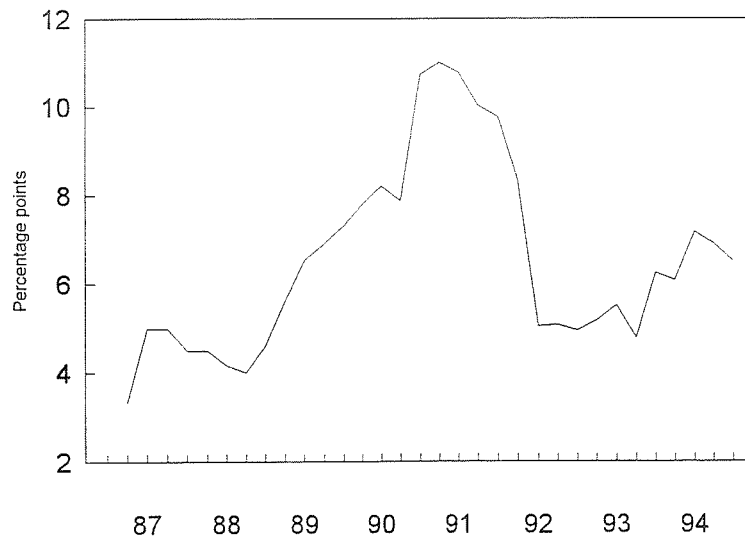


Figure 4.2

Portugal: Risk Premium, 1990-95 (lending rate premium on commercial bills)

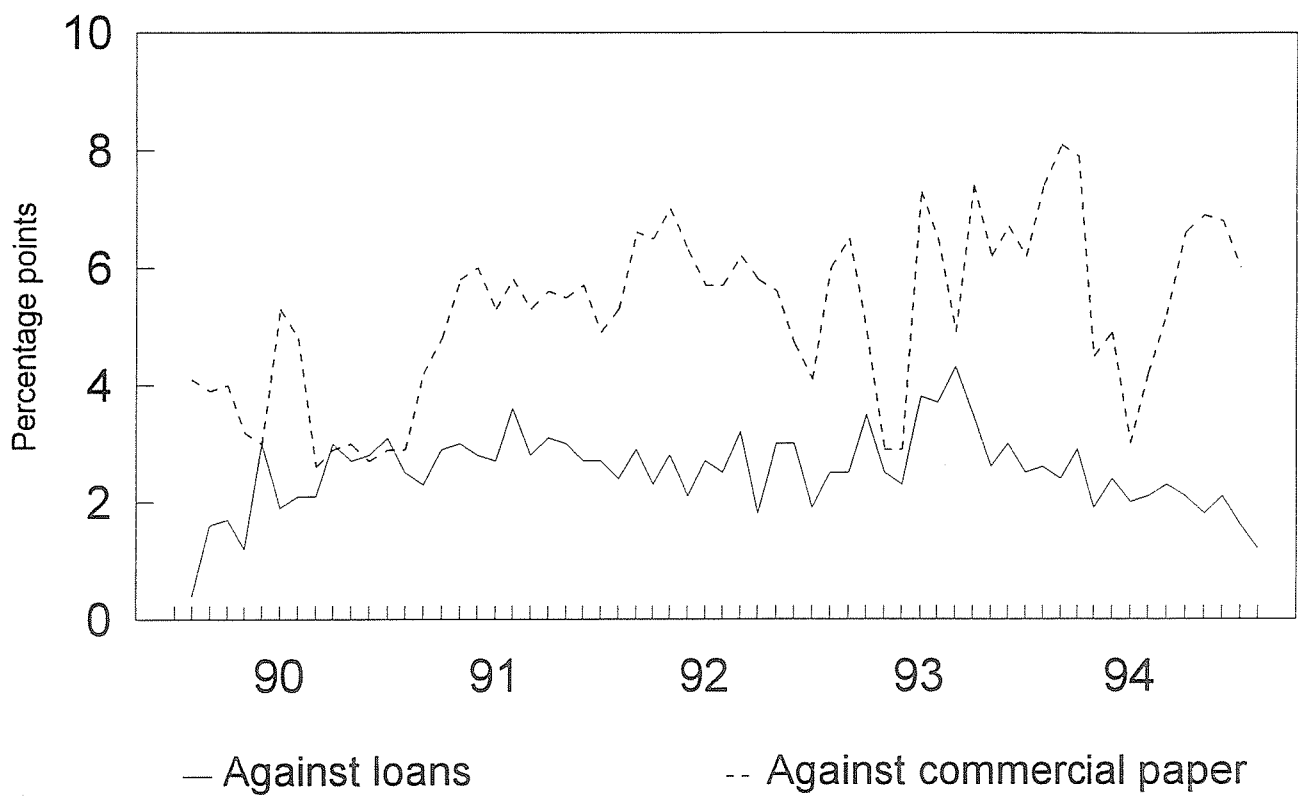


Figure 5.1

Ireland: Quoted Interest Rate Spreads

