

150 Years of Financial Regulation in Spain. What Can We Learn?

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ABSTRACT

This paper explores the changes effected in the Spanish regulatory regimes over the last 150 years, and asks what have been the forces driving the regulatory reforms. A study of the Spanish experience reveals that there was relatively little statutory legislation until 1914 and for a long time there was no reaction to crises. In contrast, regulations have been altered on numerous occasions in the twentieth century. The paper also shows that the regulatory process has been the result of the interplay between economic as well as political economy forces. Moreover, and despite some idiosyncratic features, the Spanish regulatory history is similar to that of other European nations.

1. Introduction

The current international financial crisis has brought the spectre of a long and profound economic depression. Bank failures, the need for massive liquidity assistance from central banks and the intervention of governments bailing out or partially nationalizing major credit institutions have unveiled the fragility of the financial structures in many countries. The regulatory framework in place has revealed its deficiencies and, if we have learnt anything from this crisis, it is that financial regulation and supervision need to be tightened up and their scope broadened. Bank regulators and supervisors

have an important and increasingly difficult job: they must ensure the integrity of the payments mechanism, they need to protect the interests of depositors and they have to promote efficiency in the banking sector.

Spain has undergone a number of regulatory changes in the last 150 years. By changing the rules, the Spanish authorities have tried to influence the financial structure of the country and the “modus operandi” of banks and savings banks. They have done so by resorting to all possible means, restricting entry into the industry, setting capital requirements or limiting the scale and scope of the institutions. They did this in the past and their intervention has not waned in recent times. This article analyzes the history of Spanish financial regulation from 1856 to 2000. Special emphasis is placed on the motivations driving each of the regulatory changes.

The study of banking regulation and supervision in a small and peripheral country is of interest for several reasons. First, the examination of a nation’s case may contribute to a better understanding of how regulation and supervision have changed in the last two centuries. Second, Spain’s experience is an example that, contrary to common belief, regulatory changes are not always forged in response to crisis. Third, a look at the Spanish case may shed light on the permanent debate between the two theoretical approaches that compete to explain the historic cycles of financial regulations: one based on the influence of public interest and the other emphasizing the role of private interest. Fourth, this paper offers a long-term perspective of Spanish banking regulations for the first time.

Our main findings can be summarized as follows. We have identified four distinct regulatory regimes: “the liberal era” (1856-1920), the “self-regulated era” (1921-1936), the “interventionist period” (1939-1975), and the post Bretton Woods era

(1975-2000). The nineteenth-century legislation reflected the liberal ideology of the times. Market discipline rather than public surveillance prevailed for more than half a century. Legislation to guarantee financial stability seems not to have been on the agenda of the public authorities. After 1914, the banking crises of the interwar period brought to the fore the need to regulate the financial sector and new legislation was adopted, although supervision in Spain was entrusted to the banks themselves. The Civil War marked an abrupt shift in the regulatory regime, with regulations and strict controls being imposed in 1939-1942 and again in 1946. Competition was superseded by government discretion, and banks were put at the service of political-economy goals as defined by the financial authorities. A cautious process of liberalization began in 1969, followed by an intense deregulatory process that continued until the end of the century. This paper shows that both the private and the public interest were behind the regulatory changes. It also shows that Spanish regulatory history is similar to that of other European countries, where control and regulations were modest or non-existent in the nineteenth century and then increased after the First World War and again after the Second World War.

In the first section, the two theories of regulation and the basic forms of policy intervention are briefly considered. The paper turns next to examine the four different historical periods for which changes in the regulatory framework have been identified, and asks what – over the long run – have been the principal sources of regulation and supervision. In the last section, some conclusions are drawn.

2. The impetus for regulations and the forms of banking supervision

As with other sectors, government intervention in banking can be examined from the standpoint of the broader debate on the role of government in an economy. Two theoretical approaches compete to explain the historic cycles of financial regulations, one based on the influence of public interest and the other emphasizing the role of private interests¹.

The public-interest viewpoint holds that governments regulate banks to facilitate the efficient functioning of banks by mitigating market failures for the benefit of broader civil society. The public interest would be served if the banking system allocated resources in a socially efficient manner and performed the other functions of finance competently: facilitating payments, mobilizing savings, allocating capital, monitoring managers, and providing the tools for the management and trading of a variety of risks. Because banking crises are expensive and can reduce growth and worsen income distribution, their prevention is also often an explicit goal. Hence, regulations are viewed as a means of reducing the probability of crises and of protecting agents against banking disasters.

In the private interest or political-economy approach, regulations are viewed as a product, the allocation of which is governed by laws of supply and demand. Although it accepts the presence of market failures, regulations are conceived as the outcome of the interplay between various suppliers and demanders – in which particular interests with different objective functions and political influences compete to use the coer-

¹ Seminal works are Stigler (1971), Posner (1974), and Peltzham (1976). A good synthesis of the two approaches is given in Barth, Caprio and Levine (2004 and 2006). Historical contributions in White (1982), Kroszner and Strahan (1999), and Hansen (2001).

cive power of the state to appropriate yields. Groups with greater numbers, financial resources and cohesion will have an advantage in securing regulations that are favourable to them, such as limiting competition. This approach also considers politicians and regulators to be interest groups motivated by the desire to advance a particular ideological agenda, and to maximize the desired majority vote.

Although these reasons for regulation are distinct, Grossman (2010) points out that, in practice, it is difficult to disentangle the multiple motivations behind a particular reform. In some cases, it is relatively straightforward to identify the timing of the forces driving regulatory reforms; in others, it is more complicated. History is more complex than theory. It is thus plausible that, at times, a country's regulatory choices may be more consistent with the public interest viewpoint, and at other times, with that of private interest. Kane (1997) argues that the regulatory process is akin to a Hegelian dialectical struggle, suggesting that continued oscillation is to be expected. The swings between the public – and the private – interest approaches to regulation can take place with different frequencies, and conceivably last for a long time, especially if the factors driving change reshape political constituencies.

To obtain their aims, governments typically intervene in the banking sector in a variety of ways. Mishkin (2001) has listed the nine basic instruments through which financial institutions have historically been controlled. These include:

- restrictions on asset holdings and activities;
- separation of the banking and other financial services industry;
- restrictions on competition;
- capital requirements;
- risk-based deposit insurance premia;

- disclosure requirements;
- bank chartering;
- bank examination;
- a supervisory versus regulatory approach².

Together, all these instruments provide a useful framework to categorize the different historical regulatory cycles and also facilitate cross-country comparisons with regard to how prudential regulation and supervision has been applied. In what follows, we will use this framework to categorize the four Spanish regulatory regimes and to draw conclusions about the motives for regulation in each case³.

3. The liberal banking era, 1856-1920

The modern history of Spanish banking began in 1856, when the Cortes (Spanish Parliament) approved the Bank of Issue Law and the Credit Company Law, which established a relatively open and liberal financial framework that, with minor changes, remained in place over the next six decades⁴.

The Bank of Issue Law regulated the establishment and operations of issue institutions. Incorporation required government authorization, although this was easily obtained. Plurality of issue was permitted, but limited to only one bank per town. Capital had to be paid up entirely at the time of constitution, and the maximum volume of currency banks could issue was set as equal to three times the amount of paid-up capital. The law imposed a minimum ratio of coins to banknotes in circulation, but there was no provision compelling banks to

² See also, Abial, Detragiache and Tressel (2008).

³ A study using this framework, White (2009), pp. 15-44.

⁴ The nineteenth-century Spanish banking system in Tortella (1973), Tedde (1974), and Martín-Aceña (1987).

redeem their notes into specie on demand, and banks could engage in all sorts of financial operations without restriction. Publication of monthly statements was mandatory. To supervise bank operations, the government could appoint a Royal Commissioner for each institution⁵.

The Credit Company Law was less restrictive. According to the liberal ideology of the time, banks were supposed to operate just as any other non-financial firm. Incorporation required the previous approval of the government, but there were no barriers to entry since the law did not set minimum capital requirements. Banking transactions were not subject to any sort of restrictions, the act imposed no cash or liquidity ratios. Banks and credit societies could undertake all kinds of commercial operations, no permission was needed to open branches in any region of the country and the only obligation of credit companies was to send their balance sheets and income and losses accounts to the Ministry of Finance, although no standard accounting and disclosure norms existed. No supervisory agency was created, but the government could at any time examine the accounting books of companies and verify the state of their cash holdings.

Simultaneously, a Royal order of 1835 established the bases for the foundation of savings banks. Although their establishment required the approval of the government, their organization and operations were subject to their own statutes. They had no obligation to disclose information or to publish their financial statements, and neither were they controlled by any governmental regulatory or supervisory body. In 1853, the Ministry of the Interior made an attempt to regulate and con-

⁵ Bernal Llorens (2004) and Sánchez-Ballesta and Bernal Llorens (2010) have examined the effectiveness of the act with regard to accounting norms and the role of the Royal Commissioner.

trol the thrift institutions. However, it failed due to strong opposition from the founders and directors of these institutions⁶.

A remarkable financial expansion followed the approval of these laws: sixty new banks opened and twenty two savings banks were founded. This financial expansion was associated with a parallel economic boom, led by the construction of the railway system. The promoters of the railway companies were the banks and credit societies founded after 1856. However, as happened elsewhere, the expectations raised by the construction of the railways were excessively optimistic and beginning in 1864, the stocks of the main railway companies plummeted on the Paris Bourse. Mining equity prices and government debt prices also fell. The financial crisis erupted in May 1866, the same month that Overend and Gurney in London collapsed, and the panic was particularly intense in Barcelona and Madrid⁷.

The 1866 crisis was deep and damaging: financial and non-financial companies went into liquidation, the number of joint-stock banks fell and many private bankers and merchant houses disappeared. Of the thirty seven financial institutions founded after 1856, no more than twenty survived the crisis, and of the eighty bankers and private finance houses officially registered in 1866, there were only forty three in operation by 1870⁸. Only savings banks, with no risky assets, remained untouched by the financial turmoil.

Although the crisis wiped out half of the banking system, the financial authorities did not react. No measures were taken

⁶ Titos Martínez (1991, 1999) and Tedde (1991).

⁷ For the 1866 crisis, Batchelor (1986, 41-73); Schwartz, (1986). The Spanish crisis, Sánchez-Albornoz (1963, 1967), Tortella (1973), Nuño, Tedde, and Moro (2011). The crisis in Cataluña, Navas and Sudriá (2007).

⁸ Tedde (1974), p. 255.

and the adjustment was left entirely to market discipline. A laissez-faire policy was maintained, and both the Treasury and the Bank of Spain let the crisis run its course⁹. Instead of introducing legislation to prevent similar crises in the future, the Ministry of Finance maintained its liberal stance and the authorities took further liberalization measures. In 1869, a new Joint Stock Company Law lifted all restrictions on the creation of banks of issue and credit companies. Entry into the sector was entirely free and unrestricted, with the exception that only one note-issuing bank could be opened in each town. Moreover, no regulatory or supervisory measures were adopted¹⁰. Thus, after 1869, the features of the Spanish financial system were similar to those that characterized the so-called “free banking system” prevailing in some European countries and some American states¹¹.

There were four additional banking crises: in 1881-1882, 1890, and in 1913 and 1914¹². The 1881-1882 crisis caused the failure of a considerable number of undercapitalized and badly managed banks that had been opened in the previous decade. The crash of 1890 coincided with the Baring Brother banking house crisis. There were not as many failures as in the previous

⁹ The Bank of Spain's inaction in 1866 was the result of a deliberate policy to eliminate potential note-issuing competitors.

¹⁰ A minor measure had been taken in July 1865, when the government passed the Regulation for the Inspection of Credit Institutions Act requiring credit companies to compile financial statements (Bernal Lloréns, 2004 pp. 11-13).

¹¹ It was certainly not a free banking system in its purest form, but it approached the well known cases of free banking in Scotland and the US studied by White (1991, pp. 37-72) and Rockoff (1991, pp. 73-109). See also the papers included in Capie and Wood (1991).

¹² These years are also the approximate dates for international and economic financial crises: Kindleberger (2000)); Schwartz, (1986), Neal and Weidenmier (2003), Goodhart and Delargy (1998).

crash, although banks with impaired assets were liquidated. However, the overall financial structure was damaged and it did not recover until the turn of the century¹³. As in the aftermath of 1866, these two episodes did not provoke any official reaction, and no changes were introduced to alter the financial framework or to prevent future trouble. Once again, no lender of last-resort assistance was available, despite the fact that the Bank of Spain had been granted the monopoly of issue in 1874, from that point on becoming the only supplier of liquidity¹⁴. The reform of the Commercial Code undertaken in 1885, consistent with the “laissez faire, laissez passer” philosophy of the times, maintained free entry into the industry and did not impose any limitation on banks’ operations and activities. The sole obligation for banks was to publish the balance sheets and the income and losses account in the official state and provincial gazettes¹⁵.

Although thrift institutions weathered the crises better than the banks, the Ministry of the Interior introduced legislation to regulate the creation and the scope of savings banks. According to the Savings Banks Law enacted in 1880, the foundation of thrift institutions remained open to individuals and institutions but their statutes had to be approved by the government. However, the thrifts remained essentially unregulated, under the loose supervision of the Ministry of the Interior¹⁶.

There were two more critical episodes before the First World War: one in 1913, which affected the Banco Hispano-

¹³ Tedde (1974), pp. 321-23. Martín-Aceña (2001, pp. 95-139) for a detailed account of the role of the Bank of Spain in both crises.

¹⁴ The monopoly brought about an important restructuring of the financial system. Fifteen banks of issue merged with the Bank of Spain (Anes, 1974, pp. 130-135).

¹⁵ Faus (2001), pp. 62-66.

¹⁶ Titos (1999).

Americano, a large financial institution, and the other in 1914 immediately following the outbreak of the war. Although in both instances the Bank of Spain provided lender-of-last-resort assistance for the first time, hastily and in response to pressure from the Ministry of Finance, the prevailing lax regulatory regime remained unaltered¹⁷.

The main features of the Spanish regulatory framework over the 150-year period encompassed by our study are summarized in the Appendix. The first column displays the nine forms of regulation, while the other columns show their characteristics. As elsewhere, the early form of entry regulation was through chartering. The trend towards liberalization began in 1856 and, as in Britain after 1844, the nineteenth century legislation that followed was of a liberalizing nature¹⁸. The banking codes were superseded in 1869 when the enactment of a general company law greatly simplified incorporation for all kinds of banking and non-banking joint-stock firms¹⁹. Neither the laws of 1856 nor the institutional reforms introduced thereafter in 1869 and 1885 imposed restrictions on banks' operations or limited their scope or their scale. Savings banks also operated quite unrestrictedly during most of the nineteenth century, subject only to their own statutes. Note issue was centralized in 1874, although free entry for non-issue commercial banks prevailed uninterrupted until 1920. Disclosure requirements were lax and not always complied with. Although financial crises were not uncommon, the government did not react by changing the regulatory frame-

¹⁷ Martín-Aceña (2001), pp. 114-121.

¹⁸ Capie (2007), p. 74; Cottrell (2010), pp. 21-39.

¹⁹ The shift followed in the wake of the 1867 French company law, which in turn came after the liberal company law passed in Britain some years earlier (Grossman 2010, p. 143).

work²⁰. Moreover, the commercial banks were too small and geographically dispersed to be able to form coalitions in order to ask for any sort of financial regulation or rules to enforce some degree of prudential supervision²¹.

Behind the liberal banking codes of 1856 and the general company law of 1869 lay political economy motivations. The *laissez-faire* economic philosophy and environment of mid-nineteenth-century Europe permeated all the economic legislation of the epoch and forestalled any possible reactive action to the financial crises. Legislation to guarantee financial stability seems not to have been on the agenda of the public authorities, nor in the minds of those who would have been the potential beneficiaries. The influence of ideology was thus paramount. However, the liberal reformers of the time also aimed at promoting the development of the financial system, and hence designed initial banking legislation to facilitate the establishment of banks and savings banks, as in fact happened after the banking laws were approved. The nineteenth century history of Spanish banking demonstrates the interplay between economic and political economy forces.

4. Financial self-regulation in the interwar period, 1921-1936

The interwar period was a turning point for banking regu-

²⁰ The Spanish experience was no different from that observed in Belgium (Maes and Buyst, 2009), Italy (Gigliobianco, Giordano and Toniolo, 2009), Sweden (Ogren, 2010), and Greece (Lazaretu, 2011) where crises were not followed by regulatory changes until the early twentieth-century. See also, Goodhart (2007).

²¹ The Spanish case contrasts with the Danish experience: Hansen (2001), pp. 48-50.

lation in many countries. In Denmark (1919), Austria (1924-1925), Czechoslovakia (1924), Norway (1925), Portugal (1925), Italy (1926) and Japan (1927), legislative acts were approved in response to the turbulence caused by the end of the war boom. The financial crises of the Great Depression intensified, accelerating the adoption of banking legislation in Germany (1931-1934), Switzerland (1934), Italy again (1936) and the United States (1933-1934)²². In France, although a specific banking law was not enacted until 1941, government intervention in the financial sector increased²³. Spain was no exception to this trend.

The outbreak of the war in 1914 marked the beginning of a period of uncertainty. However, as the country had remained neutral, confidence returned, the economy experienced steady growth and banking activities expanded²⁴. The financial system made a move towards universal banking. The involvement of banks in industrial promotion made them vulnerable to fluctuations in the earning potential and equity value of the manufacturing firms with which they maintained relations. Since banks made commercial loans against industrial securities deposited as collateral, their loan portfolios became highly vulnerable to variations in stock prices²⁵.

Just as the war ended, a banking crisis broke out. There were runs on deposits in various institutions throughout the country and confidence in the financial system was shaken. As with other continental European nations, the postwar financial crisis brought to the fore the lack of a regulatory framework,

²² For changes in financial regulation in various nations, Allen (1938); Alhadeff (1968); Gigliobianco and Toniolo (1999). Also Grossman (2010), pp. 139-140.

²³ Alhadeff (1968, pp. 99-217); Quennüille-Corre and Straus (2010), pp. 97-122.

²⁴ Roldán and García Delgado (1973), and Sudrià (1990).

²⁵ Spanish banking in the interwar period, Tortella and Palafox (1984, pp. 81-111), and Martín-Aceña (1995 and 2012).

and the events of 1920 raised serious concerns in the Treasury as to the adequacy of the financial legal framework. Moreover, bank directors and owners had been expressing concerns about the “lack of regulation” of the banking industry since 1910. They complained about the unfair competition of the savings banks and protested about the intrusion of unprofessional “second-rate financiers” who could freely open small banks and finance houses without minimum capital bases and guarantees. They promoted the creation of regional banking associations, and in 1918 formed the *Comité Central de la Banca Española* (Central Spanish Bank Committee). Two years later, the Federation asked for the adoption of some kind of regulatory regime²⁶. This informal attempt at self-regulation demonstrates that the banking community was interested in financial stability. Standardized and reliable accounting practices and disclosure would make it possible to discriminate between solvent, well-managed institutions and those with poor and risky assets, weak balance sheets and unclear profit and loss accounts. They also aimed to create some kind of cartel to curtail excessive competition. Cooperation was seen as a way to ensure public confidence and reduce the probability of financial panics.

Simultaneously, a committee was appointed to prepare a project to regulate and reorganize the banking system and to transform the Bank of Spain into a real central bank²⁷. The re-

²⁶ Faus (2011), pp. 71-79.

²⁷ Tortella (1970) and Pons (1999, 2012). The Spanish act antedated the Italian banking act of 1926, also enacted in response to the post-war banking crises (Gigliobianco, Giordano and Toniolo, 2009). A detailed study of the preparation of the law is given in A. Martín-Aceña (1983, pp. 18-34). Many of the features of the Spanish act can be found in similar acts enacted almost simultaneously in other European countries (Allen, 1938, pp. 3-52).

form came in 1921 with the Ley de Ordenación Bancaria (The Banking Regulation Law), which aimed to establish certain controls on banking operations and close supervision of the banks' activities. A relevant feature was the establishment of the Consejo Superior Bancario (Supreme Banking Council-SBC), entrusted with broad regulatory and supervisory powers²⁸. It could set minimum capital requirements as well as limits on pricing and fixed maximum rates for current accounts and deposits. The Council could also establish the proportionality between different items of the banks' balance sheets, such as the ratio between total earning assets and short-term liabilities, and the ratio of total deposits to paid-up capital plus reserves²⁹. The law compelled banks to submit monthly balance-sheet statements to the SBC and to publish their income statements. Moreover, the SBC was responsible for designing the model of the balance sheet and of the income and losses account, representing a step forward in increasing the banks' transparency and accountability. The SBC was also empowered to investigate bank operations and accounts and to impose disciplinary sanctions, and an official or public Banking Record Office was established under the auspices of the Council. Registration was free until 1927, but was nevertheless required to gain access to the special discount facility in the Bank of Spain.

Savings banks soon reacted to the establishment of the SBC – they had already participated in a number of national conferences organized in 1904 and in 1914. Although aiming to consolidate their social role, the directors of the savings banks

²⁸ Faus (2001, p.91-92) suggests that the creation of the Supreme Banking Council was inspired by the US Office of the Comptroller of the Currency.

²⁹ However, no restrictions on asset holdings and asset composition were imposed, so that banks could diversify their portfolio as they wished.

were more inclined to cooperate than commercial banks, and between 1910 and 1920, the savings institutions set up several regional associations to defend their interests and reduce the competition between them. In 1920, the thrifts were placed under the surveillance of the Ministry of Labor. All savings banks were compelled to register in a registration office and an inspectorate service was created. In exchange for the protective shield of the Ministry, they lost part of their autonomy and were compelled to invest a certain proportion of their funds in public debt as well to increase their mortgage lending. In 1926, the counterpart of the bankers' SBC was established: the Confederación Española de Cajas de Ahorro (Confederation of Spanish Savings Banks)³⁰.

The 1921 banking law and the SBC did not prevent the re-appearance of a new wave of banking failures. In 1924, the difficulties re-emerged. The new crisis appeared as a continuous run on bank deposits, which lasted nearly a year, until September 1925. During 1924-1926 half a dozen salient banks failed and were forced to liquidate³¹. The year 1931 was also complicated for Spain: although the Great Depression was less severe in Spain than elsewhere in Europe, the spring of 1931 was politically complex and financially unstable³². The demise of the Monarchy, the proclamation of the Second Republic and the formation of a coalition government with various socialist mi-

³⁰ Comín (2007 and 2008).

³¹ According to contemporary observers, failed banks were basically insolvent (Martín-Aceña, 1983, pp. 81-89).

³² A contemporary and comprehensive study of the impact of the Great Depression on Spain in Banco de España (1934). For the Spanish economy during the nineteen thirties, see Hernández Andreu (1980), Palafox (1980 and 2011), García Ruíz (1993). The standard international reference is Eichengreen and Sachs (1985).

nisters brought anxiety and fear to the business community and to the public in general. News of the failure of the Creditanstalt and of the difficulties of Central European institutions also contributed to darkening the atmosphere. The crisis erupted in April 1931, with an intense run on banks between April and June. The removal of funds continued throughout the summer until the end of September, when the crisis blew over. In the meantime, the total volume of deposits had declined by 20 per cent of the total outstanding in March 1931³³.

Spanish banks did not fail because they were able to obtain all the cash they needed to convert deposits into currency. Two reasons may help us to understand what made this possible. Firstly, for the first time the Bank of Spain was ready to behave as a lender of last resort; secondly, banks had plenty of liquid assets. When the run started, the Bank of Spain and the Treasury agreed to take combined action to provide all the cash banks might need. The government authorized an increase in the total of banknotes in circulation, and the bank directors agreed to lend freely, discounting bills on demand and accepting eligible paper as collateral for credit³⁴.

In 1931, the banking law was amended, although the amendment was not in reaction to the financial crisis³⁵ but was rather aimed at increasing the Government's control of the Bank of Spain. The reform was a response to the non-collaborative stance of the Bank in the attempt by the government to defend the exchange rate of the peseta. The Bank refused to side with the Treas-

³³ Martín-Aceña (1983), ch. 6.

³⁴ Martín-Aceña (1995 and 2001).

³⁵ In Italy (Gigliobianco, Giordano, Toniolo 2009) and Belgium (Maes and Buyst 2009), relevant regulatory financial reforms were introduced in the mid-1930s. In Finland, a first commercial banking act was passed in 1933 (Takka, 2009).

sure and commit its huge gold reserves to contain the depreciation of the currency. The government was convinced that the Board of the Bank preferred to safeguard the property of its shareholders (the gold reserves), rather than to co-operate with the centre-left Republican government, and firmly believed that the non-compliance of the Bank was politically motivated³⁶.

The savings bank regulatory framework was first modified in 1929 with the “Estatuto del Ahorro” (Savings Statute), and in 1933 with the “Estatuto de las Cajas de Ahorro Popular” (Statute of the Popular Savings Banks). In neither of these two cases did the changes come as a consequence of financial difficulties. It was rather an attempt by the government to control the thrifts by submitting them to its policy objectives³⁷.

The Appendix summarizes the characteristics of the supervisory regime of the interwar period. The reform of 1921 was a reaction to the banking instability of the previous two years that had threatened the public’s confidence in banks. However, the regulatory structure remained lax, despite the introduction of some prudential rules, such as minimum capital, bank registration, and some asset-to-liability ratios. There were only modest changes in the practice of bank supervision. Some improvements with respect to the previous period included the obligation of banks to send their financial statements to the Supreme Banking Council. The design of a common balance sheet for all banks increased transparency. Bank examination, although still limited, experienced a minor advance.

The analysis of the regulatory process that led to the Bank Act of 1921 and its amendment in 1931 demonstrates that the outcome was a mixture of public and private interests. The pu-

³⁶ The Spanish monetary and exchange-rate policy in Martín-Aceña (1983), chap. 6.

³⁷ Forniés (1989); Comín (2007).

blic interest was served by the 1921 act because prudential measures concerning capital and liquidity requirements as well as the provisions regarding the disclosure of balance sheets and annual profit-and-loss accounts increased transparency and in principle diminished the likelihood of future failures. These regulatory changes also affected the Bank of Spain. In this instance, the goal of the government was to transform the institution into a real central bank that could better serve the general economic interests of the nation.

The private interest was also present, since the banks and the savings banks were able to demarcate a clear line, beyond which control of the system and of the individual institutions remained in their hands. The Supreme Banking Council and the CECA were established to defend the interests of their affiliates. They could place restraints on competition if necessary, and impose norms on the financial community. Both organizations served to protect their members from unwarranted state control and supervisory competences remained in their hands, as did the power to impose penalties on members who did not comply with the rules. Between no regulation at all and government control, bankers and patrons of savings banks preferred self-regulation.

5. Interventionism and regulation, 1939-1975

From the end of World War II until the demise of the Bretton Woods system, financial regulation became more intense and widespread, both at national and international levels. Even in the UK, where there had been little statutory regulation from 1870 to 1945, the picture changed after 1945³⁸. Throughout

³⁸ Capie (2007, p. 75). Alhadeff (1968) for the regulatory measures introduced in France and Italy.

most of the 1950s and 1960s, the authorities determined and constrained the direction of lending, which was primarily directed at large industrial companies, with implicit government support. There was very little call for any supervisory or regulatory activity, and those few cases where the central banks were asked to help always involved a mixture of liquidity and solvency problems³⁹.

Once again, Spain was no exception to this general trend. After the Civil War and up until the 1970s, there were relatively few banking failures and banks and savings banks in difficulty were systematically rescued by the Bank of Spain. Mergers and acquisitions of banks in trouble by sound banks, with the fiscal support and under the auspices of the supervisory authorities, were the alternatives used to avoid bankruptcies⁴⁰. The number of banks increased in the second half of the 1940s, but then fell steadily until 1962. This decline was the result of a strong consolidation movement, whereby big national banks bought small local and provincial banks. Thereafter, a wave of financial consolidation led to new reductions in the number of institutions⁴¹.

The autarkic and interventionist orientation of the early years of the Franco regime prompted the imposition of structural controls and a shift in bank supervision away from market discipline towards government discretion. Financial stability and government-oriented resource allocation rather than competition became the priority of the authorities. First, a decree in 1939 imposed a so-called banking “statu quo” which prohibited the establishment of new financial institu-

³⁹ Goodhart (2007) argues that between 1945 and 1971, banking systems were subject to tight controls, so there were virtually no banking crises, and consequently, bank supervision was not strict.

⁴⁰ Pons (2001), pp. 106.

⁴¹ Martín-Aceña (2012).

tions without prior government scrutiny and approval. A few years later, in 1946, the old banking act was replaced by a new and more restrictive one⁴².

The Banking Regulatory Law of 1946 contained a veritable litany of regulations⁴³: the Ministry of Finance received discretionary powers to grant or deny bank charters and entry was at the discretion of the Ministry of Finance, which used its authority rather arbitrarily. A new Banking Record Office was established. Only existing banks were allowed to register and to continue in the industry. A bank's capital structure, its potential earnings, its management and the convenience and needs of the community were the elements considered by the new regulators before approving the establishment of a new bank. In addition, a favourable report from the Supreme Banking Council, also under the control of the government, was required. Branch expansion depended on the financial density of each region, the existence of unserved financial demand or well-proven insufficient financial services. The concession of branches was linked to the volume of capital and reserves of each bank; thus, the larger the bank the higher the likelihood it had of obtaining authorization to open a new branch.

The Ministry set maximum and minimum interest rates on deposits and on loans, and also set preferential rates for the so-called "priority industrial sectors". All banking operations were subject to controls: in accordance with the portfolio restrictions, only discounting and short-term commercial loans with ninety days' maturity were authorized, and long-term

⁴² See Martín-Aceña and Pons (1994, pp. 121-38), Lukauskas (1997, chap. 3, pp. 63-97), Faus (2001, pp. 119-192), and Pons (2001, chap. 3, pp. 55-74, and 2012, pp. 98-108).

⁴³ The litany in Allen *et al.* (1938). A catalogue of modern regulations, Bart, Caprio, and Levine (2004).

credit was severely restricted until 1960. Quantitative credit ceilings were imposed, according to the industrial policy of the government. Variations in nominal or paid-up capital, reserve provisions, dividend distribution and exchanges and acquisitions of shares among financial institutions were all subject to ministerial approval. Disclosure rules were also established, and banks had to permit on-site inspections at the authorities' discretion.

The state's intervention was even more pronounced with regard to savings banks⁴⁴. Under the close surveillance of the Ministry of Labour, the thrifts lost all of their remaining autonomy. While there were no relevant legislative changes, the governments of the time were able to impose their will by controlling the boards of directors of the institutions. Savings banks were forced to invest most of their resources in public debt and to channel what was left into selected economic sectors or social goals decided by the Ministry of Labour. Interest rates were officially set, as well as the type of financial operations savings banks could engage in. To a large extent, thrifts were almost transformed into government financial agencies, but to compensate for this extreme interventionism they were allowed to expand in number and open branches throughout the national territory⁴⁵.

The architecture of financial regulation was simplified. Until 1957, the main supervisory agency for banks had been the Ministry of Finance, while for savings banks it had been Ministry of Labour: now, however, the former was also made responsible for thrift institutions. Hence, Spain opted for a single supervisory agency, as was the case in many other Euro-

⁴⁴ Titos Martínez and Piñar (1993); Comín (2012), pp. 178-196.

⁴⁵ In 1957, the Ministry of Finance assumed responsibility for supervisory tasks concerning savings banks.

pean countries, e.g. Italy. The Supreme Banking Council established in 1921 remained in place, although with reduced supervisory duties and limited autonomy. It acted as a consulting agency for the Ministry of Finance; other functions included receiving applications for the establishment of new banks and for the opening of new branches and the collection of bank statistics. It housed a Supervisory Board (*Junta de Vigilancia*) with the task of enforcing official policy and the banks' compliance with all official regulations.

In 1962, the regulatory framework was partially altered. Changes in the European financial environment and the exhaustion of the domestic expansionary cycle that had begun in 1951 convinced the government that the previous autarkic and interventionist strategy ought to be dismantled. The Spanish economy grew rapidly throughout most of the 1950s, but at the same time it accumulated a series of fiscal and monetary imbalances that threatened to abruptly halt past economic gains. Protectionism and interventionism had also led to gross industrial inefficiencies and misallocation of resources. Thus, in 1959, a Stabilization Plan modeled after a similar French plan was adopted to correct the inflationary process and the mounting disequilibrium in the balance of payments. The plan was followed by a series of reforms aimed at dismantling the autarkic framework, reducing state participation in the economy, and enhancing the role of the market⁴⁶.

The old banking law was replaced in 1962 by a new Banking and Credit Regulatory Law. The Bank of Spain was nationalized and old and new monetary instruments were put in place. The law established cash and liquidity ratios and a new public-debt ratio, by which banks were required to hold a cer-

⁴⁶ Martín-Aceña and Martínez Ruiz (2007).

tain proportion of government securities in their portfolio. Reserve requirements were also introduced for both banks and savings banks. Another relevant change was the separation between commercial and industrial banks⁴⁷.

However, the liberalizing winds of the 1962 law took time to materialize. Entry barriers persisted for banks and savings bank, branch limitations remained in place and the interest-rate ceiling on deposits and loans continued to be under strict government control. Since financial institutions were supposed to play an active role in promoting industrialization, a so-called “investment coefficient” was introduced, whereby banks and savings banks were compelled to maintain a certain proportion of their portfolio in government bonds or in pre-determined industrial securities. In addition, “preferential” interest rates were adopted to favour the development of industrial sectors considered of “national interest”.

Beginning in 1969, deregulation accelerated⁴⁸. Interest-rate restrictions on long-term (two years or more) loans were lifted. Barriers to entry were relaxed and branch restrictions were partially removed. These more lenient chartering and branch policies enhanced competition. After 1974, deregulation speeded up still further. Discrimination between banks and savings banks were eliminated, banking operations were liberalized and the obstacles to competition among financial institutions were progressively suppressed. The 1974 financial reforms

⁴⁷ The law and its aftermath in Lukauskas (1997), pp. 97-121; Pons (2001), pp. 59-67; Pons (2012), pp. 103-108).

⁴⁸ In Europe, deregulation began in the late 1960s or early 1970s. In Britain, the beginning was marked by the approval of the “Competition and Credit Control” act in 1971 (Capie 2007, p. 75). The same trend for continental countries: Belgium (Maes and Buyst 2009, 95-117); Finland (Tarkka 2009, pp. 75-93); France (Melitz 1990, pp. 394-402); Norway (Berg and Eitrheim 2009, pp. 169-184). For the United States, White (2009, pp. 15-44).

sought to improve financial efficiency and monetary control through three basic elements: measures to increase interbank competition; regulations to promote competition among different types of intermediaries; and the liberalization of all long-term interest rates⁴⁹. The public or official banking system was also restructured. It had been plagued by economic inefficiencies because of politically orientated credit allocation processes to preferential customers; moreover, fraudulent practices were not uncommon. Consequently, a major piece of legislation, the Official Credit Act of 1971, attempted to rationalize the internal organization and the performance of the public banks by depoliticizing their credit allocation mechanisms⁵⁰. As in the two previous sections, the Appendix summarizes the main reforms and regulatory features of the period.

The Spanish financial regulatory regime built after the civil war, not very different from that adopted in other European nations, offers a remarkable contrast with that of the previous two periods. Competition was sacrificed for stability. The government, showing an unmistakable distrust of bankers and no faith in the market, replaced the role of the market in the allocation and distribution of resources. After 1962, deregulation made some inroads. The reforms introduced in 1962, and still more intensively after 1969, were not consequences either of banks' failures or threats to the stability of the financial structures: in both cases, the regulatory changes reflected other motivations.

Banking regulations were the result of a combination of economic factors (government interest in industrialization) and

⁴⁹ The 1974 reforms have been studied in detail by Gil (1986); López Roa (1981, chap. 7); Toribio Dávila (1983, pp. 175-92); Torrero (1982, 1989).

⁵⁰ Hernández Armenteros (1986, chap. 1)

of political economy motives (the private interest, ideology, institutions). The main economic goal was to change the allocation of resources to foster economic growth, and banks were used as an instrument of forced industrialization and as a means of obtaining cheap public financing. In return, the government offered banks advantages to secure their collaboration. Political motives were also present. The restrictions and controls of the 1940s and 1950s reflected the ideology of the Franco regime as well as an obvious political goal: that of retaining power and gaining support by distributing benefits to selected groups (the bankers). Banks were able to capture the policy-making apparatus and thus obtain extremely favourable financial regulations. Likewise, deregulation stemmed from similar motives: it took place when it was politically advantageous to deliver economic development in order to maintain power and the continued survival of the regime. Political rather than economic factors determined the timing and the pace of reforms. Moreover, the Franco regime initiated financial deregulation in the late 1960s because it confronted a new set of economic and political constraints that reduced the attractiveness of restriction⁵¹.

6. Banking crises and financial reforms, 1975-2000.

With the collapse of the Bretton Woods system, financial crises returned with a vengeance to the world scenario. In many countries, the crises had their origin in a previous cycle characterized by excessive real-estate investment, rapid credit expansion and exceptional increases in asset prices. A permis-

⁵¹ Pérez (1997) has also offered also an argument based upon the “private interest” or capture theory, albeit different from that of Lukauskas.

sive factor was the domestic financial liberalization that had begun in the late 1970s and was completed by the late 1980s. When the booms ended, insolvency led to bankruptcies and widespread financial instability. Having dismantled the safeguards provided by the postwar structural controls and not yet having set in place the new prudential instruments, the authorities were taken aback and forced to design a new architecture of financial regulation, a task which would be carried out in the 1980s and that took time to implement⁵².

In Spain, the late 1970s and early 1980s saw the most severe financial crisis since the crash of 1866. Twenty-four institutions were rescued, four were liquidated, four merged, and twenty small and medium-sized banks were nationalized. All in all, fifty two banks out of a hundred and ten, accounting for nearly 25 per cent of the system's deposits, disappeared⁵³. Savings banks also went through difficult times, although in this case consolidation was the solution adopted to prevent major bankruptcies. In many instances, insolvent small and medium-size savings banks were absorbed by larger and better managed institutions⁵⁴.

A combination of exogenous and endogenous factors lay behind the causes of the banking crisis⁵⁵. In the mid-1970s, the stable macroeconomic environment of the previous decade came to an end. Energy and raw material and labour costs rose. The balance of payments on current account deteriorated, inflation

⁵² Goodhart (2007).

⁵³ The Spanish crisis is included among the so-called "Big five" reported by Caprio et al (2005) and Reinhart and Rogoff (2009).

⁵⁴ The crisis of the savings banks and other non-profit trusts reappeared in 1990-1992.

⁵⁵ The standard account is Cuervo (1988). Other relevant references are AEB (n.d), Torrero (1981), Gil (1986), Ontiveros and Valero (1988), Faus (2001, chap. 5.1, pp. 245-270). A brief synthesis in Poveda (2012, pp. 244-245).

escalated and nominal interest rates increased. Unemployment rose to record levels of up to 25 per cent. The industrial sector was also severely hit: technical obsolescence, lack of competitiveness and dependence on external finance put industrial companies in a difficult situation. Banks caught with large industrial portfolios saw their balance sheets deteriorate. The volume of non-performing assets rose, banks' profits were reduced and in some cases losses were recorded, although they were not publicly unveiled. Equity prices fell sharply, as did housing and commercial real estate prices after several years of a pronounced upward trend, supported by high borrowing levels⁵⁶.

The end of the "statu quo" and the dismantling of the structural controls after 1962 was ill prepared and poorly conducted. The separation between commercial and investment banks failed, the paid-up capital required to establish new credit institutions was set at very low levels and plans for opening branches displayed no economic sense, leading to an excessive number of agencies. Many banks had expanded into geographical and business areas in which they had little prior knowledge. Industrial banks opened after 1962 lacked expertise and qualified professionals. Bank managers were not used to operating in a competitive environment and increased their focus on gaining market share. Problems accumulated as a consequence of undercapitalization, risk concentration over the legal limits, high leverage to sustain uncompetitive firms under the control of the bank and unorthodox accounting methods to hide solvency difficulties, if not outright illegal financial operations⁵⁷.

⁵⁶ An overview of the economic and industrial crises of those years, Rojo (2004, pp. 435-448). The links between the industrial and the banking crises in Torrero (1990).

⁵⁷ The regulatory changes of these years and their implications have been thoroughly described by Lukauskas (1997, ch. 6), Pérez (1997), Juan (1993) and Poveda (2012).

As the banking crisis erupted almost unexpectedly, the Ministry of Finance and the Bank of Spain were caught unprepared. Deregulation had not been accompanied by the establishment of an efficient system of banking supervision, and the authorities had neither the legal instruments nor the institutional mechanisms to face the turmoil caused by the banks' massive insolvencies. Although the Bank of Spain had assumed since 1971 all functions with regard to the inspection of all credit institutions (except the state-owned banks), the inspection department of the Bank lacked the human capacity to carry out adequate banking examination. Disclosure requirements for financial holdings were not in place and hence it was difficult to gauge the solvency of the financial firms within the holding. Auditing of banks was not a widespread custom at the time and many firms resisted inspection by outsiders. Procedure rules to impose sanctions on managers or to remove the administrators of banks in trouble were legally complicated, outdated or non-existent. To avoid a catastrophe, the Bank had to implement emergency measures to prevent bank runs and a contagion effect from unsound to essentially solvent institutions. Containment included lender-of-last-resort assistance to banks with temporary liquidity problems and intervention in basically failed banks.

To provide limited guarantees to depositors, two Deposit Guarantee Funds (one for banks and another for savings banks) were established in November 1977. Rescue operations began in 1978 and continued well into 1983. In addition, a new institution was set up: the Corporación Bancaria (Banking Corporation), a private joint-stock company that received contributions from the Bank of Spain and from nearly one hundred banking firms. The Corporation proved to be a quick and adequate mechanism for intervening in banks in trouble, removing

and substituting the administrators, reorganizing the banks, and in due time, returning them to the private sector. In 1980, the Deposit Guarantee Funds were reorganized, replacing the Banking Corporation and being given additional power and financial muscle. The Fund intervened in twenty nine institutions, only one of which was liquidated, while the rest were restructured, reorganized, and later sold to other banks. In one case of a major industrial bank, the intervention was conducted directly by the Bank of Spain. The Ministry of Finance also intervened directly in another special case: the nationalization of the Rumasa holding, formed by 600 commercial and industrial firms and seventeen banks.

The crisis taught important policy lessons, and the regulators moved swiftly to implement a strong banking supervisory regime⁵⁸. First, they realized that bank regulatory and supervisory agencies needed adequate resources to do their job effectively. Second, they also realized that proper accounting standards and disclosure requirements were crucial to a healthy banking system. Third, bank supervisors needed to take prompt action to stop undesirable bank activities, and even close down institutions that did not have sufficient net worth, making sure that stockholders and managers of these insolvent institutions were appropriately punished. Fourth, because prompt corrective action was so important, the bank supervisory agency would require sufficient independence from the political process to ensure that it was not encouraged to sweep problems under the rug by engaging in regulatory forbearance.

As the crisis unfolded, legislation was passed in order to reinforce the supervisory capacity of the Bank of Spain. In 1980, the *Ley de Organos Rectores del Banco de España* (Law of Governing Bodies of the Bank of Spain) transferred all responsi-

⁵⁸ Faus (2001, chap. 5.2, pp. 271-298) and Poveda (2012).

bilities for bank supervision, discipline and sanctions to the central bank, which at the same time was given ample political autonomy. A short time thereafter, the Bank, by means of ministerial orders or by mere communications, introduced new rules regulating accounting practices and disclosure norms with regard to the income-and-losses account. Spanish membership of the then European Community after 1986 was an additional incentive for intensifying the reforms and improving the supervisory framework and the capacity and performance of the institutions in charge of the tasks, in most cases the central banks. In 1988, the Credit Company Intervention and Discipline Law unified the control of all financial firms under the Bank of Spain. The law regulated the causes for bank intervention, enumerated the possible infringements, established the standard procedures for banking examination and listed the sanctions for banks and managers according to the severity of the misdemeanour. The following step came with the Autonomy of the Bank of Spain Law in 1994, enacted in order to comply with EU legislation. Finally, in 2000, the Bank of Spain introduced the so-called forward-looking provisioning, also referred to as the dynamic or statistical reserve, a mechanism of pre-provisioning for loan losses over the course of the cycle. From the moment that a loan is granted, and before any impairment in this specific loan appears, there is a positive default probability (no matter how low it might be) following a statistical distribution with an expected loss. As the risk appears at the beginning of the operation, so does the statistical operation requirement. With this system, provisions run in parallel to revenues and are, therefore, distributed through the cycle, allowing for better mapping between income and costs in the profit and loss account⁵⁹. A summary of the main featu-

⁵⁹ Poveda (2000); Caruana (2003).

res of the regulatory regime for these years is also given in the Appendix.

The regulatory changes approved in the 1980s and 1990s were a direct product of the banking crisis that had been unfolding since 1977⁶⁰. The authorities took further steps in the liberalizing drive to increase the level of competition within the system with the belief that it would enhance efficiency and better banking management practices. On this occasion, the deregulation process was accompanied by the adoption of an array of measures to put into place a coherent and powerful mechanism for prudential supervision. The reforms also responded to a genuine interest on the part of policy makers in updating the Spanish economy, aligning it with the European market system, promoting growth and competition and making a complete break with the inward-looking financial and economic strategy of the Franco years. The private interest was also present, because the regulatory reforms introduced after 1975 responded to politicians' conviction that market-based financial systems provided superior economic performance. Democratization changed the reward structure confronting leaders, making the supply of public goods, such as strong economic performance and financial monetary stability, more attractive while a narrow defence of special interests became less tenable. Spain's democracy gave politicians an incentive to dismantle the credit, entry, and interest rate controls that had traditionally been used to provide benefits to select groups, instead promoting efficiency by giving market forces greater reign⁶¹.

⁶⁰ Faus (2001) and Poveda (2012)

⁶¹ Lukauskas (1997); Pérez (1997).

7. Conclusion

As in the rest of the world, Spain has undergone periodic changes in its regulatory framework. On various occasions, regulatory changes have predated a financial crisis, while on others, financial reforms have represented a reaction to the occurrence of a banking crisis. Public policy was usually absent in the nineteenth century, whereas in the twentieth century, regulators have been more active. Moreover, the Spanish experience is similar to that of other European countries, where control and regulations were modest or non-existent in the nineteenth century and then increased after the First World War and again after the Second World War.

Until 1914, legislation reflected the liberal ideology of the times. Behind the banking codes of 1856 and the general company law of 1869 lay purely political-economy motivations. The *laissez-faire* economic philosophy of mid-nineteenth century Europe permeated all the economic legislation of the epoch and forestalled any possible reactive action to financial crises. However, the liberal reformers of the time also aimed at promoting the development of the financial system, and hence designed initial banking legislation to facilitate the establishment of banks and savings banks, as in fact happened after the banking codes were approved.

The postwar banking crisis brought to the fore the need to regulate the financial sector. The 1921 Banking Regulatory Law was to some extent a watershed, because it signaled the end of a long period of nearly “free banking”. Supervision was entrusted to the Supreme Banking Council, a new agency which was controlled by the banks themselves. The civil war marked an abrupt shift in the regulatory regime. Legislation introduced in 1939-1942 and later in 1946 imposed strict barriers to entry and restricted new branches. The lack of faith in the market led

to arbitrary administrative allocation of resources and banks were placed at the service of political-economy goals, as defined by the financial authorities. Protected from competition within the industry and from outside, the banking industry enjoyed a long period of relative stability. Liquidity problems were resolved by the Bank of Spain in individual cases, and bank insolvencies were dealt with by merging operations.

The regulatory regime was altered in 1962 as part of a general shift from an inward-looking to an outward-looking growth strategy. A new act mitigated the interventionism of the previous period and introduced a division between commercial and industrial or investment banks. Liberalization began in 1969 and accelerated after 1974. However, deregulation was not accompanied by a change in the supervisory regime. During the favourable economic environment of the 1960s, the financial industry expanded considerably, but when the world economic cycle changed in the mid-1970s, Spain was severely hit by the crisis and suffered a long and protracted period of financial turmoil. The supervisory authorities had to implement emergency measures to contain a generalized collapse. Later, in the 1980s and 1990s, the supervisory regime was reinforced and measures were introduced to comply with EU directives and the Basel accords.

One conclusion of this paper is that Spanish financial reforms over the last 150 years have not always been reactive. Until 1914, the regulatory modifications were not a response to crises, and nor were those implemented after the civil war or in 1962. In contrast, the act of 1921 and the regulatory reforms of the 1980s were clearly a reaction to banking crises. A second conclusion is that the regulatory process has always been the result of the interplay between public and private interests. Economic and political-economy forces have together

comprised the driving force that explains the timing and the character of the Spanish financial reforms of the last 150 years.

Although our paper comes to an end before the present financial crisis emerged, a final conclusion is that, obviously, the regulatory and supervisory norms adopted in the late twentieth century have not been sufficient, or efficient enough, to prevent the occurrence of a new and severe banking crisis, which is mainly affecting the savings-bank sector. The best that can be said is that at least some measures, especially the so-called statistical reserves, may have served to mitigate the impact of global turmoil on the Spanish financial fabric. Without the reforms implemented in the eighties and nineties, the combination of the international banking crisis, the excessive exposure of the building sector and the poor governance of too many institutions would have provoked a predictable collapse of the national banking system. In fact, the repetition of financial crises and the multi-causality of their origins suggest that, in Spain as well as in many other countries, it has been impossible until now to devise a regulatory framework capable of preventing banking crises. Because as Díaz-Alejandro (1985) remarked: “there is no humanly possible way of devising a fail-proof system of finding out the true intentions of borrowers”.

Appendix - Spanish Bank Supervisory Regimes

TABLE 1
Banks

Prudential regulations	First Period: 1856-1920	Second Period: 1921-1936	Third Period: 1939-1975	Fourth period: 1975-2000
1. Entry	Only one bank of issue per town (1874: monopoly of issue granted to the Bank of Spain). Incorporation required government authorization. Obtained easily with minimum requirements.	Subject to government authorization and a favourable report from the Supreme Banking Council. Compulsory registration in the Official Register of the SBC.	Restriction on entry. Entry subject to strict norms and regulations.	Subject to authorization by the Bank of Spain.
2. Capital requirements	Fixed minimum.	Fixed minimum.	Regulated. Fixed by the Ministry of Finance.	Regulated until 1986 by the Bank of Spain. After 1986, regulated according to EU and Basel rules.
3. Limits on economies of scale	No limits.	No limits.	Strong branching limits. Strict controls on mergers and consolidation.	No limits.
4. Limits on economies of scope and diversification	Banks of issue: some restrictions. Credit companies: no limits.	No limits.	Restriction on portfolio composition.	No restrictions.
5. Limits on pricing	No limits.	Maximum rates on deposits.	Strict regulation by the Ministry of Finance. All rates.	No restrictions.
6. Liability insurance	No liability insurance.	No liability insurance.	No liability insurance.	Liability insurance in place.
7. Disclosure	Publication of financial statements in the Official State Gazette.	Information disclosure to the Supreme Banking Council.	Information disclosure to the Ministry of Finance.	Obligatory disclosure rules.
8. Examination	At the discretion of the government.	Supreme Banking Council. Rarely conducted.	At the discretion of the government. Examination by the General Inspectorate	Committee. Close supervision and examination by the Bank of Spain.
9. Supervision and enforcement	Royal commissioner. Limited to compliance with the statutes.	Limited to observance of the rules established by the Supreme Banking Council.	Strict enforcement of rules. Repeal of the bank charter in case of violation of the law.	Strict enforcement of bank regulations. Strict supervision by the Bank of Spain.

TABLE 2
Savings Banks

Prudential regulations	First Period: 1856-1920	Second Period: 1921-1936	Third Period: 1939-1975	Fourth period: 1975-2000
1. Entry	Free entry. Minimal discretion. The statutes required the approval of the Ministry of the Interior.	Unchanged.	Similar to banks.	Subject to the authorization of the Bank of Spain.
2. Capital requirements				Regulated until 1986 by the Bank of Spain. After 1986, regulated according to EU and Basel rules.
3. Limits on economies of scale	One savings bank per town.	Unchanged.	Strict branching limits.	No limits.
4. Limits on economies of scope and diversification	Restriction on assets.	Unchanged.	Restrictions on assets.	No restrictions.
5. Limits on pricing	Unregulated.	Unregulated.	Strict government regulation.	No restrictions.
6. Liability insurance	No liability insurance.	No liability insurance.	No liability insurance.	Liability insurance in place.
7. Disclosure	Unregulated.	Unregulated.	Disclosure to the Ministry of Labor and later to the Ministry of Finance.	Obligatory disclosure rules.
8. Examination	Unregulated.	Unregulated.	Similar to banks. Examination performed by special agencies established to regulate savings banks.	Close supervision and examination by the Bank of Spain.
9. Supervision and enforcement	Unregulated.	Unregulated. After the approval of the General Statute of Savings Banks, supervision was conducted by the Ministry of Labor.	Similar to banks. Supervision conducted by the special agencies established to regulate savings banks.	Strict enforcement of bank regulations. Strict supervision by the Bank of Spain.

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