State-Owned Banks and Development: Dispelling Mainstream Myths

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Introduction

It is not uncommon in today's post sub-prime crisis era for staunch supporters of private banking to now admit that state-owned banks once played an important role in the post war period by 'filling market gaps'. Yet such admissions are then quickly qualified by claims that state-owned banks remain inefficient and ineffective in practice today (World Bank 2012a, 101). Yet state-like banking long preceded the post-war period and arguments that state-owned banks simply filled private banking gaps oversimplifies the historical circumstances and exaggerates the actual capacity of the private sector, thus distorting a diversity of circumstances. Indeed, some of the earliest public banks emerged in response not to market gaps but to private banking profligacy. In Medieval times the punitive consequences of debt default created periodic social instability, leading public officials to occasionally offer debt relief. Two early European state banks emerged in response to this: one in Barcelona in 1401 (which survived more than 450 years) and a second in 15th century Genoa (which came to be known as the Bank of Venice and functioned for over two centuries (Brown 2013, 100-3). Later examples include 18th century Quaker farmers in Pennsylvania, who founded a Land Bank to collectively contribute to the development of their community (and to push back against usurious British bankers) (Rappaport 1996).

To be sure, it was not until capitalist industrialization took root globally in the late 19th and early 20th century that state banking became firmly established in capitalist and socialist countries alike. National governments recognized that state-owned banks provided the only option for overcoming the limitations of private banking and, in many cases, countering the power of imperial bankers. The Ottoman government's creation of an agricultural fund in 1863 to support farmers (which evolved into modern Turkey's Ziraat Bank) is such an example, as the nascent bank also served to ease European debt dependency in the early 20th century (Marois and Güngen 2013). Through the 20th Century other socialist, social democratic, and even militaristic countries experimented with state banking. Amidst its brief 1948 revolutionary period Costa Rican officials nationalized the banks to promote the 'democratization of credit' and national development. The post-1949 Revolutionary Communist Party of China restructured the People's Bank as a single, large state bank geared to managing economic and political transformation under communism. Following the country's 1961 coup, South Korean military leaders nationalized the banks and then reoriented them towards national developmental goals (Erdogdu 2004, 265). In India, Prime Minister Indira Gandhi nationalized 14 large private banks in 1969 ostensibly to facilitate a socialist-oriented developmental policy. Many more bank nationalizations occurred in countries as diverse as Algeria, Egypt, Libya, and Tanzania in the 1960s.

This diverse post war history of state banking suggests complex logics at work – from creating banking services where none existed, to countering colonial and foreign monetary dominance, to pursuing hopes of democratization and development, to supporting militaristic goals. By the

1970s, estimates suggest that in advanced economies state banks controlled 40 per cent of the largest banks' combined assets and 65 per cent in developing economies (Levy Yeyati et al. 2007, 212). Only in the most creative ways could it be upheld that these varied and widespread instances of state-owned banking all succumb to simply filling in where private banks ought to have been.

Thirty years of neoliberal restructuring have nonetheless sidelined most alternative logics and practices to the complete private provisioning of banking and finance for development. A number of mainstream myths about state-owned banks have helped to stoke and sustain the neoliberal maxim that whatever the problem, private sectors solutions and market processes are society's best hope of resolving it effectively and efficiently. In what follows, I dispell eight additional myths common to neoliberal finance and developmental discourses today. The argument guiding this review is that there are sufficient counter examples and progressive narratives around actually existing state-owned banks to demand a systematic rethink from conventional economists and international financial institutions (IFIs). State-owned banks can form a crucial part of progressive, sustainable, and democratic strategies for long-term social development goals. In undertaking this task I would like to caution the reader that this argument is not intended to suggest, simplistically, that public or state bank ownership, in and of itself, is necessarily and innately any alternative. Rather, public ownership offers a potentially rich institutional vessel whose social content can more readily be defined by progressive, social developmental, and collective aspirations than private corporatized ownership. That is, there is latent political potential that can only be realised by the society in which a public bank exists.

Myth One: There are no state-owned banks left

It is a popular misconception that state-owned banks have disappeared under neoliberalism. To be sure, neoliberal structural adjustment and privatization processes have led to a reduction in state banking assets globally. The World Bank estimates that in emerging economies state bank ownership has fallen from 67 per cent in 1970 to 22 per cent in 2009 (2012a, 103). Patterns have varied, nonetheless. In Costa Rica, whereas in the mid-1990s more than 80 per cent of banking assets were state-owned, by 2001 it had dropped closer to 63 per cent. The Mexican banking sector went from completely public after nationalization in 1982 to fully private after 1992. Poland, too, privatized much of its state bank claim, which fell from 80 per cent in 1990 to roughly 23 per cent in 2001.

In times of crisis, however, the trend sometimes reverses as state authorities step in to rescue failed private banks via nationalization. Some examples include Sweden in 1992, Mexico in 1994-95, Latvia in 1995-96, East Asia in 1997, and Argentina in 2001. Following the 2008 financial crisis, state bank ownership among developed economies increased from 6.7 per cent pre-2008 to 8 per cent overall (World Bank 2012a, 103). Individual cases are more dramatic with Ireland jumping from 0 to 21 per cent and the UK from 1 to 26 per cent from 2008 to 2010.

Nevertheless in many more countries state bank assets remain significant. Table 1 provides data on a selection of countries from a World Bank survey on "government controlled banks," defined as those in which government exercises control through ownership of more than 50 per cent of voting shares, or other forms of control.

Table 1: State-owned banking assets, select countries, percentage of total, 2008 to 2010

	ARGENTINA	BANGLADESH	BRAZIL	BURUNDI	ECUADOR
2008	37.7%	37.8%	39.8%	49.1%	11.77%
2009	39.1%	35.2%	44.1%	48.1%	16.18%
2010	43.6%	34.1%	43.5%	48.9%	16.53%
	EGYPT	**GERMANY**	**INDIA**	**INDONESIA**	**KOREA, REPUBLIC OF**
2008	49.30%	35.44%	69.85%	38.20%	22.20%
2009	48.50%	36.08%	71.88%	39.70%	22.40%
2010	---	31.52%	73.70%	38.41%	22.30%
	KYRGYZSTAN	**LATVIA**	**POLAND**	**PORTUGAL**	**RUSSIAN FEDERATION**
2008	17.50%	10.50%	17.00%	21.04%	38.00%
2009	81.00%	17.10%	21.00%	21.73%	40.60%
2010	20.30%	15.50%	22.00%	22.64%	40.80%
	SIERRA LEONE	**SRI LANKA**	**THAILAND**	**TURKEY**	**VENEZUELA**
2008	41.49%	55.50%	22.20%	30.50%	11.90%
2009	38.62%	57.80%	21.70%	32.20%	22.01%
2010	37.71%	59.10%	17.50%	31.60%	33.06%

Source: World Bank 2012a.

It is also true that many of the largest and best-run banks remain in state hands (see Micco et al. 2004, 9). But this has led to mainstream criticisms that governments hold on to the biggest and best banks for nefarious purposes (Boubakri et al. 2005). Neoliberals argue that these large state-owned banks thus become a drag on the economy and hotbeds of political corruption. By contrast, others see these remaining public institutions as offering an important material basis and institutionalized form of social power that needs to be defended and improved (Lapavitsas 2010; Culpeper 2012). The Inter-American Development Bank, for example, recently authored a report highlighting the need for crafting a new paradigm around public banking, one that adequately accounts for their social developmental successes (IDB 2013).

Myth Two: Better to regulate private banks than own state banks

Notwithstanding renewed interest in state banking, neoclassical economists and neoliberal advocates see private ownership as innately superior to state ownership (Hayek 1984; Shleifer 1998; Vanberg 2005). In the field of banking and finance this ideological framework tied to the efficient market hypothesis is represented by the so-called 'private' or 'political' interest view, which took root starting in the late 1970s. Advocates argue that the attribution of any progressive public ethos to state ownership is both idealistic and naïve (Barth et al. 2006, 34-5; *cf*. La Porta et al. 2002). In IFI circles, these dominant private interest viewpoints translate into policy arguments that suggest it is better to regulate private banks than to own public banks (World Bank 2012a, 3). Rather than replacing markets, government regulation should support market actors and market discipline as the best guarantor of socially desirable results (Barth et al. 2006, 14;). In World Bank speak, policymakers should work with markets "to align private incentives with public interest" (2001, ix).

More than three decades of neoliberal developmentalism have yet to really substantiate mainstream hopes that private regulation is sufficient for economic growth, stability, and social equity. Notably, bank privatization and financial liberalization processes have left major gaps in the financing of development and public services – from water to health to electricity generation to agriculture (see Bayliss and Adam 2012, 330; Davis 2008; Fine and Hall 2012, 64-65; Hathaway 2012, 356; McDonald and Ruiters 2012; Sengupta 2012, 195). Private market-based finance often baulks at funding long-term, complicated projects or imposes conditions on their loans that protect their interests over and above that of the project's viability and sustainability, not to mention the public good. There remains great need for financing that comes without neoliberal and profit-maximizing conditionalities, but rather is subordinated to public service delivery and social developmental needs (Balanyá et al. 2005; Fine and Hall 2012, 46; Malaluan 2012, 258).

The shortcomings of such neoliberal idealism vis-à-vis hopeful regulation of private incentives is perhaps most evident with mainstream responses to the global financial crisis (e.g. Acemoglu 2009; Demirgüç-Kunt and Servén 2010; Mishkin 2009). As even the *Financial Times* recognizes, attempts to re-regulate private banking and finance following the US sub-prime and global crisis debacle have failed miserably, leading to larger and more systemically powerful banks, thus creating "an insane financial system" (Tett 2013). Even World Bank economists have had to admit that state banks can serve an important countercyclical lending role during times of crisis (without, however, foregoing their long-term preferences for complete private ownership of banks) (Bertay et al. 2014). Regulation alone in those countries hardest hit by the crisis, like the UK, has largely failed to stimulate economic recovery (Macartney 2014).

Notwithstanding conventional economists' and IFI attempts at containment, the recent global crisis has revived deep interest in state-owned banking across the academic spectrum and among some development institutions (see Blackburn 2011; Brown 2013; Buiter 2009; Butzbach 2012; Culpeper 2012; Lapavitsas 2010; Marshall 2010; OECD/ECLAC 2012; Veltmeyer 2010; IDB 2013). What these authors share, however diverse their analyses, is a realistic appreciation that private finance always finds ways to supersede regulatory barriers in pursuit of their own interests of profit maximization. Current circumstances and equitable developmental aspirations, however, will likely require direct government ownership as a necessary, if not sufficient, condition for viable finance for development alternatives.

Myth Three: Evidence shows that private banks are better

Bank privatization initiatives are most often shaped by neoclassical research methodologies that claim to provide solid, evidence-based support for policy decisions (Barth et al. 2006; World Bank 2012a, xiii). Large-scale samples seeking statistically relevant correlations are often the most influential (see Megginson 2005, 316). One such influential study compared ownership of the largest banks in the 1960s and 1970s to that in 1995, across 92 different countries (La Porta et al. 2002). The authors concluded that state-owned banking correlates with countries that are not only "inefficient" and "less democratic" but also "backward," "poorer," "statist" and "financially underdeveloped." A series of follow-up empirical studies have extended these findings, each recommending bank privatization as the preferred policy (Boehmer et al. 2005; Boubakri et al. 2005, 2008; Otchere 2005).

In doing so, however, neoclassical researchers have failed to respond to a wide array of methodological criticisms that question their underlying assumptions that markets are neutral, their narrow focus on property rights, and their ahistorical perspectives (Ankarloo 2002; Hodgson 1986, 213). Critical scholars contend that neoclassical deductive approaches begin by presuming the answer, namely, that state banks are inherently inferior to private banks. Conventional researchers then magnify the original problem by imposing private banking assessment criteria, namely efficiency *cum* profitability maximization, onto state banking operations without due consideration for wider historical, social, economic, or political realities. Finally, skeptics of conventional claims of evidence suggest that such large-scale empirical studies draw together countries with radically different histories, systematically hiding more about state banking than the studies can possibly reveal (Stallings 2006). The evidence of private bank superiority, thus, needs to be read cautiously. A recent report on public banks in Europe puts it succinctly (Schmit et al. 2011, 104):

> This wide range of underlying economic rationales [of public financial institutions in Europe] renders meaningless most performance-based analyses of public sector banks, since all that such analyses measure is financial performance (which presupposes the overriding aim of profit maximisation), neglecting all other kinds of objectives pursued by public financial institutions.

A close reading of the pro-bank privatization literature reveals, too, that neoclassical researchers are often disingenuous about the limits of their evidence. While claiming that their policy prescriptions are not intended as 'one size fits all', state bank ownership is ruled out *a priori* as an unviable long-term policy option (Barth et al. 2006, 5; World Bank 2001, 29). Despite acknowledging country specificity, only market-enhancing and private property protecting reforms are viable (Demirgüç-Kunt and Servén 2010; Mishkin 2009). As von Mettenheim writes, neoclassicals "fail to consider how government banks may succeed, as banks, as agents of public policy and as essential parts of political and social economies" (2010, 15). What it boils down to is that neoclassical economists "approach the analysis of social reality armed with inappropriate tools" (Lawson 2013, 972), leading to ideologically charged and distorted policy recommendations based on empirical evidence that fits their predetermined agenda. In other words, a neoclassical evidentiary basis alone is not a reliable foundation upon which to build informed banking sector policy.

Instead, a genuinely historical research program should seek to understand specific local differences within an analytical framework capable of recognizing wider global development structures and financial processes (see for example the 'variegated capitalism' approach of Peck and Theodore 2007). This can be achieved through strategies of inquiry that are qualitative and case study-oriented, which experts on methodology suggest are best able to generate original evidence-based policy recommendations (see Creswell 2009; Mabry 2008). Case study research also helps to reveal power structures, social imbalances, and their effects – concerns that have become increasingly important with the growing influence of private financial institutions today. Finally, the pre-social foundations of the private interest view of banking should be supplanted by a social content view of banking. Such an approach would seek to provide a more nuanced understanding of the socio-historical forces impacting state banks (*cf*. Hilferding 2006 [1981]; Marois 2015, 33-4). This entails resisting any temptation to elevate bank ownership, public or private, to a place of functional determinacy outside of historical and social change. Banks can be interpreted as "institutionalized social relations that reflect historically specific relations of power and reproduction between the banks, other firms, the state, and labor in general" (Marois 2012, 29). Evidence generated in this way is often far more case sensitive and open to historical (as opposed to transhistorical) determinations.

Myth Four: State banks only lend to their cronies

State-owned banks often have a reputation for only lending money to big businesses friendly to government, with East Asia being frequently cited as an illustration of why state banks might not work (Bird and Milne 1999; Lim 2012; Woo 1991). It is true that tight state-industrial group relations (so-called crony capitalism) contributed to the private sector amassing huge state bank loans that partially contributed to the 1997-98 East Asian crisis and subsequent public losses. Yet the problem of crony lending in East Asia (and elsewhere) has not been limited to state-owned banks (and, indeed, neoliberal financial liberalization demands can contribute to the problems state banks suffer (Erdogdu 2004, 272-3). Private banks in developing countries regularly lend to big businesses related to their own interests and accumulation strategies (Marois 2012, 11; 150).

It is nevertheless a powerful myth that state-owned banks are the real or only culprits in this regard, regularly reproduced in mainstream media. Taking aim at China, for example, *The Economist* quotes a young Chinese businessperson saying that the "[public] banks here only give money to big companies" (*The Economist* 2012). In reality, the Chinese state-owned banks do much more. In 2010, China's state-owned banks offered 316,000 loans to small rural start-ups equalling RMB 14.14 billion (roughly $2.3 billion) with plans to extend such loans to urban centres (CBRC 2010, 49). These loans are facilitated by thousands of smaller city and rural commercial state banks and rural financial institutions (which equalled about 20 per cent of all assets in 2010) that have a client base extending well beyond big business (CBRC 2010, 26). Furthermore, such anecdotal assertions are often intended to simply undermine state bank credibility. As Yeung (2014) suggests, Chinese state banks lend more to Chinese state enterprises because the risks are fewer and the likelihood of repayment greater than lending to unsecured and risky private enterprises, which would put the banks' capital at greater risk.

This wider pattern of lending is not limited to China either. As Table 2 illustrates, state-owned development banks – old and new, from large advanced and small developing economies alike – are mandated to lend to many different sectors, including agriculture, construction, public services, energy, education, health, SMEs, municipalities, infrastructure, and so on. These lending practices are not perfect by any means, and mandates can and do diverge from actual lending practices in problematic ways. One of the great challenges of public banking is to better institutionalize transparency and accountability. Further research is required in this area to better inform public banking policy and practice (as opposed to calls for privatization, which resolves nothing).

Table 2: Selected development banks and mandates

Development bank (100% state-owned)	**Mission**	**Sub-sectors granted credits**	**Government-backed lending?**
Fiji Development Bank (FDB) (1967)	To provide finance for projects that contribute to the development of the Fiji economy and improve the quality of life for the people of Fiji. Loan funds are provided for agricultural, small and medium enterprises, corporate and micro projects. The government also uses the FDB, as a financial instrument in its development projects/plans and special assistance programs that may be necessary from time to time.	Agriculture; construction; industry; services; mining infrastructure; energy; education; health.	Yes
North Rhine-Westphalia (NRW Bank, Germany) (2004)	To support the federal state and its municipal corporations in meeting their public tasks, particularly in the fields of structural, economic,	Agriculture; construction; services; mining infrastructure; other.	Yes

	social and housing policy.		
Uganda Development Bank Limited (1972)	Development finance institution; to provide financial support to short, medium and long term projects geared toward economic development of the nation.	Agriculture; construction; industry; services; mining infrastructure; energy; education; health; other.	Yes
Vietnam Bank for Social Policies (1996)	To help reduce the poverty rate and improve theenvironmental situation in Vietnam.	Agriculture; construction; industry; energy; education; other.	Yes
Bank of Public Works and Services, National Society of Credit (Mexico, 1933)	To finance or refinance public or private investment projects in infrastructure and public services such that it aids in the institutional strengthening of the federal, state, and municipal governments.	Services; infrastructure; other.	Yes

Source: World Bank 2012b.

Myth Five: Bureaucrats make bad bankers

According to conventional neoclassical economists state-owned banks are run by bureaucrats who pursue personal and political gain, leading to sub-optimal performance (World Bank 2001, 123; also see Demirgüç-Kunt and Servén 2010, 98-99). This neoclassical/neoliberal myth is problematic not just because of its universal and ahistorical scope. It is also problematic because it simplistically assumes that in all real world cases state ownership confers unmediated control over state banks to (inherently corrupt) bureaucrats that are active in bank management. Needless to say, the absolutism of such claims is belied by the paucity of substantiating evidence. Of course, correlations around lending patterns and elections can be made, though causation remains another matter (Dinç 2005). Yet even World Bank acknowledges weaknesses in its own knowledge base, recently stating that in fact “little is known” about state banks’ actual operations, mandates, services, clientele, regulatory and governance frameworks, and challenges (de Luna-Martinez and Vicente 2012, 2). Evidence on this matter has had little to do with promoting aggressive bank privatization. As late as 2001, the World Bank acknowledged that “the primary evidence on this issue [government failure in finance] has been anecdotal” (2001, 127).

This myth erases real world diversity in banking operations and governance structures, distorting the actual functioning of state-owned banks in different places and at different times. Neoliberal assumptions ignore the multifaceted day in and day out work and agency of hundreds of thousands of frontline bank workers, mid-level supervisors, branch and regional managers, and senior executives in addition to the many mid-level bureaucrats serving in financial authorities (bank regulators and supervisors, central banks, treasuries, and so on). We are expected to believe in some abstract, all-powerful, and resolutely self-interested universal 'bureaucrat' when state banks are institutions run by diverse people, individually and collectively. Particular bureaucrats may have power over certain banks or they may not. When bureaucrats do have institutionalized control, they may or may not exercise it, with positive or negative or neutral effects. Regardless, all policy decisions are implemented, and therefore mediated, by bank workers and managers who may support or resist certain directives. Moreover, this worldview sidesteps the ongoing neoliberal restructuring of state-owned banks that instils the very market-oriented ideology so dear to neoliberals – notably, corporatization and marketization. A few examples help to illustrate the diversity obscured by neoclassical mythology.

The State Bank of India: Corporatized but social developmental

The State Bank of India (SBI) is India's oldest and largest bank controlling roughly 20 per cent of the banking sector (Chakrabarti 2012, 250-252). Its operations are nationwide, with over 21,500 branches in 2009. In 2005 about a third of all bank employees in the country worked for the SBI. The government retains overall control but with a diversified Board of Directors. For example, the Board includes two government-appointed bank workers and management directors in addition to directors appointed because of their specialized expertise in cooperative institutions, rural economy, commerce and finance. At the same time the SBI must contend with the demands of a highly organized and militant bank workers' movement, whose million-person strikes and multi-day walkouts can shut down the banking sector. Market-oriented restructuring since the 1990s, moreover, has meant the Board must respond to a dual mandate: (a) 'profit-maximizing' for the shareholders; and (b) government developmental directives (e.g. offering rural financial services and financing fiscal policy) (Chakrabarti 2012, 253). Control over the SBI is thus both corporatized and social developmental in orientation.

The Development Bank of South Africa: Independent but neoliberal

The Development Bank of South Africa (DBSA) is a fully state-owned development bank (Beck et al. 2011, 153). Established in 1983 amidst the global neoliberal turn, the government mandated the DBSA to promote economic development and growth (World Bank 2012b). The DBSA began working closely with the World Bank in the mid-1990s and was staffed by a neoliberal technocratic wing of the government (Bond 2000). The Board and management personnel are formally independent and while the Treasury takes an active shareholder role it, too, is neoliberal in orientation. Presently the DBSA manages assets in excess of $6 billion, realizes returns on assets (ROA) of two to four per cent, and is involved in financing infrastructure, agriculture, construction, industry, energy, education, and health alongside providing technical assistance and grants to low-income municipalities. As such, the DBSA does not seem to confirm neoclassical myths about bureaucrats being bad bankers. Rather, it appears to have good neoliberal bureaucrats – if not good progressive alternative bankers – to the extent that the World Bank cites the DBSA's governance structure as a model of success (Beck et al 2011, 153).

European savings banks: Small but socially responsible
As a non-homogenous type of bank, European savings banks are typically small-scale decentralized public banks often created by local governments or organizations; that is, they are not owned by central governments unlike most of the state banks discussed here (Butzbach 2012, 36-7). The savings banks are interesting because of their often alternative ownership and control models, which mandate them to perform in a broadly defined public interest. On the one hand, the banks integrate local stakeholders, employees, government officials, and depositors into their governance decisions and certain profit imperatives to ensure operational sustainability. On the other hand, the banks pursue not-for-profit public mandates (von Mettenheim 2012, 18). For example, the French savings banks must dedicate half of their returns to social responsibility programs, which are managed by bank staff alongside social and political representatives. Spanish savings banks are mandated to contribute on average about a quarter of their returns to social welfare programs. While relatively small-scale, the savings banks illustrate important alternative governance practices that internalize explicit social mandates and community integration often missing in larger state-owned banks. In this case, bureaucrats and public officials can do well offering socially oriented banking services. Yet at the same time it is important to recognize the influence neoliberal competitive imperatives can have on these institutions, compelling otherwise socially progressive orientations to conform more closely to commercialized ones, as in the case of Spain (Ysa et al. 2012).

The *Banco Popular* (Costa Rica): Collectively run and socially responsible
Our final example is not a state-owned bank (although three large state-owned banks exist in Costa Rica). Rather, the Banco Popular is a public bank that is worker-owned and controlled.[1] Uniquely, the bank's collective 'Assembly of Workers of the Popular Bank and Communal Development' governs its operations and ensures that the bank's missions to protect the economic welfare of workers and to promote development are met. The ownership and control framework is inclusive. A participatory model of decision-making is facilitated through workshops for national delegates. This collective model has allowed for important extra-market targets. For example, the Banco Popular embodies explicit gender equity norms, which are protected by the Permanent Women's Commission. The Banco Popular workers' assembly has also ensured the bank is profitable and stable. In 2012 the BP earned $74 million and boasted a triple-A rating from Fitch. In doing so the BP anticipated providing about $820 million in consumer and development credits in 2013 – which is significant for this small country. While not a state-

[1] The following comes from the *Banco Popular* website, including its audited financial statements and president's directives; see https://www.popularenlinea.fi.cr/bpop/.

owned bank the public BP offers important governance lessons for participatory, democratized, alternative forms of financing for development.

These brief case examples demonstrate that the social content of state-owned banks can vary, shaped as it is by historically specific institutionalizations of power and class that differ according to place specificities and in the context of global capitalism – not the timeless and invariably 'bad bureaucrat banker' myth suggested by neoclassical theory. There is great real world diversity in cases of state bank ownership and control, and evidence-based policy-making should not presume particular outcomes based on pre-social neoclassical economics ideology.

Myth Six: Small is beautiful

International financial and development institutions, together with many governments, have embraced microfinance schemes as a new form of financial access and inclusion seemingly able to release virtuous cycles of individual entrepreneurial drive and developmental forces (World Bank 2013). Framed in this way microfinance fits well with neoliberal developmental strategies. The World Bank champions it because it leaves credit assessment and allocative decisions to the private sector. The only (explicit) role suggested for the state is to enable these new credit markets through better regulation and supervision.

For many scholars, however, the benefits of microfinance have been grossly oversold and misrepresented. Not only do microcredit schemes fail to offer a silver bullet for development but its various disciplinary creditworthiness mechanisms create new community and gendered debt problems (see Bateman 2010; Duffy-Tumasz 2009; MacLean 2012). Microfinance often embeds and deepens pre-existing unequal social relations of gender, power and class between financial capital and the poor, workers and peasantry (Soederberg 2013; Weber 2004).

Viable state-owned banking alternatives for small-scale lending exist, which provide financial access without the highly exploitative practices of microfinance institutions (such as China's rural financial institutions). As a Bank for International Settlements report acknowledges, in emerging markets as diverse as Argentina, Brazil, Russia and Thailand only the "state-owned banks are willing to serve customers in remote areas" (Hawkins and Mihaljek 2001, 15). Case study research supports this claim. In Brazil state-owned banks like the Caixa Economica Federal have taken a lead in increasing access for the underbanked in rural and remote areas, while simultaneously providing innovative social supports for the poor (von Mettenheim 2014, 190-1). In China, financial authorities have encouraged state-owned small and medium-sized rural financial institutions to extend access across the country, prioritizing villages and towns (CBRC 2010, 47-8). In Turkey the state-owned agricultural bank, Ziraat, has been present in small towns and rural villages for decades and the state-owned Halk (People's) Bank has long serviced tradespersons, cooperatives, and today's SMEs (Marois and Güngen 2013). Likewise, state-owned post office banks, which accept deposits but provide fairly basic financial services, can help offer financial services without the problems associated with microfinance schemes. They provide accessible money transfer services, a safe haven for savings, and banks that can help fund fiscal policy. Examples exist in Benin, Burkina Faso, Gabon, Mauritius, Tanzania and South Africa, including a new state-owned postal bank that opened in the spring of 2013 in the Congo (*Africa Research Bulletin* 2013). Even advanced economies such as the UK and New Zealand have set up postal banks to help deliver banking services to the poor and to rural areas (Hawkins and Mihaljek 2001, 15). Given that a recent UK Department for International Development systematic review concludes that the popular evidence claims of microfinance achievements are built of foundations of sand (Duvendack et al. 2011, 75), there is an urgent need to research other actually existing and viable public sector banking alternatives for financial inclusion.

Myth Seven: State-owned banks put public revenues at risk

> Banks have proved themselves to be the most hazardous economic institutions known to man… It is tempting to conclude that banks should simply be abolished. Unfortunately, that is unlikely to be possible. Banks seem to be necessary. (*The Economist*, May 1, 2003)

All banking activity involves risk of monetary loss since it usually implies lending now in order to be repaid later with interest. This is true for both state and private banks. However, under neoliberalism, an uneven process characterized by the increasing centralization and concentration of banking capital, private banking institutions have become larger and much more volatile. And now when crises strike the risks tend to be paid for (read: socialized) with the public purse: "a now generalized process by which state authorities diffuse the worst and most costly financial risks onto workers in society through the state apparatus" (Marois 2014, 309).

While state-owned banks can put public revenues at risk, so too do private banks but at far greater magnitude (the 2008-09 global crisis comes to mind). An IMF report that preceded the sub-prime crisis lists many dozens of systemic banking crises since the 1970s. Some of these crises involved state-owned banks including, but not limited to, India in 1993, Costa Rica in 1994, Vietnam in 1997, and China in 1998 (Laeven and Valencia 2008, 32-49). Brazil and Turkey also experienced banking crises that implicated their state-owned banks (Marois 2011; von Mettenheim 2010). The 2008 IMF report emphasizes that state-owned banks are "common in crisis countries, with the government owning about 31 per cent of banking assets on average" (while failing to underscore that the other 69 per cent are, of course, private assets) (Laeven and Valencia 2008, 19). The report also downplays that the frequency of banking crises has increased dramatically with neoliberal restructuring and privatization: from 1970 to 1980 there were four banking crises worldwide, but this increased to 120 from 1980 to 2007 (excluding the current crisis and ongoing instability) (Laeven and Valencia 2008, 56). These crises, due disproportionately to private banking, cost the public purse on average 13.3 per cent of GDP to resolve, with authorities, on average, only recovering 18.2 per cent of the socialized costs (Laeven and Valencia 2008, 24). State banks are not without risk, but it is private banking in general and its aggressive profit orientation that are the real threats in a neoliberal era.

As suggested, the US sub-prime crisis and global financial meltdown is a case in point (McNally 2011). Some estimates put the overall cost of the crisis, including lost output, at nearly $13 trillion (Khimm 2012). The hardest hit countries are the advanced economies of the US and UK (followed by Iceland and then Italy, Portugal, Ireland, Greece and Spain), which are dominated by private banks. Robin Blackburn (2011, 35) writes:

> The banks' heedless pursuit of short-term advantage led to the largest destruction of value in world history during the Crash of 2008. Government rescue measures were to offer unlimited liquidity to the financial sector, while leaving the system largely intact.

Even the Governor of the Bank of England, Mervyn King, was to recognize this in a 2011 address to British MPs, "[t]he price of this financial crisis is being borne by people who absolutely did not cause it" (Inman 2011). The increasingly popular phrase 'privatizing profits, socializing risks' comes to mind. It is pure ideology to suggest public banks are inherently more risky (or corrupt) than private banks (Lapavitsas 2010, 194). Rather, in the context of this global crisis, many state-owned banks have been more stable and far less risky.

Myth Eight: State banks are bad for development

In a recent review of the global financial sector the World Bank (2012a, 101) argues: "The empirical evidence largely suggests that government bank ownership is associated with lower levels of financial development and slower economic growth. Policy makers need to avoid the inefficiencies associated with government bank ownership." This view seems to be upheld irrespective of the recent global failure of private banks, though some official revisionism on their potential benefits amidst systemic crisis has emerged (Demirgüç-Kunt and Servén 2010; *cf*. Bertay et al. 2014).

Outside neoliberal circles the "evidence that the prevalence of state ownership in the banking sector conspires against its ultimate development… appears to be weaker than suggested by previous studies" (Levy Yeyati et al. 2007, 237-238). Case studies on India and Turkey, for example, both found that state-owned banks are the more efficient banks (Aysan and Ceyhan 2010; Bhattacharyya et al. 1997; Kök and Ay 2013). More to the point, many of the highest growth emerging economies over the last decade have among the highest levels of state bank ownership (e.g. Brazil, Russia, India, China and Turkey). By contrast, the archetypes of modern liberalized private finance, the US and UK, have been mired in crises and economic stagnation. This is not to suggest that state-owned banks are a cure-all for economic woes but simply to dispel the myth that they *necessarily* lead to underdevelopment and therefore should be privatized with all possible haste.

There are further reasons why state-owned banks may in fact be quite good for financing development. These include countercyclical lending at times of crisis; support for the public sector and public infrastructure; and serving as countervailing force against the power of global finance.

Countercyclical lending

In times of crisis, private banks tend to withdraw lending to reduce risks and protect profits (deleveraging), thereby worsening the crisis. That is, private banks are *pro-cyclical*. By contrast, state-owned banks are able to and often do lend *counter-cyclically* during a crisis (Hawkins and Mihaljek 2001, 15). A recent empirical study of 764 major banks from 50 countries (wherein 63 were state-owned) finds that state-owned banks effectively compensate for private banks' reticence to lend amidst crises (Brei and Schclarek 2013). Even the World Bank has had to begrudgingly accept this, as the private banks withdrew credits during the global financial crisis and the state-owned banks stepped in to offset the impact (World Bank 2012a, 102; Bertay et al 2014). A country's state-owned banks can also facilitate counter-cyclical trends through their holdings of Treasury bonds (i.e. financing the government), which tend to be more stable than when the private sector holds public debts (von Mettenheim 2010, 51). This helps hold down public debt costs and extend the terms of lending. Even a Federal Reserve Bank of Boston report recognizes that, while not without complications, owning a state bank can be useful for public policy, especially when economic downturns, instability and budget shortfalls arise (Kodrzycki and Elmatad 2011, 18). That state-owned banks can effectively lend in difficult times has gone a long way to reviving support for them in development circles.

Stable long-term support
State banks have the advantage of being able to provide stable, long-term financing – without the immediate short-term profit imperatives that private, corporatized banks must face – by drawing the investment risks into the public sphere. As such, state-owned banks can provide longer-term credits to fund infrastructure and investment than private banks (as in the East Asian developmental state examples, see Erdogdu 2004). At the same time, state banks can provide a powerful fiscal advantage by making use of the fractional reserve system (i.e. lending over and above the actual cash reserves held by roughly 10 fold) (von Mettenheim 2010, 11; 21-22). Put otherwise, state-owned banks can help realize public financing of development strategies at 10 per cent of the fiscal cost compared to direct funding. A few examples can help to illustrate.

The 100 per cent state-owned *Banco de Costa Rica* (BCR) is the most profitable of the country's three state-owned banks (BCR 2011). The BCR mission statement is to promote "social development, competitiveness and sustainability by offering customers a public financing conglomerate with innovative and excellent services." The BCR has an explicit social responsibility policy and actively funds projects of national economic interest. For example, its current projects include the Garabita Thermical for electricity generation, a hydroelectric station, and other large infrastructure projects. Together with the two other state-owned banks, the *Banco Nacional de Costa Rica* (BNCR) and the *Banco Crédito Agrícola de Cartago* (Bancrédito), they also offer a safe haven for domestic deposits and mobilize their domestic savings-based funding for the public good. In 2008 the government mobilized the state-owned banks towards more explicit developmental goals through the Law to Create a System of Banks for Development (No. 8634). The Law requires the state-owned banks to dedicate resources to a 'mega fund' for sustainable finance. Bancrédito is charged with administering this fund, which collectively supports state fiscal and developmental policy. Development in this case is posed more in the public good and as part of a larger, stable economic trajectory.

In the United States, much has been made since the 2008-09 crisis about the Bank of North Dakota (BND, established in 1919), the only US state with a public bank. The BND emerged in response to the monopoly power of large turn-of-the-century financial institutions in the US and was mandated to provide affordable credit for local farmers, ranchers and businesses (Kodrzycki and Elmatad 2011, 4-5; also see www.publicbankinginstitute.org). The BND continues to service these sectors, but it is also integrated into North Dakota's public sector and provides certain services. The BND assets are backed by the state and authorities are required to deposit all public revenues in the bank. About two-thirds of the bank's earnings, in turn, flow back into the state contributing about 0.75 per cent of revenue (Kodrzycki and Elmatad 2011, 9). The state's legislature guides the BND on important budget decisions like salaries, employee numbers, major projects, and so on. The bank's public orientation thus includes offering low-interest student loans, supporting public policy, and periodically helping to fund local governments by purchasing municipal bonds. The BND has even been mobilized to provide emergency support to the community in the aftermath of natural disasters (for example, during a flood in 1997). As the sub-prime crisis was unfolding in the US, the BND increased loans and offered letters of credit to local banks to support liquidity from 2007 to 2009 (Kodrzycki and Elmatad 2011, 4). In this case, the BND forms a stable financial bedrock that supports a range of economic services and protections that would be otherwise unavailable.

In India the National Bank for Agriculture and Rural Development (NABARD, established in 1979) is a fully state-owned development bank mandated to facilitate credits for agricultural and rural development and to support related rural economic activities (World Bank 2012b). With assets of around $23 billion in 2009, the NABARD has also established a nationwide presence (28 regional offices). The NABARD has an intermediary role helping to finance other smaller lending institutions in rural areas while assuming a public regulatory role over client banks and other cooperative banks (www.nabard.org). The NABARD also supports public infrastructure investment and collaborates with other government agencies in the planning of rural development. Some of NABARD's infrastructure projects since 2011 include: managing the Rural Infrastructure Development Fund (which targets irrigation, rural roads and bridges, health and education, soil conservation, drinking water schemes, flood protection, and forest management projects); establishing the new Infrastructure Development Assistance credit program; and managing the Watershed Development Fund. NABARD provides these major initiatives with the long-term stable financing they require to push forward with developmental initiatives. The NABARB, of course, is far from perfect and, ironically (in neoliberal terms), its least progressive role has to do with its promotion of microfinance in India, which has been heavily criticised for its exploitative, poorly managed, and unrealistic developmental ambitions (Morgan and Olsen 2011).

In Brazil the federal state-owned banks have helped to fund public policy as well. Lending to the federal government (excluding other state-owned enterprises) reached more than BRL $8 billion as the global crisis spread in 2008-09. Lending to state and municipal governments has averaged about R$10 billion per year since 2008 (von Mettenheim 2010, 34-37). Historically, the state-owned commercial bank, Caixa Economica, provided infrastructure support (water, sewer, transportation) for municipalities (von Mettenheim 2010, 128-130). The better known public development bank, *Banco Nacional de Desenvolvimento Econômico e Social* (BNDES), is the federal government's principal instrument for investment policy and the distribution of long-term financing (World Bank 2012b). As a development bank, it does not accept public deposits but draws resources from government pension funds and official savings funds. For this reason, BNDES has access to a low-cost funding base that in turn enables BNDES to offer below-market interest rates for agriculture, construction, industry, services, mining, infrastructure, energy, as well as to other SOEs (von Mettenheim 2014).

In China, the state-owned banks are at the heart of financing infrastructure and development (debt from capital markets is comparatively small). As in many emerging economies, domestic deposits provide the chief source of bank capital (about 70 per cent of resources). The government finances development both directly and indirectly. For the direct funding of infrastructure, the China Development Bank (large projects) and the Agricultural Development Bank of China (agricultural and rural projects) have been especially important (CBRC 2010, 33; Chiu and Lewis 2006, 202). The China Development Bank, for example, provided the long-term capital for both the massive Three Gorges hydroelectric project and China's new high-speed railway system (Martin 2012, 17). In 2010 alone it lent over $66 billion to develop coal, electricity, oil, telecommunications, transportation and public infrastructure. The China Banking Regulatory Commission (CBRC) can also help direct credit regionally for development purposes. For example, in 2010 the CBRC directed SOB resources to the western region of China to mitigate risks and promote development (CBRC 2010, 46). Authorities also employ indirect policy measures to finance development (Chiu and Lewis 2006, 203-204). Indirect funding policy tools include managing the exchange rate, setting growth targets for the money supply, and using differential reserve requirement ratios (RRRs) to help channel funds into preferential sectors (Turner et al. 2012). The government uses these indirect mechanisms, among other reasons, to direct large credits towards the SOEs and state infrastructure projects. The fact that ownership and control remains largely in the hands of government authorities also means that these policy tools (direct and indirect) are more effective in their implementation and can be rolled out for the long term. To be sure, here (as in most banks, public and private) the lack of democratic accountability is a serious matter around which social forces need to act.

Countervailing political force

Political battles for control over a country's money, financing, and debt have figured prominently in many struggles for national liberation, revolution and development. In the case of Portugal's 1975 popular uprising, for example, the law legalizing bank nationalization was deemed the "most revolutionary law ever approved" against fascism (Noronha 2013). The nature and outcomes of such social struggles, of course, vary considerably. However, most share some collective goal of achieving greater domestic and popular political autonomy by minimizing the power of private financial capital. Some of the most famous cases include the Russian, Chinese and Cuban revolutions (see, respectively, Lenin 1917; Chiu and Lewis 2006; Central Bank of Cuba at www.bc.gob.cu). Lesser known, but likewise inspired, struggles were seen in Costa Rica (1948) and Vietnam (see Brenes 1990; Spoor 1987). Such examples are not relegated to history, however.

Venezuela offers a different portrait of a society actively seeking to craft an alternative banking system, albeit within the constraints of neoliberalism. In 2001 Venezuela created a new development bank, the *Banco de Desarrollo Económico y Social de Venezuela* (Bandes) to help finance public sector entities, support infrastructure building, and offer technical advice with the goal of creating more equitable regional development (World Bank 2012b). The government has also increased state-owned commercial bank assets from under 12 per cent in 2008 to over 33 per cent in 2010. This began with the Hugo Chavez administration's nationalization of the Bank of Venezuela on July 31, 2008. The political intent was to subordinate the bank's operations to national developmental strategies and to strengthen the Bolivarian revolutionary process by bolstering domestic monetary capacity and the public financial sector, simultaneously weakening the power of foreign financial capital. Subsequently, a corruption scandal among private bankers in late 2008 led to the failure, liquidation and state takeover of eight other smaller banks. Four of these were merged into the state-owned *Banco de Fomento Regional Los Andes* (Banfoandes) to craft a new powerful public investment bank, the *Banco Bicentenario* (controlling about 20 per cent of deposits).[2] The bank supports alternative productive processes and, in particular, more accessible housing credits. The state-owned banks also fund the central government budgeting process by purchasing state bonds and, by institutionalized mandates, lend to the public sector. The Venezuelan example is significant because it illustrates the importance of political will for an alternative vision of development. Social and political forces understand the government's move into banking as necessary to mitigate the power of financial capital in Venezuela and as a way to mobilize domestic resources for the Bolivarian social developmental process. This process is not without complications and contradictions, but the importance of gaining control over domestic monetary resources as a means of increasing national autonomy should not be underestimated.

The newly minted New Development Bank, or so-called BRICS Bank, is the most recent political initiative to create a multilateral state-owned development bank by the member countries (Brazil, Russia, India, China and South Africa). This move is perhaps unsurprising given these societies' historic capacity with state banking and their controversial experiences with the IFIs. BRICS members ostensibly envision this new development bank as a potential counterforce the power of IFIs like the World Bank and foreign financial capital by supporting local infrastructure and sustainable development, trade and financial stability among developing economies. The formal Inter-Governmental Agreement to establish the NDB was signed in July at the Sixth BRICS Summit in Fortelaza, Brazil. The Agreement dedicated some $50 billion in start-up capital, which may increase to $100

[2] See http://www.bicentenariobu.com/index.php

billion. That developing countries can band together to press back against the neoliberal hegemony of the Bretton Woods institutions and advanced capitalisms is significant. Yet, as critical observers recognize, there is a pressing need to ensure the NDB remains beholden to the social development needs of the many, as opposed to corporate profitability imperatives in these countries, through processes of real democratization of banking and credit (Bond 2014).

Conclusion

Neoliberal mythology universally portrays state-owned banks as bad for development, unmediated by history, circumstance, or popular democratic aspirations. Privatization is sold as the only true improvement. But when this proves unworkable in reality, IFIs and neoliberal advocates push for market-oriented restructuring in attempts to make state-owned banks operate as if they were private, profit-maximizing institutions. Both strategies have been successful in neoliberal terms, as state bank numbers have fallen and state-owned banks have been corporatized.

Yet important state-owned banks remain in operation globally. Contrary to neoliberal mythology, there exists remarkable diversity as well, as each state bank is an institutional crystallization of historical and contemporary social relationships of political, economic, and class relationships of power. Understood in this way there are no *necessarily* good or bad state-owned banks. Individual state banks must be assessed according to criteria relevant and valid for each particular case, while accounting for overarching structural forces such as neoliberalism and global capitalism. By jettisoning the *a priori* and negative hypotheses of neoclassical economics we can recognize that there is much to commend in state-owned banks as potential and real progressive alternatives to privatization and neoliberalism. Not least among these reasons is because state banks, unlike private banks, can be potentially released from profit imperatives and directed to serve the public good – given the political will to do so. Saying this does not gloss over the problems state-owned banks face, but it does suggest that societies can address such challenges democratically and with an open view to the role people and state institutions can play in determining the collective nature of finance. This is perhaps one of the most promising new research programmes today, in large part opened up by the ongoing impact of the 2008-09 global financial crisis.

The stakes could not be higher. Unlike any other sector of the economy, banking and finance are key to all modern forms of development, capitalist or socialist. Non-private and democratized financial coordination capacity must figure prominently in the pursuit of any alternative social developmental strategy (for strategies of innovation and defence, see Marois and Güngen 2013). More to the point, there is no hope of creating a structural alternative to neoliberalism without first asserting democratic control over society's money resources. At this particular conjuncture, democratized state-owned banks offer the most viable alternative.

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