

5-7-1990

Banking Reform and the Resumption of Sustained Growth

Hyman P. Minsky Ph.D.

Follow this and additional works at: https://digitalcommons.bard.edu/hm_archive

 Part of the [Macroeconomics Commons](#)

Recommended Citation

Minsky, Hyman P. Ph.D., "Banking Reform and the Resumption of Sustained Growth" (1990). *Hyman P. Minsky Archive*. 97.

https://digitalcommons.bard.edu/hm_archive/97

This Open Access is brought to you for free and open access by the Levy Economics Institute of Bard College at Bard Digital Commons. It has been accepted for inclusion in Hyman P. Minsky Archive by an authorized administrator of Bard Digital Commons. For more information, please contact digitalcommons@bard.edu.

Francesco Baez
El Nacional
Mexico City, Mexico
Fax # Mexico City 592 - 02 - 63

52-5
592-02-63
Sent 12:25
PM 5/7/90

BANKING REFORM AND THE RESUMPTION OF SUSTAINED GROWTH

Hyman P. Minsky
Professor of Economics
Washington University
St. Louis, U.S.A.

The proposal to privatize the publicly owned banks in Mexico should be the beginning of, not the end of, the debate on the nature of the financial system that will advance Mexico's transformation from its present semi-industrialized state to being a fully industrialized economy. Throughout the world much of public policy discussion is now guided by the simplistic view "public bad, private good". In truth in market economies public is not always bad and private is not always good.

There are a wealth of examples in history and in recent experience where private firms, banks and markets were inefficient and corrupt and where public intervention and even ownership was necessary to prevent conditions conducive

to a big depression or run away inflation from emerging. Private behavior can destabilize the economy and public intervention may be necessary to stabilize the unstable private economy. The success that market economies have enjoyed since World War II have been due to appropriate government interventions rather than to the workings of the pure market economy.

In 1982 the Mexican banks were nationalized in order to contain the effects on the domestic economy of the international run on the peso. The situation that forced the nationalization developed when the banks were private.

Because inept policy can make an initial bad situation worse economic policy must be reflect a theory of capitalist economies in which the behavior of units that are guided solely by their own self interest may lead to system wide debacles. This is why the economic theory that is critical of the simple minded assertion "public bad, private good" needs to be the basis for economic policy. The fairy tales of orthodox economic theory must be taken with the proverbial grain of salt.

John F. Kennedy said that a rising tide lifts all boats. Economic expansion should be like a rising tide and benefit all, not just a few. All too often the banking and financial system is an instrument that promotes inequality so that the benefits from economic expansion accrue to a

few, not all. However, as was shown in the early post war United States and in much of Europe even now, a wide distribution of the benefits of growth can be achieved. For such growth to occur a wide access to finance needs to be part of the system. Not only must the institutions of the financial structure be hospitable to small deposits but they must also make financial resources available for smaller and independent enterprises.

A wide spectrum of institutional forms is available to choose from in designing a financial structure. A system can be highly centralized with a few large commercial and investment banks dominating the economy or it can be decentralized with a multiplicity of competing banks and non bank financial institutions. A financial system can be based upon institutions or it can be based upon markets. The banks can be universal and have a wide variety of instruments in their portfolio or they can have their portfolios restricted to a few types of instruments.

Given the options available the policy choices in building institutions are not easy. However some things can be ruled out early in the discussion. A highly centralized system with a few big banks is not desirable if the aim is to achieve a wide distribution of wealth and a multiplicity of independent economic agents.

It is natural for big banks to service big customers: Big banks are complementary to centralized and monopolized economies. A bank's target customer is determined by the size of loans it can make, which in turn depends mainly upon its capital. If we take the United States rule of thumb that a bank can lend no more than 10% of its capital and surplus to any single client, then if the preferred customers of a banking system are to be smaller businesses then the banking system needs to be made up of a multitude of banks.

The nationalized Mexican banking system is highly concentrated. The top two banks have 50% of the banking business and the top 3 share 67%. Privatizing the banks under these circumstances is a grant of market power - of monopoly power - to these great banks.

Before privatizing the banking system a debate should take place on whether Mexico should be burdened with a monopolized private banking structure, where the banking system will be biased towards the financing of large scale business and where the competitive pressures upon banks will be weak. "Will such a banking system facilitate a quick replay of the Mexican debacle of 1982?" is a question that should be addressed in this debate. As a minimum the options that should be considered are whether it would be best if the three largest banks remain nationalized or be privatized as they now are, be broken up into independent

units, none of which will control more than 10% of the banking business, and then privatized or be broken into these more manageable units and remain nationalized.

Furthermore before the banking system is privatized the "Central bank" that will control the regulate the banks needs to be spelled out. If the new international banking rules, by which the capital of banks and the capital absorption ratios of the different assets control the size of banks, are to apply to Mexico then the valuation of assets becomes a major determinant of the availability of credit through the banking system. The regulations and the regulatory agencies that need be part of any privatization move need to spell out and enforce the way asset values are determined for regulatory purposes. This requires sophisticated abilities at the Central bank.

Mexico is diversified geographically, in income levels, and in industry. Reform and reconstruction of the financial system should be guided by a view that one set of institutions one structure will not do for all places and all times. Thus a system of decentralized banks and non bank financial institutions that are decentralized so that local, regional and national institutions coexist is desirable for a country such as Mexico. A banking law which allows entry to small and medium banks "de nova" may well be a desirable prelude to privatization of the banks.

Mexico's stock market and non institutionalized market for private bonds are thin. This implies that private units cannot raise much in the way of external funds through the stock and bond market. One way to improve the availability of external finance in an economy with a thin capital market is to follow the German pattern and have universal banks. Another way is to follow the Italian pattern and have public holding companies, public organizations that buy and hold equities and long term debts of companies. These public holding companies finance their activities and positions either with grants from the treasury or by the sale of their own government guaranteed bonds through the capital markets. With public holding companies individual enterprises are managed like widely held private corporations. An economy with public holding companies has been characterized as combining private profit oriented management with the responsibility to the national interest that public ownership implies.

It more than likely was not a mistake to nationalize the banks during the crisis of 1982. It was a mistake to concentrate the banking system in the years following the nationalization. It would have been much better to have decentralized and divided the banks while they were nationalized regardless of whether the policy aim was the eventual privatization of the banking system or the development of an efficient system of nationalized banks.