

# Chapter 4

## State-Owned Banks and Development: Dispelling Mainstream Myths

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### ABSTRACT

*Thirty years of neoliberal restructuring have side-lined alternative financing practices, and propagated mainstream myths about state-owned banks. This chapter examines these neoliberal claims, arguing instead that state-owned banks can remain a crucial part of progressive, sustainable and democratic strategies for investments in long-term development and infrastructure. Drawing on past and present case studies, as well as the theoretical literature on finance, the chapter points to the potential to revive – and improve – state-owned banking as a viable option for financing public services and development. To this end the chapter dispels nine popular neoliberal claims about state-owned banks while discussing how state-owned banks have undergone neoliberal restructuring processes such as marketization and corporatization in ways that nonetheless challenge their status as ‘public’ banks. To illustrate, the chapter looks at imperfect, but telling or inspiring, examples from Brazil, China, Costa Rica, India, South Africa, Turkey and Venezuela, among others.*

### 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, p. 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

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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 15<sup>th</sup> century Genoa (which came to be known as the Bank of Venice and functioned for over two centuries (Brown, 2013, pp. 100-3). Later examples include 18<sup>th</sup> 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) (Rapaport, 1996).

To be sure, it was not until 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 & Güngen, 2013). Through the 20<sup>th</sup> 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 (Erdoğan, 2004, p. 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, p. 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 dispel 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

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