Theoretical and Institutional Aspects: A proposal for a conceptual delimitation of public banks

Introduction

In the 1950s and 1960s, in a political and economic scenario still heavily influenced by the so-called "Keynesian consensus", many economists advocated the direct role of the state in the banking systems, a view often shared by policymakers. The result of this position was that, in the 1970s, in industrialized countries, 50% of the assets of the largest banks were state-owned and, in developing countries, this share reached 70% (Yeyati; Micco; Panizza, 2006).

In the following decades, there was a drastic change in the view on the state's role in the economy within the scope of the new neoliberal policies codified in the Washington Consensus, which led to a widespread process of privatizations. According to a study published by the BIS (Jeanneau, 2007), these privatizations resulted from a growing perception on the part of governments that the state's significant role in financial institutions was tending to hinder, rather than stimulate, their financial development. However, despite the widespread privatization process observed in the 1990s, 25% of the largest banks' assets in industrialized countries were still under state control, whereas in developing countries this share remained at 50% (Yeyati; Micco; Panizza, 2006). As to peripheral economies, in 2004, the share of public financial institutions in the total of credit operations was of 11% in Latin American countries, 71% in India and China, 31% in other Asian countries, and 10% in Central Europe (Jeanneau, 2007).

Data provided by Novaes (2007) for the period 1998-2004 show that, except for Asian countries, there was a world trend of reduction or, at least, stabilization in the share of state-owned banks'[1] assets over the total of bank assets throughout those years. In this author's view, this downturn mirrored the great privatization wave of the 1980s and 1990s, which was in tune with a widespread perception that public financial institutions perform poorly, with systematically lower indicators than those for private banks (Novaes, 2007).

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[1] In this case, a bank is defined as a state-owned bank when the government holds 50% plus one share of the voting stock.

However, in 2008 and 2009, in the face of an intense crisis in the financial systems of most countries in the world, the debate on the role of public banks was revived to some extent, and one can perceive a relative inflection in the view on the role they are to play. On the one hand, the statization of major private financial institutions in countries with mature financial systems, such as the United States and the United Kingdom, was included on the agenda. On the other hand, the way public financial institutions acted to confront and minimize the crisis' damaging effects, as they did in Brazil, drew attention to a new vector of action for these entities. Concurrently, the unquestionable leading role private institutions played to create the extremely fragile financial environment that ended up in crisis stimulated the development of new proposals of action for public institutions (Lapavitsas, 2009).

A large part of the literature surveyed understands that the role to be played by these institutions is coupled to the perception of a certain immaturity, or incompleteness, in the development of banking systems and markets. In this sense, public financial institutions are justified as a way of bridging the gaps left behind by the private sector in the provision of credit to some economic segments and/or geographical areas, and even in the provision of some types of financial services. We call this perspective of analysis "conventional view", and consider it extremely narrow.

In contrast, we believe that these institutions can, and must, play an important role even in economies with a highly developed private sector, that is, in economies with "mature" financial systems. And this either with regard to addressing segments not serviced by the private sector – but that may be relevant for the local, sector or national economy – or with regard to contributing to implement a financial policy. Thus, besides this more "isolated" action, which we see as an action performed not only to minimize market failures and gaps, but also to create non-existent markets, public institutions can, and often must, act in other spheres. Among these, some can be highlighted straight away: a) competition regulation in markets where public institutions operate and creation of new markets, b) anticyclical performance to avoid the development of a highly fragile system (in the Minskyan sense), but especially in moments of great fragility in financial systems, establishing an informal safety net and/or guaranteeing the maintenance of credit operations.

The purpose of this study is to reflect on the ideas that permeate the conceptual debate on the role of public financial institutions. Thus, the question underlying this article and guiding the literature review concerns the need for the presence of these institutions in the economies "in general" – that is, (central or peripheral) economies with different characteristics – and concurrently relates to the insertion and performance profiles of such institutions. In this sense, we must emphasize at once the limits of a reflection on the role of these institutions "in general", that is, a reflection that does not take into account the historical moment, the institutional framework, or the economic and financial structure in which such institutions perform. Indeed, this role cannot be separated from the institutionality that exists in each of the financial systems, especially concerning their form, development, and regulatory framework. Moreover, one must consider the origins, structure, governance, logic of action, and regulation to which public financial institutions are subject. Ignoring these specificities impoverishes the theoretical exercise of reflection and even detaches it from reality, at least from specific realities. With regard to Brazil, for instance, if we take as reference the institutionality and performance of state-owned banks in the second half of the 1990s and especially in the 2000s, the argumentation advanced by critics and even by some supporters of these institutions becomes outdated, perhaps because it is marked by the institutionality and governance structure that were in force in the past. To this difficulty, one must add the frequently explicit ideologization of arguments, which makes of this discussion a far from trivial exercise.

As already stressed, the role actually played by public financial institutions, and even the role they could play, is the leitmotif of the analysis proposed here, and we try to conduct it based on the understanding of a whole set of characteristics found in capitalist economies in general, taking as central the concepts of uncertainty and instability. Following this introduction, the first section will be marked by a brief review of the diagnosis of public banks produced over the 1990s and 2000s by multilateral institutions such as the World Bank (WB), the International Monetary Fund (IMF), and the Inter-American Development Bank (IADB). In Section 2, we will discuss different views on the role of public banks, all focused mainly on the credit market, and aware of the problem of resource allocation. In this sense, we will present what we have called here conventional view, which is guided by the concepts of market failure and generation of externalities, and also what we call non-conventional view, marked by the perception that there are gaps in credit markets that may bring problems to crucial decision-making, especially on investments. The subject of analysis in Section 3 will be a discussion on the broader role to be played by the institutions under study, based on a post-Keynesian approach. To conclude, we will make our final remarks.

1. Public banks and the diagnosis made by multilateral institutions

A significant part of the available literature on public banks was produced, especially by multilateral institutions such as the World Bank (WB), the International Monetary Fund (IMF) and the Inter-American Development Bank (IADB), over the 1990s and 2000s. According to Marston and Narain (2005), the IMF's concern would be justified by the persisting perception of these banks as inefficient and, consequently, true fiscal "drags".

> "*In the course of their country work, the staff of the International Monetary Fund (IMF) regularly faces issues of how state-owned financial institutions should be dealt with, given the overwhelming perception of theses institutions as being inefficient and a fiscal drag.*" (p.51)

In this sense, as previously stressed, it is worth remembering that the 1990s and 2000s were marked by the dissemination and consolidation of a very negative view on these banks' role. This assessment, together with the finding that these institutions still play an important part in the financial systems of several countries – central and peripheral, despite the wide-ranging privatization process implemented –, is at the basis of the debate on the need to reappraise the state's role in the ownership of financial institutions held by the multilateral institutions being considered. This pervasive need was supported by the evidence of the financial institutions' inadequate performance, measured by the microeconomic financial coefficients of profitability and efficiency, especially when compared with the results achieved by private banks.[2] It is worth emphasizing that this poor performance was seen as one of the roots of the slow and feeble rhythm of economic development (Caprio et al., 2005; Hanson, 2005). In Hanson's words,

> "*State-owned banks have often high nonperforming assets and high costs and make only a limited contribution to development.*" (2005, p.13)

This causality would derive from the fact that public banks do not follow the private rationale in credit allocation decisions, which, from the institution's point of view, would always indicate worse results in efficiency and profitability, since

> "*This difference means that unless private banks really do not recognize the loans with the best return-risk characteristics, public sector banks will do worse*

[2] Among them would be the profitability index of assets, net property and default. In addition to these coefficients, higher spreads were observed as a result of increasing costs, including the provisioning costs derived from a larger number of overdue loans.

> *than private banks. In fact, the results of credit allocation by public sector banks seem worse, not better than those of private banks. In particular, their nonperforming loans are generally higher and profits are lower.*" (Hanson, 2004, p.21)

And it would imply the inefficient use of public banks' resources, given that

> "*… the state-owned banks' credit is not sufficiently productive to service the loan and that alternative uses of the credit would be productive.*" (p. 21)

Finally, still according to Hanson, this low efficiency of public bank loans would give rise to banking crises and produce a weaker macroeconomic growth.

Moreover, there was a questioning of the thesis that a more comprehensive assessment of these institutions' performance, considering their social mission – such as guaranteeing access to the bank system to a larger portion of the population or greater benefits to the whole economy –, would point to more adequate results, but it has been eventually "defeated". The explanation of this view would rest on different causes. The first would be that these banks tend to concentrate loans in the public sector rather than in the private sector. The second would relate to the fact that the scarce loan operations in the private sector concentrate mostly on large borrowers, for whom the social return does not exceed private gains (Hanson, 2004).

A great deal of criticism derived from this diagnosis has been leveled at these institutions' performance, and some more specific issues can be stressed, among them that such institutions i) tend to roll over loans in difficult times, which conceals really insignificant results; ii) are less capitalized; iii) receive government subsidies that not always are explicit.

The opinion of several authors about the importance of these institutions is quite clear, as already mentioned. They state that, from an economic point of view, given the poor performance observed in various countries and its perceived association with precarious economic development, the best solution would be privatization, since it allows for lower government expenditures and improved economic performance. These improvements would result from credit allocation based on private decisions and regulated by the logic of market agents, rather than that of bureaucrats.

However, despite their unquestionable defense of privatization, these authors seem skeptical about the actual possibility of extinguishing public banks. Somehow the arguments they advance to justify such perception bring them close to the reading of authors of the so-called political view (to be discussed in the next section), since they believe that there is a wide range of interests involved in the permanence of public banks, as can be gathered from the following passage:

> "*Where they exist, state-owned banks still have powerful constituencies: their borrowers, their managers, and of course, many officials in government who still see the institutions as an 'off-the-books' way to allocate capital toward uses believed to enhance economic growth (despite overwhelming evidence to the contrary presented here and elsewhere in the literature).*" (Caprio et al, 2005)

In this sense, they mention initiatives that could lead to a second best solution and stress that public institutions need to be subject to the same regulatory and supervision framework as the private ones, as well as to codes of good conduct.

Indeed, reading these works makes explicit that such assessment is attached to a quite clear world-view: private decisions based on the logic of the market are by definition more adequate than those guided by other objectives; state intervention in the functioning of markets, in its possible different forms, is both inappropriate and a source of problems. This reasoning and the conclusions derived from it seem rooted in the preconception that public property and the performance rationale it engenders are inferior to the private performance rationale. Thus, the analysis suffers from a "vice of origin": if it is public, it is inferior to the private one – by definition. Besides, analyses and conclusions become even more influenced by that other problem raised in the beginning of this paper, that is, the generalization of the type and form public financial institutions assume, as well as of the environment in which they perform. In other words, most of the assessments mentioned above get through generalist interpretations of the role of financial institutions in different countries and systems, often without considering the institutional environment in which they perform.

2. Public banks and resource allocation in credit markets

In several moments over the past decades, the question of public financial institutions was discussed in academic circles, among policymakers, and even by the society in general. During this debate, it is observed that the lines of argumentation were built focusing primarily on the role these institutions play in the credit market and, more specifically, in mechanisms and decisions related to credit allocation. A more accurate look at almost all these arguments makes evident that the debate was largely based on the concept of market imperfections – in this particular case, of credit market imperfections –, which eventually resulted in an opposition between the concepts of "market failures" and "government failures". In other words, one the one hand, the advocates of the presence of public financial institutions understood their intervention as necessary to allocate credit to those economic sectors and/or segments that, otherwise, would not be served. On the other hand, the critics of these institutions tied their analyses and conclusions to the concept of government failures, arguing that the existence of public banks that allocate credit to sectors the market is not serving satisfactorily, would result in distortions and even higher costs for the economic system.

However, it is important to emphasize that the perception of the existence of gaps in the credit allocation process is also present in authors who do not build on the concept of perfect markets. When constructing their arguments, they refer to the need for intervening in credit markets, especially in contexts in which the private sector cannot guarantee adequate mechanisms to finance spending decisions, mainly on investments, which are crucial for generating income and employment in capitalist economies[3].

In view of that, this section is organized as follows. First, we will present different lines of argumentation based on the perception of "market failures" and the presence of externalities, referring to a world-view in which the central issue is the best allocation for scarce resources – we call it conventional view. Next, we will discuss arguments that, building on the idea that it is important to guarantee financing for some spending categories, somehow see the state's presence in credit markets as necessary.

2.1 Market imperfections and public banks

Some of the conventional arguments highlighted above are classic and will be discussed next. It is worth underlining that the leitmotif of this discussion is not historical time, that is, the moment in time in which such arguments were brought forward, but the polarity between those who defend and those who attack the direct presence of the state – as owner – in the banking sector. However, before entering into this discussion, we make some remarks on the more general rationale of state intervention in financial markets, derived from this conventional approach – that is, from the neoclassical thought, centered on ideas of market perfection/imperfection and, in some cases, of generation of externalities.[4]

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[3] According to Minsky et al (1996), "*When market forces fail to provide a service that is needed and potentially profitable, then there is an appropriate role for government to help to create a market*" (p. 385).

[4] For this purpose, it should be clear that direct intervention, through totally or partially state-owned banks, is only one of the possible forms of state intervention in these markets.

Yeyati, Micco and Panizza (2007) try to partition the set of ideas underlying the more general rationale of intervention in financial markets, especially in banking. A first group of ideas points to the need for intervention to guarantee the soundness and safety of the financial system, given the inherent fragility of financial institutions, particularly of banks. The first vector of this fragility would be the problem of maturity transformation, since financial institutions raise funds in the short run and maintain illiquid and long-term assets. However, besides the issue of maturity transformation, these authors stress another characteristic inherent to banking institutions that makes the functioning of this market generates negative externalities – such as bank runs and bankruptcy – that demand intervention. As institutions with high leverage ratios, banks tend to adopt a less conservative behavior than that expected by depositors, demanding intervention from outside the market. The logic underlying this set of ideas is that found in the justification for prudential regulation, that is, for a regulation aiming at guaranteeing soundness and trust in the banking system. We emphasize that the central point of this argumentation is that some special characteristics of banking institutions generate important negative externalities when these institutions operate jointly in the market, justifying state intervention.

The second group of arguments stresses the need for intervention as a way of reducing market imperfections derived from costly and asymmetric information, especially in the banking business, which carries out information-intensive operations. This asymmetry is present both in the relationship between credit suppliers and demanders, which can lead to credit rationing, and in operations between depositors and deposit-collecting institutions. In this context, asymmetric information defines market as imperfect and the results obtained as not optimal in terms of price and quantity.

A third set of ideas that seek to explain the state intervention rationale is based on the possibility of financing socially relevant projects, in view of the fact that they produce positive externalities, but are not financially profitable. In this case, the market would not be an appropriate mechanism to allocate resources, because “private lenders may have limited incentive to finance projects that produce externalities” (Yeyati, Micco e Panizza, 2007, p.9). Alongside this argument is also the perception that private banks may operate to frustrate expansionary and/or anticyclical monetary policies, regarding either volumes negotiated or prices charged, since they do not internalize the fact that, responding positively to such policies, they would contribute to push the economy out of an undesirable trajectory. In these cases, the state intervention would solve the coordination problem and make the expansionary monetary policy more effective.

Finally, the fourth group of arguments for intervention is tied to the need to promote financial development and provide competitive banking services to agents (bank clients) who are not interesting from the private capital's point of view. The advocates of this form of intervention argue that guaranteeing access to banking services may lead to financial development with positive externalities for growth and poverty reduction. Another argument is that the presence of public banks may be a means of guaranteeing competitive behavior in otherwise collusive markets.[5]

A question that arises from the arguments listed above – which, at different levels, justify the need for intervention – is related to the form an intervention may assume. The total or partial ownership of banking institutions is one of the possible forms, together with prudential regulation, functional regulation – which encourages private banks to operate in sectors or regions that otherwise would not be served either by regulation or even persuasion –, and direct subsidies. However, a careful reading of the arguments discussed above, which justify the intervention rationale, points out that, to a greater or lesser degree, several of them show that the public ownership of institutions is an appropriate form of intervention. In other words, intervention as a share in the capital of financial institutions is a way of minimizing credit market failures and dealing with cases in which externalities are highly significant. It is justified, too, when there are financial underdevelopment and tendency to collusion, situations that might indicate little competitive markets.

A more comprehensive and critical understanding of the nature of this line of argumentation can be found in Chang,

> "*The point here is that, using a purely neoclassical logic, one can justify an enormous range of state intervention... Thus seen, whether a neoclassical economist is an interventionist or not depends more on his/her political preference rather than the 'hard' economics that he/she practices. Therefore, it is important to reject the myth propagated by neoclassical economists that the boundary between 'good' and 'bad'*

[5] From our point of view, the arguments in this group are connected not by a single theoretical basis (which, in more general terms, may be that of the imperfect market), but by the type of intervention discussed here, that is, direct intervention.

> *intervention can be drawn according to some 'scientific' rules.*" (Chang, 2000, p.7)

To resume the discussion initially proposed in this section, we will present next different lines of argumentation concerning the appropriateness of the presence of public financial institutions in the market, given the existence of market failures. The emphasis on certain consequences of their poor performance sets the boundary, as we will see next. However, all arguments are ultimately rooted in the concepts of market failures and generation of externalities as, in some way, all of them work with the perception that it is the public bank's role to allocate credit to sectors and segments the market does not provide for adequately. In this sense, they form what we have called conventional view, for they perceive the activity of public banks from this perspective, which we consider extremely narrow.

The social view emphasizes that the public sector's role, and more specifically the public banks' role, is to compensate for market imperfections that leave "socially profitable" investments without financing (Yeyati; Micco; Panizza, 2004). Therefore, the emphasis is on the deficiency generated by markets that do not finance socially important investments.

In turn, the perception that financial institutions are not capable of performing as development agents in the market is the diagnosis that underlies the development view (La Porta; Lopez-de-Silanes; Shleifer, 2002). This line of argumentation stresses the need for intervention in specific situations that somehow derive from the poor functioning of existing markets or even from the inexistence of such markets, and that may thus represent an obstacle to development. Among these situations it is worth emphasizing scarcity of capital, general public distrust, and endemic fraudulent practices among debtors (Yeyati; Micco; Panizza, 2004). The state's direct role in the ownership of financial institutions enables it to raise resources and allocate them to projects of interest, such as long-term strategic projects, which may mitigate the failures that hinder the functioning of the private stock market. Therefore, projects that are interesting from a social point of view, but not appealing to private capital, or extremely large for the available amount of private capital, could then be financed and contribute to development (LaPorta; Lopez-de-Silanes; Shleifer, 2002). It must be emphasized that, in essence, this line of argumentation is essential to the social view, which somehow bring these two views closer together. The argument in favor of the presence of public financial institutions is that they would facilitate financial and economic development, since they allow for accumulation and productivity increase. A conclusion derived from this line of argumentation is that public banks would be more appropriate to less developed economies, with not so mature systems – marked by the presence of less or little organized financial institutions and markets.

Also focusing on the problem of market failures and generation of externalities in the banking sector, but emphasizing a little different consequence, Rocha (2003) presents another "line of defense" for state-owned financial institutions. Her central argument is that the state's absence in the provision of banking services, besides implying it is little committed to universalizing these services, would determine lower investments in important segments of the production chain, such as infrastructure, research and development. The latter, fundamental to increase productivity, are riskier, since their chances to fail are stronger, and this might indicate insufficient or even non-existent resources for segments that provide higher productivity gains.[6] This situation could be alleviated by the presence of public financial institutions, which would be able to allocate credit to segments that provide productivity gains, since these institutions: i) would be more willing to promote the internalization of positive effects and externalities; ii) would not be subject to the same risks, given that state ownership and, consequently, state guarantee would mean the impossibility of insolvency;[7] iii) would give more emphasis to the social value of credit for essential sectors than to the risk of operations, as it would be the case for private institutions. According to Rocha (2003), another externality generated by the presence of public institutions is that it would enhance trust in the system[8].

Thus, this author's reading of the generation of positive externalities could be divided into two orders of arguments. The first, also present in the so-called "development view", is that, given its characteristics, credit provided by public banks would exert positive impacts on growth. The second is that the presence of these institutions would improve the reliability of the banking system. It is worth stressing that, according to Rocha (2003), public banks should seek to maximize social welfare, which not necessarily means maximizing profits, the chief purpose of private banks.

[6] The author considers uncertainty as a result of the association of macroeconomic conditions, debtor's credit worthiness, adverse selection, and moral risk.

[7] The idea that permeates this line of argumentation is that the state would not allow one of its institutions to go bankrupt.

[8] It is worth emphasizing that, according to this author, it is not possible to disregard the fact that this presence could generate moral risk and adverse selection.

Contrary to the argumentation explained above, the political view is quite critical of the existence of state-owned financial institutions, based primarily on the issue of their objectives and efficiency. On the one hand, according to this view, it is the politicians' intention to maximize their personal objectives that permeates state ownership of financial institutions, and not to allocate resources to socially efficient uses. Controlling public banks politically, politicians would be able to create employment, as well as generate subsidies and other benefits intended to obtain electoral, but not "economic" or "social" advantages (LaPorta; Lopez-de-Silanes; Shleifer, 2002). On the other hand, such institutions would finance politically interesting, but inefficient projects. Projects that would not be financed by the private sector, that would not be socially interesting, and that might decrease productivity, contrary to what the externalities/development view advocates (La Porta; Lopez-de-Silanes; Shleifer, 2002). Besides, public institutions would take the space of private companies, causing crowding-out. Therefore, the conclusion is that the so-called government failures prove to be greater than market failures. After this diagnosis, and considering a scenario in which public financial institutions are already present, the best path to take would be privatization.

Another line of argumentation is deduced from the so-called agency view, which, according to some authors, can be understood as "intermediary". On one side, there would be the social and development view, pointing to the benefits of direct intervention, and, on the other side, there would be the political view, indicating the deficiencies derived from intervention. In the middle of this spectrum would be the agency view (Novaes, 2007; Yeyati, Micco e Panizza, 2006). The "intermediary" nature of this view would result from the possibility of synthesizing this polarity in the idea that the service (in this case, a differentiated credit allocation) could be rendered, in principle, either by a public agent or by a private agent hired by the state. The answer would depend on the nature of the contract made between them,

> "*... when the government knows exactly what it wants from its agents, there is no difference, from the point of view of the social welfare, if they are employed by the state or by a private company that provides the service. Along this line, it makes no difference whether the government opens a post office (or a bank branch) in a remote area of the country or hires a private company to provide the same service. The search for social objectives alone is not enough to justify state*

> *ownership, which can be replaced by a contract made with the private sector.*
> *This result may be different if we admit the possibility of contracts being incomplete. In this case, the government cannot foresee, regulate or stipulate exactly what it wants... Here, the choice between private or state ownership depends on how the nature of this ownership affects the incentives to provide quality vis-à-vis the cost of offering services of a given quality.*" (Novaes, 2007, p.42)

As for banks, the problem, which would point to the inappropriateness of state's direct presence, is in the lack of quality in the interaction between agents – public institutions' administrators – and principal – governors and policymakers, who somehow are democratically representative (Pinheiro, 2007). A poor relationship between agent and principal may result "... in weak administrative incentives that may cause corruption, technical inefficiency and poor allocation of resources" (Pinheiro, 2007, p. 162).

From the debate presented above, we deduce that, in essence, all discussion about the intervention of the state, particularly as owner of financial institutions, is built on the concepts of market failures (or imperfections) and generation of externalities.

2.2 Gaps and intervention in credit markets

Another order of arguments – called here non-conventional – found in the literature and that in some way serves as a foundation for government intervention in credit markets is based on the perception of the importance of financing mechanisms that guarantee crucial decisions, especially on investment, and that, frequently, are not provided by private agents. It is worth emphasizing that some of the arguments brought forward by the authors discussed here refer to government intervention, which not necessarily means intervention through public banks. However, we believe that the nature of the arguments advanced contributes convincingly for the reflection on the role these institutions may play. Moreover, it is important to stress that the arguments were based on specific institutional contexts, which might explain the proposed forms of intervention, but certainly does not preclude a broader reading of the intervention process itself.

Minsky et al (1996) write from the perspective that the key role of a financial structure is to guarantee the accumulation of capital to promote production capacity growth and wealth generation in an economy. In this sense, they defend that whenever banking activities[9] are not adequately performed by the institutions playing in the market, there is room for government intervention, mainly in credit supply and in saving and payment mechanisms for given segments of the population – such as low-income individuals, ethnic minorities, besides small business in particular –, as can be understood from this passage:

> "*Banks now find it increasingly unprofitable to serve many parts of the population, particularly the smallest enterprises which were never well served by the banking community. Our proposal would increase the supply of short-term credit to small business. One aim of the CDB (Community Development Banks) should be to seek out projects which promise to be profitable but which will not to be financed because of the small size of the project, the riskness of the project or the 'inexperience' of the prospective management.*" (Minsky et al, 1996, p.387)

Thus, one can observe that the defense of intervention is related to the perception of the existence of gaps in service supply, especially in the credit market, in given segments and regions. However, this perception is based on the importance of financial services, particularly financing mechanisms to guarantee decisions on expenditures, income generation and, consequently, economic development, as can be deduced from:

> "*Capital development of the country, in general, and of depressed regions, in particular, requires a broad range of financial* ***services in order to raise effective demand and revitalize the regional and national economies.*** *In other words, 'capital development' is the primary concern (...) this includes the provision of financial services to all segments of the economy, including consumers, small and large business, retailers, developers, and all levels of government.*" (Minsky et al, 1996, p. 387, grifos nossos)

Finally, we underline that, in the article under discussion, the form of intervention being considered is the creation of Community Development Banks within the United States

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[9] They define as banking activities: i) payment system; ii) household financing; iii) commercial and investment banks' services, especially loans; iv) assets management services.

financial system, and that this form (and not another) was probably proposed because it is related to the institutionality and structure of that system.[10]

Torres Filho (2007) develops a line of argumentation to justify the presence of public development banks based on a broader debate on state intervention in credit markets[11]. He builds on the observation that intervention occurs worldwide, even though with different purposes, and acts in three areas: monetary policy, credit regulation and credit allocation (or earmarking).[12]

Intervention in the credit market in the form of regulation takes place as the enforcement of norms, mechanisms, and public institutions to preserve the functioning of the financial market. As for monetary policy, acting on shorter-term interest rates, it directly or indirectly influences credit demand and supply.

The direct intervention on credit allocation, differently from the others, does not focus on the market as a whole. In fact, it aims at generating or reallocating resources to sectors, regions, or specific types of borrowers, such as micro-, small- and medium-sized companies. However, aware of the fact that this debate has an important and irremovable institutional dimension, the author shows that the degree of intervention and its instruments vary considerably among countries.

A possible form for intervention, typical of the United States, would be, for instance, providing instruments to guarantee credits of private origin. However, this allocation may well assume another form, that is, through public banks, as it does in Brazil:

> "*The degree of intervention and the types of instruments for allocating credit in each country vary greatly. They reflect, basically, the diversity of structures and the historic and institutional characteristics of each financial market. In the United States, the allocation is made primarily through instruments to guarantee credits of private origin. In Japan, public banks play a more relevant role...*

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[10] The article was published in 1996 to discuss the US government's proposal to create one hundred Community Development Banks presented. According to Minsky et al, a key issue is lack of clarity regarding the concept of CDBs, whose intent should be providing credit, as well as savings and payment options for communities underserved by commercial and investment banks, as can be deduced from the following passage: "*The primary goals of the CDBs are to deliver credit, payment, and savings opportunities to communities not well served by banks, and to provide financing throughout a designated area for businesses too small to attract the interest of the investment banking and normal commercial banking communities*" (Minsky et al, 1996, p.386).

[11] Certainly, when compared to the analysis by Minsky et al (1996), the structural and institutional context is quite distinct, since the author's final objective is to reflect on the Brazilian case.

[12] Within the scope of this paper, our focus is on credit allocation.

The existing development banks are a particular form of allocating credit. They are, to a good extent, products of the evolution of mechanisms created as of the Second World War, either to rebuild large economies destroyed during the conflict – Germany and Japan – or to promote industrialization and development in Asian and Latin American countries. In Brazil, the Brazilian Development Bank (BNDES)[13] *is the main example of this type of institution.*" (Torres Filho, 2007, p.278)

The aim of this section was to present and analyze a list of the most commonly debated arguments whenever public banks are under consideration. As we have already pointed out, the discussion on public banks, irrespective of the side one takes on the need for their presence, focuses on their role either as institutions capable of minimizing market failures or, according to a non-conventional view, as institutions that can fill market gaps, given the crucial role of financing in certain spending decisions.

We see as fundamental the issue to which the authors of the non-conventional view have called attention, emphasizing the distinct hierarchy of certain categories of expenditures and the need for reducing the uncertainty that surrounds them, and hence deducing the need for the presence of the state. However, we intend to go further into this debate and present another set of ideas, complementary to this one, which help to develop a more comprehensive – and appropriate – argumentation about the need for public banks.

3. Financial instability and public banks

The role of public banks can, and must, go beyond that of facing deficiencies in the process of credit allocation, as stressed by what we called in the previous section "conventional" and "non-conventional" views. Next, we will present a set of arguments that point to a more comprehensive action of these institutions, which can contribute significantly to oppose and reduce the uncertainty and instability inherent to capitalist economies. Thus, considering Minsky's theoretical contribution as a central piece, the purpose of this section is to discuss the role that may be played by public banks in the context of an economy marked by financial instability and generation of inequalities.

Hyman Minsky is acknowledgedly among the most important authors of the post-Keynesian theoretical approach. However, following in the footsteps of the international

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[13] In spite of structuring his argument on the action of these institutions in credit allocation by analyzing the performance of a specific development bank – the Brazilian Development Bank (BNDES) –, Torres Filho highlights another aspect of its action, that is, its anticyclical behavior in the credit market.

financial crisis that erupted at the end of 2008, within the scope of this debate, an interesting phenomenon recently transformed Minsky in a reference not only in the academic mainstream – thus going beyond the post-Keynesian discussion –, but also often in major newspapers.

It is worth observing that if, on the one hand, it is remarkable, and also laudable and necessary, that an author as important as Minsky has broken through theoretical and ideological barriers and begun to emerge in almost trivial debates[14], on the other hand, this phenomenon did not happen without sacrificing much of the theoretical richness of his ideas. We must underline that, as opposed to what has been sanctioned in the debate held in the media, the central question in Minsky is not characterizing a moment – the alleged "Minsky moment", which marked the start of a more open crisis process in financial markets, with very serious consequences for the so-called real side of the economy –, but understanding precisely the nature and dynamics of a capitalist economy. At last, Minsky is not the theoretician of a moment, but of a movement, the movement of the capitalist economy, the movement of capital in an economy with developed financial markets, which, as opposed to the postulate of the neoclassical thought, does not tend to equilibrium.

In Minsky's words, in a passage in which he attacks directly the famous Adam Smith's formulation in *The Wealth of Nations*:

> "*In a world with capitalist finance it is simply not true that the pursuit by each unit of its own self-interest will lead an economy to equilibrium. The self-interest of bankers, levered investors, and investment producers can lead the economy to inflationary expansions and unemployment-creating contractions. Supply and demand analysis – in which market processes lead to equilibrium – does not explain the behavior of a capitalist economy, for capitalist financial processes mean that the economy has endogenous destabilizing forces. Financial fragility, which is a prerequisite for financial instability, is, fundamentally, a result of internal market processes*."(1982, p. 280)

It is important to stress the meaning of this passage, which is not trivial. The author points to the fact that, in a developed capitalist economy – that is, one with developed

[14] This is what the author wrote about it: "*Economic issues must become a serious public matter and the subject of debate if new directions are to be undertaken. Meaningful reforms cannot be put over by an advisory and administrative elite that is itself the architect of the existing situation. Unless the public understands the reason for change they will not accept its cost; understanding is the foundation of legitimacy for reform*" (Minsky, 2008, p.321).

financial systems –, the expected result from the agents' endless search for their own interests is not equilibrium. It is quite the opposite, disequilibrium, instability. In addition, Minsky shows that the heart of this instability may be found in the unbalanced behavior of financial markets, and that such disequilibrium does not result from a "failure" introduced "from the outside" into the system – in the sense that the system tends to perfection, but an external element would prevent it from reaching such perfection. On the contrary, disequilibrium is endogenous, it is in the nature of the system. To Minsky, instability is the counterpart of a system that seeks continuous expansion.[15] Finally, it should be clearly stated that, to Minsky, a capitalist economy with developed financial systems does not tend to an optimizing equilibrium.

From this point on, the issue to be discussed is how such instability is, or should be, faced. In other words, how it can be mitigated on the one hand and, why not, intensified on the other.[16] The author's answer is that it is the institutions, created within societies, in certain economic and political conjunctures, that play this role.

Minsky's analysis of the behavior of capitalist economies, emphasizing their tendency to generate inherent fragility and instability, allows for a different perspective on the discussion about public banks, opening space to reflect on their performance in much more general – and appropriate – terms than those based on failures, or even on market gaps, especially in the process of credit allocation. The importance of and the need for such institutions as public banks should be thought about from this point of view. Public banks can, and must, be considered in the context of institutions capable of contributing to more efficiency in the service provided to given segments of the financial (or credit) markets, and also able to assure more stability to the financial system and the economy as a whole:

> "*Decentralized markets are fine social devices for taking care of the particular outputs and prices of an economy, but they are imperfect devices for assuring stability and guaranteeing efficiency where large expensive capital assets are used in production. But most important, capitalist market processes that determine the prices of capital assets and the flow of investment introduce strong destabilizing forces into the system. Once we achieve an institutional*

[15] For a more detailed explanation of the mechanisms through which the system endogenously generates financial fragility and instability, see chapters 7 to 9 in Minsky, 2008.

[16] In his words: "*Such a debate will acknowledge the instability of our economy and inquire whether this inherent instability is amplified or attenuated by our system of institutions and policy interventions*" (Minsky, 2008, p. 320).

structure in which upward explosion from full employment are constrained even as profits are stabilized, then the details of the economy can be left to market processes." (Minsky, 2008, p.329)

We can see that the author's perspective is radically opposed to that of the mainstream, showing the destabilizing role of markets and the (potentially) stabilizing role of institutions created not by markets, but by governments. Therefore, the presence of institutions with a logic of action different from that of the market is necessary. Along this line, besides pointing to the need for intervention in key markets, he holds the view – logically derived from his analysis of the economy's unstable dynamics – that deep and long-lasting recessions are not observed today as a consequence of the important role governments play in the economies:

"*Big Government is the most important reason why today's capitalism is better than the capitalism which gave us the Great Depression. With Big Government, a move toward a deep depression is accompanied by a large government deficit that sustains or increases business profits. With profits sustained, output and employment are sustained or increased…However, the proportion that Big Government is necessary does not imply that government need be as big as our present government* (…) *Each structure of government has systemic effects*…" (Minsky, 2008, p.330)

The passage above is unmistakable as evidence for the central stabilizing role of the state in modern capitalist economies, and we are not going to refrain from showing that, in many of these economies, public banks, which in some cases could even be called Big Government Banks, are parts of this government structure.

Andrade and Deos (2009) make an effort to conceptualize public banks from a Keynesian-Minskyan theoretical perspective not limited to the conventional idea of public banks as institutions that act to correct market failures[17]. The authors incidentally criticize the use of this concept to discuss the need for and appropriateness of public banks. They say that, more than correcting failures, such institutions structure the markets in which the private sector is reluctant to act.

For these authors, a public bank may be characterized as an institution that performs activities that exceed the traditional – but important, it must be emphasized – role of

[17] We must stress that one of the authors' concerns in the text was to define a conceptual boundary between public bank and state bank, trying a delimitation not only defined by their ownership structure, but also centered on their logic of action.

providing long-term development and credit lines to segments politically defined as priority and that are not served by the market. Public banks go, or should go, beyond this point when a) defining new financial products and/or new conditions for existing products, so as to induce the market to operate on new foundations – that is, engaging in financing politics in a broad sense; b) operating in the market to change its "natural dynamics", clearly procyclical, as a privileged means to convey the impacts of decisions made within the scope of monetary and credit policies; c) taking actions in the credit market to minimize uncertainty, especially in moments when it is exacerbated, since in such circumstances there is a natural and defensive "shrinking" of credit on the part of the private sector. It is worth observing that the latter spaces for public banks' action mentioned by the authors under discussion are very close to perceptions deriving from the Minskyan discussion.

Andrade and Deos (2009) observe that, when playing its role as a public bank, an institution should not be primarily concerned with profitability. Carrying this argument further, the authors show that, if profitability is the institution's main concern, this may indicate that its public role is not being adequately fulfilled. Let's read the whole passage:

> "*In this sense, the concern with social returns, more difficult to measure, overcomes the concern with the private returns of investment projects the institution may come to finance, and even with the returns to the banking institution when performing that credit operation. Indeed, the good performance of a bank, taken as a development agent and as a means of proposing new directions for the market, may be, and often must be, opposed to the financial performance of this bank.*" (Andrade e Deos, 2009, p.52)

In Mollo (2005), we also find a broader analytical perspective on the role of public banks, following in Keynes' and Minsky's footsteps. The author gives a discussion on unstable monetary and financial dynamics that enlightens the reflection on the need for public banks and on their role. For her, parallel to the development of financial markets and increasingly liquid instruments, easily negotiable, there is an increase in the speculative dimension of the system and in its instability. In this sense, she points to the need for state regulation – which we can understand in a broad sense, since it concerns indirect intervention, such as prudential regulation, but certainly includes direct intervention as well, through public banks, for instance.

"*The regulation of the monetary and financial system and of the monetary and financial dynamics, therefore, requires state intervention, precisely because the market by itself does not prevent instability. The latter, as we have seen, is of an endogenous nature* (...) *either inherent to the subjective behavior of banks and companies in conditions of uncertainty, as those that permeate the economy, or to the logic of the functioning of capitalist economies*." (Mollo, 2005, p. 409)

Besides highlighting the endogenous aspect of financial instability, the author stresses another inter-related dimension, which concerns the fact that the logic of the market increases social, sector, and/or spatial (regional and even national) inequalities.[18] Therefore, it is worth emphasizing that the need for regulation/intervention to reduce inequalities does not derive from the "absence" of the market. On the contrary, it is the outcome of its full functioning, and the state's role is to break with its logic. The author says that, to this end, it is necessary to design discretionary policies, redefining actions in the monetary and financial domain, both to guarantee investment financing, and thus assure employment and income growth, and to reduce instability and inequalities. The following passage synthesizes Mollo's view:

"*The theoretical foundation on which we stand... is that that sees the financial system as a condition to potentialize production by means of expanding investment, but that, at the same time, perceives that it may encourage speculation, financial fragility, and crises. Regulating this system to promote long-term financing is, then, the first objective; the second is to guarantee a regulating apparatus enough to reduce financial instability and the probability and seriousness of financial crises. The third objective is to emphasize the necessary measures to reduce inequality and social exclusion by means of productive insertion.*" (2005, p. 413)

The message conveyed by the authors analyzed in this section is, therefore, that the role of public banks can, and must, go beyond the role traditionally discussed (and analyzed in the previous section), that is, that of acting to face deficiencies in the credit allocation process, stressed by what we have called "conventional view" and "non-conventional view". Here, we advocate that these institutions can, and must, be used to face situations

[18] Mollo (2005) adds a third dimension to discuss the proposals to remodel or restructure the monetary and financial dynamics in Brazil whose purpose is to reduce inequality and social exclusion. This third dimension is related to the need for long-term financing to guarantee investments that expand employment. Thus, it can be associated with the "non-conventional view" on the gaps of the credit allocation process, discussed in the previous section.

such as the instability and inequalities generated by the normal – but not optimizing – functioning of the market.

Final remarks

Following the intense crisis experienced in central and peripheral financial markets at the end of the first decade of the 2000s, a relative inflection was perceived in the debate on the role of public banks, after two decades of extremely negative assessments, especially within some multilateral institutions.

Written in this context, this paper had the purpose of reflecting on ideas and concepts that permeate the debate on the role of public financial institutions. It is worth observing that the boundaries for a reflection on the "general" role of these institutions were set without taking into account the historical moment, the institutional framework, and the economic and financial structure in which they perform. We advocate that ignoring these specificities impoverishes the exercise of theoretical reflection, and even detaches it from reality, at least from specific realities.

The literature review has shown that most authors who discuss public banks understand that the role to be played by these institutions is coupled to a perception of some immaturity, or incompleteness, in the development of banking systems and markets. In this sense, public financial institutions are justified as a way of correcting the failures or filling the gaps left by the private sector when it fails to meet credit demands in given economic segments and geographical areas, and even to provide certain types of financial services. We have noticed this reading in authors who are based on a more conventional (neoclassical) theoretical approach, and also in others, firmly tied to the perspective of effective demand.

We see as fundamental the discussion about resource allocation in credit markets, especially after the perception of the importance of financing spending decisions that generate income and employment, emphasizing the existence of a hierarchy among spending categories, as well as a need for reducing the uncertainty that surrounds them, and hence deducing the need for the state's presence. However, we have sought to go beyond this dimension and present another set of ideas, complementary to this one, which help to build a more comprehensive – and, in our opinion, more appropriate – argumentation about the need for public banks.

For such purpose, we started from a Keynesian-Minskyan theoretical approach and concluded that public banks can, and must, be used to reduce the inherently cyclical behavior of markets, acting to slow down both their contraction and expansion movements by applying an alternative to their logic. At the same time, public banks can, and must, be used to reduce sector or regional inequalities generated and reinforced by the market. Finally, there must be no questions about the key role government banks, which may occasionally be Big Government Banks[19], can play to face more severe situations of instability and generation of inequalities that result from the normal functioning of the markets.

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[19] As it is known, a recent cogent example is the performance of Brazilian big government banks – BNDES [National Development Bank], Banco do Brasil [Bank of Brazil], and Caixa Econômica Federal [Federal Savings Bank] – during the recent crisis, with results still to be assessed, but definitely deserving to be emphasized at once.

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