Synthetic paper on the effects of different financial systems on economic performance

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Abstract: This paper considers the effects of different financial systems on economic performance (broadly defined). Section 2 summarises the empirical and theoretical literature on financial development and economic performance, with particular emphasis on the size of the financial sector and economic performance. Section 3 is concerned with ownership forms and economic performance. Section 4 moves on to consider role of mutual ownership and of microfinance. Section 5 considers some aspects of foreign ownership and internationalisation.

Key words: financial systems; economic performance; financial deepening

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1. Introduction

The key purpose of this paper is consideration of the effects of different financial systems on economic performance (broadly defined). At one level, there is a basic similarity between financial systems across countries in that the system provides a payments technology including the creation of money, provides intermediation between those who save and those who invest (in capital equipment), and involve the development, issue and trading of financial assets. At another level, there are substantial differences in the structure and nature of financial systems, as is evidenced in the 18 country studies conducted within the FESSUD project.\(^1\) There may well have been some degree of convergence between national financial systems, and the national financial systems become further brought into a global financial system. The particular foci of this paper are (i) how does the scale and reach of the financial system (that is financialisation) impact on economic performance, (ii) how do different ownership forms (public, private, mutual, international) and different types of financial institutions impact on the real sector.

Financial systems have often been investigated through the lens of the bank-based vs. market-based typology. The use of those terms could be seen as a reminder that the financial system contains a wide range of institutions (where a stock market is regarded as an institution) and a wide range of market arrangements (where banks enter into exchange transactions). In this paper we do not draw on that typology as a means of classifying financial systems, but rather focus on different ownership forms. A critical appraisal of the bank-based vs. market-based typology was undertaken in Sawyer (2014a).\(^2\) The points made there of particular significance here were: (i) the function of banks as creators of money was largely ignored, and all financial systems necessarily involved banks as money creators; (ii) there are diversity of institutions under the rubric of banks in terms of ownership, objectives and functions which can be overlooked in a dichotomy. This becomes an important theme in this paper with the

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\(^1\) The financial system reports are published as FESSUD Studies in Financial Systems, and available on fessud.eu.

\(^2\) For more recent discussions see, for example, Hardie and Howarth (2013), Christophers (2015).
emphasis on the examination of different ownership forms and the different market segments in which banks and financial institutions engage; (iii) banks have always engaged in market transactions (e.g. selling loans, ‘buying’ deposits) and have shifted into securitized market transactions, fusing the boundaries between banks and markets.

Hence rather than drawing on a typology we proceed, drawing heavily on the earlier work of Work Package 8, by a consideration of the effects of different ownership forms and of foreign operation of banks on economic performance. In the main the focus is on commercial and investment banks (interpreted to include a range of micro-finance and co-operative organisations). The roles and effects of financial institutions such as hedge funds, private equity, and sovereign wealth funds are not included here: for work on them see Pitelis and Anthopoulos (2014a, 2014b, 2014c), Pitelis, Anthopoulos and Liakou (2014), and Work Package 8 Synthesis paper. A possible shortcoming of this approach of examining different ownership types is that the complementarities between the different types are not captured. Different types of financial institutions can have different functions and different sets of customers, e.g. savings banks vs investment banks, firms as customers vs. households as customers. Thus, complementarities between financial institutions arise with each type having their own functions and specialisms (as is to some degree discussed below). The approach adopted here also underplays the inter-relationships of the financial sector with households, firms and the State.

Sawyer (2014a) provided a concept paper on the relationship between finance and industry. The financial sector stands between those who save and those who undertake investment (as well as between those whose go into debt and dissave). It is recognized that commercial banks play a crucial role in the provision of initial finance, and the emphasis is on to whom that initial finance is provided and how the final finance (funds) are allocated. That paper could be summarised in terms of two themes. First, the financial institutions (which are taken to include equity markets) determine the terms on which loans, credit etc. are provided to the non-financial
sector, whether corporations, SMEs or households. This is not only a matter of what is the costs of finance including the rates of interest to be charged but also how credit rationing operates. It is an inevitable feature of the provision of credit, loans and funds that the lender has to be concerned over the risks of default, late payment and non-performing loans. It is then an inevitable feature that (formal or informal) credit ratings are made by lenders, with consequent effects on cost and availability of funds to potential borrowers.

Second, there are governance issues in that financial institutions intervene in and monitor the use of the funds provided to companies and when the financial institutions (here, for example, insurance companies, pension funds, mutual funds) are the owners of equity and bonds, then there are issues of corporate governance, objectives and motivation and re-structuring arising.

This paper is structured in the following manner. In section 2, the literature on financial development and economic performance is summarised, with particular emphasis on the size of the financial sector and economic performance³. Section 3 is concerned with ownership forms and economic performance, drawing on the WP8 deliverables. Section 4 moves on to consider role of mutual ownership and of microfinance. Section 5 considers some aspects of foreign ownership and internationalisation. Section 6 makes some concluding comments.

2. Financial development and economic performance

Financialisation has involved the growth of the financial sector and changes in its structure with the faster growth of equity markets and developments of securitization, derivative trading etc. The growth of the financial sector has often been evaluated under terms such as financial development, financial deepening. Drawing heavily on Sawyer (2014c, 2015), we focus on the relationship between the size of the financial sector and economic performance.

It is necessary to consider what is meant by economic performance. This is often treated in terms of GDP, growth of GDP and industrial development. This reflects not

³ Section 2 uses much of the material which was included in Sawyer (2014c, 2015).
only the obsession of economists with GDP as a potential measure of economic welfare, but also the perceived role of financial development as a promoter of savings and investment (in terms of raising the level of savings through the provision of liquidity and financial assets, an assumed causal relationship from savings to investment, and the monitoring roles of financial institutions).

There has been a substantial literature on the relationship between what is termed financial development and economic development where the latter is generally viewed in terms of level and growth of GDP (whether in total or per capita). Financial development, often measured by variables such as bank deposits to GDP, focuses on the growth of the formal financial sectors and does not reflect the role of informal financial sectors and ‘curb markets’. There continue to be issues of causation – does financial deepening ‘cause’ economic development, or is it ‘caused’ by it. Some of the measures of financial development, notably those related with the stock market, can be highly sensitive to the occurrence of financial crisis. In a similar vein, economic growth (and development) often relates to the formal sector and (implicitly) industrialisation.

Under the heading of financial development and deepening rather than financialisation, there has been a large literature extending back many decades on the relationship between finance and economic growth, notably using measures such as bank deposits to GDP, stock market value to GDP as measures of financial development. This literature has generally found a positive relationship between financial development and economic growth, though the causal relationships involved are matters of debate. A more recent literature which has tended to find a much weaker relationship, and often finding an inverted U-shaped relationship such that industrialised countries are often operating on the negative part of the curve.

Levine (2005) in his extensive review of the empirical literature concluded that ‘a growing body of empirical analyses, including firm-level studies, industry-level studies, individual country-studies, time-series studies, panel-investigations, and broad cross-country comparisons, demonstrate a strong positive link between the functioning of the financial system and long-run economic growth. While subject to
ample qualifications and countervailing views noted throughout this article, the preponderance of evidence suggests that both financial intermediaries and markets matter for growth even when controlling for potential simultaneity bias. Furthermore, microeconomic-based evidence is consistent with the view that better developed financial systems ease external financing constraints facing firms, which illuminates one mechanism through which financial development influences economic growth. Theory and empirical evidence make it difficult to conclude that the financial system merely—and automatically—responds to economic activity, or that financial development is an inconsequential addendum to the process of economic growth.’ (p. 921)

Arestis, Chortareas, and Magkonis (2015) conduct a meta-analysis of the existing empirical evidence on the effects of financial development on growth. They conclude that ‘the type of data employed, and the different variables used to measure financial development in the literature can constitute sources of heterogeneity. Specifically, the usage of market-based proxies of financial development seems to result in lower correlations than the usage of either liquid liabilities or market-based variables. On the other hand, the estimated coefficients of bank-based measures and complex indices are found statistically insignificant in all specifications. … Additionally, panel data, which are frequently used from the late 1990s onwards, produce smaller correlations. The same seems to hold for time series. … [H]owever, the results suggest the existence of a statistically significant and economically meaningful positive genuine effect from financial development to economic growth’ (pp. 10-12).

The relationship between financial development and economic growth in the past three decades or so in the industrialised world is of particular interest. Casual observation may suggest that the general growth of the financial sector and the enhanced size of that sector have not obviously been associated with any faster economic growth. Indeed it is often argued that growth in the Western industrialised economies has been somewhat slower over the past three decades of financialisation. Black (2010) – referring to the American economy – remarks that ‘forty years ago, our real economy grew better with a financial sector that received one-twentieth as large
a percentage of total profits (2%) than does the current financial sector (40%).' Further, the literature on financialisation has indeed suggested a variety of ways in which the processes of financialisation may have diminished investment, as further discussed below.

Authors have reported on at least some weakening of the links between financial deepening and economic growth. Rousseau and Wachtel (2011) argue that ‘we show that it [the finance-growth link] is not as strong in more recent data as it was in the original studies with data for the period from 1960 to 1989.’ Another study documents ‘that the size of the financial sector has increased dramatically in both the developed and developing world in combination with a high volatility of the financial sector relative to the economy as a whole. In line with previous research we find that in the long run financial intermediation increases growth and reduces growth volatility. Both effects have, however, become weaker over time.’ (Beck, Degryse, Kneer, 2013, p. 13).

A study of ‘the complex real effects of financial development and come to two important conclusions. First, financial sector size has an inverted U-shaped effect on productivity growth. That is, there comes a point where further enlargement of the financial system can reduce real growth. Second, financial sector growth is found to be a drag on productivity growth. Our interpretation is that because the financial sector competes with the rest of the economy for scarce resources, financial booms are not, in general, growth enhancing. This evidence, together with recent experience during the financial crisis, leads us to conclude that there is a pressing need to reassess the relationship of finance and real growth in modern economic systems. More finance is definitely not always better’ (Cecchetti and Kharroubi, 2012, p.14).4

Overall, it could be concluded that a positive relationship between of the financial sector and economic growth has generally been found though issues of causation have not been resolved. The positive relationship has weakened and indeed may have been reversed in recent years. The empirical work has focused on measures of the financial sector such as bank deposits, size of the stock market, and has not in general

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4 For other studies see, for example, Barajas et alia (2012, 2013), Rioja and Valev (2004, 2005), Aghion et al. (2005), Dabla-Norris and Srivisal 2013.
reflected the expansion of the financial sector in recent decades in terms of derivatives, securitisation and volume of trade in assets and liabilities. There has been a general increase in the incidence of financial crises over the past four decades. Laeven and Valencia (2012) provides a listing of some 400 financial crises since 1970, and provides estimates of the fiscal and output costs of crises, particularly in the banking sector (see, for example, Amaglobeli, End, Jarmuzek, and Palomba, 2015). Dymarski and Paes Mamede (2016) provide detailed discussion on the notion of stability and instability in the financial system. They also provide estimates of the effects of financial instability on output during the recent financial crisis. The modes and effectiveness of regulation have roles to play in limiting financial crisis, and, of course, the era of financialisation has been more associated with de-regulation, ‘light-touch’ regulation and liberalisation. The scale of the financial sector and the interlinkages with the real sector would make the costs of a financial crisis greater. A financial crisis is typically preceded by a relatively rapid growth of credit and asset prices, and in so far as investment is thereby stimulated a faster rate of growth (at least of the capital stock). Some have argued that while the post-crisis slump lowers output and employment the pre-crisis boom has raised output and employment, and the combined effects may leave the trend growth little changed. Others though have pointed to the tendency of financial crisis (of which the 2007/09 appears to be a particular example) to have a permanent downward effect on the level of output, and that while growth after the crisis may resume at the previous rate it does so from a lower base.

Financial liberalization and growth

McKinnon (1973) and Shaw (1973) propounded the `financial liberalisation' thesis arguing that government restrictions on the banking system restrain the quantity and quality of investment. Financial liberalisation was to remove ‘financial repression’ which referred to a high degree of regulation of the banking and financial system in many countries, and specifically control by Central Bank and government of the level of interest rates and the allocation of credit. McKinnon (1973) and Shaw (1973) stressed two other issues: first, financial repression affects negatively the efficient
allocation of savings to investment; and second, through its effect on the return to savings, it has a restraining influence on the equilibrium level of savings and investment. The financial liberalization thesis argues for the removal of interest rate ceilings, reduction of reserve requirements and abolition of directed credit programmes. In short, liberalise financial markets and let the free market determine the allocation of credit. With the real rate of interest adjusting to its equilibrium level, low yielding investment projects would be eliminated, so that the overall efficiency of investment would be enhanced. Further, as the real rate of interest increases, saving and the total real supply of credit increase, which induce a higher volume of investment. Economic growth would, therefore, be stimulated not only through the increased investment but also due to an increase in the average productivity of capital. Moreover, the effects of lower reserve requirements reinforce the effects of higher saving on the supply of bank lending, whilst the abolition of directed credit programmes would lead to an even more efficient allocation of credit thereby stimulating further the average productivity of capital.

Bumann, Hermes, and Lensink (2012) summarise the position with regard to the ‘hotly debated’ relationship between financial liberalisation and economic growth’ in the following terms: ‘whereas some have claimed that liberalisation of financial markets contributes to the efficiency with which these markets can transform saving into investment, which ultimately fosters economic growth, others have pointed out that these liberalisations have contributed to various financial and economic crises in the past. … The evidence that emerges from these studies [of the relationship] remains inconclusive.’ (p.41)

They undertake a meta-analysis based on 60 empirical studies. Their ‘meta-regression analysis provided the following main results. First, the unconditional mean of the t-statistic of the financial liberalisation variable equals 1.42, which is highly significant. Using a chi-squared test we also have to reject the null hypothesis that the average t-statistic equals 1.96. … Hence, we conclude that although our results indicate that, on average, there is a positive effect of financial liberalisation on growth, the significance of this effect is only weak. Second, for most of the variables that may
help explaining the heterogeneity of results about the relationship between financial liberalisation and economic growth we do not find any significant results. There are two exceptions. Our analysis suggests that data from the 1970s generate more negative financial liberalisation coefficients which suggests that financial liberalisation policies carried out during the 1970s seem to have a stronger negative relationship with growth. Moreover, our results show that studies that take into account a measure of the level of development of the financial system report lower t-statistics for the relationship between liberalisation and growth’ (pp.43-5).

A conclusion which can be drawn from this is that growth of the financial sector particularly in terms of the banking sector has generally gone alongside growth of the real economy. The causal relationships have been much discussed without a clear settlement. In more recent times, the generally positive relationship between growth of financial sector and growth of the real economy appears to have weakened. Further, the ways in which the financial sector has grown, specifically the growth of shadow banking, securitization and trading in financial assets, may not be conducive to economic growth.

Shareholder value, Investment and Industrial Re-structuring

Financialisation has been associated for many with the rise of the push for the maximisation of shareholder value, as for example in the formulation of van der Zwan (2014). Financialisation often involves the growth of the financial sector’s ownership and dealings in equity, and the growth of financial markets. There has been the speed-up in the trading of equity (as with other financial assets), and emphasis on short-term share-price performance rather than on longer-term growth prospects. The particular significance of these developments here comes from the impact on decisions on investment, employment, output etc., as made by corporations. Do these developments foster more or less investment, more or less research and innovation? – questions often summarised under issues of short-termism. Further, do these developments favour some sectors over others? What would impact be on the quality and quantity of jobs?
The advocacy of the pursuit of ‘shareholder value’ is a route through which shareholder interests are imposed on managerial interests. It also acts in the interests of the financial sector who gain from increasing stock market valuations. ‘The decade-long boom in the US stock market and the more recent boom in the US economy have fostered widespread belief in the economic benefits of the maximization of shareholder value as a principle of corporate governance. In this paper, we provide an historical analysis of the rise of shareholder value as a principle of corporate governance in the United States, tracing the transformation of US corporate strategy from an orientation towards retention of corporate earnings and reinvestment in corporate growth through the 1970s to one of downsizing of corporate labour forces and distribution of corporate earnings to shareholders over the past two decades. We then consider the recent performance of the US economy, and raise questions about the relation between the maximization of shareholder value and the sustainability of economic prosperity.’ (Lazonick and O’Sullivan, 2000).

Hein summarises a range of arguments on the generally adverse effects of ‘shareholder value’ under financialisation on investment:

‘1. Shareholders impose higher distribution of profits on firms, i.e. a higher dividend payout ratio and hence a lower retention ratio and/or a lower contribution of new equity issues to the financing of investment, or even share buybacks. Therefore, internal means of finance for real investment are reduced, and the ability to invest hence suffers (‘internal means of finance channel’).

2. Managers’ (firms’) preference for growth is weakened as a result of remuneration schemes based on short-term profitability and financial market results. The preference for growth, and hence the willingness to invest in capital stock, therefore suffers, too (‘preference channel’)’ (Hein, 2012).

‘Regarding investment in capital stock, financialisation has been associated with increasing shareholder power vis-à-vis management and labourers, an increasing rate of return on equity and bonds held by rentiers, and decreasing managements’ animal spirits with respect to real investment, which each have partially negative effects on firms’ real investment.’ (Hein, 2012)
The often rise in profit rates and shares in industrialised countries over the past three or more decades can be compared with a tendency for investment to slow. ‘A remarkable macroeconomic phenomenon that has been recognized by various political economists is that profit rates have developed very favorably in many advanced economies over the past 20 or 30 years, while physical investment dynamics have tended to slow down … One popular (microeconomic) explanation of this macroeconomic phenomenon is that increased shareholder value orientation, as an important constituent of financialisation, has induced firms to develop a larger preference for profitability at the expense of investment (and potentially jobs and growth). Indeed, such a conclusion appears logical from the point of view of a firm-centered political economy where firms are seen as ‘the key agents of adjustment … whose activities aggregate into overall levels of economic performance’ (Hall and Soskice, 2001: 6). Similarly, the observation that financial profits have increased relative to non-financial profits has led many authors to conclude that there has been some sort of ‘decoupling’ of the financial sphere of the economy from the real sphere in the sense that, with financialisation, ‘profits accrue primarily through financial channels rather than through trade and commodity production’ (Krippner, 2005: 174). Apparently, many firms have decided to abandon the real sector and ‘moved into financial operations to increase profits’ (Epstein, 2005: 7).’ (van Treeck, 2009, p. 908)

A rather similar view comes from Dallery (2009) who argues that ‘whether a firm’s orientation is decided by managers under shareholders’ pressure or by shareholders themselves, financialisation effectively leads to a decreasing tendency to accumulate. …On the one hand, managers do not blindly pursue growth, and they also care about target utilization rates and the indebtedness threshold. On the other hand, shareholders are not only motivated by profit rate; they are also concerned with debt-leverage and growth. …What I have shown is that financialisation taken as a constraint for managers entails a relatively small drop in accumulation, and it could even lead to a constant accumulation through increased pressure on workers and/or increased real fragility. Considering the opposite case where shareholders preside over firms’ fates, I find that the decrease in accumulation is far greater, but the scale of this
reduction is dependent on what is assumed to be shareholders’ objectives and time horizons (the longer it is, the more need for growth). The way financialisation has been presented here offers a theoretical representation of the historical change in corporate governance, “from an orientation towards retention of corporate earnings and reinvestment in corporate growth through the 1970s to one of downsizing of corporate labor forces and distribution of corporate earnings to shareholders over the past two decades” (Lazonick and O’Sullivan 2000: 13).’ (Dallery, 2009).

**Inequality and poverty**

The relationships between financialisation and inequality and poverty are not straightforward, and since financial development and growth can take many forms and working through a variety of institutional arrangements the relationships will vary over time and space. It is easy to point to features of the financial system and institutions which are intended to aid the poor – micro-finance institutions, credit unions being notable examples. At the other end of the spectrum private equity companies operate to make high returns for the already rich. As Piketty (2014) argues that the rich receive higher returns on their wealth than the poor.

‘The majority of theoretical studies on the relationship between income inequality and financial development argue that financial deepening might be a feasible instrument for improving income distribution. This paper finds that the prediction crucially depends on the stages of financial development that the country is undergoing. The benefits of financial depth only occur if the country has reached a threshold level of financial development. Below this critical value, financial development counteracts income inequality. Our policy implication is that a minimum level of financial development is a necessary precondition for achieving reduction in income inequality through financial development’ (Kim and Lin, 2011, Abstract).

Beck, Levine, and Demirguc-Kunt (2007) ‘found that financial development disproportionally helps the poor. Greater financial development induces the incomes of the poor to grow faster than average per capita GDP growth, which lowers income inequality. … Although the results show that financial development is particularly
beneficial to the poor, this research is silent on how to foster poverty-reducing financial development.’ (p.46)

Some argue that ‘theory provides sound reasons for believing that the poor disproportionately benefit from financial development. Financial developments that lower the fixed costs of accessing financial services are especially useful to low-income individuals, helping them to pay for education and health care. Financial development that operates on the extensive margin facilitates entrepreneurship by people with promising ideas, but little collateral and income. This both reduces inequality of opportunity and enhances aggregate efficiency...[However], theory is not unambiguous, however. In particular, financial development that operates on the intensive margin and improves the financial services available to rich individuals and well-established firms can reduce the equality of opportunity, perpetuate cross-dynasty relative income differences, and widen the distribution of income. While theory provides guidance on the potential mechanisms linking inequality and the operation of the financial system, many of the core questions about the nature of the relationship between inequality and finance are empirical.

Although far from conclusive, an accumulating body of empirical evidence supports this view. The results of cross-country, firm-level, and industry-level studies, policy experiments, as well as general equilibrium model estimations all suggest that there is a strong beneficial effect of financial development on the poor and that poor households and smaller firms benefit more from this development compared with rich individuals and larger firms. Empirical research suggests that an improvement in financial development expands economic opportunities, particularly for those whose opportunities had previously been tightly curtailed.’ (Demirguc-Kunt and Levine, 2009, pp.45-7)

‘Using data restricted only to African countries for the period of 1980-2004 and applying the generalized method of moment (GMM) techniques, this study test the alternative hypotheses by investigating the impact of financial development on the distribution of income in African countries. Our empirical result show that the alternative financial development variables and the composite index predict a negative
and linear relationship between finance and Gini Coefficients while the inverted U-shaped relationship is not established.’

‘Two phenomena can be observed over the last five decades around the world – increasing financial development and increasing gross income inequality in many countries, especially in the developed world. ... Earlier empirical research focusing on this financial development versus income inequality nexus has broadly confirmed the decreasing effect of financial development. ...Using a broader data set and time-invariant country specifics in our panel estimation, we reach a different conclusion in the analysis of this nexus and reject these earlier theories and previous empirical research. Integrating time-invariant country characteristics, we find a positive relationship between financial development and income inequality within countries. Better-developed financial markets lead to higher gross income inequality. This finding holds for several robustness checks, e.g., for subsamples by different income groups, neglecting country characteristics and including further control variables, as well as bank deposits as an alternative measure for financial development. The positive relationship is highly significant but is only of a small magnitude. An increase in the provision of credit by ten percent leads to an increase in the Gini coefficient by 0.23 for the within estimation.

We do not exclude the possibility that all income groups within a country benefit from more financial development, but we do find that those who are already better off benefit more because income inequality is increasing. Our results should, at the very least, allow researchers to remain somewhat skeptical when confronted with the supposedly beneficial effects of financial development. It appears instead to be very important to target financial development towards the poorest in society. Only then can we hope for inefficient and excessive inequality to reduce. Nonetheless, the relationship between finance, financial development and income inequality offers more research opportunities and merits more resources and effort’ (Jauch and Watzka, 2012).

For the USA Onaran et alai (2011) ‘find that the primary redistribution of income in favour of the rentier income as well as the non-rentier profits at the expense of wages
suppresses consumption; however, the secondary redistribution of profits in favour of rentier income has a positive effect on consumption. The wealth effects of rising housing and financial asset prices on consumption also lead to an increase in consumption. A higher rentier income suppresses investment through both lower investable funds available to the firm and shareholder value orientation, and an increase in non-rentier profits has a positive effect on investment. However, the overall effect of a pro-capital redistribution on investment is modest. As a result the US economy is moderately wage led, however the lower bound of the estimate is almost zero, indicating little effect of distribution on private excess demand; thus, the positive and negative effects of a pro-capital income distribution almost cancel each other out.

The results suggest that the changes in functional income distribution and wealth effects in the era of financialisation have had an overall neutral effect on aggregate demand. But without the wealth effects, the overall effect on consumption and investment would have been negative. Thus, the macro economy is not finance led (in the sense of Boyer, 2000) while still being shaped by changes in the financial sector. The effects of financialisation regarding income distribution at the expense of wage earners, the consequent reliance on debt fuelled by the housing bubble to maintain consumption and growth based on low physical investment has led to a risky and fragile economy. This is exactly the mechanism that underlies the financial crisis of 2007–09. The coming years will show the negative consequences of debt repayments and the bust of the housing bubble on consumption. Indeed, over the longer term, if the negative wealth effects of the bust phase are also incorporated, the overall consequences of financialisation for growth may prove to be significantly negative. An alternative scenario with an improving wage share and declining rentier income share would provide a sounder and more sustainable basis for growth.’ (p.657)

A more direct linkage with financialisation comes from the following: ‘Using time series cross-section data at the industry level, we find that increasing dependence on financial income, in the long run, is associated with reducing labor’s share of income, increasing top executives’ share of compensation, and increasing earnings dispersion
among workers. Net of conventional explanations such as deunionization, globalization, technological change, and capital investment, the effects of financialization on all three dimensions of income inequality are substantial. Our counterfactual analysis suggests that financialisation could account for more than half of the decline in labor’s share of income, 9.6% of the growth in officers’ share of compensation, and 10.2% of the growth in earnings dispersion between 1970 and 2008.’ (Lin and Tomaskovic-Devey, 2013, p.1284).

Das and Mohapatra (2003) present ‘evidence of a strong statistical association between the event of liberalization and income shares. The data strongly support a positive coefficient between liberalization and the highest income quintile’s share of mean income, and a negative coefficient between liberalization and the middle class income share… We find no evidence of any statistical association between liberalization and the lowest income quintile. Although the middle class “suffers” in the wake of a liberalizing reform while the upper quintile gains, this statement is true for income shares. We find that income levels in liberalizing nations almost universally rise after liberalization. … However, it is important to note that there are mechanisms which should relate capital market liberalizations to income shares under a wide variety of hypotheses that are true in emerging markets (e.g., differential access to credit markets, limited stock market participation, and the tight links between upper quintiles and policy makers).’ (p.245).

3. Ownership issues

Three broad forms of ownership in the financial sector can be identified, namely private (usually corporate), public and mutual & co-operative. Within each of those categories there are variants which are discussed below when each type of ownership is discussed. In addition, whether ownership is domestic or foreign, that is based on inward foreign direct investment is considered. The three forms of ownership are, not surprisingly, viewed as being potentially different in terms of their objectives, their scope of operations, and their efficiency.

The financial sector, perhaps more than any other sector, has had a mix of different forms of ownership – public, private, and mutual and co-operative. Although under the
recent decades of financialisation there has been a general shift away from public and mutual forms of ownership towards private, there remains a significant component of mutual ownership, and at present under the effects of the financial crisis and associated bail-outs a significant component of public ownership. It is also worth to investigate the relative performance of the different forms of ownership. In doing so, it would have to be borne in mind that, apart from having different objectives, the different forms of ownership have arisen in different sectors of the financial system. For example, mutual and co-operative ownership has often been a feature of savings banks with a focus on home ownership.

Consideration of different forms of ownership (and implicitly the impact of the shifts away from public and mutual forms of ownership to private ownership) may be considered under a number of headings:

(i) The relative efficiency of the different forms of ownership;
(ii) The relative extraction of profits under different of ownership, and who receives the profits;
(iii) The differences in the nature of the relationships between financial institutions and their customers;
(iv) The differences in the objectives pursued by different ownership forms;
(v) Stability/instability of the banking system including risk taking.

The financial sector has a history of different ownership forms, and particularly mutual and co-operative organisations have often plays a much greater role in the financial sector than in the non-financial sectors. The scale of the role of co-operative banks in a range of countries is given in Table 1, which is reported in Tomidajewicz (2014b) (and where further information is given in his Table 2 and the text), and for mutual and co-operative insurers in Table 2. The importance of these types of institutions in a number of countries is clear as is the variations across countries. Tables 1 and 2 near here

Dymarski with Tomidajewicz, 2015 observe a steady trend towards privatisation in the financial sector in European countries commencing in the 1980s and intensifying in
the 1990s. A variety of reasons and objectives were behind these privatisations, and different methods and tools were deployed. ‘In the Western Europe the most spectacular change in ownership occurred in the Italian and French banking sectors, which were transformed from predominantly state-controlled into almost fully privatised. In Italy the process took ten years while in France spread over about twenty years. In both countries impetus for large-scale privatisation of banks came from their governments. However, the case of the Banque Publique d’Investissement, established by the French government in 2012 on the role model of German KfW may signify that the global financial crisis has spurred politicians on to rethink their opinion on the role of state-owned banks in in the economy.’

In Sweden ‘the State gradually sold all its stakes in commercial banks, though the process was alternated with temporary nationalization of non-performing banks or increase in holdings of the State in in those banks in times of financial crises.

On the other hand, in Germany since the 1980 privatisation of banks has been incidental. Instead of privatisation, far going commodification of activity of the publicly-owned savings banks took place in the early 2000s. It should be stressed that – contrary to Italy – this process was initiated under strong pressure of German private banks decidedly supported by the European Commission.

The countries differ markedly in their approach to savings and cooperative segments of the banking sector. In Germany savings banks have remained a part of public sector, whereas in Italy, France and partially in Sweden they have been privatised. However, while the first two countries the privatisation was obligatory for all savings banks, in Sweden it was left to decisions of particular banks. On the other hand, In Italy and Sweden savings banks has been transformed into public limited companies while in France into cooperatives. Simultaneously, in all three countries separate legal entities have been established as owners of savings banks (public limited companies in Italy and Sweden and cooperative companies in France), but while in the first two countries social and public services, hitherto provided by the savings banks, was entrusted to
these institutions, in France these services have remained a part of savings banks activity.

In Germany and Italy cooperative banks retained its traditional status and its role. Very peculiar changes in savings banking occurred in France, where – by the decision of the parliament – savings banks have been transformed into cooperative organisations, and therefore formally privatised, but actually still controlled by local and regional authorities. In Sweden, in turn, the cooperative banking has been dramatically reduced to a very small margin of the entire banking sector.’ (Dymarski with Tomidajewicz, 2015).

Jurek (2014a) argues that ‘the importance of the structure of ownership in the financial sector of the EU stems from two phenomena. First, changes in the structure of ownership in the financial sector reflect the progress of privatisation in many European countries, especially in the new member states. This process manifests itself in a transfer of ownership of financial institutions from the state to the private sector. Secondly, the above mentioned changes are a result of freedom of capital mobility in the whole EU. Consequently, both presented phenomena have a strong influence of the withdrawal of the state from the financial sector. This makes exerting the control over the functioning of the domestic financial institutions less focused.’

According to one line of argument ‘Private ownership is generally preferred to public ownership, especially when incentives to innovations and to reduce costs are strong, as well as the competition in the market (Shleifer, 1998). Most studies underline inefficiency of state-owned firms along with their inability to maximize profits (Dewenter, Malatesta, 1997, Dewenter, Malatesta, 2001). According to Shleifer and Vishny (1997), the performance of state-owned company is inferior to that of privately owned one because of the existence of perverse incentives of managers and bureaucrats in state-owned firm’ (Jurek, 2014b). Of course, perverse incentives are not absent from privately owned financial institutions, and indeed the incentives towards risk-taking in large interconnected financial institutions have been seen as
raising the likelihood of financial crash and a significant factor in the generation of the 2007/09 financial crisis.

‘If the analysis [of state ownership] is limited only to financial institutions, many authors underline that the higher the state ownership the slower the financial development, the stronger the financial instability, the higher concentration of bank lending and the lower the economic growth (La Porta et al., 2002). Many authors claim that state-owned financial institutions generate lower profits and reveal lower cost efficiency (La Porta et al., 2002; Barth et a., 2001, Beck et al. 2003). Such institutions often fail to screen out good projects. This reduces profitability and limits interest margins (Allen et al., 2005, Micco and Panizza, 2006, Sapienza, 2006’ (Jurek, 2014b)

It can be argued that ‘Government acquire control of financial institutions in order to provide employment, subsidies, and other benefits to supporters who return the favour in the form of votes or political contributions (La Porta et al., 2002). This leads to a political corruption (Khwaja, Mian, 2005). Therefore, especially in emerging and developing countries, the state ownership tends to be associated with poor protection of property rights and poor governance, because the government does not need to compete with the private sector as a source of funds (Barth Jr et al.)’ (Jurek, 2014b). It could be added that private ownership of the financial sector is not a barrier against political corruption on the part of the banks.

What may be labelled the development view of the role of State institutions is more than just a market failure approach and views a State bank as potentially able to pursue different objectives. In this view state ownership of financial institutions can be a response to institutional deficiencies. ‘State-owned financial institutions pursue specific social—not political—goals and can set up projects that private entities would be unable or unwilling to finance. Schmit et al. (2011) identify three types of missions of such institutions:

Promotional, highly specialised missions aimed at filling market gaps left by private financial institutions,

- general-interest missions focused either on investing in socially valuable but financially non-profitable ventures or on compensating the private sector’s short sightedness by funding long-term investments,

- geographically-focused missions, conveying the objective of serving a specific geographic area’ (D8.09)

Mutual organisation and state-owned ones may be considered to have objectives other than the maximisation of profits, but do have to at least break-even (what exactly that would mean depends on how costs are evaluated) and in that sense pay regard to the ‘bottom line’. Further, such organisations have a range of other objectives – serving particular income groups, providing funds to specified groups etc. These organisations may then be termed double bottom line institutions (DBLI)

Privately owned banks and DBLIs generally differ in size – the former vary greatly in size though in many countries there is a high degree of concentration amongst such banks and which have often spread internationally. Privately owned banks may be ‘less capable of processing and transmitting the soft and relational information through their hierarchical structures, DBLIs can better respond to the needs of smaller local enterprises (Stien, 2002). They can foster regional development by mobilising savings and lending the funds in the region where they belong, thus preventing a capital drain even if a region is less developed (Hakenes, Schnabel, 2006). In effect, countries, in which stakeholder banks play an important role, display low level of financial exclusion (Carbó et al., 2007). Moreover, local DBLIs provide stable tax revenue, since they are less prone than large multinational banks to shift profits to countries with a favourable tax regime (Demiorgüç-Kunt, Huizinga, 2001). They also aim at maximising the expected labour expenditures understood as a preference for expansion in order to fulfil the social goal of providing access to credit to certain categories of the population, or as a preference for maximizing the expected salary pay to the workers (Akella, Greenbaum, 1998). Finally, accountability of the managers of mutual DBLIs to owners may be greater than that of managers of private
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organizations, because each claimholder can exercise the right to withdraw funds if he or she assess management to be inefficient (Fama, Jensen, 1983, Girardone et al., 2009). As a result, the presence of stakeholder banks increases systemic financial stability and social welfare (Lopez Puertas-Lamy, Gutierrez, 2012).

‘DBLIs are often expected to have weaker incentive to maximise profits than private-owned banks, thus achieving lower efficiency due to lack of capital market discipline and lower intensity of environmental pressure (O’Hara 1981, Masulis, 1987). However, the empirical support for this argument is rather blurred. Despite the fact the private-owned institutions and DBLIs in the EU countries have competed in the same markets, under the same regulatory framework (Iannotta et al., 2013) they at the same time have followed different paths of development. This is why it is hard to provide an unambiguous proof of the dominance of one of the ownership form over other, as results of research remain highly dependent on the sample as well as the period and the region under study’ Jurek (2014b).

Tomidajewicz (2014b) indicates that the behaviour of institutions with regard to their ownership form will be exhibited through the selection of the type and scope the functions performed in terms of the structure of the financial services provided, and the market segments in which the institution operates. Further, the ‘methods of and criteria for making decisions about the way to conduct financial activities (provide services), relating to such characteristics of business activity as profitability, levels and methods of risk protection, the related level of liquidity preference, and the time horizon of economic calculation’.

Private owned financial (as other) institutions are generally taken to be profit maximisers (or at least seeking to gain the highest profits). It should though be noted that there has long been a stream of thought where managers are the effective decision makers in a firm and their interests are not necessarily aligned with profits – leading to arguments that managers would be more rewarded by size of their institution and its growth. The emphasis that a key element of financialisation has been the pursuit of shareholder value, as indicated above, has reinforced the pursuit of profits. Mutual, co-operative and public owned institutions, in some contrast, have
objectives other than profits, though will generally have requirements to at least break-even.

More typical of cooperative financial institutions than the choice of a generally understood business sector is the choice of the market sector (group of target customers) to which financial services are offered. From this point of view, it should be first of all emphasised that, in the statement of their mission and declared directions of their activity, the majority of cooperative financial institutions emphasise concentrating their offer on meeting the financial needs of entities (households, companies, and local communities) that have financial problems and experience difficulty in obtaining access to financial services provided by commercial (usually private) financial entities.

‘The theoretical literature, legal definitions (formulated in order to formally and/or fiscally separate collectively-owned institutions), as well as the statutes and mission statements of collectively-owned financial institutions emphasise that the aim of their activity is not to make or maximise a profit but to meet the financial needs of their members or a specific customer group. At the same time, it should be noted that in cooperative organisations providing services mostly for non-members of cooperatives, any surpluses generated by this part of activity can be used to increase the benefits of cooperative members, which makes these cooperatives interested in increasing profits from their activity.’

Tomidajewicz (2014b) presents data which suggest that there is great diversity in profitability though there is ‘no clear trend can be seen towards cooperative banks’ lower level of profitability.’ The paper reports that ‘co-operative banks are characterized by strong capitalization (high solvency ratio), by moderate risk levels, and stable profit levels, as emphasized in the reports by Standards & Poor’s, Fitch and by FMI. The FMI report in particular points out that co-operative banks act as a buffer against any crisis in the banking system. The S&P report equally highlights their regulatory function: co-operative banks have demonstrated their capacity to
consistently produce operational results, (...) such a capacity being linked to their minimum involvement in more volatile transactions.’

As Tomidajewicz (2014b) indicates public banks often perform roles of savings banks with a focus on low- and middle-income customers, and others act as development banks providing access to finance for major long-term development projects. The paper, based on analysis of the mission statements of the financial institutions concerned the following target stakeholders in public financial institutions’ services have been identified: the general public as customers, the general public as stakeholders, shareholders, SMEs, public entities, other banks and employees. At the same time, it should be emphasised that, depending on the type of institution, the customer groups identified here were indicated as directions of activity at various frequency, and various significance was attached to them. The activity orientation most often indicated as important was the general public as customers as well as SMEs and public entities, whereas the least importance was attached to an orientation towards shareholders and employees.

In terms of the aims formulated in the mission statements of public financial institutions, M. Schmit et al have identified four types of their missions, namely promotional missions, general-interest missions, geographically focused missions and general mission.

However, this lower default risk does not derive from a lower operating risk – as would be reflected in better economic and financial conditions – but, rather, from governmental support. Thanks to this government protection mechanism, GOBs are likely to benefit from a lower cost of funding when issuing debt securities in capital markets. In addition, government protection shields GOBs from the effects of market discipline and provides them with an incentive to increase risk taking. Indeed, despite

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7 M. Schmit, L. Gheeraert, T. Denuit, C. Warn, Public Financial Institutions in Europe, op. cit., p. 75
their lower default risk, GOBs have a higher operating risk – as reflected in their worse economic and financial conditions – compared to POBs.”

A unique feature of public financial institutions is also their relatively high involvement in the funding of projects characterised by a long payback period. Consequently, the funding of long-term projects is largely undertaken by public financial institutions. All European members of the Long-term Investors Club, an organisation of long-term investors, are fully-public or publicly-controlled institutions.

Tomidajewicz (2014b) argues that the most important aspects of the behaviour of public financial institutions include a lower focus on achieving high profitability, services offered to those who can encounter difficulties in obtaining finance from private financial institutions and can offer a strong focus on supporting development projects at local, regional, national and international scale.

Tomidajewicz (2014b) argues that public banks often have lower profitability and higher operating costs than private banks. “However, this does not necessarily spell a poorer achievement of social and developmental aims. As A. Micho et al have put it, “The paper finds that in the case of industrial countries there is no correlation between bank ownership and bank performance, but that there is a strong correlation between bank ownership and bank performance in developing countries. In particular, we find that state-owned banks located in developing countries tend to be characterized by lower profitability, higher overhead costs, and higher non-performing loans than their private counterparts.(..) We are not able to test whether the lower profitability of public banks is due to mismanagement or a development mandate and hence we cannot express any value judgment on the desirability of having state-owned banks.”

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8 G. Iannotta, G. Nocerab, A. Sironi, The Impact of Government Ownership on Bank Risk, http://www.unibocconi.it/wps/wcm/connect/320d3d70-60bb41ec95ae970d67ca9929/j F1_5r_19oct12%2528Final%2529.pdf?MOD=AJPERES
Dymarski with Tomidajewicz (2015) conclude that ‘in most of the cases of privatisation carried out in the European countries since the early 1980s as part of their economic policies this kind of analysis has not been made, and because the basic rationale and impetus for privatisation activities were broadly-understood ideas of efficient market and property rights theories, it can be concluded that these theories [of efficient markets and property rights] has been transformed from a scientific analysis of the implications of various forms of ownership into an ideology of economic policy. Also privatisation itself has been transformed in practice from a means of rationalising the economy into an instrument of an ideologically motivated restructuring of the socio-economic system. [For the Central and Eastern European countries after the fall of the socialist system in the 1990s], privatisation was transformed from a tool for achieving specific efficiency objectives into an independent aim of economic transformation policy.’

**Microcredit, microfinance and mutual ownership**

Microcredit differs from traditional credit because of the small size of loans, alternative collateral requirements, and non-traditional credit evaluation (Evers & Jung, 2007). Although often associated with co-operative or public ownership, microfinance can also involve private ownership.

There are two types of microcredit (Lämmermann, 2010): microcredit for business start-ups and social microcredit. The latter type of microcredit intends to help excluded persons to finance expenses in their social and economic integration.

Microfinance Institutions (MFIs) have distinctive characteristics from commercial banks, namely they aim to obtain social impact together with a reasonable return/risk relationship; practise higher interest rates; have higher cost-to-income ratio due to the small dimension of loans; grant uncollateralised loans; sometimes use group lending; have a closer relationship with borrowers; combine credit with advisory; and use step lending techniques where larger loans are successively granted after successful repayments (Kraemer-Eis & Conforti, 2009). Indeed, in general MFIs pay little attention to their profitability, operational costs are covered and institutions
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depend on public subsidies and private charity funds (Evers & Jung, 2007). See Table 1 of appendix of Lagoa (2014), for mission statements of micro finance

Lagoa (2014) draws some overall conclusions with regard to micro finance. The first concerns how the general economic environment affects the development of microfinance. These range from public policies, structure of tax regime, bureaucracy in Sweden hampering the development of microcredit, the effects of the financial crisis of 2008 (examples given as Spain and Romania), and the development of the banking system recognising that there is a degree of substitutability between the banking system and the microcredit sector.

Lagoa (2014) points to the factors influencing positively or negatively the growth of MFIs. ‘national public and EU funds and support are a key element to create and sustain the sector, filling the gap left by a market failure. Other Government policies to foster microcredit include the creation of guarantee funds and coverture of risk, simplification of processes to create micro and SMEs, tax incentives to microfinance, and the orientation of social policies to favour self-employment. Public policy is also important in creating a friendly regulatory environment for MFIs and micro-entrepreneurs’. ‘Public policies may instead create difficulties to the microcredit sector’. ‘One of the main threats to the sustainability of many microcredit programmes (especially in Western Europe) is that they depend on public grants of limited duration, and are not able to sustain their activities when these funds end (Evers and Lahn, 2010).’

Janc, Leao, Lagoa, and Marszalek (2014) ask ‘what are the financial services provided by non-profit financial institutions?’ and ‘are there any specific financial needs or specific forms of economic activity that only non-profit financial institutions address?’ This working paper undertakes a case study in Portugal and argued that ‘(1) non-profit financial institutions supply services to customers excluded from the mainstream (commercial) financial system; (2) non-profit financial institutions supply specific financial services which mainstream … financial institutions don’t supply; (3) some non-profit financial institutions work as a channelo through which governments
perform their social role; and (4) some non-profit financial institutions work as a channel through which benefactors perform their patronage role.’

‘Non-profit financial institutions tend to focus on receiving deposits and making loans—the primal banking activities—and they do not normally enter the field of securities management like most mainstream banks nowadays do. As a consequence, they are less prone to large losses and some people see this as something that makes them have more trust in non-profit banks. Reinforcing this is very often their proximity to customers and the network of personal linkages that connects these banks and the local communities’ (Janc, Leao, Lagoa, and Marszalek, 2014)

The objectives for micro finance institutions are often portrayed in terms of the ‘double bottom line’ – that is both profitability (or at least break even) and poverty reduction.11 The poverty reduction aspect is intended to come from the provision of credit to those previously excluded from credit which enables them to establish a business (even if a one person business). Micro finance could also be seen as using peer pressure within local groups of borrowers as a means of reducing default rates. It has often been promoted as promoting financial inclusion and addressing gender inequalities through a focus on female participation.

However, the successes or otherwise of MFIs in poverty reduction and (self) employment creation have hotly disputed. By way of examples, consider the following. On the one side: ‘The emerging microfinance revolution—the large-scale provision of small loans and deposit services to low-income people by secure, conveniently located, competing commercial financial institutions—has generated the processes needed to democratize capital… Appropriately designed financial products and services enable many poor people to expand and diversify their economic activities, increase their incomes, and improve their self-confidence. Financial institutions knowledgeable about microfinance can become profitable and self-sustaining while achieving wide client outreach. Governments and donors no longer need to provide ongoing credit subsidies; they also need not cover the losses of state banks providing

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credit subsidies. Over the past 20 years these characteristics of the microfinance revolution have been demonstrated in widely differing country environments.’ (Robinson, 2001, p. xxx). On the other, ‘By the early 1990s, however, it was becoming clear that the original Grameen concept – microcredit provided to establish or expand income-generating projects – was transmuting into the much wider concept of microfinance, meaning the supply of a whole range of financial services to the poor, including microcredit, micro-insurance, micro-savings, and so on … In particular … it was becoming quite clear that most microcredit is actually used not so much for income-generating projects, but mainly to facilitate consumption spending.’ (Bateman and Chang, 2014, p. 4). They organise their doubts on micro-finance under three headings: the construction of ‘hugely optimistic narrative constructed around the microfinance model [which] is actually rather seriously flawed’; that the dominant microfinance model ‘has not unambiguously resulted in a sustainable poverty reduction and economic development episode anywhere’; and the ‘intimate relationship [of microfinance] with neoliberalism and the globalisation project.’ (pp.4-5)

Many would argue that MFIs suffered from ‘mission creep’ and became more focused on profit than on poverty relief. Micro finance institutions have suffered from financialisation in being sucked into operating as profit-seeking financial institutions, and from the financing of consumer debt rather than provision of investment.

The ‘development model’ which lay behind micro-finance could be seen as groups (whether because poor, on grounds of gender etc.) could not otherwise secure credit, and this acts as a constraint on their economic activities. The reasons why they could not otherwise secure credit would include transactions costs for small loans, discrimination etc. Providing those groups with credit would then enable investment to be undertaken. But there is the need for support (education, management skills, infrastructure) and the need for demand for what they produce. Further, MFI represents the allocation of existing funds which detract from their use elsewhere: that may of course be socially preferred.
4. Foreign ownership and Internationalisation

The involvement of the financial sector with the global economies is necessarily of long-standing: after all international trade has to be financed. It is also the case that banks operating internationally (HSBC for example) is also of long-standing. However, within the European context, national owned banks have until recent years been the norm. This was re-inforced by the licensing and regulation requirements and by capital controls.

Foreign ownership and foreign direct investment in the banking sector has largely taken the form of the acquisition of existing banks (‘brown field sites’) rather than the entry of new banks (‘green field sites’).

The internationalisation of the banking system has a long history, and indeed some forms of finance would accompany international trade. Janc and Marszalek (2014) identify three stages of internationalisation. They note that it had already started in the 19th century, and accelerated during the 1960s. Internationalisation of the banking and financial institutions can be seen as a necessary part of the globalisation processes, and also part of processes of financialisation, and ‘contributed to profound changes in banking systems of individual countries, especially developing ones. Banking institutions which took part in the process transformed into large multinational banks, conducting their businesses globally.’

In the first stage of internationalisation, from circa 1830, ‘the main factor that stood behind the beginning of going abroad by banks was attempts to improve financing of trade between Great Britain and its colonies.’ Similar developments occurred with other colonial countries and banks developed as multinational institutions, though coming to a close at the time of the First World War. The internationalisation process returned during the 1950s and accelerated during the 1960s as banks from the USA expanded overseas. This second stage of internationalisation were responses to ‘specific regulations [which] came into force in the United States. They were aimed at restoring stability in the balance of payment and boosting the American economy. They limited to a large degree opportunities to run banking activity (e.g. they not allowed to lend US dollars to finance foreign direct investments by US multinational
enterprises) as well as discouraged foreigners from issuing bonds in the United States. …It must be noticed here that enforcement of restrictions in the export of capital from the USA contributed to development of the so-called Euromarket.’ However, this ‘second wave of internationalization was influenced not only by political and economic factors, but also by development of new technologies, especially from the IT sector. Implementation of new solutions and devices from this area into banking business caused significant decrease of its costs and strengthened competitive position of banks from industrial countries. Thus, conducting banking activity in less developed countries became much more profitable [Curry, Fung and Harper 2003]’

Janc and Marszalek (2014). Janc and Marszalek (2014) identify a third stage of internationalisation beginning in the 1990s. ‘Banks involved here are mainly from Europe, with special attention paid to the institutions form Spain. Expansion of the latter ones in Latin America constitutes the main strain of the third stage. As a result, Spanish banks, focused on retail banking, have become the most important players in this region [Sebastian and Hernansanz 2002; Small 2004].’ A particular feature of this third stage was the extent to which banks were conducting retail banking operations. ‘It is also worth noticing that this third wave was accompanied by deregulation and liberalization of capital flows, characteristic of economic life and intellectual climate of (neo)liberalism during the 1990s. It is conducive to unification of banking services and makes so-called universal banks dominant organizational form on the financial market [Janc 2008].’

Janc and Marszalek (2014). Drawing on Solarz and Wyczański (1997), Janc and Marszalek (2014) note that internationalization of banking can be viewed in two ways: ‘as a process of expanding activities by a domestic bank through expansion on foreign markets or as a process of entering foreign investors into domestic banks. The authors add simultaneously that under such circumstances foreign banks are treated as an institutional form of transmitting worldwide tendencies into the domestic banking sector.’

Internationalisation, whether of the banking system or more generally, has been viewed in rather positive terms by mainstream writers. One aspect of that comes from
a perceived increase in competition (Padoa-Schioppa 2001). Internationalization is viewed as increasing the number of banks operating in a particular market – though that depends on the mode of entry – that is whether through establishment of new bank or the acquisition of existing bank. ‘Larger becomes the very market, on which banks may run their operations. Additionally, international scope of banks’ activity enforces improvements in safety net and supervisory frameworks. Moreover, through its interdependencies with deregulation, internationalization contributes in a way to international cooperation between supervisors from individual countries. That cooperation, in turn, is conducive to consistency of regulatory frameworks worldwide [Frackowiak and Szambelańczyk 2000, Heffernan 2005, Krugman and Obstfeld 2007].’

Janc and Marszałek (2014) note that ‘it is often assumed that ‘Foreign ownership results in a positive influence on financial sector efficiency and stability. The dominance of the foreign ownership in the financial sector may have negative consequences. …foreign-owned subsidiaries react not only to changes in the host country economic (“pull factor”), but also to changes in the parent institution’s home country (“push factor”). Therefore worsening economic conditions in the home country can force a parent institution to scale down foreign activities. Foreign institutions may be also be less inclined than their domestically owned peers to provide financing for domestic companies, having difficulties in lending to borrowers that lack the hard information to prove their creditworthiness. The small domestic banks tend to be better at relationship-lending that is based on “soft information”, such as reliability of the firm’s owner. It has to be mentioned, however, that surveys of empirical research do not provide a clear-cut answer to these concerns.’ Jurek (2014b).

‘In the light of presented literature, the foreign ownership seems to have a positive influence on financial sector efficiency and competition, enhancing stability of this sector through bringing capital and knowledge. At the same time, it may limit access to credit, especially for SMEs and individuals, and import economic disturbances from
Their host country. Moreover, tough competition with foreign banks can pit into danger the functioning of the smaller domestic banks, with DBLIs among them.

‘Originally, the scope of services offered by the multinational banks on its home market and abroad differed significantly. The basic incentive for banks to go abroad was then the opportunity of conducting activities not allowed in the domestic banking system. Such limitations resulted from asymmetry in legal frameworks regulating activity of banks in individual countries. As a result of deregulation tendencies, such discrepancies have been eliminated systematically, with all – good or bad – consequences of that process.’

While ‘multinational banks have played a key role in the financial integration of global financial markets and the economic integration of individual countries … they have also been important actors in financialization process’ Janc and Marszalek (2014).

The assessment of the internationalisation process appears rather ambiguous. ‘Multinational banks contributed to the emergence, proliferation and transmission of financial innovations and highly risk prone operators. All activities of those institutions connected with spreading and distributing products of financial engineering on individual domestic markets (often offered to agents with lack of sufficient knowledge) contributed to greater risk (political, operational, etc.) in the individual markets as well as to great instability of the overall financial system’ Janc and Marszalek (2014)

‘The EU banking sector is dominated by domestic credit institutions, which control more than 70% of total assets’, though that would represent a considerable fall from earlier figures. ‘Only remaining 30% total assets is controlled by non-domestic subsidiaries and branches of credit institutions. Particularly high level of foreign ownership is observed in the new EU member states, raising concerns regarding the degree of concentration and competition… As a result, the outburst of the global financial crisis proved the new EU member states’ banking sectors vulnerable because of high levels of foreign ownership. Policymakers in these countries became increasingly concerned that foreign-owned banks, despite their declared long-term interest in the region, would seek to cut their losses and run’ (Jurek, 2014b)
‘Foreign financial institutions are also expected to pressure governments to improve regulation and supervision. As a result, foreign ownership may contribute to improvement of the risk management and decline in costs of financial intermediation, Claessens et al. (2001) use 7900 observations from 80 countries over the 1988-1995 period, and show that for most countries a larger foreign ownership was correlated with a reduction in profitability and margins of domestically owned institutions, Similarly, Lensink and Hermes (2004) indicate that the present of foreign institutions increase competition, thus lowering the costs for clients and increasing service quality, and force the domestically-owned institutions to adapt new technologies’ Jurek (2014b)

5. Concluding remarks

Epstein in his key-note address at the 2015 FESSUD conference in ‘confronting financialization’ asked ‘do the financial system’s social benefits justify its size?’12. In section 2, we have raised similar questions and like Epstein have generally concluded that it has in a number of senses become ‘too large’. This paper has noted the previously well-established positive relationship between the size of the financial sector (under the heading of ‘financial development’, ‘financial deepening’, and often measured in terms of the size of the banking system and the ratio of assets traded on the stock exchange to GDP) and economic growth, with the direction of causation a matter of debate. This finding has been largely superseded by a range of studies, which in the nature of econometric estimation draw on the experience of the last three decades or more, indicating more of an inverted U-shaped relationship and often with developed countries operating in the negative relationship area. In the discussion in section 2, the more general arguments on possible negative impacts of financialisation on economic performance were evaluated.

It has long been recognized that the structure of the financial system may also be relevant for the ways in which the financial sector relates to the real sector and to economic performance. For reasons hinted at in the opening section and rehearsed

12 The powerpoint for the key note address will be available on the FESSUD web site, and an interview on this topic available on the FESSUD website.
at length in Sawyer (2014) we have not adopted the bank-based vs. market-based typology to explore the effects of financial sector structure on economic performance. Instead, and drawing on the earlier work in Work Package 8, the ways in which different ownership forms (private, public and mutual/co-operative, foreign/domestic) can impact on economic performance are explored. The different ownership forms and their effects on the real economy are not readily comparable as there are not only different motivations involved (profits or not), but also different ‘mission statements’ and objectives involved, and a tendency to serve different market segments.

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Table 1 Cooperative Banks – Market shares of assets 1994-2003 (as % of total banking system assets)

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<td>21.2</td>
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<td>26.7</td>
</tr>
<tr>
<td>Portugal</td>
<td>...</td>
<td>3.5</td>
<td>3.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Spain</td>
<td>3.0</td>
<td>3.5</td>
<td>3.7</td>
<td>3.9</td>
</tr>
</tbody>
</table>

1/ Including savings banks, before and after their conversion to cooperative banks in 2000

Table 2 Numbers and market shares of mutual and cooperative insurers in Europe

<table>
<thead>
<tr>
<th>Number of mutual/cooperative insurers</th>
<th>Mutual/cooperative market share (definition 1 &amp; 2) 2008 in %</th>
<th>Mutual/cooperative market share (definition 1 &amp; 2) change 2004-2008 in percentage points</th>
<th>Mutual/cooperative market share (definition 1-3) 2008 in %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Life</td>
<td>Non-life</td>
</tr>
<tr>
<td>Austria</td>
<td>59</td>
<td>4.0</td>
<td>2.4</td>
</tr>
<tr>
<td>Belgium</td>
<td>57</td>
<td>7.9</td>
<td>5.4</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>2</td>
<td>2.3</td>
<td>6.3</td>
</tr>
<tr>
<td>Cyprus</td>
<td>0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>1</td>
<td>0.3</td>
<td>0.0</td>
</tr>
<tr>
<td>Denmark</td>
<td>87</td>
<td>19.6</td>
<td>19.5</td>
</tr>
<tr>
<td>Estonia</td>
<td>0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Finland</td>
<td>97</td>
<td>32.5</td>
<td>16.9</td>
</tr>
<tr>
<td>France</td>
<td>716</td>
<td>31.6</td>
<td>15.7</td>
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<tr>
<td>Germany</td>
<td>1,120</td>
<td>33.8</td>
<td>20.4</td>
</tr>
<tr>
<td>Greece</td>
<td>47</td>
<td>3.7</td>
<td>2.6</td>
</tr>
<tr>
<td>Hungary</td>
<td>31</td>
<td>7.2</td>
<td>8.3</td>
</tr>
<tr>
<td>Ireland</td>
<td>1</td>
<td>2.1</td>
<td>1.8</td>
</tr>
<tr>
<td>Italy</td>
<td>5</td>
<td>9.3</td>
<td>7.5</td>
</tr>
<tr>
<td>Latvia</td>
<td>1</td>
<td>14.4</td>
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<tr>
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<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Luxembourg</td>
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<td>9.4</td>
<td>6.7</td>
</tr>
<tr>
<td>Malta</td>
<td>0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Netherlands</td>
<td>104</td>
<td>18.0</td>
<td>1.6</td>
</tr>
<tr>
<td>Poland</td>
<td>0</td>
<td>3.1</td>
<td>0.7</td>
</tr>
<tr>
<td>Portugal</td>
<td>1</td>
<td>1.9</td>
<td>1.1</td>
</tr>
<tr>
<td>Romania</td>
<td>0</td>
<td>11.3</td>
<td>6.4</td>
</tr>
<tr>
<td>Slovenia</td>
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<td>1.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Slovakia</td>
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<td>0.1</td>
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<tr>
<td>Spain</td>
<td>458</td>
<td>11.9</td>
<td>5.0</td>
</tr>
<tr>
<td>Sweden</td>
<td>296</td>
<td>36.3</td>
<td>33.5</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>205</td>
<td>6.4</td>
<td>3.6</td>
</tr>
<tr>
<td><strong>European Union</strong></td>
<td><strong>3,332</strong></td>
<td><strong>18.3</strong></td>
<td><strong>11.1</strong></td>
</tr>
</tbody>
</table>

**Notes:**

1 Does not include the subsidiaries and sub-subsidiaries of mutual/cooperative insurers. In Europe, there are more than 300 of these.

2 The main reason for the decline is that some insurers fell outside the scope of the study (definitions 1 & 2), generally due to demutualisation. Some of these insurers are, however, included in the figures for definitions 1-3.

3 Includes mutual provident societies whose number was (optimistically) estimated at about 400. Their figures are not included in market and market share data.

4 If the statutory pensions business had been included in both overall market data and data for the mutual sector, the mutual market share in life insurance (including statutory pensions) would have been close to 80%.
5. The main reason for the increase is the privatisation of health insurance in 2005; mutuals obtained a significant share of that market.

6. Subsidiaries of foreign mutual/cooperative insurers were, however, active in the market.

Definition 1 insurers are insurance undertakings in the legal form of a mutual or cooperative.
Definition 2 insurers are subsidiaries (and sub-subsidiaries etc) of mutual and cooperative insurers.
Financialisation, Economy, Society and Sustainable Development (FESSUD) is a 10 million euro project largely funded by a near 8 million euro grant from the European Commission under Framework Programme 7 (contract number: 266800). The University of Leeds is the lead co-ordinator for the research project with a budget of over 2 million euros.

THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation?; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?’
THE PARTNERS IN THE CONSORTIUM ARE:

<table>
<thead>
<tr>
<th>Participant Number</th>
<th>Participant organisation name</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (Coordinator)</td>
<td>University of Leeds</td>
<td>UK</td>
</tr>
<tr>
<td>2</td>
<td>University of Siena</td>
<td>Italy</td>
</tr>
<tr>
<td>3</td>
<td>School of Oriental and African Studies</td>
<td>UK</td>
</tr>
<tr>
<td>4</td>
<td>Fondation Nationale des Sciences Politiques</td>
<td>France</td>
</tr>
<tr>
<td>5</td>
<td>Pour la Solidarite, Brussels</td>
<td>Belgium</td>
</tr>
<tr>
<td>6</td>
<td>Poznan University of Economics</td>
<td>Poland</td>
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<td>7</td>
<td>Tallin University of Technology</td>
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</tr>
<tr>
<td>9</td>
<td>Centre for Social Studies, University of Coimbra</td>
<td>Portugal</td>
</tr>
<tr>
<td>10</td>
<td>University of Pannonia, Veszprem</td>
<td>Hungary</td>
</tr>
<tr>
<td>11</td>
<td>National and Kapodistrian University of Athens</td>
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</tr>
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<td>12</td>
<td>Middle East Technical University, Ankara</td>
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<tr>
<td>15</td>
<td>University of the Basque Country, Bilbao</td>
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