TOWARDS A NEW TYPOLOGY OF BANKING

The political economy of finance, through the sub-disciplines of Comparative Political Economy (CPE) and International Political Economy (IPE) has shed significant light not only on the significance of finance on economic activities, but on the subtleties of the typology of financial systems and their effect on economic growth, structural transformation and macroeconomic stabilisation (Zysman, 1983; Levin, 1997; Hardie et al, 2014; Mittenheim, 2016). This is besides what most leading economists had long recognised that the character of the financial system (types of banks and markets) has a material impact on the real economy (Veblen, 1904; Keynes, 1936). And indeed the types of finance too (Minsky, 1992; Mazzucato et al, 2015 (Levy Inst.).

The analytical usefulness of John Zysman's (1983) seminal work on the political economy of national financial systems (bank-based and market-based systems typology) became even more relevant after the 2007/8 global crisis, in understanding the differential impact on nations especially why some economies managed to withstand the crisis better than others and also the deferring periods of recovery from the crisis (Detzer, Daniel et al, 2014; Hardie, 2011; Werner, 2012. Germany, a bank based economy with a typology of banking regarded as supremely stabilising and diverse, recovered the fastest and was employing at the height of the crisis whereas the opposite was true in the US, UK and parts of Europe (Hardie, 2011; Faltermeier, 2013; Detzer, 2012, Werner, 2012). Indeed, French President Nicholas Sarkozy, leaving the G20 summit in the wake of the 2008 financial meltdown reported that the world had "turned the page on the Anglo-Saxon model", in reference to the market based system (Hardie et al, 2011).

The quintessentially Anglo-Saxon nations of the UK & US (market based financial systems) were the epicentre of the global financial crisis. Globally, policy makers and eminent scholars alike identified the market-based finance as the culprit (Braun et al, 2017). Is this an indictment on the financial systems they employ? These economies have a single pillar banking system where private sector banks dominate their markets with negligible or non-existence alternative banks. South Africa fits snugly in this category. On the other side, Germany has about 71% of the banking market in the hands of public banks, with a very stable macroeconomic environment (Werner, 2010, 2012)

Perhaps a relevant macroeconomic question for South Africa and indeed any other developing economy is whether the financial architecture (structure) of an economy, past to present, has any impact on the economic performance of the real sector. To this question, empirical evidence answers it in the affirmative (Levin, 2002; Tadesse, 2003. More specifically empirical evidence in these cross-country studies finds South Africa as a market based system. It did not, however, require empirical confirmation to show that South Africa is such an economy. A mere cursory look at how the financial system is organised, conducts itself and how the banking system is, reveals that the economy squarely falls in the market-based financial system group of nations. And what about industrialisation?

The high industrialisation of the "late comer" Germany then Japan and the rest of East Asia, including China, Korea and Taiwan, all of which implemented the bank-based system, attests to the strength and resilience of the system. Literature supports and confirms this. Chakraborty et al, 2004 finds that the bank-based system outperforms the market-based system when it comes to industrialisation. Investment and per capita incomes are higher, and income inequality lower, under a bank based system. Bank based systems are also more conducive to broad based industrialisation. These studies confirm what Rajan & Zingales, 1998b & 1999 and Tadesse, 2002 found that make a strong case for bank-based systems in developing countries. Tadesse concludes that these findings suggest that recent trends in financial development policies that indiscriminately prescribe market-oriented financial-system-architecture to emerging and transition economies might be misguided.

Beyond the typology of banks typical of bank-based systems that lead to the undisputed superiority of the system from a microeconomic perspective (through the resource mobilization) albeit with some macroeconomic benefits, there are profound macroeconomic issues that arise from the bank based system that are not captured in most studies, including these mentioned above. It is the role of banks and the type of finances that is characteristic of the two financial systems. At macroeconomic level, banks are not only crucial unlike other "financial intermediaries" but that the finance (credit money) from banks is unique.

The South African government, exemplified by the Department of Finance (Treasury) and the Department of Trade and Industry (DTI), including the Reserve Bank, supported by the entire economic establishment, consider banks as financial intermediaries. They also consider money as a mere veil. As such banks are of no macroeconomic significance. Economic models derived from such logic inevitably manifests themselves through the absence of banks in the models or where there are, they are included as mere financial intermediaries. It follows therefore that in the instance where banks are mere intermediaries, bank finance (bank money) is similar in its macroeconomic effects from finance sourced from other financial intermediaries. Similarly it may be assumed that the typology of banks in South Africa, as is often said so by most, has no material effect on the macro-economy. Firstsource Money says that this characterization and understanding of banks and bank money is misplaced. Banks are not intermediaries but manufacturers of money supply.

This understanding of both money, banks and the typology of banks is not only misguided, but has deleterious effects on the economy. In our view (Firstsource Money)- the manifestation of such (mis)understanding is in the performance of the economy since 1994- where we (SA) are de-industrializing, generating unemployment and inequality in disturbing numbers at the same time increasing the price structure of the economy. The contribution to these outcomes of our financial system, our misunderstanding of money and banks can be immense, however maybe underplayed.

This failure to recognize banks as money supply creators is almost endemic to the market based economies and hence the risks that emerged from such nations that spread to even bank based countries. Failure to recover from the crisis, as in SA's case while not seen from the lenses of a financial system due the existing blind spot, has exacted a heavy economic price on South Africa.

But as the Reserve Banks of the UK (BoE, 2014); Germany (Deutsche Bank, 2017); Switzerland (SNB, 2018) and many other Europeans central banks have confirmed and eventually dispelled the prevailing notion, banks are not financial intermediaries but creators of money supply. The macroeconomic effects of this realization on the economy and in the manner economic modeling has to be done is profound. However, Firstsource Money's intervention for now is on the issue of the typology of our banking and the need for deliberations about it. That Firstsource Money is aware of the many limitations of our (SA's) approach across fiscal, monetary and exchange rate policies (macroeconomic framework) may be touched on as we engage on the exploratory discussions surrounding a possible regulatory framework that maybe consistent with a new typology of banks for South Africa.

The domestic banking landscape is entirely dominated by an oligopoly of few but big private banks with almost non-existent mutual banks and poorly instituted state banks. Due to the dominance of private banks, the business models of all other tiny banks are based on the majority model. As such there are no noticeable distinguishing features among the banks. Aligned to the dominant model is a regulatory framework, also largely drawn from the big banks public policy capture, that places importance on this single pillar banking system, which by design is market-based.

Our position is one that suggests a more diverse banking system that can not only contribute to greater financial stability for the economy but plays a supportive fiscal position to government, as are banks in Germany, China and other leading bank based powerful nations. At the centre of our proposal is the possible establishment of a solid and robust not-for profit public banking system with a distinct business model, akin to the Sparkassens in Germany and other European democratic economies.

This type of banking would be central to and be a pillar of industrial development and other capital formation activities in a nation where much of the lending is now being directed to or being withheld for purposes of quick returns in the ever growing financial services sector- thus increasing the financialisation of the economy to the detriment of the real economy. The need for more patient capital in South Africa also means structural transformation, which has since failed may now have an opportunity to be realised sooner than would be the case under the current financial regime.

Firstsource Money is aware of moves in the UK to revert to their old banking system that was very diverse prior to the wave of deregulations, privatisations and liberalisations that swept many nations at the height of the neoliberal era. Similar moves are happening in the US too (Mazzucato, 2017; Werner, 2010; Brown 2017)

It is in light of the above and need to create a sustainable banking system and its accompanying enabling regulatory regime aligned to the developmental priorities of government and the people that Firstsource Money seeks to engage you (Treasury) on a multi-pillar typology of banks for the Republic. We are of a strong view that better macroeconomic outcomes are possible with the introduction of such an alternative model of banking.