# A STATE-OWNED PAYMENT AND SAVINGS SYSTEM AS AN ALTERNATIVE TO THE BANKING REGULATIONS STRENGTHENING

**Razvan STEFANESCU**
razvan.stefanescu@ugal.ro
**Ramona DUMITRIU**
ramona.dumitriu@ugal.ro
*Dunarea de Jos University of Galati, Romania*

The dramatic consequences of the global crisis forced governments to take into consideration the banking sector reform. The main initiatives are based on the banking regulations strengthening. In this paper we approach another kind of solution to the banking sector problems: a state-owned payment and savings system which could induce a responsible behavior to the financial institutions.

Keywords: Banking Sector Reform, Regulations, Global Crisis, Payment and Savings System

JEL Classification: G01, G21, G28

## 1. Introduction

The recent global crisis highlighted some major vulnerabilities of the banking system. Several important financial institutions were near to bankruptcy and the perspective of a systemic failure forced the authorities to intervene. Huge public financial resources were directed to bailouts offered to banks. These measures restored the financial stability but they couldn't repress the banks unpopularity increase. The excessive risks taken by financial institutions are perceived as one of the main causes of the global crisis. The banks are also considered as responsible for the financial products proliferation, which facilitated the speculative investments. In these circumstances, structural reforms of the banking system became unavoidable (Avgouleas, 2008; Harvey, 2008; Murphy, 2008; Friedman and Friedman, 2009; Campello et al., 2009; Gorton, 2009; Wilmarth, 2009; Avgouleas, 2010; Whitehead, 2010; Bayazitova and Shivdasani, 2011; Bordo et al., 2011).

Many of the recent attempts to reform the banking system were viewed as updated versions of the Banking Act of 1933, known as Glass - Steagall Act, which imposed, in the context of the Great Depression, drastic regulations to the United States banking sectors. In the next decades, some of them had to be modified to keep pace with the changes of the financial sectors, especially the financial innovations proliferation (Funk, Russell and Hirschman, 2014). Since 1980s, under the banks pressure, the authorities gradually relaxed the regulations. This process of the banking deregulation was blamed, lately, as encouraging the development of the shadow banks and over-the-counter derivative markets. The dramatic consequences of the crisis prompted authorities to reinforce the banking regulations (Pozsar et al., 2010; Ricks, 2010; Adrian and Ashcraft, 2012; Schwarcz, 2012; Subramanian and Yadav, 2012; Chava et al., 2013; Kneer, 2013; Funk and Hirschman, 2014). The Basel Committee on Banking Supervision proposed a new framework of the banking regulation, known as Basel III, meant to reduce the risks by the bank capital requirements strengthening (Spinassou, 2013; Atik, 2014; Siskos, 2014). In the United States, after the Financial Crisis Inquiry Commission had indicated the deregulation process as one of the main causes of the crisis, a clause of the Dodd-Frank Wall Street Reform and Customer Protection Act, known as the Volcker Rule, prohibited banks from engaging in proprietary trading (Skeel, 2010; Thomas et al., 2011; Whitehead, 2011; Duffie, 2012; Whalen, 2014). In United Kingdom, the Independent Commission on Banking, chaired by John Vickers, recommended the ring-fencing of the banks' retail operations (Chow and Surti, 2011). At the European Union level, the diversity of the banking legislations hampered an appropriate reaction to the financial institutions problems. The drastic consequences of the crisis revealed the necessity of the banking regulations harmonization (Fahey, 2010; Ferrarini and Chiarella, 2013; Guarracino, 2013). The EU members agreed on the creation of the European Banking Authority responsible with the coordination of the national banking supervisors. The final report of the High-Level Expert Group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen, contained, along with measures inspired by Volcker Rule or the Vickers Report, proposals meant to convince banks to rely on bail-ins rather than to wait for the bailouts (Gambacorta and van Rixtel, 2013; Kneer, 2013; Ojo, 2013).

These plans of structural reforms were criticized as being non viable and too costly. In this paper we approach a new way of the banking reforms. Instead of the regulations strengthening we propose the creation of a state-owned payment and savings system (SOPSS) which could help in preventing new banking crisis. The rest of this paper is organized as it follows: the second part presents some characteristics of the SOPSS management, the third part discusses the main arguments in favor of this alternative and the fourth part concludes.

**2. Management of a SOPSS**

The functions that a SOPSS has to perform provide five specific dimensions of its management:
a. the administration;
b. attracting the financial resources;
c. lending activities;
d. liquidity management;
e. asset and liability management.

a. The administration. The state ownership of the financial institutions has many opponents. They pointed out on some factors that could affect the management efficiency, especially the incompetence and corruption brought by the involvement of the politics (La Porta et al., 2000; Micco et al., 2007). Such situations usually occur in the case of institutions administrated by the entities subordinated to the Government. We propose, in these circumstances, that the SOPSS administration to be assigned to the Central Bank. In the last decades, the Central Banks of most of the countries gained a real autonomy in relation with the Governments so they are able to defend SOPSSs against the involvement of the politics. The Central Bank, which has to defend the monetary stability, is supposed to assure an efficient management of the substantial resources attracted by SOPSS.

b. Attracting the financial resources. To fulfill the purposes of its creation, a SOPSS has to be preferred by a large part of the population. Moreover, it has to become attractive, in time, by significant proportions of companies and small and medium size enterprises. Obviously, all Government payments, including the wages of the state employees and the pensions, have to be realized through SOPSS. The risk counterpart free services provided by SOPSS represent its main advantage against its competitors and it will become more valuable when the Government intention to ban the bank bailouts will be credible. The interest rates for the attracted financial resources will be established based on those applied by the main competitors and on the Central Bank forecast of the inflation.

c. Lending activities. A half of the financial resources attracted could be directed to the acquisition of the Government bonds. SOPSS could also offer loans for financing Government development projects. Less than 10 percents could be used in lending to population or to small and medium size enterprises.

d. Liquidity management. As we specified before, half of the financial resources attracted by a SOPSS will be used to buy Government bonds which are characterized, for most of the countries, by a low risk of liquidity (Ejsing, 2012). Anyway, in case of temporary liquidity problems a SOPSS could count on the Central Bank help.

e. Asset and liability management. The main component of the SOPSS assets will consists in government bonds, which usually have a very low counterpart risk. SOPPS will establish, for each category of loans, specific procedures of managing credit risk. The main component of SOPSS liabilities will consists in deposits with different terms. Their structure has to reflect the exigencies of the liquidity management. The SOPSS management should also provide the control of the interest-rate risk and of the currency risk.

**3. Arguments in favor of a SOPSS**

The opportunity of a SOPSS should be assessed by comparison to the alternative of banking regulations strengthening. In our opinion a SPOSS has some significant advantages:
a. it offers opportunities of free counterpart risk payments and savings;
b. it induces a responsible behavior to the banks;
c. it increases the monetary policy efficiency;
d. it offers reliable financial resources to the state.

a. Opportunities of free counterpart risk payments and savings. In the context of the growing complexity of the financial system it is hard to assess the counterpart risk of the private financial institutions. The global crisis also revealed the inaccuracy of the credit rating agencies risk evaluations (Cole et al., 2014). Moreover, the problem of the moral hazard was aggravated by the arbitrary of the governments' interventions during the crisis (Okamoto, 2008; Kao, 2012; Hett and Schmidt, 2013). In

these circumstances, the state should offer to population and to enterprises free counterpart risk alternatives for payments and savings.

b. Inducing a responsible behavior to the banks. One of the main reasons the regulations failed, until now, to keep safe the banking system consists in the fact that most of the financial institutions perceived them not as a protection against excessive risks but rather as constraints to increase the profitability. They, especially those which considered they could count on Government bailouts, tried to elude them by financial innovations. In the war between banks and institutions which impose the regulations, the first ones usually won because they are more inventive and flexible. Somehow the banking regulation is similar to the Prohibition in the United States between 1920 and 1933. Because the lack of a substantial popular consensus, the measures against the alcoholic beverages didn't succeed to stop the consumption. Instead, they stimulated the proliferation of criminal organizations which provided alcohol on the black market. As in the case of Prohibition, the best solution for the excessive risks taken by banks could be not the regulation strengthening, but making them more responsible. A SOPSS could achieve that because, after its creation, the Government will have no justification for bailouts of the bank. We could expect that, without the perspective of the bailout as a seat-belt, the banks will avoid to take excessive risks. In the presence of such an evolution, the regulations could be even gradually relaxed.

c. Increasing the monetary policy efficiency. In the last decades many central banks experienced difficulties in influencing the monetary aggregates growth or the interest rates evolution. This fact led to the abandon of the two variables as targets of the monetary policy. A SOPSS which could succeed in attracting a large part of the population savings could offer to the Central Bank an efficient tool to interfere with the monetary aggregates evolution. Beside that, the interest rates announced by SOPSS could influence those practiced by the commercial banks.

d. Reliable financial resources to the state. In the last years, the credit rating agencies downgraded the sovereign debt of many countries. As a result, the borrowing by issuing governments bonds became not as easy as it had been before the crisis. A SOPSS that can use about a half of its attracted resources to buy Government Bonds could help authorities in solving the problems of financing their activity.

## 4. Conclusions

In this paper we approached the possibility that a SOPSS could solve some of the banking sector by inducing a responsible behavior to the financial institutions. Obviously, in such complex circumstances it is not easy to predict all the results of this solution. However, while the success of the recent attempts to reform the banking system in US and EU is still in doubt, the creation of a SOPPS could be taken into consideration as an alternative to strengthening the regulations.

The recent crisis added new dimensions to the debate on the intervention of the state in the banking system. Now it is admitted that proliferation of the shadow banking system and the financial innovations were stimulated by the inappropriate state intervention. In the last decades the private financial sector experienced a too high growth which had as effects the excessive borrowing and the increase of the speculative activity proportions on the financial markets. The use of huge public funds for the recent bailouts should legitimate a more active state intervention on the banking sector, for example through a SOPPS. The analysis of this solution could be extended in accordance with the results of the new regulations.

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