The Rise and Fall of State Banking in OECD Countries

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State banking is the intervention of the state in the allocation of credit. State banking became important during the course of this century in some Organization for Economic Cooperation and Development (OECD) countries but not in others and then declined in the 1980s. Why? State banking was demanded by sectors that were pressed to invest but that could not find access to long-term credit because of the marginal importance of small and local banks in countries with centralized market and state institutions. The class cleavage enabled these groups to extract state banking from central governments thanks to their pivotal role in the Right-Left rivalry. The current demise of state banking reflects the shift from class to territorial modes of interest articulation in capital markets.

THE RISE AND FALL OF STATE BANKING IN OECD COUNTRIES

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State banking is the direct intervention of the state in the allocation of credit. State banking first appeared in some countries during the second half of the 19th century in the form of agrarian mortgage banks; it gained momentum between the wars, with the creation of banks for industry, and really took off in the postwar decades, reaching a climax in the 1960s. It has been declining ever since. Although this trend was general, state banking became much more important in some countries than in others. State banking assumed considerable importance in Belgium, France, the Netherlands, Norway, and New Zealand but remained of limited importance in Britain, Italy, Germany, Japan, Spain, and Sweden and was insignificant in Denmark,

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Canada, Switzerland, and the United States. The purpose of this study is to explain the historical trend and the cross-national variation.

Why study state banking or banking in general? Although political economists have not neglected the study of banking, comparative knowledge on how capital markets are organized and how distributive conflicts in that market are allocated is scant and unsystematic. Capital alternatively appears as an employer in a class-cleft polity,[1] or as the owner of fixed capital in a game of rent seeking (see Alt & Gilligan, 1994; Frieden, 1991; Frieden & Rogowski, 1996 ; Magee, 1980; Rogowski, 1989; Verdier, 1995), but rarely as plain, liquid, and territorially mobile cash. And yet, distributive conflicts in financial markets, as opposed to labor and product markets, ought to be territorial because cash is inherently mobile and mobility forces neighboring jurisdictions, be they national or subnational, to vie for this factor of production.[2] There are imminent signs, however, that the territorial cleavage is becoming as important as the class and sectoral cleavages. “Globalization,” a generic term referring to the growing mobility of capital across borders, is making domestic financial markets central again in the allocation of gains and losses (see Garrett, 1995; Quinn, 1997). Local communities are increasingly active in the competition for investment (see Guisinger, 1985; Thomas, 1997). I will try to show that state banking was the unintended child of class politics; its subsequent demise reflects the resetting of interest articulation in capital markets from national to territorial modes.

The argument holds in three points. First, state banking was a demand expressed by sectors that were pressed to invest but could not find access to long-term credit because of the marginal importance of small and local banks in countries with centralized market and state institutions. Second, the emergence of the class cleavage as the main line of partisan battle gave these groups the power to extract state banking from central governments because of their capacity to arbitrate the rivalry between the capitalist Right and the working-class Left. Third, the recent fading of the class cleavage in the polity, associated with the mounting opposition of profit banks to state banking and the growing attention paid by local governments to firm implantation, are causing a reorientation of the small capitalists’ lobbying away from central toward local governments, especially in decentralized countries where local banks are still well implanted.

1. See the literature on party systems and neocorporatism.

2. For examples of modeling of cross-border capital mobility, see Krugman (1993) and Rogowski (1997).

The next section provides a working definition of state banking and describes its longitudinal and cross-national variations. A second section reviews the existing literature on state banking. The following three sections develop and test the argument about the origins of state banking. The last two sections before the Conclusion do the same about the present decline of state banking.

DEFINITION AND FACTS

I define state banking as the allocation of credit by the central government through so-called state banks, which finance their needs by issuing state-guaranteed bonds. A state bank is not to be confused with a nationalized bank, which usually is an ex-privately held, commercial bank. Because nationalization merely aims at appropriating bank profits, a nationalized bank has traditionally been run like any other bank.[3] State banking, in contrast, aims at reallocating bank credit. A state bank is not a central bank either in that the central bank enjoys a monopoly on note issuing, whereas a state bank enjoys a bond borrowing privilege. Finally, within the category of state banks, it is important to distinguish between deposit and credit banks. On the deposit side of state banking one finds postal savings, which were almost universally created in the second half of the 19th century to provide central treasuries with access to individual deposits and which are cheaper than bonds. One also finds systems of national savings in Britain and Belgium performing the very same function, although in the Belgian case, state control may have been initially decreed to consolidate fledgling private savings banks. I will exclusively focus on the credit side of state banking, that is, banks that are specialized and were founded to meet a strongly felt need for credit by a category of borrowers whose relative borrowing power from the capital market was below their political power.

State banking came in three waves, the first targeting farmers, the second small firms, and the third traditional sectors. The first state banks were built on the model of the French Crédit Foncier, a special agricultural credit institution created by Louis Napoléon in 1852, the year he was elected emperor by a plebiscite, thanks to the rural vote. According to Karl E. Born (1983), "Napoléon was returning a favour to his supporters among the rural popula-

3. On the French nationalizations, Karl E. Born (1983) writes, "In essence, the business activity of the big nationalized banks remained unchanged. In this sense, it may be said that the French case has demonstrated the pointlessness of nationalizing big banks" (p. 310).

tion" (p. 104). Similar state banks were created in Sweden and Norway. By the turn of the century, governments created systems of credit to agriculture, notably in New Zealand, the United States, and France, of course, with the Crédit Agricole. In the 19th century as well were created municipal credit banks to finance urbanization in small towns; the first instance was the Belgian Crédit Communal, founded in 1860.

Whereas the first wave of state banking essentially targeted agriculture and local urbanization, the second wave targeted small firms. Small firms were diagnosed after World War I to suffer from the famous "Macmillan Committee gap" in the provision of finance over the medium term. The Japanese government created the Relief Fund for Small Farmers and Manufacturers in 1912. Other examples include the French Crédit National (1919) and Crédit Hôtelier, Commercial et Industriel (1923) (see Baubeau, Lavit d'Hautefort, & Lescure, 1994; Lescure, 1987), the Dutch Middenstandsbank (1927), the Swedish AB Industrikredit (1934) (see Thunholm, 1954, p. 689), the Manufacturing Bank of Norway (1936) (see Knutsen, 1995, p. 94), and the Belgian Caisse Nationale de Crédit aux Classes Moyennes (1937). The second wave swelled after World War II with the addition of the Canadian Industrial Development Bank (1944) (see Marsh, 1954, p. 157), the Industrial Finance Department of the Commonwealth Bank (1945) in Australia (see Hytten, 1954, p. 35), the British Industrial and Commercial Finance Corporation (1945) (see Coopey & Clarke, 1995), the Dutch Herstelbank (1945) (see Batenburg, Brouwer, & Louman, 1954, pp. 633-638), the German Kreditanstalt für Wiederaufbau (1948) and Industriekreditbank A. G.–Deutsche Industriebank (1949) (see Hu, 1984, p. 37), the Italian Cassa per il Credito all imprese Artigiane (1947) and Mediocredito (1952) (see Gerbi, 1954, p. 489), the Spanish Credito Oficial (a generic term referring to all state banks) (see Clayton, 1962), and the Belgian Société Nationale d'Investissement (1962) (see Van Molle, 1995). Specialized banks also were created in the 1920s to finance international trade. Although these banks mostly served large business' needs, their share of state banking was relatively small.

Many of these banks, along with specially created ones, participated in the postwar financing of the third wave of state banking. Patterned after the Italian fascist model, its purpose was to relieve the failed (and, from then on, tightly regulated) banks from the burden of financing fixed assets in some sectors of heavy industry (steel, shipbuilding). The most important instance is the Istituto Mobiliare Italiano (1931) (see Castronovo, 1992). This third wave was most developed in Belgium, France, Japan, and Italy, all countries that separated deposit from investment banking after World War II.

Although state banks exist in all countries, the relative importance of state banking varies considerably across countries and through time. I have tried to measure this twofold variation for Organization for Economic Cooperation and Development (OECD) countries. For each country, I have categorized credit institutions into four sectors: profit, nonprofit, local, and state.

Profit includes all commercial banks, whether joint stock or partnership and whether nationalized by the central government or in private ownership. The central bank is not included. All profit banks, with the central bank as primus inter pares, were initially created by private bankers and later incorporated into joint-stock banks, usually in the second half of the 19th century, with central government approval in the form of a charter. Many of these banks were nationalized after World War II and privatized in the last two decades. They were not run by the state, and even when owned by the state, its directors enjoyed enough autonomy to pursue market-oriented strategies.

Nonprofit includes savings banks, mortgage banks, credit cooperatives, and a residual category of credit banks, such as the German Landesbanken and the Swiss Kantonzl banks, that are operated by local governments. Nonprofit banks benefit from legal privileges that allow them to compete with profit banks—they typically pay no (or less) taxes and enjoy a state guarantee on their deposits. During the postwar era, they were spared from reserve requirements in all countries but Germany. Nonprofit banks differ from profit and state banks in terms of territorial scope—they are local institutions. Savings banks were initially chartered by city governments in the first half of the 19th century. They were (and quite often still are) local monopolies. Private mortgage banks are also local or regional institution. Credit cooperatives are grassroots organizations.

Local includes commercial (profit) banks chartered by subnational levels of government—they are only to be found in two federal countries: the United States and only marginally in Australia.

State includes all state credit banks, with the exclusion of all postal savings and three national savings schemes—the British national savings accounts and the share of the Belgian national savings system that must be deposited with a central government fund. All state banks were created, and run, by the central government.

The four sectors combined cover the entire financial system, with the exception of the central bank, stock brokerage firms, specialized installment finance companies, specialized money market firms, and postal and national savings. Figure 1 displays country-specific graphs representing the proportion of assets falling into each category throughout the period 1860-1995 for the years and country for which data are available. Missing data points

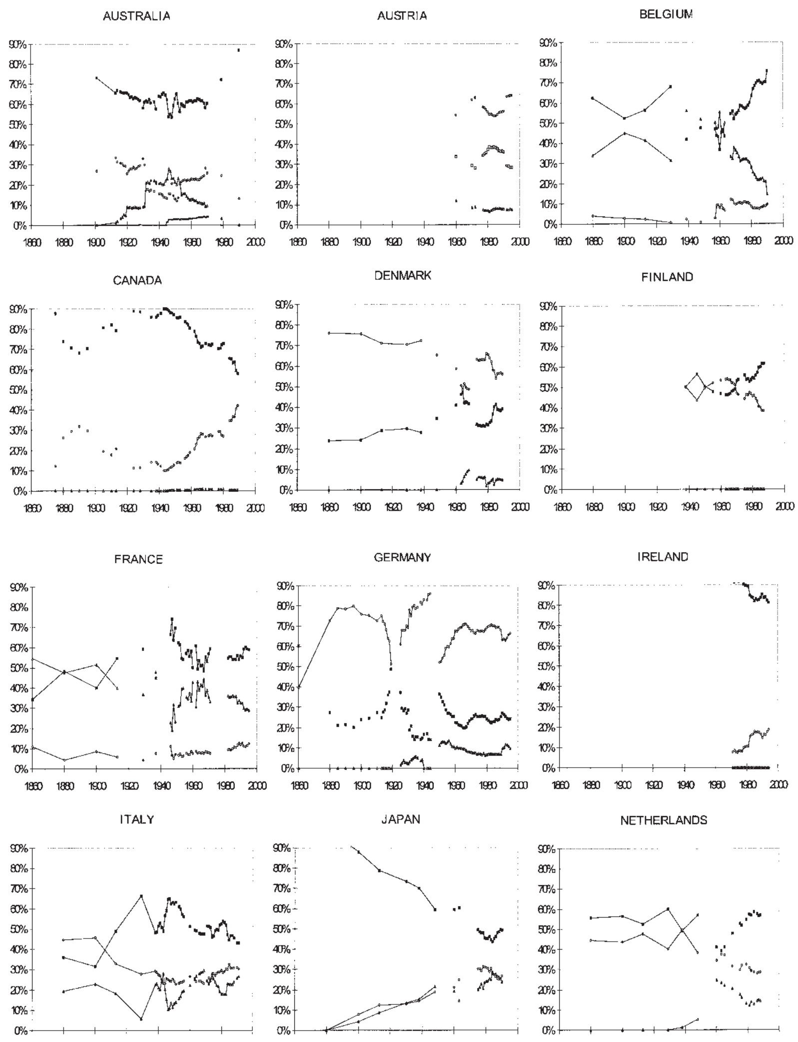

Figure 1. Assets of the four banking sectors in percentages, 1860-1995.
Source: Goldsmith (1969). Australia: *Australian Financial System* (1980); Butlin, Hall, and White (1971); *Official Year Book of Australia* (various years); White (1973). Austria (Austria and the Czech Lands in 1913): Diwok (1982); Mitchell (1992, pp. 774, 781); Österreichische Nationalbank (various years); *Statistiches Jahrbuch* (various years). Belgium: *Annuaire statistique de la Belgique* (various years); OECD *Financial Statistics. Methodological Supplement* (various years); Mitchell (1992, pp. 781, 784); Société des nations (1931, p. 116). Canada: *Canadian Yearbook* (various years); Société des nations (1931, p. 329). Denmark: Johansen (1985); Société des nations (1931, p. 125). Finland: *Statistical Yearbook of Finland* (various years).

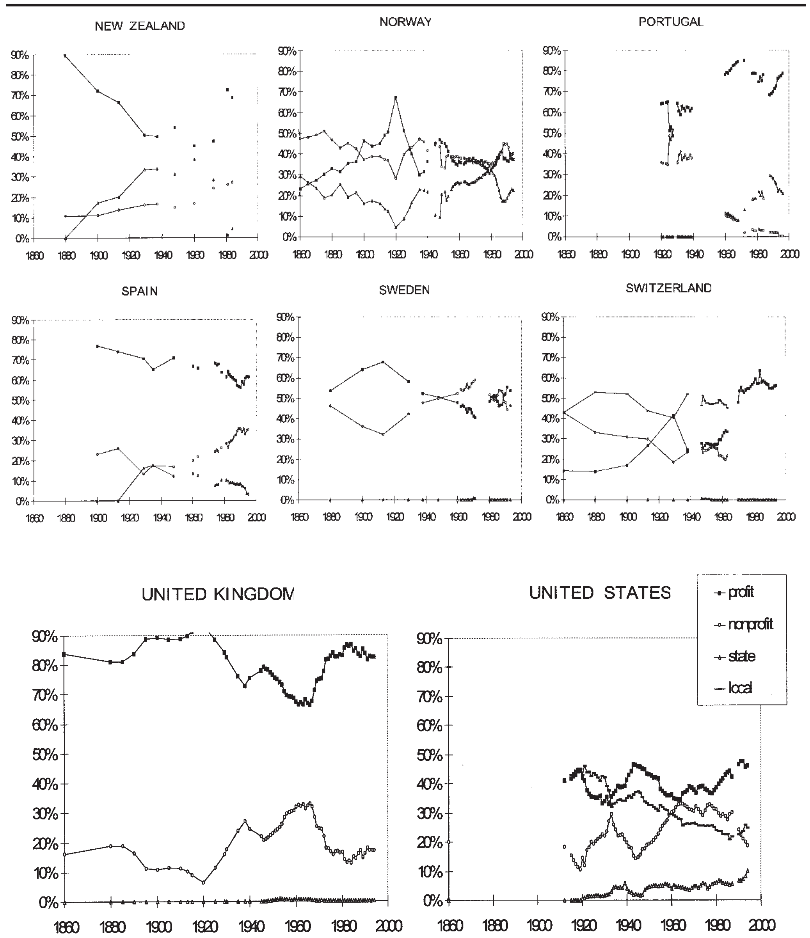

Figure 1. continued
France: Banque de France (various years); Bayliss and Philip (1980, p. 127); Conseil National du Crédit (various years); Mitchell (1992, pp. 774, 782). Germany: Deutsche Bundesbank (1976); *Statistisches Jahrbuch für die Bundesrepublik Deutschland* (various years). Ireland: Central Bank of Ireland (various years); *Ireland Statistical Abstract* (various years). Italy: Banca d'Italia (various years); Garofalo and Colonna (1997); Mitchell (1992, pp. 774, 782); Société des nations (1931, p. 187). Japan: *Economic Statistics Monthly* (various years); Tamaki (1995, pp. 223-236). the Netherlands: Nederlandsche Bank (1987, pp. 34, 48, 52); Nederlandsche Bank *Annual Report* (various years); OECD *Financial Statistics. Methodological Supplement* (various years). New Zealand: Bloomfield (1984); *New Zealand Official Yearbook* (various years); Société des nations (1931, pp. 447). Norway: Mitchell (1992, p. 782); Société des nations (1931, p. 199); *Statistisk Arbok* (various years). Portugal: *Estatística Financeiras* (various years); Nunes, Bastien, and Valério (1994). Spain: Banco de España (1986, 1996); Martin-Aceña (1995, p. 522); Mitchell (1992, p. 782); OECD *Financial Statistics. Methodological Supplement* (vari-

Figure 1. continued
ous years). Sweden: Bankaktiebolagen Fondkommissionärerna Fondbörsen och VPC (various years); Mitchell (1992, p. 783); Société des nations (1931, p. 275); *Statistisk Arsbok för Sverige* (various years); Sveriges Riksbank (1971). Switzerland: International Monetary Fund (1962); Ritzmann (1973); Schweizerische Nationalbank (various years); Société des nations (1931, p. 288). United Kingdom: *Annual Abstract of Statistics* (various years); OECD *Financial Statistics* (various years); Sheppard (1971); Société des nations (1931, p. 260). United States: Board of Governors of the Federal Reserve System (various years, 1943, 1959); Mitchell (1983, pp. 775, 785); Société des nations (1931, p. 346); *Statistical Abstract of the United States* (various years); U.S. Bureau of the Census (1975).
Note: Profit banking sector: commercial banks regulated by the central government. The central bank is not included. Nonprofit banking sector: savings banks, mutual credit societies, mortgage banks. State banking sector: state credit banks. Postal savings and the assets of the savings banks that must be deposited in a central treasury fund in Belgium are excluded. Local banking sector: commercial banks regulated by local governments, such as state banks in the United States. The four sectors add up to unity.

indicate that part or whole of the relevant data are missing for that particular country-year.

The fourfold categorization is the product of two intersecting cleavages: center versus local and profit versus nonprofit. The profit sector includes all credit institutions that are centralized as a result of the play of market forces. Profit banks usually are the most competitive. The state sector includes all those that are centralized because they were created by the central government and enjoy special borrowing privileges. The local sector includes banks that are local because they were chartered by local governments. Local banks operate under less strict regulations than larger profit banks or are protected by branching restrictions hindering the development of large profit banks. The nonprofit sector also includes banks that are local in scope but have traditionally enjoyed legal privileges (tax, deposit guarantee), allowing them to withstand both competition with profit banks and the rivalry of central government state banks.

The graphs reveal the following information about state banking. Cross-nationally, countries fall into three distinct groups. At one extreme are the countries in which state banking reached at some point in history a high level—Belgium, France, Norway, New Zealand, the Netherlands, and perhaps Italy. At the other extreme are the countries for which state banking is either nonexistent—Canada, the United Kingdom, Ireland, Finland, Sweden, Switzerland—or little developed—Germany, Austria, Denmark, the United States. The residual (Spain, Portugal, Japan, Australia) falls somewhere in between.

Longitudinally, countries also fall into three groups. A first group of countries shows a traditionally high level of state banking—Belgium, France, Norway, New Zealand, and Italy. A second group of countries acquired state banking in the course of this century, either in the wake of World War I—Spain, Australia, Japan, and the United States—or in that of World War II—Denmark, Germany, Austria, Portugal, and the Netherlands. A third, residual group never acquired state banking. Note finally that state banking has been declining since the 1950s in Australia; the 1960s in France, Belgium, the Netherlands, and New Zealand; and the 1980s in Spain, Portugal, Norway, and Japan.

THE LITERATURE ON STATE BANKING

Five explanations of state banking can be found in the comparative literature on state banking. The traditional view is that state banking is a functional response to a market failure. The idea was initially propounded by Alexander Gerschenkron (1962) in his account of Russian industrialization. The more capital was needed in the shortest amount of time, Gerschenkron argued, the less could private fortunes and equity markets cope with the task of allocating long-term financial capital; instead, banks had to step in. State banking, in Gerschenkron's argument, entered the picture as the ultimate substitute for profit banking should the latter prove unable to meet the demand for investment. Gerschenkron's argument has been faulted for two weaknesses: (a) a functionalist causality, mistaking what in effect was a policy choice—high growth—for a constraint, and (b) case selection, overlooking governments that chose not to pursue a high-growth policy.

Building on new developments in information economics, Haggard and Lee (1995) attribute the origins of state banking to transaction costs. Markets are unable to gather and transmit information when one side of the contract has an interest in hiding information, as is the case with borrowers. As a result, markets are unable to differentiate between good and bad investments, treating them alike and thus discouraging the former and encouraging the latter. Economists argue that banks overcome this market failure because they have access to private information (see Diamond, 1984). They not only have a vested interest in closely monitoring the institutions to which they grant credit but also their relations with borrowers are long term and impregnated with reputation and personal trust. Absent banks, Haggard and Lee argue that a government (nonprice mediated) financial market, in which decisions are made hierarchically and firms are monitored and coordinated by bureaucrats, provides a plausible solution to the problem of information asymmetry. Bureaucratic coordination helps economize on communication expense and reduce uncertainty. Haggard and Lee also are quick to point to the potential drawbacks of government-administered finance, such as corruption and cronyism. The authors ascribe the rise and fall of state banking to the change in the relative balance between advantages and drawbacks, a change that is usually fuelled by financial crises or coalitional shifts (see also Haggard & Maxfield, 1993).

A third line of argument carries the study of state banking beyond the limited notion of economic efficiency, emphasizing instead its redistributional aspects. Michael Loriaux (1991) argues that postwar state banking in France was an instance of Hicks's "overdraft economy," in which private investment is bankrolled by the central bank. A string of weak French governments pursued full employment at the cost of inflation, passing on the negative effects to France's trade partners through recurring devaluations of the franc under the pretext that any other policy might lead to a strengthening of communism in France and elsewhere. The decline of American hegemony removed the preconditions for state banking. State banking, in Loriaux's argument, is not just an efficient way of channeling capital to fast-growing sectors or overcoming market failures but also a means of buying the political support of the sectors that are condemned by rapid industrialization. Loriaux's argument also is useful in understanding the synchronic demise of state banking.[4] However, no systemic variable can account for the cross-national variation in state banking. Indeed, why did only a handful of countries take advantage of American hegemony to create an overdraft economy?

Sofía Pérez (1997) seeks to explain differences in banking outcomes in Spain, France, and Italy by linking it to differences in the relative strength of the communist Left. The presence of a strong Leftist challenge in France and Spain, she argued, forced governments to choose an arm's-length model of interventionism, whereas the temporary weakness of the Left in Italy made possible the use of "direct political control over credit allocation through state ownership of financial institutions" (Pérez, 1997, p. 171). Although insightful, the emphasis on Left strength, in Pérez's formulation, fails to generalize; the communist Left was weak in all European countries but France and Finland (and, hypothetically, Spain, where its visible manifestation was suppressed), and yet state banking also emerged in Belgium, Norway, the Netherlands, and New Zealand.

A fourth approach stresses rivalries between various banking sectors. Sylvia Maxfield (1990) points to a zero-sum game between the private and public banking sectors. A traditionally strong "bankers' alliance," such as the one she observed in Mexico, made it difficult for the government to build an

4. For an attempt to generalize parts of the argument to other national experiences, see Loriaux (1997).

effective state credit program. Conversely, a weak alliance in Brazil allowed the government to pursue policies of subsidized credit. Two French historians, André Gueslin and Michel Lescure (1995), have alternatively emphasized the rivalry between state and nonprofit banking. They ask themselves why nonprofit banking, especially in the form of credit cooperatives (the *secteur mutualiste*), did not take root in France the way it did in Germany. They answer the question by pointing to the unfair competition of the state banking sector, which by the turn of the century included postal savings and all savings banks. The *banques mutualistes* could not afford the subsidized rates paid by the state banks on small individual deposits. The claim of incompatibility between the state and nonprofit banking sectors, I will show, is not limited to the French case but generalizes to other countries. Nor does it work only one way—if the presence of a strong state banking sector inhibits the development of a nonprofit sector, then, by definition, the presence of a strong nonprofit banking sector makes the development of a state banking sector redundant. Last, and coming full circle, Richard Deeg (1999) has chronicled the secular rivalry between the profit and nonprofit banking sectors in Germany, showing how the existence of a very strong nonprofit sector at the outset constrained the development of the Berlin banks. Of course, the question of what sector came first and succeeded in preempting the development of others is left open.

A final line of argument underscores the importance of cross-national variations in domestic institutions. John Zysman (1983) attributed the existence of a "state-directed, price-administered" financial system in postwar France and Japan to the existence of a strong state. Drawing from Gerschenkron, Zysman also propounded the technocratic version of state banking, depicting state banking as the product of a concerted effort by government officials and heavy industry, mostly steel, to rebuild the postwar economy.[5] Zysman contrasted the state-directed model with the Anglo-Saxon "market-based" model and the German private-bank-organized credit market.[6]

Zysman's (1983) institutionalist argument has the advantage of suggesting a partial answer to the question of what came first—state, profit, or nonprofit banking; the former was more likely to develop in strong states. The definition of state strength, however, is ambiguous—it is not coterminous with centralization. Britain has a centralized state and no state banking

5. Zysman's "state-directed," credit-based model of financial system, in conjunction with Gerschenkron's late-industrialization thesis, has found its greatest support among students of East Asian finance (on Korea, see Woo, 1991). Not sharing this view, however, are Rosenbluth (1989) and Calder (1993).

6. For a similar argument, see Shonfield (1965) and Hu (1984).

(except in its deposit form). All institutionalist arguments, moreover, share the same limitation: They are good at revealing cross-national variations but offer no grip on historical change.

Zysman's (1983) technocratic view of state banking as a postwar policy adopted by strong states in response to a Gerschenkron-like capital scarcity reduces state banking to its third wave. This third wave, however, plays a secondary role both in volume and theoretical import. It is secondary in volume because it developed only in Italy, Belgium, France, and Japan, countries that already had a large state banking sector serving a large constituency of farmers and/or small capitalists (see Figure 1). It has limited theoretical import because the reason for which steel was co-opted in the state banking constituency is ad hoc. The large banks, on which that sector had relied until then for financing its long-term investments, were stopped in the wake of the interwar banking crises—explicitly in Japan, France, and Belgium and implicitly in Italy—from dabbling in investment banking. A replacement had to be found and was found in the form of state banks.

The present analysis recasts state banking within its *longue durée*. It integrates the main themes of the literature (market failure, partisan polarization, rivalry between banking sectors, and state institutions), recombining them in a way that is novel and generalizable to a broad sample of OECD countries.

THE ORIGINS OF STATE BANKING: THE DEMAND SIDE

The provision of state banking reflected the conjunction of an economic demand and a political supply. I first consider the demand side. Demand for government aid, as Gerschenkron argues, was triggered by a market failure, but not in the form of a missing prerequisite for growth. Demand mostly came from sectors that were harmed by rapid industrialization. Agrarians were the first to fall in that category. Terms of trade for agricultural foodstuffs had been worsening relative to industrial products since the 19th century in all countries. This trend was compounded for European agrarians by the loss of their comparative advantage in the 1860s. Along with farmers, small business, especially in traditional sectors, were hurt by industrial concentration from the turn of the century onward.

Governments aided these potential losers through tariffs, but tariffs had their limits. Tariffs would protect domestic producers against import competition, but short of a complete cartelization of the sector, which was only achieved in the most concentrated sectors of industry (steel and chemicals), tariffs could not generate enough cash for investment. Farmers seeking to move away from land-intensive grain production into higher value-added farming such as milk and meat products or small capitalists seeking to expand or innovate needed reliable access to long-term capital.

Farmers and small firms have always experienced greater difficulties in procuring long-term capital than large manufacturing firms for several reasons. First, they lack the visibility that would give them access to securities markets and must mainly rely on bank loans.[7] Second, not all bankers are willing to lend to small farms and firms. Only small, usually local, bankers are willing to lend to small, local borrowers because they know them personally and are able to assess the credit risk at its right value (see Cottrell, 1992, p. 53; Guinnane, 1994; Lamoreaux, 1994). Large banks, in contrast, neither have the interest nor the competence to price loans that require local knowledge. Even monitoring through physical presence at board meetings is impractical for the small and medium-size firms because bankers are able to attend only so many board meetings a year, preferably those of the largest companies.

Third, the secular trend in the profit banking sector from 1850 until the present has been toward greater concentration. Small and local banks are disappearing or are amalgamated into larger banks with the head office in the financial center. Bankers used to rely on personal connections until the mid-19th century. Following the deposit revolution of the late-19th century, the simultaneous rise in securities markets, and the even greater concentration in industry, banks grew in size and moved away from personal loans toward more standardized products. Branch agents who were appointed by and applied standard lending rules devised by the head office replaced local, private bankers.

The trend toward concentration, along with standardization and centralization, was not general, however. It only affected the profit banking sector. The nonprofit banking sector and, to a lesser extent, the territorially bound local sector were sheltered from the competitive drive toward concentration. Surely, savings banks and credit cooperatives in countries such as Germany, Italy, Austria, and Scandinavia would eventually develop central organizations of their own to coordinate payments across regions as well as interface with other banks and the rest of the world. Similarly, in the United States, local banks established correspondent relations with New York- and Chicago-based banks. But these adaptations came later and were not as much triggered by competition from the profit sector as by the need for these nonprofit and local banks to accompany the growth of their clientele of small and local firms. Indeed, in countries in which the local and nonprofit sectors were

7. Commodity futures markets are novel and undeveloped outside North America.

well developed, thanks to long-standing political protection, these banks, including the savings banks, pressed their regulators to give them the right to offer the same credit services as those offered by commercial banks.

As a result, not everywhere did farmers' and industrialists' need for easy access to long-term credit lead to a demand for the chartering of state banks. Where nonprofit and local banking sectors were well entrenched, farmers' and small industrialists' demand for credits piggybacked these banks' demand for broader market share. In countries of nonprofit banking (Germany, Austria, Italy, Scandinavia), government adopted legislation facilitating the establishment of small, local mortgage banks and favoring the development of cooperative and savings banks to lend to local industry.[8] In countries of local banking, such as the United States, it led to the beefing up of restrictions against branching in 1911, and the insurance of small deposits in 1933, with the effect of equalizing the otherwise unequal illiquidity risk between banks scattered across rural areas and large banks gathered in financial centers (see Lamoreaux, 1994).

Nonprofit and local banks were unable to extract the same advantages in countries in which they were not already well established. They faced the opposition of the profit sector. Large profit banks, although uninterested in local and small borrowers, were fiercely competing for local depositors' money. Their strategy was to drain savings from local areas toward financial centers, where these savings would be invested in sizeable, profitable, and riskless placements—mostly bonds floated by foreign governments, railroads, and other state-guaranteed infrastructure projects. Profit banks competed with savings banks for local savings and were opposed to the latter's privileges. The consequence is that nonprofit and local banks did not fare well in countries with large profit banking sectors, such as France, Belgium, Britain, and the Netherlands, forcing farmers and small business to turn their attention toward the creation of state banks.

The demand for state banking was thus a function of the share of the profit banking sector. Where profit banks were left unhindered in their competition for market shares, the local and nonprofit banking sectors were small, specialized, and unlikely to serve the credit needs of farmers and small firms. Farmers and small firms had no alternative but to lobby for the creation of state banks. Conversely, where regulations sheltered the local and nonprofit sectors against market competition, these sectors were well developed and able to serve the credit needs of farmers and small firms. Because demand

8. On Germany, see Deeg (in press); on Austria, see Michel (1976, pp. 30-43), Köver (1991), and Albrecht (1989); on Denmark, see P. H. Hansen (1991) and S. A. Hansen (1982); on Sweden, see Nygren (1983); on Norway, see Egge (1983); and on Italy, see Polsi (1996).

need not necessarily elicit supply, we must now consider the political side of the transaction.

THE ORIGINS OF STATE BANKING: THE SUPPLY SIDE

Two conditions had to be met for politicians to be responsive to the farmers' and small firms' demand for state banking: (a) politicians needed these groups' electoral support and (b) state banking faced no concentrated opposition.

Politicians' responsiveness. I argue that the political class as a whole became responsive to the farmers and small capitalists' plea for subsidized state credits thanks to the advent of class politics. Class politics is the alignment of the Right-Left partisan fight along the worker-capitalist cleavage. The class struggle created unique opportunities for groups without any prior affiliation to either of the two main protagonists.

The first manifestation of the intermediate groups' new leverage was the creation of the iron-and-rye coalitions in almost all European countries during the last two decades of the 19th century (see Rogowski, 1989). Fearing the rise of a socialist Left, Liberals rallied the cause of the agrarian conservatives, sacrificing free trade to the defense of the capitalist order.[9] This strategy eventually failed in the period from the 1920s through the 1930s, when socialist parties garnered enough electoral support to form governments on their own. In Italy, Spain, and Germany, the iron-and-rye coalitions were restored through the suspension of democratic rule, whereas in Scandinavia, the United States, and tentatively in France, farmers switched sides, forming Red-Green coalitions with the socialists. Following World War II, the cold war merely consolidated prewar partisan alignments along the class cleavage.

The class cleavage created coalitional opportunities for groups with no prior affiliation to the working and capitalist classes. Although this was certainly true for farmers (with the iron-and-rye and Red-Green coalitions), it also applied to the small capitalists—artisans, small merchants and

9. Note, however, that the socialist threat remained insignificant in France until World War I. The French 1891 "alliance of iron and wheat," to use Lebovics's (1988) phrase, was not formed in response to the socialist threat but to stabilize republican institutions against the risk of a Bonapartist-style restoration fueled by farm discontent. I also should note that state banking in Norway preceded both socialism and the 1897 farm-industry tariff deal.

manufacturers, and workers on their own account. Farmers and small capitalists, who, until then, had been scattered around the party spectrum, in many cases found themselves in the strategically enviable position of arbitrating the electoral competition between capital and labor. The Right needed their support to fight the political battles of big business, whereas the Left needed their support to stem the tide of nationalist, antidemocratic movements. Hence, state banking in Belgium, according to Van Molle (1995), reached its high level in the 1930s in order "to meet the financial needs of farmers and middle classes, two unstable yet important social groups . . . which threatened to reinforce rightist and Flemish nationalist movements" (p. 87).

In banking matters, moreover, the working class was the enemy of the small capitalists' enemies—the "money trust." Because working-class parties could rarely govern alone, they needed the small capitalists' support to stay in power. The regulation of the capital market was the ideal terrain of entente between two partners who, in other areas, especially with respect to labor market issues, had little in common.

More fundamentally, party systems with strong Left parties were polarized, and polarization empowered farmers and small capitalists. Polarization thinned the ranks of unorganized median voters, thereby enhancing the intermediate groups' leverage.[10] Polarization, indeed, reflects a bimodal distribution of the electorate, in which the floating center is, if not "empty" as Giovanni Sartori (1976) starkly put it, at least not the most densely populated location on the partisan continuum. Depolarization, in contrast, describes a case in which voters are normally distributed around the center, with parties converging in their policy offerings to gain support from the densely populated median. In the latter case, often referred to as Downs's (1957) "median voting" model, organized interest groups have their electoral weight diluted within the larger mass of median voters.

In some cases, ideological polarization led to the institutionalization of interest group representation. In countries where polarization was such that all-out competition was not deemed viable by political elites, lest it destabilize the political institutions, elites sought instead to form a cartel encompassing all organized interests—workers, employers, agrarians, and small capitalists. Government cartels took the forms that have traditionally been analyzed by the consociational literature: grand coalition and Proporz in Austria, multiple executive in Switzerland, and so forth (see Lijphardt, 1977). In Japan, the postwar encompassing, state-centered system of interest

10. The point was well argued by Samuel Beer (1982) in his study of 1970s Britain.

representation worked like a cartel, limiting competition in the economy and ensuring widespread support for the Liberals in the polity.

In the spirit of the consociational literature, federalism is a subset of polarization. It is a form of cartelization between territorially defined interests, adopted to mitigate territorial tensions. Moreover, federal systems, as already suggested, do empower farmers and small capitalists given the latter's political entrenchment in local governments. The substantive difference between territorial and class polarization is that only the latter was a response to the rise of working-class movements in the interwar and immediate postwar era; only class polarization would start fading away in the 1960s.

Therefore, keeping aside the federalist case, it is possible to argue that the partisan realignment along class lines that took place during the first half of the century empowered farmers and small capitalists because they were small, well organized, ideologically unattached to the working class or the capitalist Right, and available for tactical alliances.

Opposition. State banks were likely to face opposition from two quarters—local and nonprofit banks on one side and profit banks on the other side. The nonprofit and local banks, first, sought to assume the very role of extending medium and long-term credit to local industry for which state banks were created. This was, of course, the case of mortgage banks, which were but Crédit Fonciers in miniature. The savings banks sought the authorization to use their state-guaranteed deposits to finance investments other than safe, but low-yield, government bonds. Their natural zone of expansion in the first half of the century, before it would become the market for consumer credit in the 1960s, was the small corporate loan market. As for the local banks, in the United States notably, they merely wanted the government to insure their deposits, which they were already using to finance loans to local industry. All of these banks wanted the state to help them stabilize their environment so that they could develop safely. They did not want the state to charter a direct competitor, which would have taken business away from them and checked their further growth.

Local and nonprofit banks had the support of their respective local governments. In fact, they owed their very existence, or their survival, to these local governments, who, in turn, saw local banks as a requisite for a vigorous local economy. I have shown elsewhere the existence of a close relation in each country between the economic weight of the nonprofit and local banking sectors together and the relative power enjoyed by local governments (Verdier, 1998, p. 23). Only in decentralized countries did local governments consistently enjoy sufficient power, individually in the form of regulatory competence and collectively through representation in a high chamber, to defend their control of the local economy against the encroachments of large firms, large banks, central treasuries, and regulatory agencies. The creation of state banks was thus likely to meet the powerful opposition of local governments in decentralized countries.

State banks were also likely to face opposition from profit banks. Profit banks worried that a financial institution initially designed to deal in a specific line of credits would, once created, use its political connections to expand its scope. This is precisely what happened with the first state bank—the French Crédit Foncier—which was initially created to lend to farmers but soon branched out into the lucrative Parisian real estate business, in competition with private bankers. State banking remained circumscribed until the banking crises of the interwar years. Besides real estate, existing state banks were focused on agrarian, town, and small firm credit. The more expansive Norwegian state banking system was losing ground to the late-developing profit banking sector. The banking crises of the interwar decades, however, destroyed the opposition of the profit sector. Drawing on the lesson that universal (multipurpose) banks had fared worse than specialized ones, governments tried to tear banks away from the business of taking long-term positions in industry through artificial requirements of liquidity rules, reserve requirements, and—in France, Belgium, Japan, and the United States—the legal separation of deposit from investment banking. This regulatory-engineered credit gap facilitated the creation of state banks. Figure 1 confirms the idea that it is after the 1930s that state banking, wherever it developed, reached its highest level.

In sum, the political system was most likely to supply state banks during the century of class politics (1870s-1960s), more especially after the weakening of the large banks in the 1920s and 1930s, and in countries with centralized state institutions.

THE ORIGINS OF STATE BANKING: HYPOTHESES AND EVIDENCE

I have argued that the demand for state banking historically rose with the second industrialization in countries with undeveloped nonprofit and local banking sectors. In addition, I have argued that supply historically piggybacked the class cleavage and was least opposed in centralized countries. Combining these findings yields two propositions. First, state banking rose and fell with the class cleavage. Second, variations in state banking across countries were a function of state centralization and of the weakness of the nonprofit and local banking sectors. Given the difficulty of measuring the intensity of the class cleavage, I will concentrate on the second hypothesis.

I use a cross-section regression analysis. The dependent variable is the change between the relative asset share of state banks between 1913, the earliest date for which we have sufficient data, and 1963, also a year for which we have good data and which roughly corresponds to the beginning of deregulation in Belgium and France. More generally, the 1960s constitute a turning point—it corresponds with the first period of détente between the superpowers and marks the beginning of the present period of globalization, both in product markets and financial markets, with full currency convertibility, the development of the Euromarkets, and the consecutive surge in international banking. Because the dependent variable is the simple difference, a necessary control variable is the 1913 asset share of state banking; the sign on this variable should be negative because an initially high share of state banking should put a damper on successive expansion.

The first independent variable is the relative change in local and nonprofit banking. The sign should be negative because we expect state banking to vary inversely with local and nonprofit banking. The second independent variable is the degree of centralization of state institutions in 1963. State centralization is proxied by the proportion of total revenues going to the central government. The sign should be positive because greater state centralization correlates with weaker local governments and, thus, less opposition to state banking.

Table 1 reports the results of the multivariate regression. All variables in the first regression are correctly signed. Coefficients for the two independent variables are highly significant. Only the fit for the control variable fails to reach standard levels of significance. The exclusion of this nonperforming control variable improves the overall fit (Regression 2). To increase confidence in the robustness of the results, I performed a case sensitivity test. Small-*N* studies do, indeed, suffer from case sensitivity—it takes but a few outliers to make or break a correlation. I calculated the DFITS statistic—a measure of the degree to which each observation has a deviant residual or pulls the regression line toward itself. This allowed me to identify one potentially mild outlier consistent across both specifications—the Netherlands.[11] Although there is no reason to believe the Dutch case to be a real outlier, I ran

11. I use standard definitions of *strong* and *mild*. A strong potential outlier is one with a DIFTS value superior to what is known as the high cut-off point—the square root of *p*, with *p* being the number of variables plus one (the constant). A mild potential outlier is one whose DFITS statistic is situated between this high cut-off and the so-called low cut-off point—2*square root of *p*/*n*, with *n* being the number of cases.

Table 1
Change in State Banking as a Function of State Centralization and the Change in Local and Nonprofit Banking

	Regression 1		Regression 2		Regression 3 (Regression 2 without the Netherlands)	
Intercept	–0.16	(–2.16*)	–0.12	(–1.91*)	–0.09	(–1.30)
Asset share of state banking sector 1913	–0.11	(–0.93)				
Revenue share of central government 1960	0.34	(3.21***)	.027	(3.13***)	.22	(2.39**)
Change in asset share of local and nonprofit banking sectors 1913-1963	–0.35	(–2.73**)	–0.28	(–2.42**)	–0.26	(–2.01*)
Adjusted R^2	0.49		0.50		0.30	
Root *MSE*	0.04987		0.04959		0.04651	
Number of observations	15[a]		15		14[b]	
Outliers						
Strong	None		None			
Mild	France, United Kingdom, the Netherlands		the Netherlands			

Source: The main source is the OECD's *National Accounts* (various years); the supplementary source is the United Nations' *Yearbook of National Accounts Statistics* (various years).
Note: The dependent variable is the difference between the 1963 and 1913 asset market shares of the state banking sector. Data for the dependent variable, the control variable, and the change in asset share of the local and nonprofit banking sectors 1913-1963 are from Figure 1. The revenue share of the central government is the ratio: Central Government Receipts/(Central and Local Government Receipts – Transfers from Central to Local Governments). The sums transferred from the central to the local governments are subtracted from the denominator to avoid double counting. In some cases, the ratio was redefined as (Central Government Receipts – Social Security Contributions)/(General Government Receipts – Social Security Contributions), with General Government including all forms of government. The second ratio was used for Australia, France, the Netherlands, Switzerland, Japan, Austria, Norway, and New Zealand. Values of *t* statistics are given in parentheses.
a. Includes Australia, Austria, Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, New Zealand, Norway, Sweden, Switzerland, the United Kingdom, and the United States.
b. Includes Australia, Austria, Belgium, Canada, France, Germany, Italy, Japan, New Zealand, Norway, Sweden, Switzerland, the United Kingdom, and the United States.
*, **, *** *t*-values significant at the 10%, 5%, and 1% levels respectively.

a third regression without the Dutch observation (Regression 3). Results are virtually unchanged. The hypotheses stand unfalsified.

THE DECLINE OF STATE BANKING

State banking has declined overall. Calculated on a sample of 15 countries, the mean proportion that had risen from 11.6% in 1913 to 20.7% in 1963 had declined to 13.2% in 1990 (see Table 2).

Table 2
Means and Standard Deviations (in parentheses) of the Asset Shares of State Banking and Local and Nonprofit Banking for 15 Countries, 1913, 1963, 1990

	State Banking	Local and Nonprofit Banking
1913	0.116 (0.149)	0.345 (0.234)
1963	0.207 (0.164)	0.338 (0.188)
1990	0.132 (0.122)	0.343 (0.175)

Source: See the source note for Figure 1.
Note: The 15 countries for which data are available are Australia, Austria, Belgium, Canada, Denmark, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden, the United Kingdom, and the United States.

The decline of state banking could potentially reflect a decline in demand, a decline in supply, or both. On the demand side, it could be that small firms are enjoying greater access to capital markets and have a lesser need for state banking. Note, however, that if this were the case, this would not be because small firms are today enjoying greater access to securities markets or to the profit banking sector. If anything, current trends toward the internationalization and securitization of finance are making worse small firms' access to regular financial channels (see Verdier, 1999). It could be, instead, that small firms are enjoying greater access to the local and nonprofit banking sectors. This option does not seem verified either. The 15-country mean share of local and profit banking combined does not show a decline equivalent to that of state banking, but neither does it show an increase that could have offset the decline in state banking—it has merely remained constant over time: 34.4% in 1913, 33.8% in 1963, and 34.3% in 1990 (see Table 2). In sum, not much has changed on the demand side; small and medium-size firms are still suffering from the same-old Macmillan gap in the provision of long-term credit.

It is on the supply side that things have changed: Class politics is defunct and the opposition from other banking sectors has stiffened, leading central governments to eliminate all borrowing privileges. Small firms have lost their privileged access to central governments and have probably redirected their efforts toward local governments. I consider each point successively.

Although the class cleavage may still supply the essential symbols of the Right-Left rivalry, class politics, for all practical purposes, is defunct. Deindustrialization, the embourgeoisement of the working class, and the weakening of trade unions and other intermediate groups have led to a disalignment of the electorate. The inability of Keynesian macroeconomic policies to deal with the price shocks of the 1970s and the consecutive delegation of macroeconomic management to markets and independent central banks further reduced the stakes of partisan competition. Left and Right governments began to pursue the same promarket policies. The collapse of the Soviet Bloc lifted off all semblance of partisan polarization. Electoral politics became a specie of Downs's (1957) median voting model, with voter normally distributed, a sizeable floating vote, and the policy orientation of successive governments differing only at the margin. The first rents to be sacrificed to this new economic experiment were those enjoyed by the small capitalists because it was politically easier to dismantle rents in the capital market than in the labor market. Farmers and small capitalists no longer occupy a strategic location on the Left-Right partisan continuum.

Opposition to state banking from the other banking sectors also stiffened in the period from the 1970s to the 1980s. We saw that the profit bank's principled opposition to the sprawl of state banking was checked by the regulatory corset imposed on them as a precaution against interwar-like financial mayhem. Created to avoid another crisis of illiquidity, the restraints were used instead, after the war, to contain inflation. Being spared from those in all countries but Germany, the state and nonprofit state banks expanded their market share at the expense of the commercial banks—profit and local combined.[12] However, the profit banks sought ways to escape or reverse this damaging trend. They had the support of their regulators, who grew disturbed at the negative impact of the commercial banks' decline on the efficiency of monetary policy, for which the banks served as conduit. Starting in the 1960s, a process of so-called deregulation took place, eventually leading to the total or near abolition of the difference between commercial banks, savings banks, credit cooperatives, and mortgage banks; the repeal of territorial curbs on major bank branch expansion; and the extension of the central bank's authority to all financial institutions. Unsurprisingly, the deregulation of deposit rates and the dismantling and/or generalization of reserve requirements to all financial sectors reversed the secular decline in the market shares of the commercial banks. Owing their growth to the regulations imposed on banks, noncommercial banks responded to the new competition from banks either by taking greater risks, such was the case with the North American Savings and Loans (S&Ls) and the British building societies, or by turning themselves into regular banks, as in Australia, or still by joining the fray against the last bastion of financial privilege—state banking.[13] Mounting pressure forced states to renounce borrowing privileges for state banks.[14] As a result, state

12. For an account of the United States, Britain, and Germany, see Kregel (1997, p. 305).

13. On Australia, see Ackland and Harper (1992). On Britain and the United States, see Kregel (1997).

14. On Belgium, see Van Molle (1995). On France, see Baubeau, Lavit d'Hautefort, and Lescure (1994). The Maastricht Treaty provides for the abolition of all existing regulations that give public authorities privileged access to the financial intermediaries of any European Union (EU) member state.

banks lost ground to commercial banks most dramatically in Belgium, France, the Netherlands, New Zealand, and Norway—countries in which they were most developed in the 1960s.

The hypothesis that state banking was a victim of class disalignment is not testable because measuring the latter through time and across nations is quite impractical. In contrast, the hypothesis that state banking was a victim of the opposition of profit banks is readily testable. As above, I use a cross-section regression analysis. The dependent variable, once again, is the change in the asset share of the state banking sector, although this time from 1963 until 1990. Because the dependent variable is a simple difference, the 1963 level of state banking is used as a control; the sign should be negative because a higher level of state banking is more likely to correlate with a larger drop in percentage points of market share than an initially low level.

The independent variable, the profit bank's opposition, is first proxied by the change in asset share of the profit banking sector. The idea is that the two sectors' market shares are inversely related. The profit's bank opposition also is proxied by international capital mobility. The banks' opposition to the postwar regulatory regime, a regime on which state banks' postwar fortune depended, grew more effective as capital mobility increased because capital mobility implied that deregulation in one country led to deregulation in another. I use a simple measure of capital mobility: inflows of foreign direct investment weighted by gross domestic product in the 1980s. Last, the two proxies for profit banks' opposition should be correlated, a proposition testable by regressing the change over the period in asset share of the profit sector against the Foreign Direct Investment (FDI) inflows variable while controlling for the initial level of profit banking.

Results are reported in Table 3. The first four specifications (4-7) regress the recent change in state banking against the two proxies of profit banks' opposition; the last two (8, 9) make sure that the two proxies covary. All coefficients are correctly signed, all fits are significant, and all potential outliers have no decisive impact on the results, with the exception of Regression 6. The fit for the FDI variable in that regression is poor. I checked for possible outliers and found two strong cases thereof, using a DFITS diagnostic. A rerun of Regression 6 without the Belgian and Portuguese cases provides much stronger results (see Regression 7). To be on the safe side, I administered a second case-sensitivity test that was less systematic than DFITS but more informative. It consists in the visual inspection of the partial regression plots for selected variables. Each plot generates a coefficient and a fit that are equal to the coefficient and fit of the dependent variable against the chosen right-hand-side variable while simultaneously controlling for the effect of

Table 3

Change in State Banking, 1963-1990

	Change in Asset Share of State Banking Sector 1963-1990				Change in Asset Share of the Profit Banking Sector 1963-1990	
Dependent Variable	Regression 4	Regression 5	Regression 6	Regression 7	Regression 8	Regression 9
Intercept	0.05 (2.32**)	0.04 (2.23**)	0.09 (2.48**)	0.06 (3.19*)	0.21 (3.28*)	0.21 (3.87*)
Asset share of state banking sector 1963	–0.42 (–3.77***)	–0.32 (–3.62***)	–0.49 (–3.73***)	–0.28 (–3.70***)		
Asset share of profit banking sector 1963					–0.64 (–4.75***)	–0.62 (–5.60***)
Change in asset share of profit banking sector 1963-1990	–0.39 (–3.31***)	–0.31 (–3.32***)				
foreign direct investment (FDI)/gross domestic product (GDP) 1981-1990			–0.44 (–1.70)	–0.51 (–3.70***)	1.45 (5.13***)	1.40 (5.93***)
Adjusted R^2	0.69	0.59	0.54	0.62	0.68	0.78
Root *MSE*	.06494	0.0395	0.07895	0.03673	.0828	0.06593
Number of observations	17[a]	14[b]	17[a]	15[b]	17[a]	15[b]
Outliers						
Strong	None		Belgium, Portugal		None	None
Mild	Canada, Belgium, Portugal		None		Australia, Spain	

Source: OECD (1989, p. 60; 1996a, p. 80).
Note: All variables measuring a change are simple differences. FDI/GDP is the cumulative inflows of direct investment weighted by GDP over the period 1981-1990. All other variables are from Figure 1. Values of *t* statistics are given in parentheses.
a. Includes Austria, Australia, Belgium, Canada, Denmark, France, Germany, Italy, Japan, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, and the United States.
b. Indicates the same prior regression excluding outliers.
*, **, *** *t*-values significant at the 10%, 5%, and 1% levels respectively.

the other right-hand-side variables on the dependent variable.[15] Figure 2 provides the plot for the two right-hand-side variables in Regression 6. The Portuguese observation figures as a clear outlier. The explanation for the relatively steep increase in Portuguese state banking in the 1980s is unclear—it could reflect democratization or unreliable data. Although the Belgian observation also pulls the regression line to itself, it nicely fits our explanation—Belgium scored high on both the control variable (the initial level of state banking) and the independent variable (deregulation). Belgium is an influential case but not a real outlier. With the indecipherable exception of Portugal, therefore, the test confirms the hypothesis that financial deregulation and internationalization weakened state banking.

A RETURN TO TERRITORIAL POLITICS IN CREDIT MARKETS?

Although central governments may be losing interest in small firms, the argument can be made that local governments, in contrast, are focusing their attention on small firms. The reason is that the degree of centralization of the state is becoming matter for political debate. Two cleavages are emerging simultaneously, one pitting wealthy against poor industrial districts and the other pitting the financial center against the periphery. I develop them successively.

There is an emerging consensus across disciplines that modern production has a territorial, local dimension. Paul Krugman (1991) shows, in contrast to the prevailing assumption that the decline in transportation costs makes firms indifferent to localization, that it makes them want to agglomerate. Agglomeration reflects the presence of positive externalities, in the form of better infrastructure, specialized services, and the creation of well-supplied local factor markets. Students of flexible specialization stress the importance of geographical concentration in attracting talented people and the role of proximity in the production of learning and innovation (see Deeg, 1997; Sabel, 1989; Saxenian, 1994; Storper, 1995, p. 210). Michael Porter (1990) writes that “more open global competition makes the home base more, not less, important” (p. 158). It is a fact that multinational firms locate their most advanced technological capacities in their home countries (see Dunning, 1988).

15. The partial regression plot is, according to Bollen and Jackman (1990), “the multivariate analog of the bivariate scattergram” (p. 260).

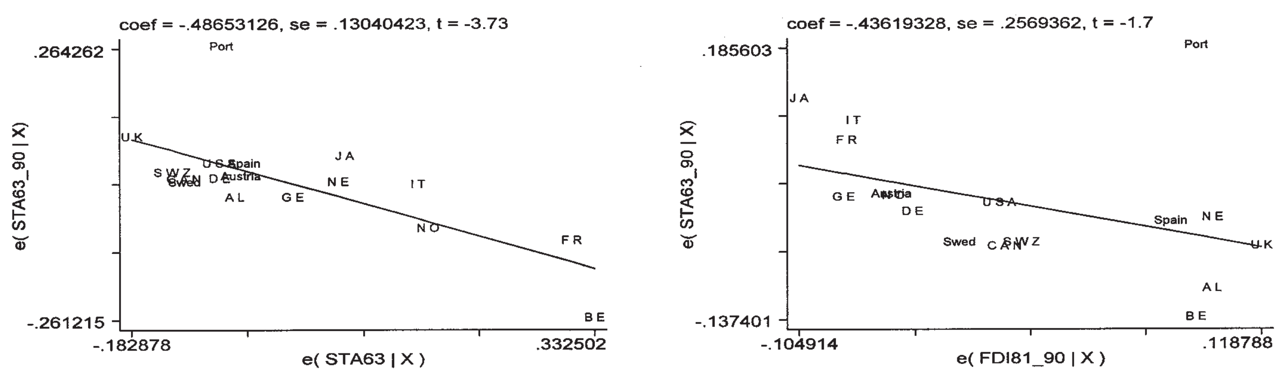

Figure 2. **Partial regression plots for Regression 6, Table 3.**

Economies of agglomeration potentially have severe redistributional consequences for local governments. Those with an already dense industrial base may see it further reinforced, whereas those with a weak one risk to lose what they have and those without any might remain barren. The redistribution raises the issue of interregional transfers, with likely winners welcoming fiscal decentralization but probable losers opposing any weakening of the central government's capacity to ensure that competition proceeds on an equal footing by means of transfers from rich to poor regions.

The second territorial cleavage is a product not of free trade, as the first cleavage, but of free finance. The ongoing deregulation and internationalization of financial markets liberate economies of agglomeration that accrue to the financial center at the expense of the periphery. Deregulation has increased interest rate volatility, as well as increased competition, squeezing profit margins. The largest banks have responded to this double threat by pursing a threefold strategy of (a) product (asset) standardization, transforming into marketable securities as many bank loans as the markets will take; (b) concentration through acquisition of existing branch networks; and (c) internationalization, both sourcing out monetary resources and floating corporate and government bonds on the Euromarkets (see Verdier, 1999, for elaboration). These trends have a negative impact on local economies. The banks drain local savings to the center and from there on to international markets. They do not lend to local entrepreneurs, even though those are too small to access the securities market but must rely on bank loans instead. Financial deregulation and globalization is reducing local governments' control over local capital and threatening investment.

This trend is reinforced by the fact that budget constraints have forced central governments to compress the sums traditionally devoted to regional development policies, with local and regional communities left to bear the burden of change. Local communities are pressed to make themselves attractive to savers and firms, both local and external. Regions are increasingly locked into a race of which the winners may well be those that, in addition to their natural resources, have the most policy instruments at their disposal (see Deeg, 1997; Keating, 1997). Two of the most centralized governments (Britain and France) have engaged on the road of institutional decentralization. The French state, for instance, devolved to local governments the power to guarantee loans to local business (Ganne, 1995). The British and French devolution programs, however, are quite modest in comparison to what is being done in federal countries. In Germany, for instance, beginning in the 1970s, the Länder adopted subsidies to help the Mittelstand with consulting, technology, and export. Some of them also created their own banks, the

Landesbanken, to provide small firms with loans for start-ups, modernization, and innovation (see Deeg, 1997).

The upshot is that the subnational government is an increasingly attractive level of organization and lobbying for small business. The same firms that, until a recent past, identified as small business, and organized small business federations to lobby the central government, are now more concerned about lobbying their respective local governments—the small has become the local. This redefinition has actually affected the way governments target subsidies to business, away from aid to small and medium-size business toward aid to regional growth. This trend is visible in Figure 3, which provides the relative proportion represented by these two types of aid among European Union (EU) countries and among OECD countries. Both data sets, and notwithstanding the change in methodology in the OECD one, exhibit a rise in the share of aid allocated to regional development and a decline in the share allocated to small business. The recipients are the same; they are the small and the local. Only the channels have changed; they have been decentralized.

CONCLUSION

The class cleavage, which emerged in the late-19th century and peaked in the postwar years, placed farmers and small capitalists in the enviable position of arbitrating the conflict between the capitalist Right and the working-class Left. Farmers and small capitalists took advantage of their positional advantage to extract various rents from the state. One of these rents, mostly in countries in which local and nonprofit banks were not already serving the investment needs of these producer groups, was state banking.

State banking was an exceptional and ephemeral form of state intervention in the allocation of credit. Neither did it preexist nor outlive the class cleavage. It was the product of a unique set of circumstances, not of any logic internal to capital markets. State intervention in the capital market usually takes the route of local banking—locally chartered and nonprofit. Local governments are keen to see local savings invested in local projects; they seek to promote local banks. In all countries but France, Britain, and to a lesser extent, Belgium, New Zealand, and the Netherlands, incomplete state building provided local governments with the regulatory means to fragment the capital market along territorial lines. Local and nonprofit banking were dominant in decentralized countries before World War I; they remained important during the heyday of state banking; and they are still important today, after the parting of state banking.

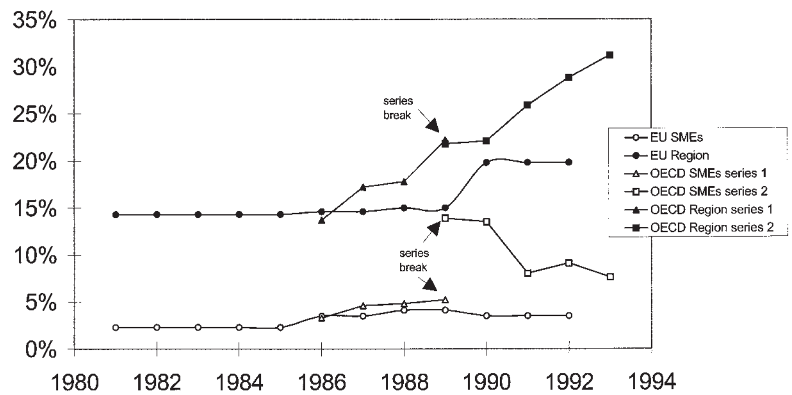

Figure 3. **Shares of regional aid and aid to small- and medium-size enterprises (SMEs) in European Union (EU) and OECD countries.**
Source: European Commission (1990, 1992, 1995); OECD (1992, 1996a, 1996b).
Note: Each measure is the proportion of total aid allocated to the specific function (aid to small and medium-size enterprises, aid to regional development) within the European Union (EU) and the OECD, respectively. The EU data set includes 10 countries for the period from 1981 to 1985 and 12 for the period from 1986 to 1992. The OECD first series (1986-1989) includes 22 countries, the second series (1989-1993) includes 24 countries. EU data are by year; OECD data are multiyear averages—1981-1986, 1986-1988, 1988-1990, 1990-1992.

There seems little doubt that the demise of state banking corresponds with the realignment of interest articulation from the national to the local level in credit markets. But what are its implications outside credit markets, that is, for interest representation and policy making as a whole? It seems that the capital market is reclaiming its past salience on politicians' agenda. The epoch during which all issues revolved around the employer-employee cleavage is over. In the same way that price stability has become a far higher priority than employment, labor considerations have taken a back seat to financial considerations. Once again, it is the stock market, not some central macroeconomic manager, that is pulling the economy in and out of growth cycles. Surely, Right and Left still differ on issues of redistribution—that is, the welfare state, the extent to which the state should try to help market actors bear the pain of competition, and how these transfers should be financed (see Garrett, 1995). But there is a centripetal consensus (although not shared by the partisan extremes) that redistribution ought not to interfere with market efficiency in general and with financial market efficiency in particular. Politicians no longer see state intervention as the solution to conflicts but are willing to toy with the territorial organization of the nation state, either directly, by devolving authority to local governments and supranational agencies (EU, North American Free Trade Agreement [NAFTA], Association of Southeast Asian Nations [ASEAN], World Trade Organization [WTO]), or indirectly, by delegating tasks to a market that is allocating values according to a logic that transcends national borders.

The territorial cleavage has portentous effects—it undermines national unity. Its effect was not strongly felt in the 19th century under the Gold Standard because it was offset by the trend toward national protection. Unlike today, there was no free trade under the Gold Standard. Protectionism is what allowed the political elites in countries such as France, the United States, and many others (Britain excepted) to surround themselves with, and rely on the support of, national trade associations, bodies that organized and represented all firms belonging to the same sector. In decentralized countries, such as Germany, Austria-Hungary, Italy, Spain, and Switzerland, tariffs allowed the political elites to form iron-and-rye coalitions, which allowed them to bridge the widening chasm between urban center and agrarian periphery and steer their country clear of the ethnic, separatist, and nationalist conflicts of the time. The electoral success of socialist parties in the wake of World War I injected a further element of nationalization. Neither national protection nor class politics, however, are foreseeable options in today's world. The territorial organization of the nation state, as the European flirting with monetary federalism ought to remind us, is at issue, and the threat of disintegration in countries such as Germany and Italy is probably greatest since unification.

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