

### **Abstract**

During the 80's and 90's, the increase in financial instability shook up the idyllic vision of the financial liberalization in developed nations. The difficulties borne by the banking sectors spread out in some Asian and Latin American countries as systemic crises. The deregulation of the financial sector has really affected their banks.

We try to carry out an examination of the the financial liberalization process through a review of the literature. We analyze at first endemic weaknesses, then we study some institutional and conceptual solutions. We try to identify the micro-economic banking dimension as a driving force for the growth. The role of banking system is described in a development process usually facing the apology of the stock market.

### **Résumé**

La vision idyllique de la libéralisation financière est obscurcie par l'accroissement des instabilités financières des années 80 et 90. Les difficultés éprouvées par les secteurs bancaires ont conduit à des crises systémiques de grande ampleur. Dans certains pays, asiatiques et latino-américains, les banques ont été gravement affectées par la déréglementation du secteur financier.

On se propose ici de procéder à un examen critique de la libéralisation financière à travers une revue de la littérature. On analysera d'abord ses faiblesses endémiques, ensuite on étudiera quelques solutions de nature institutionnelles et conceptuelles. Il s'agit d'identifier notamment la dimension micro-économique des banques en tant que moteur de la croissance et d'affirmer leur rôle dans un processus faisant souvent l'apologie du marché financier.

During the 80's and 90's, the increase in financial instability shook up the idyllic vision of the financial liberalization in developed nations. The difficulties borne by the banking sectors spread out in some Asian and Latin American countries as systemic crises. The deregulation of the financial sector has really affected their banks<sup>1</sup>.

The financial liberalization aims at the passage from a regulated economy to a liberalized one<sup>2</sup>. It underlines the effects of training of the financial sector on the economic growth with the sequences : liberalization of interest rate and nominal rate rise, increase saving and investment, and finally economic growth. The end of financial repression and the adoption of real positive interest rate would be favorable to savings<sup>3</sup>. The process performed by this measure of liberalization aims at a structural

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<sup>1</sup> Arestis and Demetriades (1997 b), specify that since 1980, more than a hundred developing countries have been affected by banking crises having as consequence the insolvency of banks and the loss of depositor confidence. The direct cost of these crises has been supported by the taxpayer. It represents a substantial amount : 50% of the GNP for Koweït, 30% for Chile, 20% for Venezuela and more of 10% of GNP for Mexico, the Czech Republic and Hungary.

<sup>2</sup> It has become common to attribute the paternity of financial liberalization to McKinnon (1973) and Shaw (1973) even if that can go back to A. Smith (1776).

<sup>3</sup> The financial repression makes reference to governmental restrictions demonstrated by the regulation of interest rate, the fixing of the obligatory reserve rate at a high level, the administrative orientation of the credit allocation and the limitation of banking competition.

change. It describes the banking integration of private agents into the intermediation process. The measure of the degree of financial deepening is made therefore with monetary aggregates.

From this point of view, the thesis of financial liberalization considers that governmental restrictions on the banking system reduce the quantity and the quality of investments. Interventions of the State on the financial system would induce a negative effect on the growth rate.

Financial liberalization encourages the liberalization of national banking sectors and foreign bank penetration aims to increase competition, transfers of know-how and financial operation transparency. That means also the development of stock markets. It may be a condition of the financial reform success.

Several studies confirm the existence of a first order positive relationship between financial development and economic growth<sup>4</sup>. They consider that the financial development level is a good indicator of the future rate of growth, capital accumulation and technical change. The financial system influences thus technological innovations, investments, and growth.

However, the expansion of the financial sector involves a lot of consequences on growth. They are sources of controversy and remain poorly known. It seems that above a certain level negative effects, such that the increase of instability, can be important. Liberalization presents therefore conceptual and empirical weaknesses that institutional corrections aim to consider.

We will examine four features : the weaknesses induced by the conceptual structure of liberalization (section 1), the weaknesses revealed by financial crisis of the 80's (section 2), the micro-economic re-examination of banking for a better real economic growth and development (section 3) and the good governance and the institutional corrections (section 4).

## **WEAKNESSES INDUCED BY THE CONCEPTUAL STRUCTURE**

The theoretical model of the financial liberalization presents five main weaknesses. It deals with specification mistakes that induced the appearance and the amplification of financial crises in emerging countries.

### **Financial Development and real Growth : the Order of the Causality issue**

What is the source, what is the effect ? Should we consider finance as a motor sector of economic growth or simply as a consequence of economic performance ? Earlier the banking sector was

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<sup>4</sup> Levine (1997).

perceived as a motor of growth. It represents one the most beautiful inventions ever made. Other more skeptical authors wonder if finance really induces an impact of first order on economic activity<sup>5</sup>.

Schumpeter studied this subject matter for the first time in 1911. The author considers that financial services represent an essential element in the promotion of economic growth. The process of production requires credit. The idea is that one can become an entrepreneur only by first becoming a debtor. In the capitalistic firm, the entrepreneur first wants credit, that is purchasing power. The banker is considered then as the intermediary contributing to the production of goods and as the pillar of an exchange economy.

Later some empirical studies tried, in the tradition of the IMF, to verify that the more developed a financial system is, the more economic growth allows to develop finance. On the contrary, some studies test the effect of growth on financial development. It appears that this effect is verified in every case except for some African and Latin America.

The order of this causality seems to be a source of theoretical and empirical problems and it would be a source of controversies even in the case of developed countries. It can vary according to countries. For example for Germany, the development of the banking system and the stock market would directly act on economic growth<sup>6</sup>. The order of causality goes from the first to the second. Thus, the volatility of the stock market would induce a negative effect on German growth : more than 10 % on the German volatility stock market would reduce the growth of the GNP of 3,5%. The situation of the United States would be quite different. At first, the American banking system and the stock market appear rather competitive. Then, these two components of the financial system would be linked positively to the economic growth in the long-run but the directions of the causality would go from growth to finance.

### **Financial Liberalization and Savings : a weak Relationship**

Empirical examinations of the relationship between the interest rate and the saving rate in countries with an early liberalized financial system have not led to the determination of a significant positive correlation between the two variables. Financial development does not directly stimulate savings progression.

This conclusion is the result of a wealth effect induced by the rise of the interest rate on deposits. This rise does not encourage agents to save more money<sup>7</sup>. They leave the amount of their savings

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<sup>5</sup> It is the case of Robinson (1952) even if his contribution in 1979 is clear and less hesitant concerning the creation of purchasing power by banking. Note that the second President of United States, John Adams, went as far as accusing banks of causing harm to the morality, to the tranquillity and even to the wealth of nations.

<sup>6</sup> Arestis and Demetriades (1997 b).

<sup>7</sup> See recent works of Demirgüç-Kunt and Detragiache (1998) and Beck, Levine, Loayza, (2000).

unchanged. Simultaneously they benefit from the same financial income amount because the interest rate rises.

This wealth effect can be observed in most OECD countries despite the interest rate rise during the 80's. The rate of savings decreased on average from 15.2 % in 1980 to 10.8 % in 1997<sup>8</sup>. For African countries this rate decreased as well<sup>9</sup>. The global internal savings rate in percentage of the GDP rose from 19.3 % in 1965-73 to 23.3 % between 1974-1980. Nevertheless, the tendency turned inside out because the savings falling to 18.5 % during the period 1981-87 and to 16.7 % between 1988-1996. Consequently, we may consider the existence of a decreasing function of savings in relation to the real interest rate<sup>10</sup>?

### **Are Financial Systems well specified and well integrated ?**

The weakness of some empirical results and especially the fragility induced by financial crises in emerging countries lead to thinking that financial systems have been taken into account theoretically and without the right specifications. The consequence has been a superficial connection of the financial intermediation to macroeconomic phenomena. The role of banks, for instance, does not seem to have been taken into account appropriately and does not appear to be essential. In macro-economic approaches, the financial system is summarized in a simple equation of money demand completed by a negative relationship between the interest rate and the level of investment<sup>11</sup>.

The heterogeneity of financial systems is recognized. There are important differences between countries. The traditional classification presents two types of financial systems : based on banks (bank-based) and based on the stock market (capital-based)<sup>12</sup>. The first system is characterized by an important participation of banks in industry. A small number of banks finance long term investments. Companies are controlled and managed by a small number of inside shareholders holding the largest number of shares. Banks intervene effectively into firms' affairs and the management and supervision team. Firms are therefore linked to banks with credits that they raise rather than bonds that they issue on the Stock market. There are very few mergers and changes of control. Therefore, banks directly play a key role in the process of growth. In case of weak performances, the firm managing team is discharged thus avoiding costs induced by hostile control plugs. Such financial systems can be found in Japan, in Germany ( 2/3 of banking credits to the industry are long term credits) and in Southern Korea.

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<sup>8</sup> Average savings rate of households as a percentage of the available income calculated from 6 countries : the United States, Japan, Germany, France, Italy, the United Kingdom and Canada.

<sup>9</sup> Involving a group of 50 countries according to CNUCED and World Investment Transfer, 1997.

<sup>10</sup> Villieu (1997).

<sup>11</sup> Stiglitz (1998).

On the contrary, financial systems based on the stock market as those of the United Kingdom and the United States are characterized by a strongly developed stock market. The banking system does not contribute strongly to the resource allocation and to the financial asset acquisition. Stock Market intermediaries mobilize the essentials of the long term funds. This market appears as the best means for mergers and controls operations. Companies are owned by a large number of shareholders each holding a small number of shares, which therefore implies a strong capital dilution. Companies depend on external control. This strong external control is held by institutional investors as pension funds and insurance company funds.

### **The traps of the Financial Sequencing Process**

The bank-oriented financial system is often considered as an administered system. It is defined as a State-assisted or State-engendered system. On the contrary, the stock market-oriented financial system is defined as a liberalized system. This viewpoint is close to the financial repression thesis, which is often presented in an evolutionist perspective. The financial system would then evolve through a succession of stages moving from banks towards the market. One often refers elsewhere to the sequencing of liberalization. This typology is usually defined with two opposite cases, on one hand, administered or regulated financing and, on the other hand, deregulated or liberalized financing. To simplify matters drastically, this sequential process becomes grotesque and caricatural by comparing banks to administration and stock markets to liberalization.

This «unilinear» evolutionist vision has to be specified. It is more judicious to claim the heterogeneity of financial systems according to their specificities which result from the mutual relationship between industry and finance. The emphasis is put on financing sources. Thus the financial system's configuration is determined by more or less important banking credit availability. If firms have easy access to credit then the stock market is low-developed and banks can even control it. The banking debt level then determines the control and supervision degree of firms by banks as well as their level of control by the stock market. A level of high banking debt leads to financial systems in which the role of banks is important and the presence of stock markets is weak. However, in the case of a weak level of banking debt, the sanction and the control of projects come from the financial market.

### **Things suitable for the North are not necessarily so for the South**

The success of the financial liberalization depends on the local actors' behaviors. These behaviors depend on informal local usages and practices. The main difficulties in the construction of an efficient

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<sup>12</sup> This distinction would date back to Gerschenkron (1962) quoted by several authors whose Goux (1993,

financial system are the recognition of the role of the time which is necessary for the local actors' adherence to the new institutions. This time is longer than the time required for the installation of the institutional reforms.

Indeed, actors do not adopt instantaneously financial product innovations and institutional change. They need time, which is necessary to evaluate changes through practice. Costs induced by this effort of evaluation are compared to existent benefits resulting from existent informal practices. This is the reason why the formal definition of new specific institutions from developed countries by developing countries is not an immediate and absolute guarantee of better performance and development.

Weaknesses in the theoretical structure of financial liberalization have promoted the appearance and the amplification of financial crises in emerging countries.

### **WEAKNESSES REVEALED BY THE FINANCIAL CRISIS OF THE 80'S**

The optimistic vision of financial liberalization is obscured by the increase of the financial instability of this last decade. Some difficulties occurred by emerging banking sectors have transformed into systemic crises. It was the case of Chile in 1981 where banks faced the financial sector deregulation. This experience shows that the benefits of financial liberalization have to be considered and compared to the increase in costs induced by the financial weaknesses. Three main factors have promoted the emerging economies weakness : the lax attitude of central Banks, the absence of adequate competences concerning risk management, effects of risk contagions induced by a too rapid economic opening.

#### **The Central Bank Guarantee as a "Lender of Last Resort" : is it indispensable ?**

Institutional imperfection problems go with the passage from a close economy to a liberalized one. They are generated by the implicit deposit guarantee that the central Bank offers to banks. The opportunist behavior of commercial banks, which guarantee the insurance to be helped in case of a lack of liquidities, has promoted their excessive risk commitment which is a source of inefficiency.

With this implicit guarantee as a "lender of last resort" and in the absence of a «benign neglect» or a «constructive ambiguity» as for the central Bank's intervention, banks have multiplied their credits and have been committed on very risky activities. This situation has changed into a perverse effect that is an excessive banking credit allocation. The «overborrowing syndrome» is an expression of a credit boom. It constitutes a threat to the financial stability of developing countries.

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p.210), Arestis and Demetriades (1997 a, p.4).

In industrialized economies, the solution, which is commonly adopted to exit a financial crisis, is that the central Bank plays the role of last resort moneylender and leads an expansive monetary policy. It seems that such a policy considered in emerging countries promoted inflation. The depreciation of the national currency leads then to a rise of interest rate with all the consequences that one can imagine on the statements of banks as well as on the accounts of firms and households. The role of the central Bank as a generous last resort moneylender has therefore to be envisaged in more prudently in emerging countries.

### **The Difficulties in managing Risks**

The liberalization of interest rates increases their volatility. This new situation requires a more elaborate management of risks supported by the portfolio of banks. However bankers accustomed to a regulated financial system not necessarily have the knowledge nor the necessary experience to manage these risks. The risk project evaluation and their demand control competencies were not acquired during all the period where the credit system was regulated by the State. Such competencies are difficult to import from foreign countries. They are acquired gradually by the « learning by doing » process.

Financial liberalization has changed in many countries with a diminution of the international capital movement control. The early liberalized financial systems were committed on a new type of risk : the exchange rate risk induced by the raising of funds on international capital markets and their transformation in credit risks drawn in currencies to local agents. This monetary disparity or « currency mismatch » transforms the risk of exchange into a risk of credit allowed by non protected debtor agents. It is not therefore surprising that exchange crises precede banking crises and contribute to the early liberalized financial system's vulnerability.

### **The Tequila Effect : from the Risk of Exchanges to Banking Bankruptcies**

By a contagion effect the exchanges risk borne by borrowers transforms into credit risk for banks having granted credits drawn in foreign currencies<sup>13</sup>. The choice of short term credit in currency allows to avoid the risk induced by inflation. Indeed, emerging countries suffer from high rates of inflation whose evolution is very volatile and uncontrolled. This is the reason why the strong uncertainties on the future value of the national currency make that an important quantity of the debt is drawn in foreign currencies. It was the case of Chile before the financial crisis of 1982 and in Mexico before the Tequila crisis of 1994. A depreciation (or a national currency devaluation) consecutive to

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<sup>13</sup> Mishkin (1999) note that the exchange crisis that has undergone the United Kingdom in September 1992 has not induced the devastating effects that Mexico experienced during the depreciation of its currency in 1994-1995, the rise of interest rates not having had the same effects on growth.

speculative attack leads to a fast increase of debt costs for domestic firms. Their net value falls because of the rise in interest rates. The consecutive devaluation due to the exchange crisis in emerging countries leads to an alteration of the exchange pegging rate immediately involving an increase in the anticipated inflation. The consequence is an increase of nominal interest rates and an immediate increase of the cost of the short term debt involving the reduction in the firms' liquidity whose balance sheets are deteriorated. A exchange crisis then transforms into an extensive financial crisis.

Firms having contracted credits in dollars and escaping the risk induced by the inflation of their national currency suffer from a severe degradation of the balance sheet because the value of their liabilities in foreign currencies increases considerably. Thereby, firms face difficulties in refunding their credits, which translated into a deterioration of the balance of the domestic banks and precipitate their bankruptcies.

The erosion of the net value of domestic firms therefore affects the domestic stock market. Because this decline, the net firm value can no longer serve as collateral. Such a situation leads banks and moneylenders to being more reticent to lend to these firms. Thus we see a contraction of economic activity.

This context can lead to a financial crisis and to a strong contraction of economic activity. The stock market is in trouble. It no longer is able to insure efficiently the allocation of resources to most productive projects. The result is a productive investment decline.

## **A MICRO-ECONOMIC RE-EXAMINATION OF BANKING DEVELOPMENT**

In the process of growth, banks are often forgotten for a too large vision of financial intermediation process<sup>14</sup>. The analytical and theoretical contributions deal with a macro-economic level. Thus the weak integration of the role of banks among the other financial intermediaries leads to an amplification of the financial crisis. Banks were considered as a booster of financial crises<sup>15</sup>. In developing countries, banks exist while Stock market often is an embryonic structure. In average and weak income countries the value of bank assets does approximately about 55% of the GDP, the no-banks institutions represent about 14% and the value of financial market transactions is about 5,5%. Have the financial developing countries systems to follow an «unilinear» evolutionist process in which financial developing countries system would evolve through a succession of stages, leading them to move from banks to the financial market ? Has one favor the development of stock markets with risks of instability that they induce on fragile countries? It is indispensable to identify the role of banks as creative of currencies in the financial system. It is also essential to examine their interactions with the productive machine in the framework of a mutual training process of industry and finance.

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<sup>14</sup> Levine (1997), p.689.

## **The Banking Approach of the Liberalization has to be a Schumpeterian Approach**

For Schumpeter the entrepreneur is firstly a bank debtor. It considers that changes in the cycle of businesses induced by innovations modify the economic balance (circular flow) prevailing initially. Schumpeter grants a great importance to financial and monetary factors in the economic development process. In its chapter 3, title *Credit and capital : The nature and function of credit*, Schumpeter (1911) precise «If one had to assert that the currency is only a means facilitating the circulation of goods and that there are no important phenomena connected to it, that would be false» (p.96). The author adds that management and the creation of means of payment by banks constitutes their fundamental function. It criticizes the vision of Ricardo for that banking operations do not contribute to the increase of the wealth of nations and Law for that these operations are only the «steamy speculation».

The schumpeterian approach of the financial intermediation stipulates that innovative activities can not find a place without the banks' collusion that provides to the entrepreneur the necessary financial means. As a rule, first the businessman is debtor beside the bank to become creditor then. First he borrows and after he puts his money in a bank deposit. The function of financing is a prerogative of banks and banking credit plays an essential role. It contributes to the mobilization of the capital as financial fund to the service of entrepreneurs and the capital is more efficient as it allows an increase of the real product.

Schumpeter notices that the essential [the three-quarters] of what one calls commonly «banks» corresponds to institutions that insure the financing by credits by creating *ad hoc* means of payment qualified by the author of «abnormal credit». It proceeds from the creation of an *ex nihilo* purchasing power leading to the creation of goods. The credit creates a new currency allowing the expense to be as the motor of the economy. Banks take then the risk to bet on the future. They allow projects to be financed without the *ex post* saving constraint. It means that the projects are not limited by the existing savings quantity in the economy.

Schumpeter sets this abnormal credit against the normal credit considering that the normal credit exists at the same time with collateral serving as a counterpart. Furthermore, the monetary velocity does not increase in normal credit case contrarily to abnormal credit.

For Schumpeter, what we call commonly «monetary creation» is only the mobilization of resources already existent. The bank makes more than that. It contributes effectively to the creation «to a purchasing power» before the creation of a goods. This credit banking type is essential to finance the innovation.

Schumpeter notes that the essential role played by banks in the economic development consists in choosing firms that will be able to benefit from the public savings. The banking sector performs on the

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<sup>15</sup> Mishkin (1999), p.1525.

economic expansion path through the saving allocation. Hence, the finance and development schumpeterian approach is an excellent explanation of the banks' economic role and function in the productivity growth and the technological change process. The Schumpeter idea is that the accumulation of the capital is the key of the economic growth. In this framework, banks have to contribute there by the monetary creation as well as by the mobilization and the allocation of the savings.

### **The Banking Approach of the Liberalization has to integrate a Social Dimension**

The bancarization and the improvement of the accessibility to banking services increase the financial deepening. As reminds Fry (1995, p.453) it is the proximity of the system more than the level of deposit rate that has contributed grandly to the increase of domestic rural ratio savings from 1 to 5% over a period 20 years in six developing Asian countries. According to Sarr (2000), the behavior of bank price can be influenced by the state of the economic development of a country. In the initial development phase where income levels are weak, savers and depositors are less sensitive to levels of deposit rate. They are more sensitive to the different bank services through the proximity and to the density of branches as well as to the quality of the service of saving management.

We suggest here a banking micro-economic re-examination of the financial liberalization process. It consists in identification of the role of the financial banking intermediate in the financial deepening. The importance of banks in the development is not only to achieve a transformation of the existent savings in credits. Banks have to make more than that function. They have to analyze projects and risks that are associated them, to accompany them by the advice and to finance them by taking the risk to make bets measured on the future. They also manage the appreciation of the influence of the liberalization on their behavior, their statement and their accounts.

Thus banking industry in developing countries did not require the deregulation imposed by the McKinnon and Shaw financial sequencing. For developing countries, an appropriate regulation of banking industry is necessary. A deregulation of depositor rate accordingly to McKinnon and Shaw does not constitute the panacea. The existence of a banking market power on the market of deposits and the maintenance of a regulation of creditor rate are not in contradiction with financial deepening.

The banking regulation is not a homogeneous and compact judicial block. The regulation is indispensable if it is guaranteed a collective wealth in poor people countries. The deregulation can be useful if it does not dangerous to the social equity.

### **THE RIGHT GOUVERNANCE AND THE INSTITUTIONAL CORRECTIONS**

The good governance defines how to establish an efficient institutional framework allowing to reduce imperfections of the liberalization.

## **The Governance : some objectives**

The problem of the governance in developing countries has been pointed out for the first time in the World Bank report of 1993. In substance, governance aims to restore an efficient institutional framework. It means :

- the struggle against the corruption and the ineffective bureaucracy,
- the security of depositors and the respect of the shareholders and creditor right,
- the installation of accounting norms allowing a good management of firms,
- the rigorous application of contracts.

The quality of the governance deals at least with three aspects of the financial and economic activity in developing countries.

*The efficiency of economic policies and industrial structures.* Two countries presenting similar financial systems and committing a similar economic policy can exert a different effect and a different causality between financial development and economic growth. This is due to the difference of the quality of their governance linked to the efficiency of institutions that exert it. As a rule, the industrial dynamism is more important for countries subject to a highest level of financial development, a best judicial shareholder and creditor protection and an efficient mechanism of application of contracts.

*The financial system performance.* The quality of the governance explains differences in the financial systems efficiency. The banking sector stimulates more or less the growth according to the institutional framework. The quality of the governance as exogenous component acts on the performance of the banking system which would exert a significant and positive influence on the growth of the GDP, on the accumulation of the physical capital and on the growth of the productivity.

*The probability of banking crisis appearance.* The weakness of the institutional environment increases the probability of crises due to the financial liberalization. That is the case in countries where applications of rules of the law are weak, the corruption and the ineffective bureaucracy extended and low respect of contract mechanism application. In this context, the financial liberalization increases the probability of banking crisis appearance. Weaknesses of the institutional environment can then translate into the two amplification types of risks : the risk of credit and the risk of changes.

## **The Banking Governance: some recommendations**

An efficient banking governance requires a strong supervision-regulation that can be define with five ways<sup>16</sup>:

- First the existence of a supervision and banking regulation agency. The structure needs adequate resources to achieve its monitoring mission allowing banks to avoid being committed in risked activities of hazardous manner. Such a structure allows banks to match the risk on the basis of an expertise and a rigorous control. It leads banks to have sufficient funds with the result that the moral risk of the clientele does not entail to excessive risk commitments,
- The installation of steady procedures based on accounting rules allowing a greatest financial institution transparency. They would offer to the supervisor an appropriate information allowing it to detect excessive risk commitments and to control them adequately. These measures guarantee a healthy banking system environment,
- The recourse to rapid corrective actions to the initiative of the banking supervisor allowing to stop undesirable banking activities. Its actions would have not only to end the activities of banks whose net value is insufficient but also to insure that shareholders and managers of these banks are well punished,
- The independence of the banking supervision/regulation agency from the political power. It is not good that the agency is under the tutelage of the central Bank because that risks altering the independence of the agency,
- The transparency of actions of the banking supervision/regulation agency. These actions have to be available to the public, what do guarantee more autonomy from the political power and from some groups of influence.

If the financial liberalization is adopted while the supervision and regulation structure is not installed then the capacity of bank expertise will not be efficient concerning the credit allocation and this will not be made prudently. In a context of boom of credit lied to a financial deepening characterized by an increase of financial flows, such a situation behaved to a weakening of the quality of the banking portfolio.

It became apparent that the liberalization and the financial deepening have a positive effect on the economy in the long-run. However, in the short-run, the boom of credit can outstrip resources in necessary information for the future stability of the banking system. Banking crises has elsewhere often followed this boom. It is the case, for example, for Mexican banks whose deterioration of the balance sheet proceeded by an explosion of credits.

## **CONCLUSION**

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<sup>16</sup> Mishkin (1999).

When the Nobel Prize Joseph Stiglitz was Chief economist at the World Bank, he already stressed on weaknesses and corrections to bring to the financial liberalization in developing countries. He suggested that it was imperative to specify the relationship between the finance, on one hand, and macro-economic fluctuations and the growth, on the other hand. He suggested to give micro-economic foundations for this relationship by taking the information's imperfection in financial systems into account. He added «This reorientation of microeconomics provides the basis for building a sounded macroeconomics on the basis of microeconomics models» (1998,p.5). He proposed to integrate micro-economic models developed during these last twenty five years in finance putting in obviousness the specificity of the financial sector. In other words, the usual micro-economic framework in which all equilibrium is pareto-optimal may not describe stock markets characterized by the imperfection of the information and the problems of contracts<sup>17</sup>. The State has to play an important role in the regulation of these markets. As an example, Stiglitz quotes Wall Street considered as the free market emblem but that is one of the most regulated market. It is true that the regulator is often in a situation of informational disadvantage in the market. It is thereby faced a typical principal-agent problems. The regulator can however reduce adverse selection and moral hazard problems relevant for financial markets. It can thus promulgate laws establishing security commissions protecting the minority and the shareholders of the fraud. One can militate in favor of a development «by the low» based on a micro-economic approach of the macro-economy of the development. It is necessary but not sufficient. In poor countries the liberalization has also to go with appropriate measures allowing to guarantee the welfare and the social equity for peoples.

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<sup>17</sup> «In introductory economics races we are taught to uses demand and supply diagrams to analysis markets for apples and bananas...Some go one to apply this theory to financial markets... This simplistic theory is the basis for the belief that financial markets need to be fully liberalized from the «interference» of governments» Stiglitz (1998, p.1).

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