Modern Economy, 2017, 8, 378-385
http://www.scirp.org/journal/me
ISSN Online: 2152-7261
ISSN Print: 2152-7245

The Mexican Banking System and Its' *Oligopsonic-Oligopolistic* Structure

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How to cite this paper: Encinas-Ferrer, C. (2017) The Mexican Banking System and Its' *Oligopsonic-Oligopolistic* Structure. *Modern Economy*, **8**, 378-385.
https://doi.org/10.4236/me.2017.83027

Received: February 2, 2017
Accepted: March 3, 2017
Published: March 6, 2017

Abstract

The dual figure of the oligopsonic-oligopolistic enterprise is mainly applied to commercial intermediaries. This dual personality has a double negative impact on markets of goods: On the one hand, as an oligopsonic buyer, it reduces demand to producers by lowering the prices they would sell to be in a competitive market, and, on the other hand, as oligopolistic sellers, reduce supply, thereby raising prices to final consumers. In the case of the banking sector, the lack of competition that this dual figure implies means that the gap between the passive interest rates paid to the savers and the active rates they charge for lending the same savings are very high and often lead to negative passive rates that discourage savings and active rates so high that they discourage productive investment and consumption.

Keywords

Oligopsony, Oligopoly, Oligopsony-Oligopoly, Imperfect Competition, Banking System.

1. Introduction

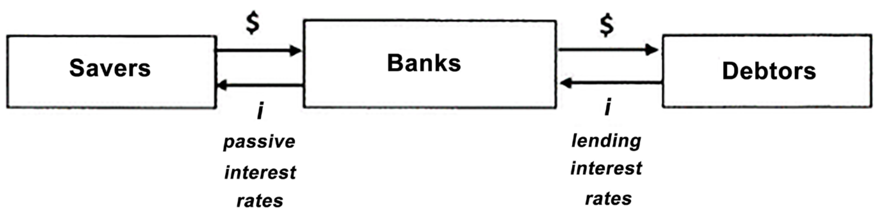
In 2003 I published my first work about the dual figure on the imperfect monopsony[1]-monopoly[2] competition [1]. In 2010 I broadened these analyses and wrote them in an article published in Spain [2]. In the year 2013 I applied those first analysis to the oligopsony[3]-oligopoly[4] figure [3] and observed that although there is some competition in the second figure, the results for both, the seller (the producer of the goods) and the final consumer, are like those of the monopsony-monopoly figure. It is therefore of the utmost importance that the na-

[1]Monopsony: market in which there is only one buyer.
[2]Monopoly: market in which there is only one seller.
[3]Oligopsony: market in which there are few buyers.
[4]Oligopoly: market in which there are few sellers.

tional offices responsible for promoting competition in the markets be very clear about the differences between an oligopoly in the productive sector and the oligopsony-oligopoly in the intermediary market sector.

The dual personality of the oligopsonist-oligopolist intermediary has, as I mention in my first works, a double negative impact on markets: On the one hand, as oligopolies they lower the prices that producers could get if they were in a competitive market, and, on the other hand, as oligopolistic sellers, through a reduced supply they raise prices to final consumers. In this way, their benefits are increased to buy cheap and sell expensive, affecting effective demand of the consumer and the effective supply of the initial producer.

In the case of the banking system, an intermediary between savers and credit claimants, the lack of competition leads to a high market power that allow banks to pay savers very low interest rates—in many cases negative rates for being inferior to inflation—compared to the ones they charge its creditors.



The lack of competition in a market such as banking has a double negative effect on the economy, on the one hand discourages savings and, on the other, by making credit more expensive, reduces consumption and investment.

Therefore, being a sector so relevant for the development of economic policies, it must be firmly regulated by the monetary authorities of a country which should actively promote competition in it, as well as regulate the commissions charged to its clients by their services.

Mexican Banking System

The Mexican banking system has gone in the last 35 years through three processes that modified it deeply. In 1982 Mexican banking was nationalized by the government and became part of the public sector. In 1990 the bases for its reprivatization were established but leaving the former owners out of it and giving preference in their acquisition to owners of brokerage houses to acquire them [4]. This process coincided with the domination of neoliberal politics in the national economic policy and during the same was extended the possibility of the entry of foreign capital in their societies. The banking crisis of 1995 led to legal changes by the government of President Ernesto Zedillo that allowed that 100% of the capital of Mexican banks could be acquired by foreign banks.

More developed countries have restricted the inflow of foreign investment into their banking systems, especially in those banks that have the largest share in their financial markets. The reason for this is the need in such a relevant sector to serve primarily the development needs of national capital.

Notwithstanding the foregoing, our politicians carried out the denationalization of our banking system which, far from increasing competition, was accompanied by a high banking concentration.

2. Measuring Market Concentration

A market is competitive if both, supply and demand, are atomized enough to ensure that prices and quantities are established close to those that would occur in conditions of perfect competition.

In cases of oligopsony, oligopoly or oligopsony-oligopoly, in which a small number of buyers, sellers or buyers which are at the same time sellers-I am speaking of commercial intermediaries-can affect the price and quantities traded, we are facing imperfect competition. The smaller the number of competitors or the greater weight they have in that market, the closer we will be to the total absence of competition: the monopsony, the monopoly or the monopsony-monopoly.

To know if there is competition in a market, different criteria and methods are used, the most important being:

1) The concentration ratio (CR) which measures the concentration of market share held by suppliers in a market. It is equal to the percentage of total market share by a given number of leading firms. The most popular are the CR4, the concentration ratio of the four top firms with the largest market shares, and the CR8, the concentration ratio of the eight firms with the largest market shares [5].

2) The Herfindahl Index or Herfindahl and Hirschman Index (IHH) which is a measure that reports on the economic concentration of a market, or, inversely, the measure of lack of competition in an economic system. A high index expresses a very concentrated and uncompetitive market. The index is calculated by squaring the market share that each company owns and adding up those amounts. The results range from 0 (perfect competition) to 10,000 (monopoly).

Let's apply those indexes to the actual Mexican banking system.

3. Banking Market Concentration in Mexico

The capitalization of the Mexican banking system, achieved through the foreignization of its capitals, was accompanied by an accelerated concentration in the four largest banks. In November 1999 CR4 (**Figure 1**) was 33.46% and CR8 (**Figure 2**) 44.37%. Those numbers show that the banking system was highly competitive.

From January 2000 to April 2003 the market concentration in the four biggest banks (CR4) increased from 33.46% up to 72.51% and in January 2005 reached its highest level: 73.29%. During this time the market concentration in the eight largest banks (CR8) went from 44.37% to 91.31% and in January 2005 reached its highest level: 95.82%.

At the beginning of 1999, the number of banks operating in Mexico was 48. By February 2005, that number dropped to 28. The decrease in units was due to the fact that foreign banks acquire not only one but several different banks, integrating them into a single financial company.

Mexican monetary and banking authorities promoted during 2007 the creation of more banks and by December of that year the number of banks increased to 37. One year later, in December 2008, this number was already 41. Currently, November 2016, we have 43 banks in our country.

The increment in the number of banks in Mexico has increased competition and reduced the bank concentration. The CR4 index went to 63.05% and CR8 to 84.5%, a decrease of 10.24% in the first Index and a decrease of 11.76% in CR8.

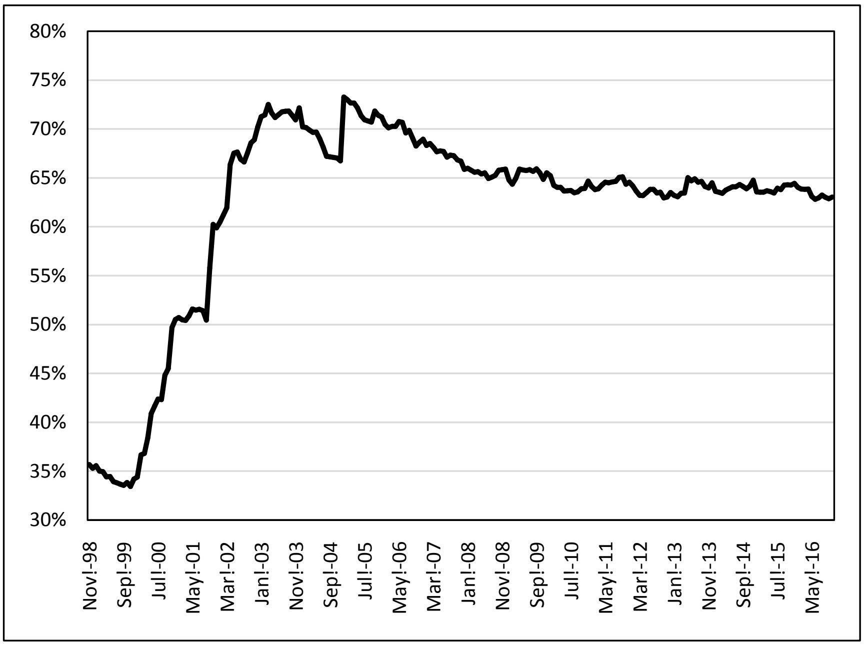


Figure 1. Mexican bank system: CR4 Index. Own elaboration with data from Banco de México [6].

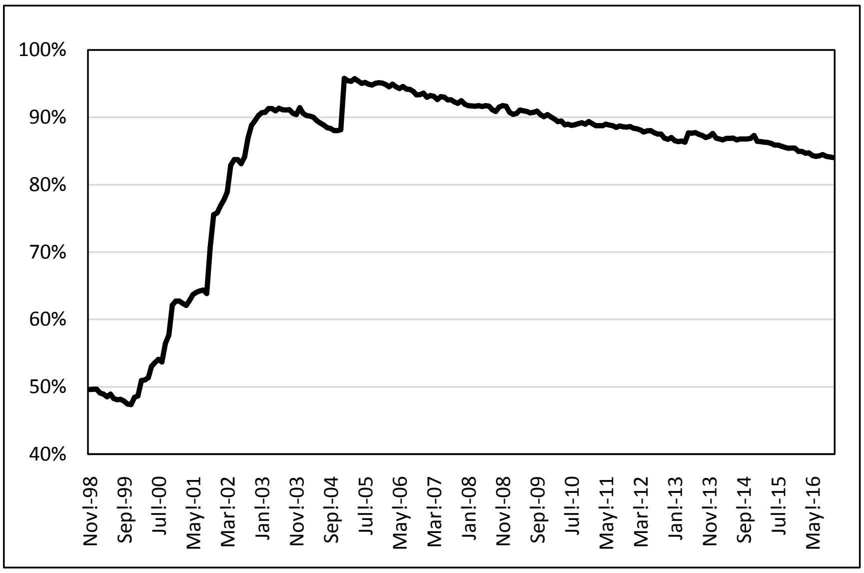


Figure 2. Mexican bank system: CR8 Index. Own elaboration with data from Banco de México.

This decrease in rates is still very low and reflects the small number of banks in our country compared, for example, with the 209 existing financial institutions in Spain.

To know the percentage of the market that foreign banks have in Mexico, we have added their assets and obtained an index of foreign capital penetration in our banking system. This is also important to know more precisely the degree of lack of competition that we face.

In Figure 3 we see that in the first months of 2000 only 44.15% of the banking system was in the hands of foreign banks. In January 2005, foreign banks owned

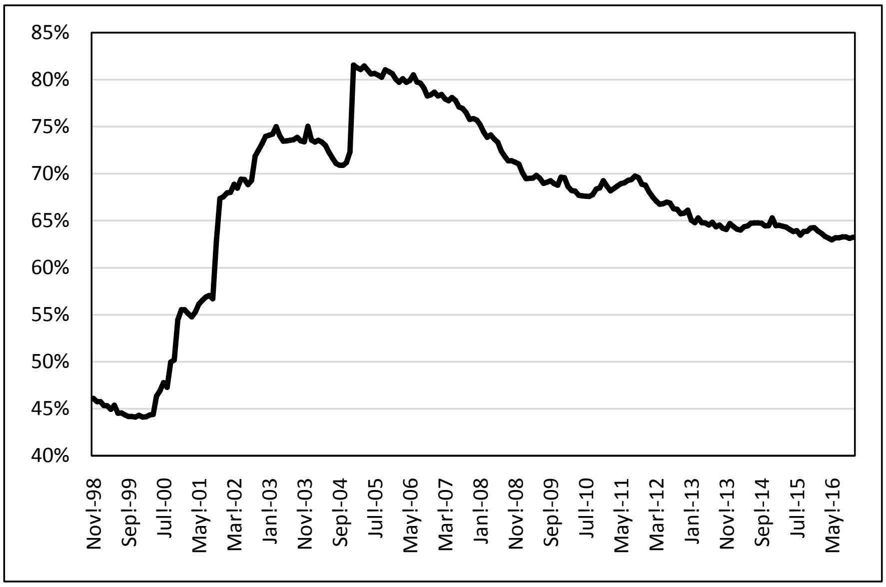


Figure 3. Foreign capital participation in the Mexican banking system: FCP Index. Own elaboration with data from Banco de México.

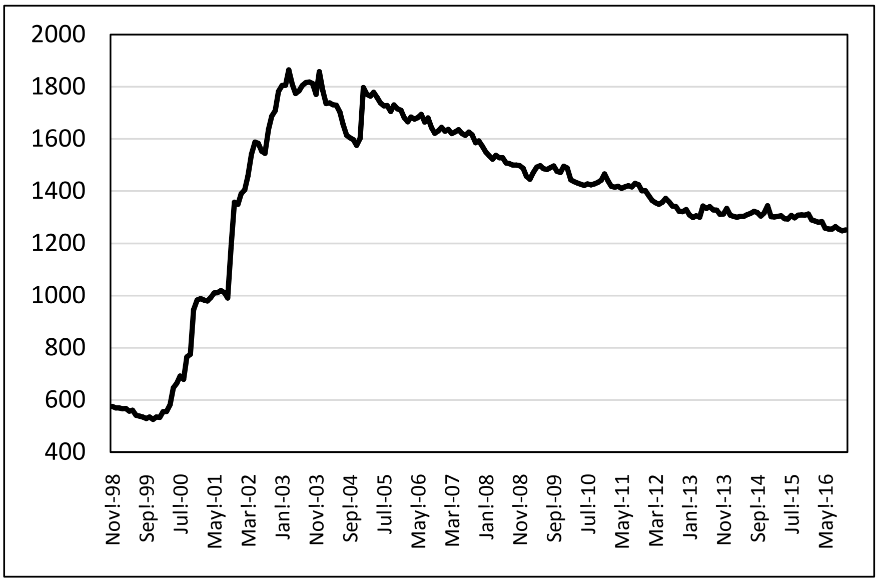


Figure 4. Mexican bank system: Herfindahl-Hirschman Index (HHI Index). Own elaboration with data from Banco de México.

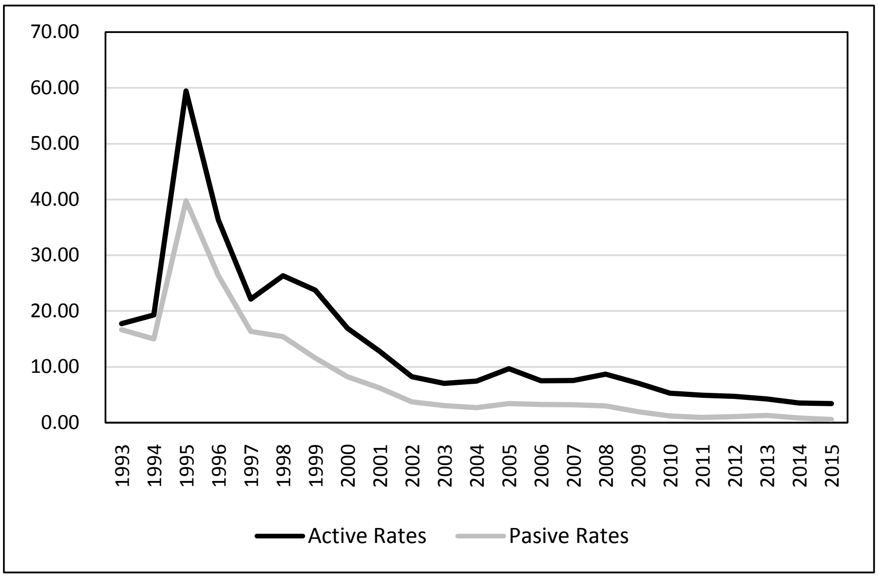


Figure 5. Mexican banking active and passive rates. Own elaboration with data from World Bank [8].

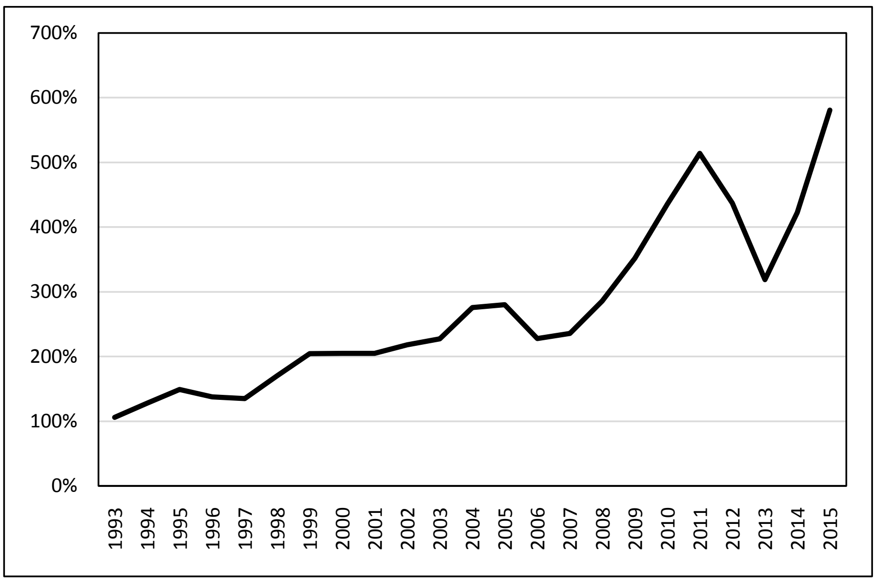


Figure 6. Active interest rates/passive interest rates. Own elaboration with data from World Bank.

81.56% of total market. From that date to now this Index decreased to 63.24%, still too high a figure.

The Federal Economic Competition Commission (COFECE) [7] in Mexico uses the Herfindahl-Hirschman Index (HHI Index) to measure sectoral concentrations and avoid monopolistic practices. In **Figure 4** we see its evolution from November 1998 to November 2016. As in previous indexes, there is a great increase in the first years when it reached 1864.16 (March 2003). This percentage decreases in the following years but remains stable above 63% at present. COFECE considers that this market share is not currently serious because it is below 2000 points. In my opinion the HHI was developed for oligopolistic manufacturing companies but not for oligopsonic-oligopolistic intermediaries since they have a double effect by acting simultaneously on supply and demand.

4. Economic Impact of the Lack of Competition

The absence of competition that involves the oligopsony-oligopoly figure is obseved in the increase of profits obtained by buying cheap and selling expensive. In the case of the banking system it can be observed in the differential between the active rates charged to its loans and the passive rates it pays its customers for their deposits.

In **Figure 5** we can see the evolution of passive and active interest rates in the Mexican banking system from 1993 to 2015.

By generating an Active Rates/Passive Rates coefficient, we clearly observe how banks in Mexico have increased their active rates relatively to the rates they pay savers, thus increasing their profits by reducing their costs (**Figure 6**).

5. Conclusions

The Mexican banking system is heavily concentrated and requires the entry of new banking entities to the market to increase competition.

The dominant presence of foreign banks in the market is another element that affects the Mexican economy, since it entails capital flows of large amounts of foreign currencies as factorial payments to their headquarters abroad.

The lack of competition has allowed banks to pay low interest rates to their clients, thereby discouraging savings and charging high rates of lending interest depressing both consumption and investment.

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