



**MEDEG-Master in Economic Development and Growth  
Edition 2017-18**

**FINANCIAL SYSTEMS IN DEVELOPING ECONOMIES**

**Course:** optional

**Credits:** 3 ECTS

**Term:** 2º (February-May)

**Language:** English

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**OBJECTIVES**

The course aims to present a selection of scholarly research on the role of financial systems in developing economies. Both economic theory and empirical research emphasize the importance of financial development for growth in the long run. Financial development is a broad concept which encompasses not only the deepening of banking systems and financial markets but also improvements in their allocative efficiency as well as in their resilience to macroeconomic shocks. In fact developing economies often exhibit low levels of financial intermediation, inefficient allocation of funds, and high exposure to financial crises. Poor institutions, heavy regulation and macroeconomic volatility are generally at the roots of such weaknesses. At micro level, low financial development translates into the exclusion of large part of the population and firms (especially SMEs and micro-enterprises) from access to financial services, and a large role for informal finance. In an attempt to promote financial development, since the 1990s governments in emerging and developing economies have pursued financial reforms that in a number of cases led to an improvement of the legal and institutional environment, the deregulation of financial intermediation, the liberalization of financial markets and an expansion of financial access by households and firms. However, liberalized financial systems suffer from market inefficiencies specific to the process of financial intermediation. Moreover external liberalization may provide an additional source of instability by exposing developing countries to shocks brought home by international financial markets, such as sudden stops or reversals of capital flows. For this reason financial reforms must also include the construction of effective institutions for the supervision and prudential regulation of intermediaries and markets. After a brief introduction about the **legal determinants of financial development**, the course deals with this three main issues: **1) financial development and growth; 2) access to finance, inequality and poverty; 3) financial liberalization and financial crises.**

## FORMAT AND ASSESSMENT METHOD

The module is based on 11 sessions of 2 hours each and combines lectures and seminars:

- Lectures outline insights from economic theory and survey relevant findings of empirical research.
- Seminars deal with specific topic and aim at enhancing presentation skills and promoting discussion. For seminars, students work in groups of three. Each group is required to write a short essay (max 4,000 words) based on a selection of readings and present the essay in class. All students are encouraged to participate in the discussion in class. A list of topics and readings will be provided separately.

Grading:

- seminar (essay and presentation), 40%
- final exam, 60%.

## TOPICS AND READINGS

Readings marked by ■ are required for the final exam. Those marked with + are complementary readings used in the lectures.

For a brief survey of various topics covered by the course:

- D. Ray, *Development Economics* (Oxford University Press), chapter 14, pp. 529-590
- M.P. Todaro, S.C. Smith, *Economic Development* (Addison-Wesley), chapter 15, pp. 750-768

### **Introduction. *Legal roots of financial development***

- + La Porta R. et al. (1998), "Law and finance", *Journal of Political Economy*, 106 (6), pp. 1113-1155
- Beck T. et al (2003), "Law and finance: why does legal origin matter?", *Journal of Comparative Economics*, 31, pp. 653-675
- + La Porta R. et al (2013), "Law and finance after a decade", in *Handbook of the Economics of Finance*, Ch. 6, pp. 425-491

### ***Topic 1. Financial development and growth***

#### Exam readings

- Rajan R., Zingales L. (1998), "Financial dependence and growth", *American Economic Review*, 88, pp. 559-586
- Levine R., Loayza N., Beck T. (2000), "Financial intermediation and growth: causality and causes", *Journal of Monetary Economics*, 46, pp. 31-77
- Beck T., Büyükkarabacak B., Rioja F., Valev N. (2012), "Who gets the credit? And does it matter? Household vs. firm lending across countries", *The B.E. Journal of Macroeconomics*, 12, pp. 1-44.

#### Complementary readings

- + King R.G., Levine R. (1993), "Finance and growth: Schumpeter might be right", *The Quarterly Journal of Economics*, 108 (3), pp. 717-737
- + Levine R. (1997), "Financial development and economic growth: views and agenda",

- Journal of Economic Literature*, 35, pp. 688-726
- + Beck T., Levine R., Loayza N. (2000), "Finance and the sources of growth", *Journal of Financial Economics*, 58, pp. 261-300
  - + Rioja F., Valev N. (2004), "Does one size fit all? A reexamination of the finance and growth relationship", *Journal of Development Economics*, 74, pp. 429-447
  - + Rousseau P.L., Wachtel P. (2011), "What is happening to the impact of financial deepening on economic growth?", *Economic Inquiry*, 49, pp. 276-288
  - + Arcand J-L., Berkes E., Panizza U. (2015), "Too much finance?", *Journal of Economic Growth*, 20 (2), pp. 105-148

## **Topic 2. Access to finance, inequality and poverty**

### Exam readings

- ▣ Beck T., Demirguc-Kunt A., Martinez Peria M.S. (2007), "Reaching out: access to and use of banking services across countries", *Journal of Financial Economics*, 85 (1), pp. 234-266
- ▣ Beck T., Demirguc-Kunt A., Levine R. (2007), "Finance, inequality and the poor", *Journal of Economic Growth*, 12 (1), pp. 27-49
- ▣ Guirkinger C. (2008), "Understanding the coexistence of formal and informal credit markets in Piura, Peru", *World Development*, 36 (8), pp. 1436-1452
- ▣ Beck T., Demirguc-Kunt A., Singer D. (2013), "Is small beautiful? Financial structure, size and access to finance", *World Development*, 52, pp. 19-33

### Complementary readings

- + Beck T., Demirguc-Kunt A. (2006), "Small and medium-size enterprises: access to finance as a growth constraint", *Journal of Banking and Finance*, 30, pp. 2931-2943
- + Beck T., De La Torre A. (2007), "The basic analytics of access to financial services", *Financial Markets Institutions and Instruments*, 16:2, pp. 79-117
- + Claessens S., Perotti E. (2007), "Finance and inequality: channels and evidence", *Journal of Comparative Economics*, 35, pp. 748-773
- + Honohan P. (2008), "Cross-country variation in household access to financial services", *Journal of Banking and Finance*, 32:11, pp. 2493-2500
- + Beck T., Demirguc-Kunt A. (2008), "Access to finance: an unfinished agenda", *The World Bank Economic Review*, 22:3, pp. 383-396
- + Karlan D., Morduch J. (2009), "Access to finance", in D. Rodrik, M. Rosenzweig (eds.), *Handbook of Development Economics*, v. 5
- + Barajas A., Beck T., Dabla-Norris E., Yousefi R. (2013), "Too cold, too hot, or just right? Assessing financial sector development across the globe", IMF Working Paper, n. 13/81
- + Bauchet J., Morduch J. (2013), "Is micro too small? Microcredit vs SME finance", *World Development*, 43, pp. 288-297
- + Beck T., Feyen E. (2013), "Benchmarking financial systems. Introducing the Financial Possibility Frontier", World Bank Policy Research Working Paper, n. 6615

## **Topic 3. Financial liberalization and financial crises**

### Exam readings

- ▣ Kaminsky G., Reinhart C. (1999), "The twin crises: The causes of banking and balance-of-payments problems", *American Economic Review*, 89 (3), pp. 473-500
- ▣ Bekaert G., Harvey C., Lundblad C. (2005), "Does financial liberalization spur

growth?" , *Journal of Financial Economics*, 77(1), pp. 3-55

■ Ranciere R., Tornell A., Westermann F. (2006), "Decomposing the effects of financial liberalization: crises vs. growth" , *Journal of Banking and Finance*, 30, pp. 3331-3348

■ Eichengreen B., Hausmann R., Panizza U. (2007), "Currency mismatches, debt intolerance and original sin: why they are not the same and why it matters" , in S. Edwards (ed.), *Capital Controls and Capital Flows in Emerging Economies* (University of Chicago Press), pp. 121-169

#### Complementary readings

+ Mishkin F. (1996), "Understanding financial crises: a developing country perspective" , NBER Working Paper, n. 1996

+ Fry, M. J. (1997), "In favour of financial liberalization" , *Economic Journal*, Vol. 107, n. 442, pp. 754-770

+ Hellman T., Murdock K., Stiglitz J. (1997), "Financial restraint. Towards a new paradigm" , in M. Aoki et al (eds), *The Role of Government in East Asian Economic Development* (Oxford University Press), pp. 163-207

+ Edwards S. (2000), "Contagion" , *The World Economy*, 23 (7), pp. 873-900

+ Milesi Ferretti G.M., Razin A. (2000), "Current account reversals and currency crises: empirical regularities" , in P. Krugman (ed.), *Currency Crises* (University of Chicago Press/NBER), pp. 285-326

+ Demirguc-Kunt A., Detragiache E. (2002), 'Does deposit insurance increase banking system stability? An empirical investigation' , *Journal of Monetary Economics*, 49 (7), pp. 1373-1406

+ Kaminsky G., Reinhart C., Vegh C.A. (2003), "The unholy trinity of financial contagion" , *The Journal of Economic Perspectives*, 17 (4), pp. 51-74.

+ Reinhart C., Rogoff K., Savastano M.A. (2003), "Debt intolerance" , *Brookings papers on Economic Activity*, v. 1, 1-74

+ Kose A., Prasad E., Rogoff K., Wei S. (2009), "Financial globalization: a reappraisal" , *IMF Staff Papers*, 56 (1), pp. 8-62

+ Angkinand A., Wihborg C. (2010), "Deposit insurance coverage, ownership, and banks' risk-taking in emerging markets" , *Journal of International Money and Finance*, 29, pp. 252-274

+ Dell'Ariccia et al (2012), "Policies for macrofinancial stability: how to deal with credit booms" , *IMF Discussion Note*, 12/06.

+ Elekdag S., Wu Y. (2013), "Rapid credit growth: boon or boom-bust?" , *Emerging Markets Finance and Trade*, 49 (5), pp. 45-62