

MEDEG-Master in Economic Development and Growth
Edition 2024-25

FINANCIAL SYSTEMS IN DEVELOPING COUNTRIES

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 different aspects of the role of financial systems in developing economies. Both economic theory and empirical research emphasize the importance of financial development for growth, inequality and poverty in the long run. Financial development is a broad concept that 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 generally are at the roots of such weaknesses. At micro level, financial underdevelopment translates into the exclusion of large part of the population and firms (especially SMEs and micro-enterprises) from access to, and from the use of formal financial services. Conversely, the role for informal finance remains large. In an attempt to promote financial development and inclusion, since the 1990s governments in developing countries 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, liberalization may increase financial instability by exposing developing countries to external shocks, with significant effects on growth, inequality and poverty. For these reasons financial reforms must also include the construction of effective institutions for the supervision and prudential regulation of intermediaries and markets.

FORMAT AND TOPICS

The course is based on 10 sessions of 2 hours each and combines lectures and workshops.

Lectures provide insights from economic theory and discuss selected findings of empirical research on six topics:

- 1) roots of financial development
- 2) financial development, inequality and poverty
- 3) financial inclusion
- 4) microfinance
- 5) mobile money
- 6) informal finance

Workshops deal with financial policy challenges – i.e. problems related to different dimensions of financial development that demand actions and reforms. The format aims at enhancing active learning and critical thinking. Students will form small teams and select a topic of their interest. Using a variety of sources, including research and policy papers, reports and surveys, each team will analyze the selected issue in two stages: Stage 1) defining the characteristics of the problem and discussing its causes; Stage 2) analyzing the actions/reforms so far implemented and proposing new actions/reforms.

The use of inter- or multi-disciplinary perspectives is strongly encouraged. The process allows students to develop their own learning module on an issue they care about. The instructor guides them through the process by helping them to locate and select relevant literature and sources, and by providing a constant feedback on the different stages of the process. Each stage will be presented and discussed in class. At the end of the course each team will deliver a written policy report.

To facilitate the identification and selection of topics for the policy report, a selection of research-based surveys and reports from the World Bank, the IMF, the Inter-American Development Bank and other research and policy institutions is uploaded on Aula Global. However, students can suggest additional topics if adequately motivated.

EVALUATION

Grading weights:

- final exam 50%
- workshops (presentations and final written report) 50%.

READINGS

Introductory background readings from popular textbooks:

- P. Montiel, *Macroeconomics in Emerging Markets* (Cambridge University Press), ch. 20
- D. Ray, *Development Economics* (Oxford University Press), ch. 14
- M.P. Todaro, S.C. Smith, *Economic Development* (Addison-Wesley), ch. 15

For the final exam, students will prepare 6 readings (one for each topic):

Topic 1: Roots of financial development

- Ang J. (2019) "Culture, legal origins and financial development" *Economic Inquiry* 57(2): 1016-1037
- Beck T., Demirguc-Kunt A., Levine R. (2003) "Law and finance: why does legal origin matter?" *Journal of Comparative Economics* 31: 653-657
- Stulz R.M., Williamson R. (2003) "Culture, openness and finance" *Journal of Financial Economics* 70: 313-349

Topic 2: Financial development, inequality and poverty

- Beck T., Demirguc-Kunt A., Levine R. (2007) "Finance, inequality and the poor" *Journal of Economic Growth* 12 (1): 27-49
- de Haan J., Sturm J-E. (2017) "Finance and income inequality: a review and new evidence" *European Journal of Political Economy* 50: 171-195
- Rewilak J. (2013) "Finance is good for the poor but it depends where you live" *Journal of Banking and Finance* 37: 1451-1459
- Rewilak J. (2017) "The role of financial development in poverty reduction" *Review of Development Finance*, 7: 169-176

Topic 3: Financial inclusion

- Allen F. et al (2016) "The foundations of financial inclusion: understanding ownership and use of formal accounts" *Journal of Financial Intermediation* 27: 1-30
- Chamboko R. et al (2021) "The role of gender in agent banking: Evidence from the Democratic Republic of Congo" *World Development* 146: 105551
- Ghosh S., Vinod D. (2017) "What constrains financial inclusion for women? Evidence from Indian micro data" *World Development* 92: 60-81
- Grohmann A., Klühs T., Menkhoff L. (2018) "Does financial literacy improve financial inclusion? Cross country evidence" *World Development* 111: 84-96

Topic 4: Microfinance

- Banerjee A. et al. (2015) "The miracle of microfinance? Evidence from a randomized evaluation" *American Economic Journal: Applied Economics* 7 (1): 22-53
- Bruhn M., Love I. (2014) "The real impact of improved access to finance: evidence from Mexico" *The Journal of Finance* 69 (3): 1347-1376
- Nakano Y., Magezi E. (2020) "The impact of microcredit on agricultural technology adoption and productivity: evidence from randomized control trial in Tanzania" *World Development* 133: 104997

Topic 5: Mobile money

- Batista C., Vicente P. (2023) "Is mobile money changing rural Africa? Evidence from a field experiment" *The Review of Economics and Statistics*
https://doi.org/10.1162/rest_a_01333
- Riley E. (2018) "Mobile money and risk sharing against village shocks" *Journal of Development Economics* 135: 43-58

- Suri T., Jack W. (2014) "Risk sharing and transaction costs: evidence from Kenya's mobile money revolution" *American Economic Review* 104 (1): 183-223
- Suri T., Bharadwaj P., Jack W. (2021) "Fintech and household resilience to shocks: Evidence from digital loans in Kenya" *Journal of Development Economics*, 153: 102697

Topic 6: Informal credit

- Du J., Li C., Wang Y. (2023) "Shadow banking of non-financial firms: arbitrage between formal and informal credit markets in China" *Journal of Financial Intermediation* 55: 101032
- Guirking C. (2008) "Understanding the coexistence of formal and informal credit markets in Piura, Peru" *World Development* 36: 1436-1452
- Tsai K. (2004) "Imperfect substitutes: the local political economy of informal finance and microfinance in rural China and India" *World Development* 32: 1487-1507

WEEKLY SCHEDULE

<i>Date</i>	<i>Weekday</i>	<i>Class content/activity</i>
12-mar.-25	Wednesday	Course presentation + Introduction: Financial development
13-mar.-25	Thursday	1) Roots of financial development
19-mar.-25	Wednesday	2) Financial development, inequality and poverty
20-mar.-25	Thursday	3) Financial inclusion
26-mar.-25	Wednesday	4) Microfinance
27-mar.-25	Thursday	Workshop: presentation of stage 1) of policy reports
2-abr.-25	Wednesday	5) Mobile money
3-abr.-25	Thursday	6) Informal credit
9-abr.-25	Wednesday	(buffer)
10-abr.-25	Thursday	Workshop: presentation of stage 2) of policy reports