

**MEDEG-Master in Economic Development and Growth
Edition 2022-23**

FINANCIAL SYSTEMS IN DEVELOPING COUNTRIES

Course: optional

Credits: 3 ECTS

Term: 2º (February-May)

Language: English

Instructor: Stefano Battilossi , Department of Social Sciences UC3M

Office: 18.2.D.07

Office hours: Thursdays, 13:00-14:00 am

Email: stefano.battilossi@uc3m.es

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, liberalized financial systems also suffer from market inefficiencies (asymmetric information, moral hazard) specific to the process of financial intermediation. In some case, the process of liberalization has been “captured” by incumbent interests. Moreover, external liberalization may increase financial instability by exposing developing countries to shocks brought home by international financial markets, such as sudden stops or reversals of capital flows. 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 11 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 broad topics:

- 1) financial development and inequality/poverty
- 2) financial fragility
- 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 an issue of their interest. Using a variety of sources, including research and policy papers, reports and surveys, each team will analyze the selected issue in four stages: a) defining the characteristics of the problem; b) discussing its causes; c) analyzing the effectiveness of actions/reforms implemented; d) 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 weekly frequency. At the end of the course each team will deliver a written policy report.

A list of possible topics for the workshop/report and, for each topic, a preliminary list of readings are provided on Aula Global, together with 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. However, students can suggest additional topics if adequately motivated.

EVALUATION

Grading weights:

- exam 50%
- workshops (weekly discussions and final report) 50%.

READINGS

General background:

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

For the final exam, students will prepare the following readings:

Topic 1

- Claessens S., Perotti E. (2007) "Finance and inequality: channels and evidence", *Journal of Comparative Economics* 35, pp. 748–773

- Beck T., Demirguc-Kunt A., Levine R. (2007) "Finance, inequality and the poor", *Journal of Economic Growth* 12 (1), pp. 27-49
- Rewilak J. (2013) "Finance is good for the poor but it depends where you live", *Journal of Banking and Finance* 37, pp. 1451-1459

Topic 2

- de Haan J., Sturm J-E. (2017) "Finance and income inequality: a review and new evidence", *European Journal of Political Economy* 50, pp. 171-195
- Kose M., Prasad E., Rogoff K, Wei S. (2009) "Financial globalization: a reappraisal", *IMF Staff Papers* 56(1), pp.8-60
- Ranciere R., Tornell A. Westermann F. (2006) "Decomposing the effects of financial liberalization: crises vs. growth", *Journal of Banking & Finance* 30, pp. 3331–3348

Topic 3

- Allen F. et al (2016) "The foundations of financial inclusion: understanding ownership and use of formal accounts", *Journal of Financial Intermediation* 27, pp. 1-30
- Ghosh S., Vinod D. (2017) "What constrains financial inclusion for women? Evidence from Indian micro data", *World Development* 92, pp. 60–81

Topic 4

- Banerjee A. et al. (2015) "The miracle of microfinance? Evidence from a randomized evaluation", *American Economic Journal: Applied Economics* 7 (1), pp. 22-53
- Bruhn M., Love I. (2014) "The real impact of improved access to finance: evidence from Mexico", *The Journal of Finance* 69 (3), pp. 1347-1376

Topic 5

- Aron J. (2018) "Mobile money and the economy: a review of the evidence", *The World Bank Research Observer* 33: 135-188
- Suri T., Jack W. (2014) "Risk sharing and transaction costs: evidence from Kenya's mobile money revolution", *American Economic Review* 104 (1), pp. 183-223

Topic 6

- Tsai K. (2004) "Imperfect substitutes: the local political economy of informal finance and microfinance in rural China and India", *World Development* 32, pp. 1487–1507
- Guirkinger C. (2008) "Understanding the coexistence of formal and informal credit markets in Piura, Peru", *World Development* 36, pp. 1436-1452