

What Works for Financial Sector Development?

A review of the evidence
DIIS

December 2nd 2014

FSD: ToC - Overview

Policies & Institutions

Reduced risk of financial shocks

Support Functions

Better info., security to lend

Long term Finance

Long term savings=investing

Financial Deepening

Higher private investment

Financial Inclusion

Poor, marginalised able to save/invest/insure

Outcome

Stable, deep & inclusive financial system

- Financial stability

- Financial depth

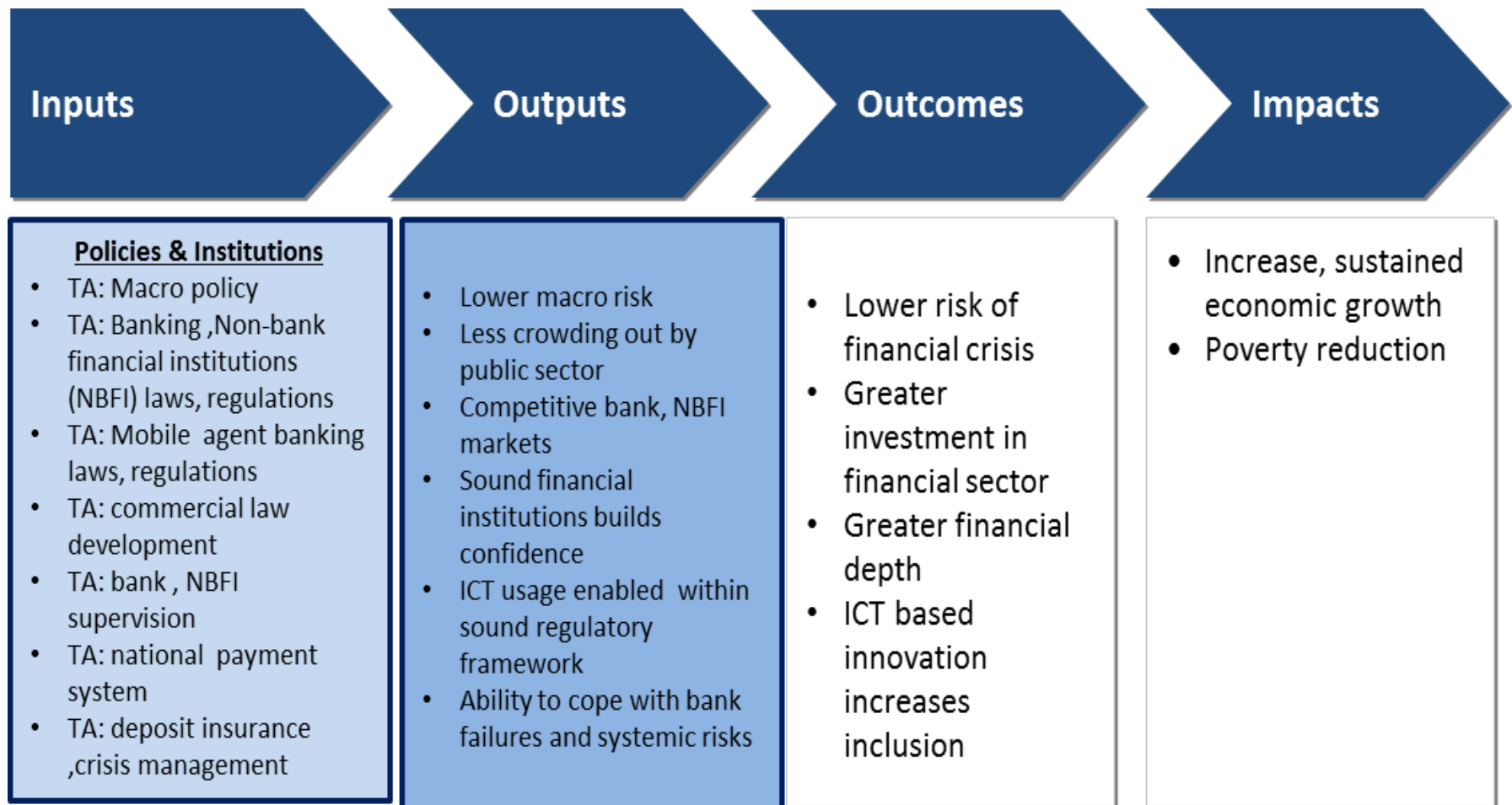
- Higher investment

- Pathways out of poverty, avoid poverty traps

Impact

Sustained economic growth, poverty reduction

Results chain: Policies & Institutions



Evidence: policies, institutions

Policies, institutions=stability + financial development

Financial shocks=recessions, increased poverty. Strong evidence, 2009, Asian crisis

30% variation in rates of poverty reduction attributable to cross-country variation in financial development

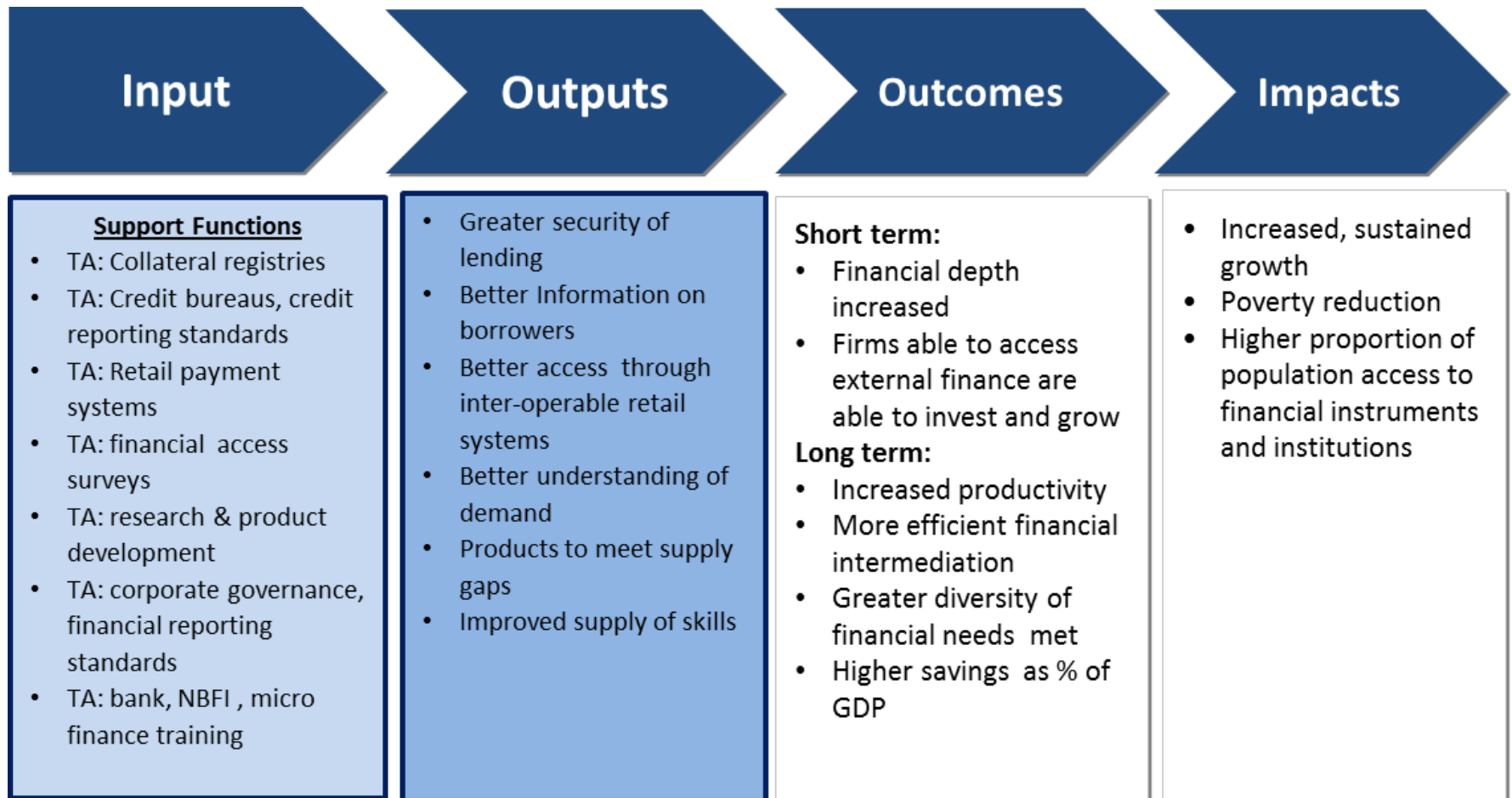
Strong evidence that macro stability, liberal policies and effective prudential regulation lead to financial . But liberalisation not leading to lower spreads.

Strong evidence that creditor rights, contract enforcement and bankruptcy laws lead to financial development

Essential for Systems
Approach

Results Chain: Support Functions

Support Functions for Stability, Deepening & Inclusion



Evidence: support functions

Support functions = better information + security of lending + efficient infrastructure + skilled workforce

Good evidence that credit bureaus, collateral registries contribute to greater lending.

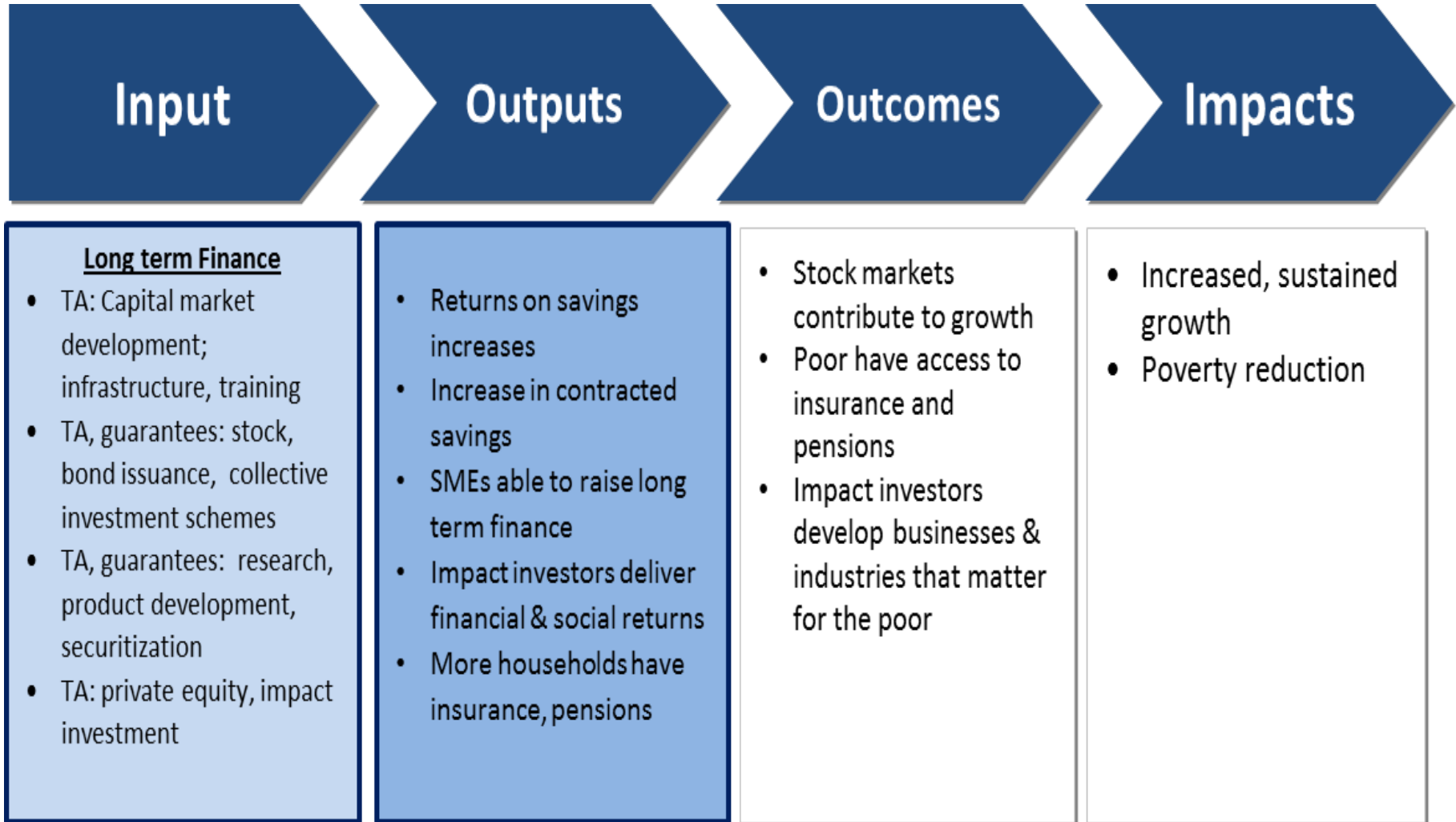
Good evidence that payments infrastructure, inter-operability, rating systems lead to efficiency

But supply driven. Information on demand can make a difference (low cost accounts, savings) but is woefully inadequate. Many products fail

Many programmes focus on skills but lack of good evidence on outcomes

Enabler of Systems Approach

Results Chain: Long Term Finance



Evidence: Long Term Finance

Demigurc-Kunt and Levine (1996) – Financial development leads to increase in the assets of the banking system and non-bank financial institutions

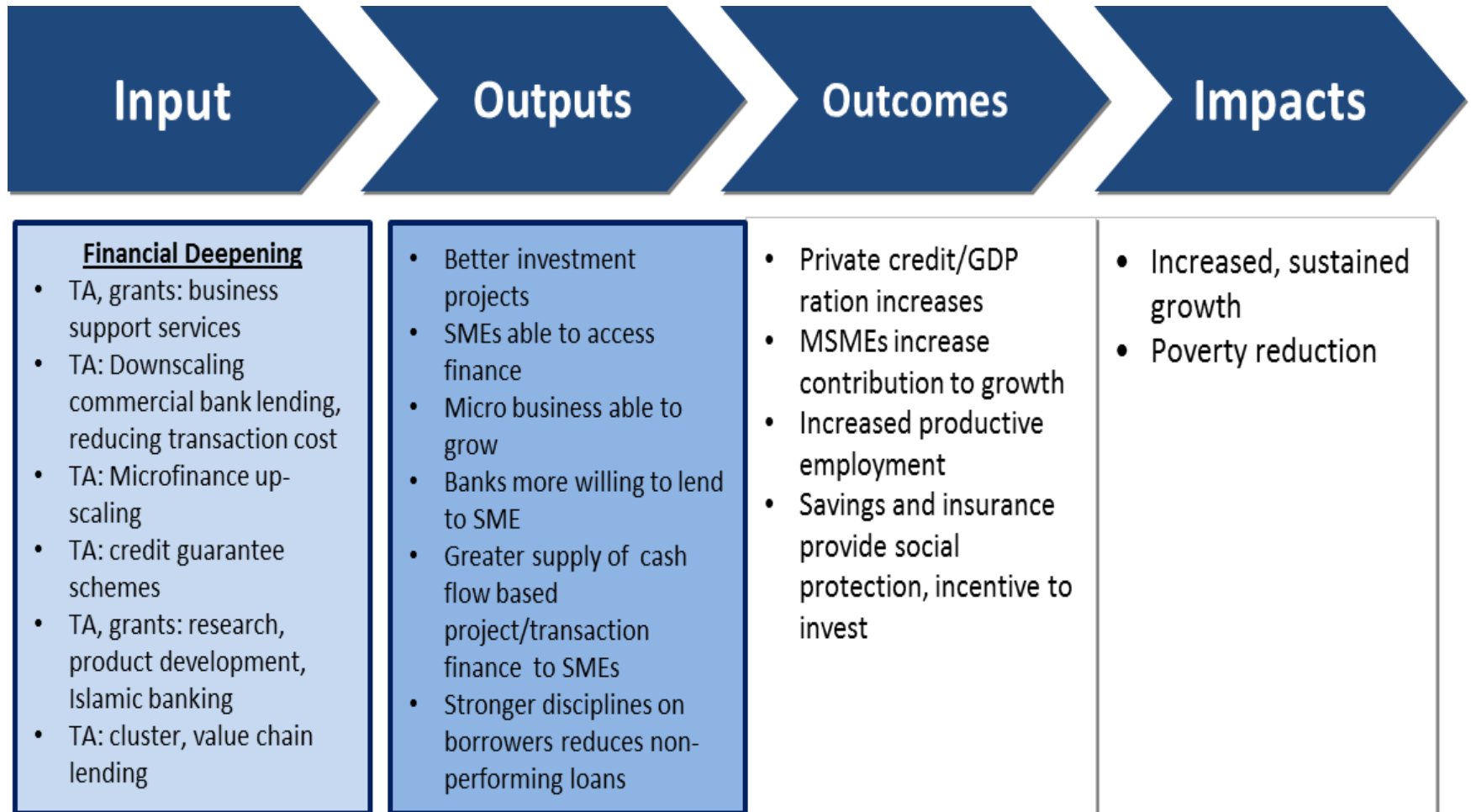
Financing for infrastructure shown to have good results and some evidence to support impact investment

But macro evidence of link between stock markets and growth is weak. Micro Evidence shows link to credit and growth but not conclusive.


Evidence for pensions and insurance weak; many studies show reverse causality. Micro insurance is growing rapidly but results not as expected and some products have proved expensive failures.

Impact may be on FSD not growth or poverty. More research needed.

Results Chain: Financial deepening



Evidence: Financial Deepening

Private credit/GDP = higher investment  consumption smoothing 
investment in human capital

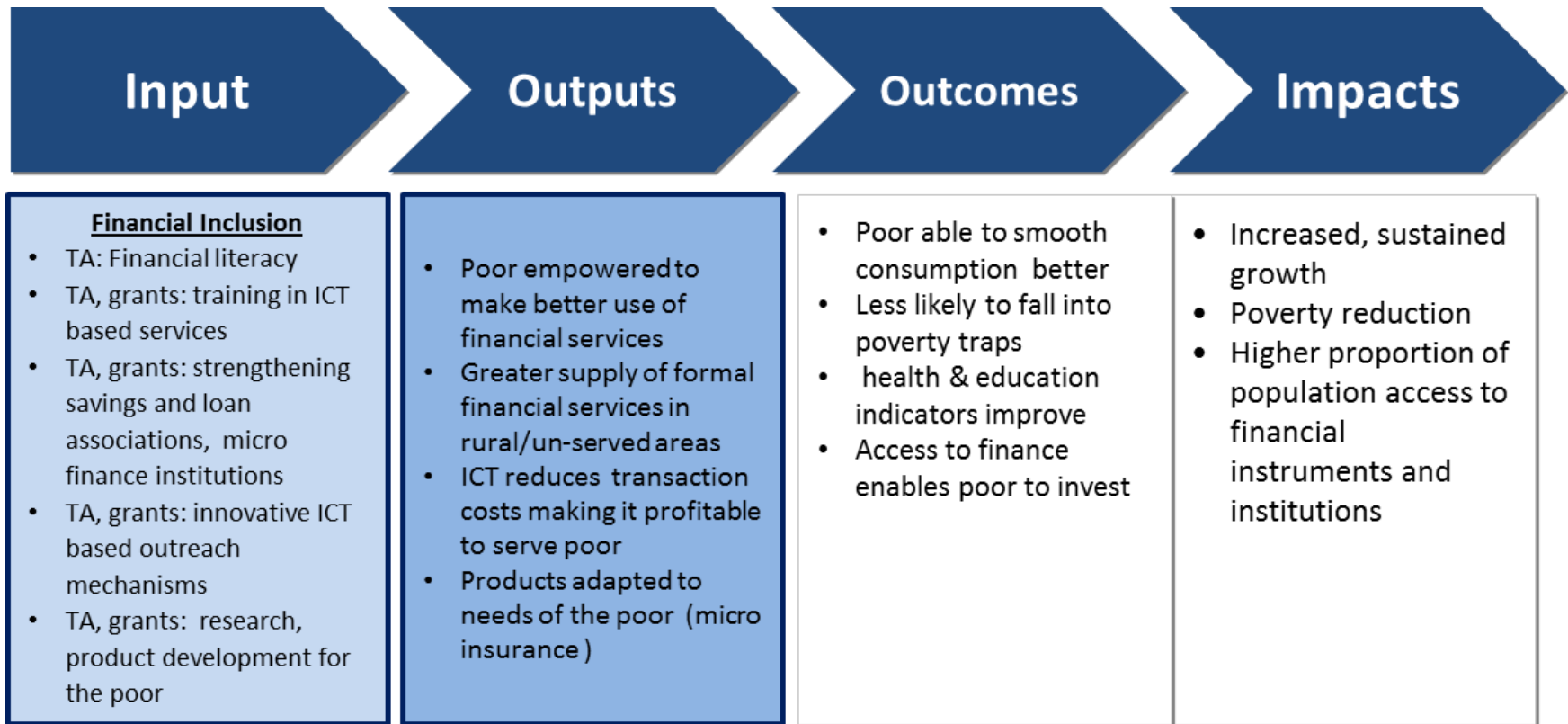
Causality of deepening to growth has been proven robustly. Strong evidence for depth and growth in country. But pathways not well understood.

Positive links with reducing inequality, hunger, resilience to shocks and poverty but transmission pathways not well researched.

Link between A2F and SME growth strong but not panacea, works with transformative enterprises only.

Impact of deepening on growth & poverty
is robust

Results Chain: Financial Inclusion



Evidence: Inclusion

Weaker macro evidence in support of inclusion. Linked to depth and this does reduce inequality/ poverty.

BUT still important for poor: to support livelihoods/ diversification, finance health,/education, smooth consumption, promote resilience.

Financial literacy only works at teachable moments, allied to products.

Past focus on microcredit. But better understanding now that poor need savings, insurance, payments.

Despite financial diaries, dont know much about demand.



Evidence: Microfinance

Microcredit – No miracle, used for consumption, modest benefits but essential for entrepreneurs

Limitations of one-size fits all. Small sums, not tailored to need. Works better when vary terms. Gap between MFIs, banks.

Stronger evidence for micro savings & smoothing consumption.

Mirco insurance – very little evidence. Little demand.

ICT – no evaluations done. But reduces costs and increases outreach

Need for further research

