Course Structure and Standard Syllabus

Course Topic: Financial Sector Policies

Course Title: Financial Development and Financial Inclusion (FDFI)

Overview:
This two-week course outlines the macroeconomic relevance of financial development broadly, and of financial inclusion more specifically. Beginning with an analytical framework that defines the role played by finance in the economy, the course reviews the conceptual and empirical literature on finance's impact and addresses key policy issues that arise in either encouraging its development (market enabling policies) or limiting its destabilizing effects (market harnessing policies).

The course introduces financial inclusion as an integral dimension of financial development, but which only recently has received much attention, as the discussion for many years has mainly revolved around the concept and measure of financial *depth*. The course reviews the indicators currently used to measure financial inclusion, the distinct macroeconomic impact of financial inclusion, as well as the main policy strategies that have been pursued.

Learning Objectives:
At completion of the course, participants will be able to:

- Measure the level of financial development and inclusion for a country or countries by means of a wide range of standardized indicators, identify their shortcomings as well as the possible need to collect more detailed microeconomic data.
- Use a simple analytical model to predict the likely outcomes from different policy actions.
- Assess policy options and strategies for financial development and inclusion from a macroeconomic perspective, by identifying relevant tradeoffs that arise. To this end, participants will formulate the following questions to evaluate the appropriateness of a given pro-financial development or inclusion policy:

    - Is the policy the most effective use of government resources to achieve the stated goal?
    - Does the policy conflict with other macroeconomic policies or goals?
    - What bottlenecks hindering financial development or inclusion exist in your country?
    - In particular, are there risk gaps that prevent agents (households, firms, or the government) from engaging is certain financial activities that could have a social benefit?

- What is the appropriate sequencing of financial development and inclusion for a given country?
- Is more financial development or inclusion necessarily better?
- Why haven't certain instruments and/or institutions taken off in your country?
- Why have others (shadow banking, mobile banking, etc.) been able to grow quickly?

General Approach of the Course

As the above implies, the course does not argue for a one-size-fits-all policy approach but aims to equip participants with the analytical tools necessary to formulate a macroeconomically coherent policy strategy appropriate for a given country at a certain state of development.

The course will provide multiple opportunities for participant interaction and sharing of experiences, through classroom discussions, case studies, workshops, and final presentations.

UNIT 1: A Framework for Financial Development

A Framework for Financial Development — Lecture (1.5 hours)

- Functional approach
- Importance of contracts and contracting
- Main players and their roles
- Principal-agent relationships in finance
- Types of financial contracts: credit, savings, and insurance
- Types of borrowers: household, agriculture, business.

Financial Development — Case Study (3 hours)
"Peer-to-Peer Lending and Crowdfunding"

References:

- Beck, T., 2012. "The Role of Finance in Economic Development – Benefits, Risks, and Politics." In ed. *Handbook of Capitalism, ed.* Dennis Müller: *Oxford*
- Chami, R., C. Fullenkamp, and S. Sharma, 2010, "A Framework for Financial Market Development," *Journal of Economic Policy Reform*, Vol. 13, No. 2 (June), pp.107-135. http://www.imf.org/external/pubs/ft/wp/2009/wp09156.pdf
- Levine, R, 2005, "Finance and Growth: Theory and Evidence." In *Handbook of Economic Growth, ed. Philippe Aghion and Steven N. Durlauf, 865–934. Amsterdam: Elsevier*.
- Merton, R. and Z. Bodie, 2005, "The Design of Financial Systems: Towards a Synthesis of Function and Structure," Journal of Investment Management, Vol. 3, No. 1, pp. 1–23. http://www.nber.org/papers/w10620
- Townsend, R. and K. Ueda, 2003, "Financial Deepening, Inequality, and Growth: A Model-Based Quantitative Evaluation," IMF Working Paper Working Paper No. 03/193, http://www.imf.org/external/pubs/cat/longres.aspx?sk=16846.0

UNIT 2: Financial Structure

Financial Structure—Lecture (1.5 hours)

- Characterization of financial structure: banks vs. nonbank financial intermediaries, financial intermediaries vs. capital markets, debt vs. equity
- Show how financial markets are organized in different regions of the world and the reliance on different types of financing
- Financial structure and macroeconomic outcomes
- Use of asymmetric information, transactions costs, other market imperfections to explain the structures we see within and across markets

Financial Structure—Case Study (1.5 hours)
"What can we learn from theory, cross-country regressions and country case studies?"

References:

- Allen, F and D. Gale, *Comparing Financial Systems*, 2000, (Boston: MIT Press).
- Allen, F, L Bartiloro, X Gu, O Kowalewski, 2018, Does economic structure determine financial structure?, Journal of International Economics, 114, pp. 389-409.
- T. Beck, A. Demirgüç-Kunt, D. Singer, 2013**, "**Is small beautiful? Financial structure, size and access to finance," World Development, 52 (2013), pp. 19-33.
- Demirguc-Kunt, A, E Feyen and R. Levine, 2011, "The Evolving Importance of Banks and Securities Markets," World Bank Policy Research Working Paper 5805.
- International Monetary Fund, 2012, "Changing Global Financial Structures: Can They Improve Economic Outcomes?" Chapter 4, *Global Financial Stability Report*, October.
- R. Levine, 2002, "Bank-based or market-based financial systems: which is better?" Journal of Financial. Intermediation., 11, pp. 398-428.
- Mishkin, F, 2010, "An Economic Analysis of Financial Structure," Chapter 8 in *The Economics of Money, Banking, and Financial Markets* (New York: Prentice Hall, 9th Ed.), pp. 169–197.

UNIT 3: Sequencing

Part 1: Banks to bonds—Lecture (1.5 hours)

- Why banks are first to appear and dominate financial systems
- How and when to introduce fixed income instruments
- Risk gaps and developing the yield curve
- Overcoming banks' resistance to bond market development
- Possible intermediate steps: private equity financing, mixes of stock and bond financing

Case Study: Fixed Income Market Development (1.5 hours)
"The case of Indian municipalities"

Part 2: When to Develop the Equity Market—Lecture (1.5 hours)

- Why equity markets are the last to appear
- Family businesses and the equity markets
- How to encourage firms to go public
- Intermediating equity through mutual funds, private equity, venture capitalists
- The importance of institutional investors

Case Study: Equity Market Development (3 hours)
"The hypothetical case of Imaginaria"

Part 3: Secondary Markets and Liquidity Providers—Lecture (1.5 hours)

- The needs of liquidity providers
- Types of liquidity providers in bond and stock markets
- Different types of secondary markets
- OTC vs. Exchange Markets

References:

- Allen, Franklin and Douglas Gale, *Comparing Financial Systems*, 2000, (Boston: MIT Press).
- Bank of International Settlements, Monetary and Economic Department, 2002, *The Development of Bond Markets in Emerging Economies*, BIS Paper No. 11.
- Bodie, Z., A. Kane, and A. Marcus, 2014, "Asset Classes and Financial Instruments," Chapter 2 in *Investments* (Singapore: McGraw Hill, Asia Global Edition).
- International Monetary Fund, World Bank, European Bank for Reconstruction and Development, and the Organization for Economic Cooperation and Development, 2013, "Local Currency Bond Markets—A Diagnostic Framework," (Washington, DC: International Monetary Fund).

UNIT 4: Measuring Financial Development

Measuring Financial Development—Lecture (1.5 hours)

- Measurement issues:
    - **a.** single indicators,
    - **b.** broad-based concept of financial development and construction of composite indices,
- Benchmarking
- Stylized facts on financial across countries and over time

Measuring Financial Development—Workshop (4.5 hours)

Participants use existing databases (the Global Financial Development Database and Finstats 2019) to assess the state of financial development in selected countries. Three breakout groups are formed, each of which presents their assessment to the rest of the class.

References:

- Beck, T. and E. Feyen, 2013, "Benchmarking Financial Systems: Introducing the Financial Possibilities Frontier," World Bank Policy Research Working Paper 6615.
- Demirgüç-Kunt, A, L. Klapper, D. Singer, S. Ansar, J. Hess, 2018, The global findex database 2017: Measuring financial inclusion and the fintech revolution World Bank, Washington, DC
- Demetriades, P. O., Rousseau, P. L. (2016) "The changing face of financial development." Economics Letters 141, 87-90.
- Sahay, Ratna, and others, 2015, "Rethinking Financial Deepening: Stability and Growth in Emerging Markets," IMF Staff Discussion Note 15/08.
- Svirydzenka, K (2016): "Introducing a new broad-based index of financial development", *IMF Working Paper*, IMF WP/16/5.

UNIT 5: Financial Innovation and Evolution

Part 1: Fintech, Cryptocurrency and Financial Development —Lecture (1.5 hours)

- Defining and understanding Fintech
- Determinants of future Fintech landscape and possible paths of evolution
- Understanding Distributed Ledger Technology (Blockchain) and Virtual (Crypto-) Currencies

Part 2: Financial Evolution and Financial Crisis—Lecture (1.5 hours)

- The relationship between financial liberalization and financial crisis
- Can excessive development of financial markets be harmful?
- Credit booms—good and bad

Part 3: Shadow Banking—Lecture (1.5 hours)

- Definition of shadow banking
- Why and how does shadow banking develop?
- What are the benefits and dangers?
- How to regulate shadow banks

Shadow Banking—Case Study (3 hours)
"The case of consumer automobile loans"

References:

- Financial Stability Board, 2017, "Fintech Credit: Market Structure, Business Models and Financial Stability Implications."
- Financial Stability Board, 2017, "Financial Stability Implications from Fintech."
- International Finance Corporation, 2017, "Digital Financial Services: Challenges and Opportunities for Emerging Market Banks," *EM Compass*, Note 42.
- International Monetary Fund, 2017, "Fintech and Financial Services: First Considerations," IMF Staff Discussion Note 17/05.
- Jenik, I., and K. Lauer. 2017. "Regulatory Sandboxes and Financial Inclusion." Working Paper. Washington, D.C.: CGAP.
- Kodres, L., 2013, "What is Shadow Banking?" *Finance and Development*, June 2013.
- Pozsar, Z., Tobias A., A. Ashcraft, and H. Boesky, 2013, "Shadow Banking," *FRBNY Policy Review*, December.
- Ranciere, R., A. Tornell, and F. Westermann, 2006, "Decomposing the Effects of Financial Liberalization: Crises vs. Growth," Journal of Banking and Finance, 30(12): 3331-3348.
- World Economic Forum, 2017, Beyond Fintech: A Pragmatic Assessment of Disruptive Potential in Financial Services

UNIT 6: **Financial Regulation**

Regulation and financial development— Lecture (1.5 hours)

- Justifications for financial regulation
- Market imperfections and financial development
- Macroeconomic and financial stability
- Regulations that affect banking development
- Regulations that facilitate innovation

References:

- Barth, James; Gerard Caprio, and Ross Levine, 2002, “Bank Regulation and Supervision: What Works Best?” NBER Working Paper 9323.
- Barth, James; Gerard Caprio, and Ross Levine, 2012. *Guardians of Finance: Making Regulators Work for Us,* MIT Press.
- Barth, James; Gerard Caprio, and Ross Levine, 2013, “Bank Regulation and Supervision in 180 Countries from 1999 to 2011,” (Washington, DC).
- Cihak, Martin, Asli Demirguc-Kunt, María Soledad Martínez-Pería, and Amin Mohseni-Cheraghlou, 2012, “Bank Regulation and Supervision around the World: A Crisis Update,” World Bank Policy Research Working Paper 6286.
- Claessens, Stijn and Neeltje Van Horen, 2014, Foreign Banks: Trends and Impact,” *Journal of Money, Credit and Banking*, Supplement to Vol. 46, No.1 (February 2014), pp. 295-326.
- Elliott, Douglas, Arthur Kroeber, and Yu Qiao, 2015, “Shadow banking in China: A primer,” (The Brookings-Tsinghua Center), March 2015.
- Gutiérrez, Eva and S. Singh, 2013, “What Regulatory Frameworks are More Conducive to Mobile Banking? Empirical Evidence from the Findex Data,” World Bank Policy Research WP 6652.
- Tressel, Thierry and Enrica Detragiache, 2008, “Do Financial Sector Reforms Lead to Financial Development? Evidence from a New Dataset,” IMF Working Paper 08/265.

UNIT 7: **Introduction to financial inclusion**

Introduction to financial inclusion— Lecture (1.5 hours)

- What is financial inclusion, how does it differ from financial development?
- Measurement: supply-side, user-side, enabling environment
- Financial inclusion for households and for firms
- Cross-country variation in financial inclusion
- Recent trends
- Limitations of current measures and search for more informative indicators of financial inclusion
- Recent evidence on macroeconomic effects

References:

- Aga, Gemechu Ayana and María Soledad Martínez Pería, 2014, "International Remittances and Financial Inclusion in Sub-Saharan Africa," World Bank Policy Research Working Paper 6991 (Washington: World Bank).
- Allen, Franklin, Aslı Demirgüç-Kunt, Leora Klapper, and María Soledad Martínez Pería. 2012. "The Foundations of Financial Inclusion: Understanding Ownership and Use of Formal Accounts." Policy Research Working Paper 6290, (Washington, D.C.: World Bank).
- Asonguab, Simplice A. and Lieven De Moora, 2015, "Recent advances in finance for inclusive development: a survey," African Governance and Development Institute Working Paper 15/005.
- Beck, Thorsten, Asli Demirguc-Kunt, María Soledad Martínez Pería, 2007, "Reaching Out: Access to and Use of Banking Services across Countries, *Journal of Financial Economics*, 85, pp. 234-266.
- Dabla-Norris, Era, Yixi Deng, Anna Ivanova, Izabela Karpowicz, Filiz Unsal, Eva VanLeemput, and Joyce Wong, 2015, "Financial Inclusion: Zooming in on Latin America," IMF Working 15/206.
- Demirguc-Kunt, Asli, Leora Klapper, Dorothe Singer, and Peter Van Oudheisden, 2015, "The Global Findex Database 2014. Measuring Financial Inclusion around the World," Policy Research Working Paper 7255, World Bank, Washington, DC.
- Economist Intelligence Unit, 2014, *2014 Global Microscope* (London: The Economist).
- Love, Inessa, María Soledad Martínez Pería, and Sandeep Singh. 2013. "Collateral Registries for Movable Assets: Does Their Introduction Spur Firms' Access to Bank Finance?" Policy Research Working Paper 6477, (Washington, D.C.: World Bank).
- Sahay, Ratna, and others, 2015, "Financial Inclusion: Can it Meet Multiple Macroeconomic Goals?" *IMF Staff Discussion Note* 15/17.
- World Bank Group. 2013. *Global Financial Development Report 2014: Financial Inclusion*, (Washington, D.C.: World Bank.

UNIT 8: A Conceptual Framework for Financial Inclusion

A Conceptual Framework for Financial Inclusion—Lecture (1.5 hours)

- Financial underdevelopment/exclusion as a series of market frictions
- Benefits and tradeoffs in removing frictions
- Contrasting partial with general equilibrium effects

A Conceptual Framework for Financial Inclusion—Workshop (3 hours)

Participants investigate the real-world implications of the Dabla-Norris, et al (2015) model covered in the lecture. Each of three breakout groups concentrates on one of three frictions affecting financial development and financial inclusion and assess the macroeconomic impact of policies aimed at reducing these frictions. Each group then present its findings to the rest of the class.

References:

Dabla-Norris, Era, Yan Ji, Robert Townsend, and D. Filiz Unsal, 2015, "Identifying Constraints to Financial Inclusion and Their Impact on GDP and Inequality: A Structural Framework for Policy," IMF Working Paper 15/22.

Gine, Xavier, and Robert Townsend, 2004, "Evaluation of Financial Liberalization: a General Equilibrium Model with Constrained Occupation Choice," *Journal of Development Economics*, 74, pp. 269-307. http://www.sciencedirect.com/science/article/pii/S0304387804000161

Townsend, Robert, and Kenichi Ueda (2010), "Welfare Gains from Financial Liberalization," *International Economic Review*, 51(3), pp. 553-597. http://www.blackwell-synergy.com/doi/abs/10.1111/j.1468-2354.2010.00593.x

UNIT 9: **Financial education and capability—Lecture** (1.5 hours)

- Definition and assessment of financial capability
- Financial literacy as a first step
- Financial capability as a key component of financial inclusion
- Approaches to enhancing financial capability
- Meta-analysis of financial capability interventions
- The case of a large-scale capability intervention
- Alternative delivery channels for financial education

References:

- Grohmann, A., Klühs, T., Menkhoff, L. (2017). Does financial literacy improve financial inclusion? Cross country evidence. *DIW Discussion Papers, No. 1682*. Berlin, Germany: German Institute for Economic Research.
- Grohmann, A., Menkhoff, L. (2017). Financial literacy promotes financial inclusion in both poor and rich countries. *DIW Economic Bulletin, 7*(41), 399-407.
- Lusardi, A. and O. S. Mitchell, 2011, "Financial Literacy around the World: An Overview," NBER Working Paper 17107.
- World Bank, 2013, "Financial Capability Surveys around the World: Why Financial Capability is Important and How Surveys Can Help," (Washington, DC: World Bank).
- World Bank, 2013. "Making Sense of Financial Capability Surveys around the World: A Review of Existing Financial Capability and Literacy Measurement Instruments," (Washington, DC.: World Bank).
- Yoong, J., Mihaly, K., Bauhoff, S., Rabinovich, L., and Hung, A. 2013. "A Toolkit for Evaluation of Financial Capability Programs in Low- and Middle-Income countries." (Washington, DC: World Bank).

UNIT 10: **Policies for Financial Inclusion**

Part 1: SME financing—Lecture (1.5 hours)

- A primer: what's different about SMEs? (Answer: Opacity)
- SMEs and the economics of family businesses
- The experience so far: what works for SME finance?
- Exploring lending technologies that might work for SMEs: leasing, factoring, equity crowd-funding, peer-to-peer lending

Part 2: State banking—Lecture (1.5 hours)

- Theories of the role of the state in banking
- Worldwide experience with state banks
- Credit guarantees

Part 3: Microfinance—Lecture (1.5 hours)

- Characterization of microfinance
- A model of microcredit
- Experience with microcredit throughout the world

References:

- Banerjee, A., D. Karlan, and J.Zinman, 2015, "Six Randomized Evaluations of Microcredit: Introduction and Further Steps," *American Economic Journal: Applied Economics*, 7(1):1-21.
- Berger, A.N. and G. F. Udell, 2006, "A More Complete Conceptual Framework for SME Finance." *Journal of Banking & Finance*, Volume 30, Issue 11, pp. 2945-2966.
- Chami, Ralph, 2001, "What's Different about Family Businesses," IMF Working Paper 01/70.
- Khwaja, A.I. and A. Mian, 2005, "Do Lenders Favor Politically Connected Firms? Rent Provision in an Emerging Financial Market, *Quarterly Journal of Economics*, Vol. 120, Issue 4, pp. 1371-1411.
- Feler, L., 2015, "State Bank Privatization and Local Economic Activity," (Washington, DC: SAIS, Johns Hopkins University).
- R. La Porta, F. Lopez-De-Silanes, and A. Shleifer, "Government Ownership of Banks", *Journal of Finance*, http://onlinelibrary.wiley.com/doi/10.1111/1540- 6261.00422/pdf
- Korner, T and I. Schnabel, 2010, "Public Ownership of Banks and Economic Growth: The Role of Heterogeneity," CEPR Discussion Paper No. 8138.
- World Bank, 2013, *Global Financial Development Report: Rethinking the Role of the State in Finance*. (Washington, D.C.: World Bank). (http://siteresources.worldbank.org/EXTGLOBALFINREPORT/Resources/8816096-1346865433023/8827078-1346865457422/Chapter-4.pdf)
- Banerjee, A. V. (2013), "Microcredit under the Microscope: What Have We Learned in the Past Two Decades and What Do We Need to Know?" *Annual Review of Economics*, 5: 487-519.

UNIT 11: **Final Debate-Style Presentations: Case studies in financial inclusion — (**10.5 hours).

- Mobile banking in Kenya (M-Pesa) and beyond.
- Recent financial inclusion strategy in India
- Banco Azteca in Mexico
- The U.S. subprime crisis: a case of excessive financial inclusion?
- Government policies to promote SME financing in Korea

UNIT 12: **Review Session—Lecture** (1.5 hours)

- Summary of the main issues and policy messages covered in the course

Table 1. Distribution of Course Hours

Unit	Lecture Title	Hours
1	**A Framework for Financial Development**	
	Lecture	1.5
	Case Study	3.0
2	**Financial Structure**	
	Lecture	1.5
	Case Study	1.5
3	**Sequencing**	
	Banks to Bonds	1.5
	Case Study: Fixed-Income Market Development	1.5
	When to Develop the Equity Market	1.5
	Case Study: Equity Market Development	1.5
	Secondary markets and Liquidity Providers	1.5
4	**Measuring Financial Development**	
	Lecture	1.5
	Workshop	4.5
5	**Financial Innovation and Evolution**	
	Fintech, Cryptocurrency and Financial Development	1.5
	Financial Evolution and Financial Crisis	1.5
	Shadow Banking	1.5
	Case Study: Shadow Banking	1.5
6	**Financial Regulation**	1.5
	Total Hours, Financial Development	28.5
7	**Introduction to Financial Inclusion**	1.5
8	**Conceptual Framework for Financial**	
	Lecture	1.5
	Workshop	3
9	**Financial education and Capability**	1.5
10	**Policies for Financial Inclusion**	
	State Banks	1.5
	Microfinance	1.5
	SME Lending	1.5
11	**Three Case Studies in Financial Inclusion**	
	Case Study 1	3.5
	Case Study 2	3.5
	Case Study 3	3.5
	Total Hours, Financial Inclusion	24.0
12	**Course Recap and Panel Discussion**	1.5
	Total Hours, Full Course	52.5