



**POLICY OPTIONS AND CHALLENGES
FOR DEVELOPING ASIA—
PERSPECTIVES FROM THE IMF AND ASIA**

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DEVELOPING FINANCIAL SECTORS IN LOW-INCOME COUNTRIES

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PERSPECTIVES FROM THE IMF AND ASIA

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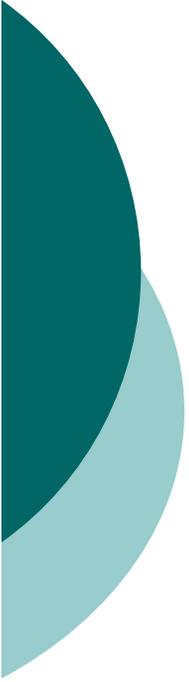
Tokyo, Japan

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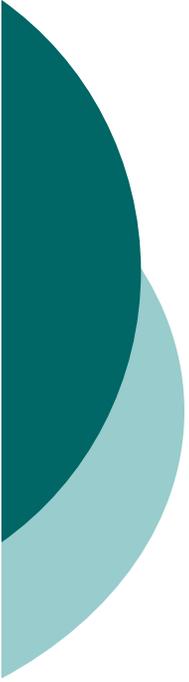
Developing Financial Sectors in Low-income countries

Thorsten Beck



Financial sector reforms

- Transition to market-based efficient and stable financial system requires an array of reforms and policies
- Focus on which area?
- Prioritizing, sequencing?
- Trade-off between development and stability?



Taxonomy of reforms (1)

- Financial Market Frontier = constrained optimum given state variables
 - Evaluate financial system according to country-level “state” variables
- Market-developing policies
 - Create conditions for efficient and stable financial markets
 - Long-term institutions building
- Market-enabling policies
 - Operate within current institutional framework and constraints
 - Push financial markets to maximize current conditions
- Market-harnessing policies
 - Policies to avoid that financial markets move beyond the frontier
 - Prevent banking crisis



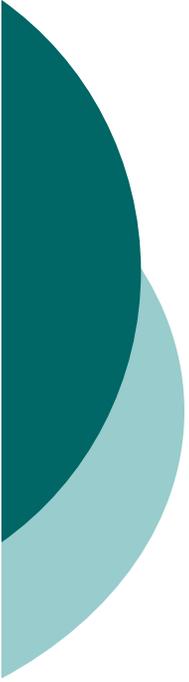
Taxonomy of reforms (2)

- Market-developing policies
 - Move towards private ownership in financial and real economy
 - Stable macroeconomic environment
 - Effective contractual framework
- Market-enabling policies
 - Encourage foreign bank entry
 - Move towards market-based interest rates
 - Specific institutions (asset registries, credit registry)
- Market-harnessing policies
 - Market-based regulation and supervision
 - Incentive-compatible financial safety net



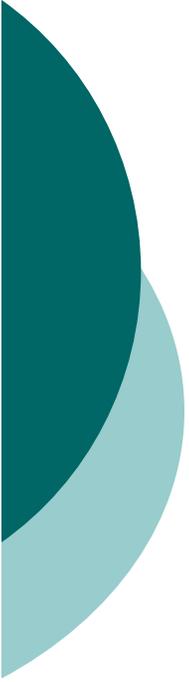
Policy conclusions from taxonomy

- What is the binding constraint?
 - Low frontier
 - Far away from frontier
 - Beyond frontier
- Design policies accordingly
- Development/stability focus depends on where the financial system stands



Interdependence of reforms – an Asian example

- Bangladesh has undertaken wide-ranging financial sector reforms
 - Allowing in private domestic banks
 - Liberalized interest rates
 - Built credit registry
 - Moving away from government-owned banking
 - ...
- But: Government still intervenes strongly in banking system
 - Corrupt licensing process
 - Implicit guarantee for depositors and owners
 - “Strong” (interventionist) regulatory and supervisory approach
- Constraints on financial markets
 - Excessive risk taking
 - Political interference
 - Undermines competition
 - Prevents system to move towards an open, arms-length economy



Policy conclusions

- Divestiture of SOCB necessary but not sufficient condition
- Complimentary:
 - Eliminate implicit guarantee
 - Authorities as facilitator not operator of financial system
 - Build market-based regulatory and supervisory system
- More general debate on moving from relationship-based to arms-length economic system
- Does not imply a laissez-faire approach, but a new and important role for government in enabling and creating markets