Mr. Ugo Panizza  
Professor of Economics and Department  
Head, Pictet Chair in Finance and Development  
The Graduate Institute of International and Development Studies  
Switzerland
Finance and Economic Development
Known Knowns, Known Unknowns, and Unknown Unknowns

Ugo Panizza
Background readings


Outline

• Known Knowns
  – The traditional literature
  – The new literature
  – The new-new literature

• Known Unknowns

• Unknown Unknowns

  – Two types of banks, two views
Known Knowns (1)

• The traditional literature
  – Goldsmith (1969)
  – King and Levine (1993)
  – Levine, Loayza, and Beck (2000)
Known Knowns (2)

• The new literature
  – Rousseau and Wachtel (2011)
  – Arcand, Berkes, and Panizza (2012)
  – Beck et al. (2012)
Vanishing Effect (panel data)

Source: Arcand et al. (2012)
Too much finance?

Source: Arcand et al. (2012)
Who gets the credit?

\[ PC = 0.35 + 0.66 \times PC \]

\( R^2 = 0.07 \)

Source: Own elaborations based on data from Beck et al. (2012)
Known Knowns (3)

• The new-new literature
  – Laeven et al. (2013)
  – Beck et al. (2013)
  – Kneer (2013)
Known Unknowns

• Causality
  – Some problems with cross-country exercises
  – Industry (or firm)-level exercise only allow for relative statements

• Measurement & Channels

• Dark side of finance
  – Crises
  – Allocation of talent
  – Politics
  – Types of credit

• Firm-level data
  – But with general equilibrium considerations
Unknown Unknowns

It's not what you don't know that kills you, it's what you know for sure that ain't true

Attributed to Mark Twain
Unknown Unknowns

- State-owned banks remain important
- But the profession does not love them
- "state ownership tends to stunt financial sector development, thereby contributing to slower growth" (World Bank, 2001)
- What do the data say?
- Are the profession's views internally consistent?
State-Owned Banks
The evidence

• At the cross-country-level, there is a negative correlation between the presence of state-owned banks and each of financial development and economic growth, but they are less procyclical than private banks
  – La Porta, Lopez de Silanes, and Shleifer (2002); Micco and Panizza (2006)

• State-owned banks are less profitable than private banks
  – Micco, Panizza, and Yanez (2007)

• State-owned banks engage into political lending
  – Micco, Panizza, and Yanez (2007)
State-Owned Banks
The evidence

• No evidence of a causal relationship between state-ownership and development outcomes
  – Levy Yeyati, Micco, and Panizza (2008)
• A state-owned bank which is as profitable as a private bank is probably useless
  – De la Torre et al. (2007)
• Political lending is indeed a problem
A different-type of state-owned bank, similar empirical evidence

• The World Bank (IBRD)
  – Does it have an effect on economic growth?
    • We don’t know!
  – Is it as profitable as Goldman Sachs?
    • We don’t care!
  – Does it engage into political lending?
    • YES it does! (Dreher et al., 2009, 2013)
A different-type of state-owned bank, similar empirical evidence

- **Erwin Blumenthal (early 1980s)**
  
  There is not any – I repeat any – chance on the horizon that the numerous creditors of Zaire will recoup their funds

  - (Ndikumana and Boyce, 2011)

  
  Cooperation between the United States and Zaire under President Mobutu's leadership stretches back through 20 years ... Mobutu and his people face a heavy foreign debt burden. We have encouraged Zaire to hold firm to the responsible, economic reforms it is attempting, while promising to do our best to ease the way
...and money kept flowing
A different-type of state-owned bank, different evaluation criteria

- The consensus on how state-owned development banks should operate (Gutierrez et al., 2011)
  - Target well-identified market gaps
  - Do not crowd out the private sector
- MDBs that lend to counties target a well-identified market failure associated with credit constraints generated by lack of enforceability of sovereign debt contracts
  - Panizza, Sturzenegger, and Zettelmeyer (2008)
- But do MDBs lend to credit constrained countries?
Do MDBs lend to credit constrained countries?

Composition of IBRD outstanding loans (2011)

- Mexico: 10%
- China: 10%
- Turkey: 9%
- India: 9%
- Indonesia: 8%
- Brazil: 7%
- Colombia: 6%
- Argentina: 4%
- Romania: 3%
- Ukraine: 2%
- Remaining 57 countries: 32%

Total outstanding loans: approximately USD130 billion to 67 borrowers
World Bank and China

- Why does the World Bank lend to China?
  - Cross-subsidization
- Why does China borrow from the World Bank?
  - Political power
  - Knowledge transfer
  - But, why should knowledge transfer be bundled with lending?
  - How does the World Bank get the knowledge?
    - Fernandez-Arias, Hausmann, and Panizza (2014)
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