



**MULTI-YEAR EXPERT MEETING ON TRADE, SERVICES AND DEVELOPMENT**

Geneva, 11–13 May 2015

**FINANCE AND ECONOMIC DEVELOPMENT:  
KNOWN KNOWNS, KNOWN UNKNOWNNS,  
AND UNKNOWN UNKNOWNNS**

SESSION 3



UNITED NATIONS  
**UNCTAD**

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

A close-up photograph of Ugo Panizza, a man with short grey hair, wearing a dark suit, white shirt, and dark tie. He is gesturing with his right hand, pointing upwards. The background is a blue wall with a white circular light fixture.

# Finance and Economic Development

## Known Knowns, Known Unknowns, and Unknown Unknowns

Ugo Panizza

MULTI-YEAR EXPERT MEETING ON TRADE, FINANCES AND DEVELOPMENT  
THIRD SESSION, UNCTAD  
11-13 May 201

# Background readings

- J.L. Arcand E. Berkes & U. Panizza (2015) “Too Much Finance?” *Journal of Economic Growth*
- U. Panizza (2014) “Financial Development and Economic Growth: Known Knowns, Known Unknowns, and Unknown Unknowns, *Revue d'économie du*
- U. Panizza (2012) “Finance and Economic Development,” *International Development Policy*
- E. Levy-Yeyati, A. Micco & U. Panizza (2004) A Reappraisal of State-Owned Banks, *Economia*
- E. Fernandez-Arias, R. Hausmann, and U. Panizza (2015) “Smart Development Banks” mimeo

# Outline

- Known Knowns
  - The traditional literature
  - The new literature
  - The new-new literature
- Known Unknowns
- Unknown Unknowns
  - Two types of banks, two views

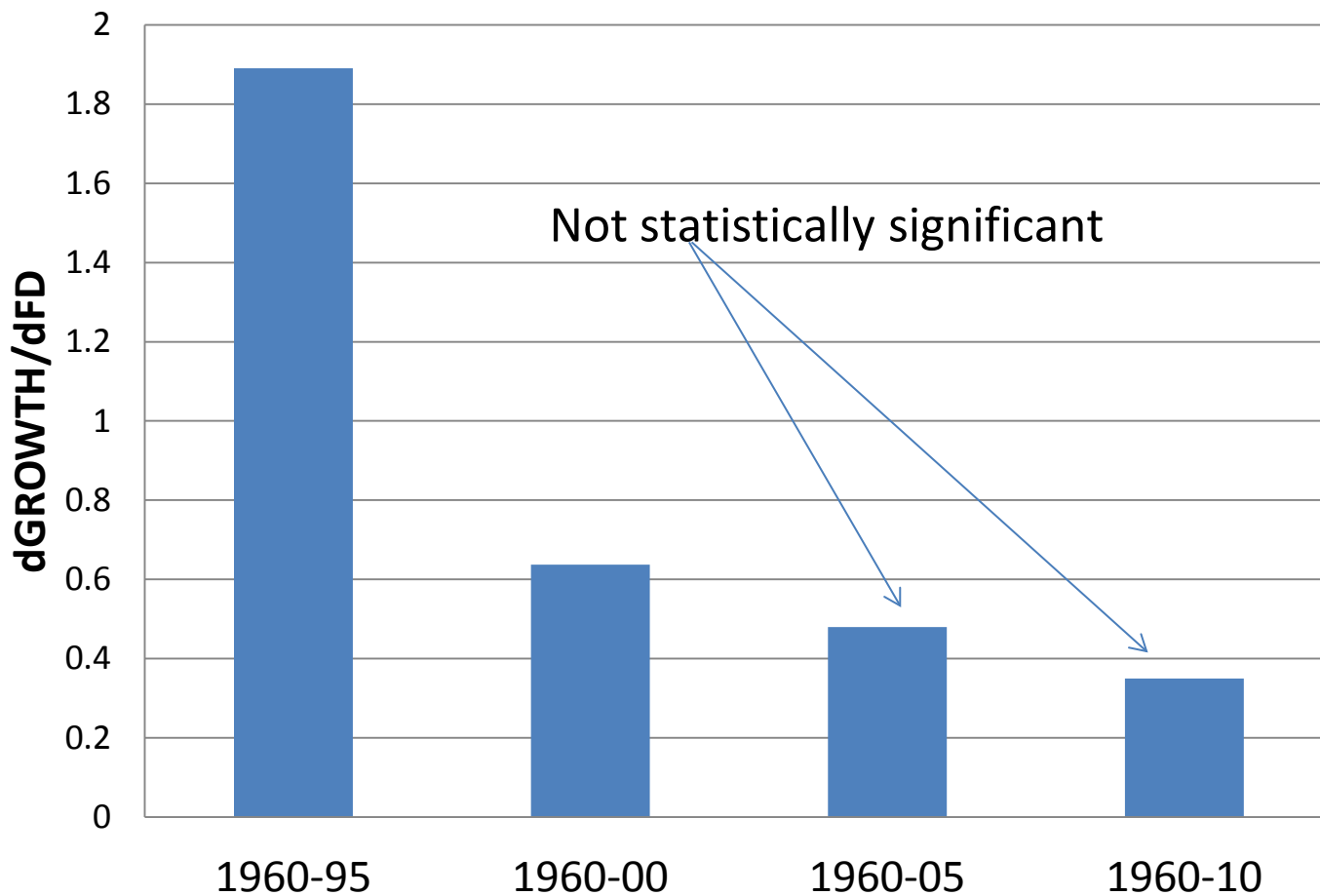
# Known Knowns (1)

- The traditional literature
  - Goldsmith (1969)
  - King and Levine (1993)
  - Beck, Levine, and Loayza (2000)
  - Levine, Loayza, and Beck (2000)
  - Rajan and Zingales (1998)

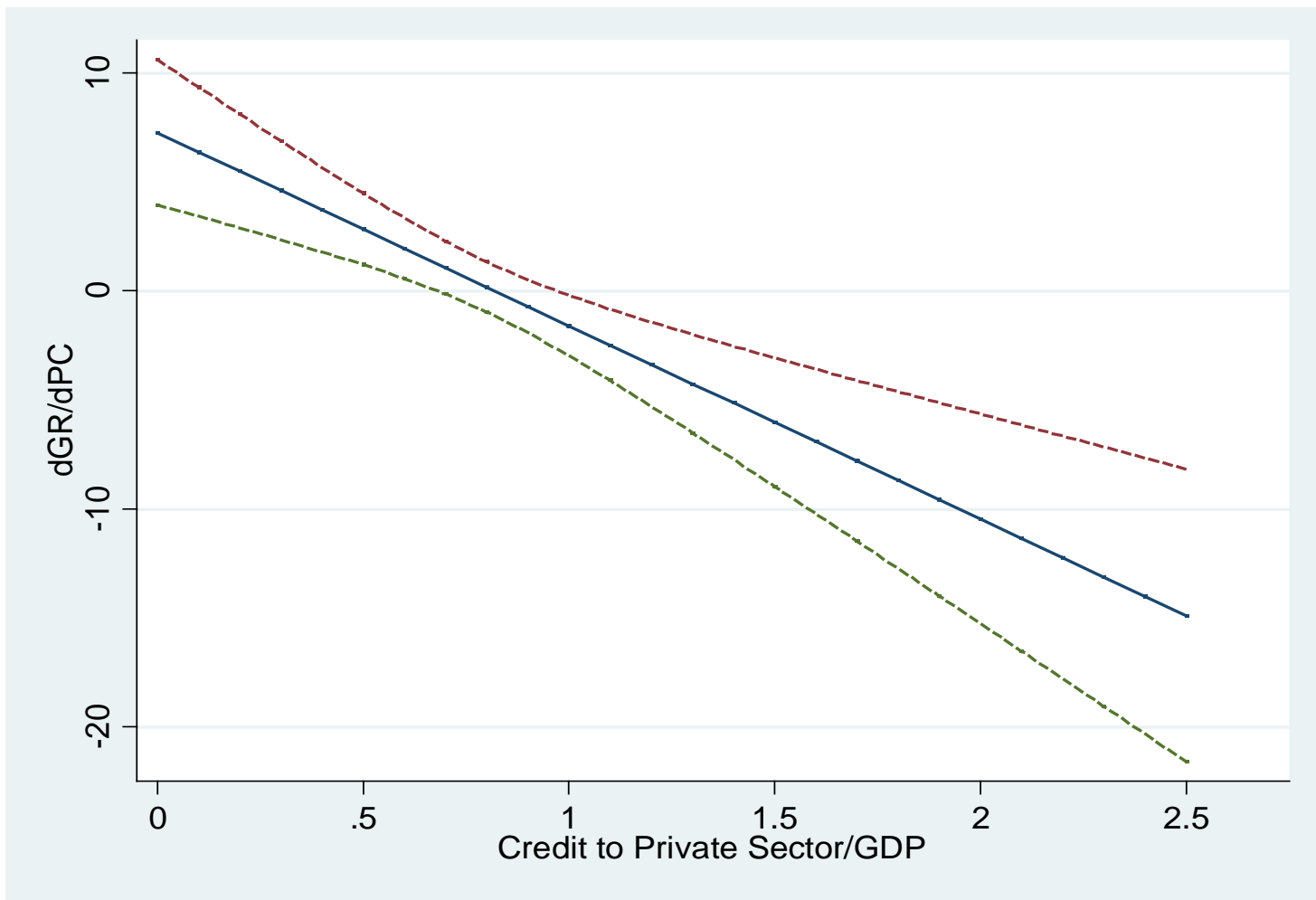
# Known Knowns (2)

- The new literature
  - Rousseau and Wachtel (2011)
  - Arcand, Berkes, and Panizza (2012)
  - Beck et al. (2012)

# Vanishing Effect (panel data)



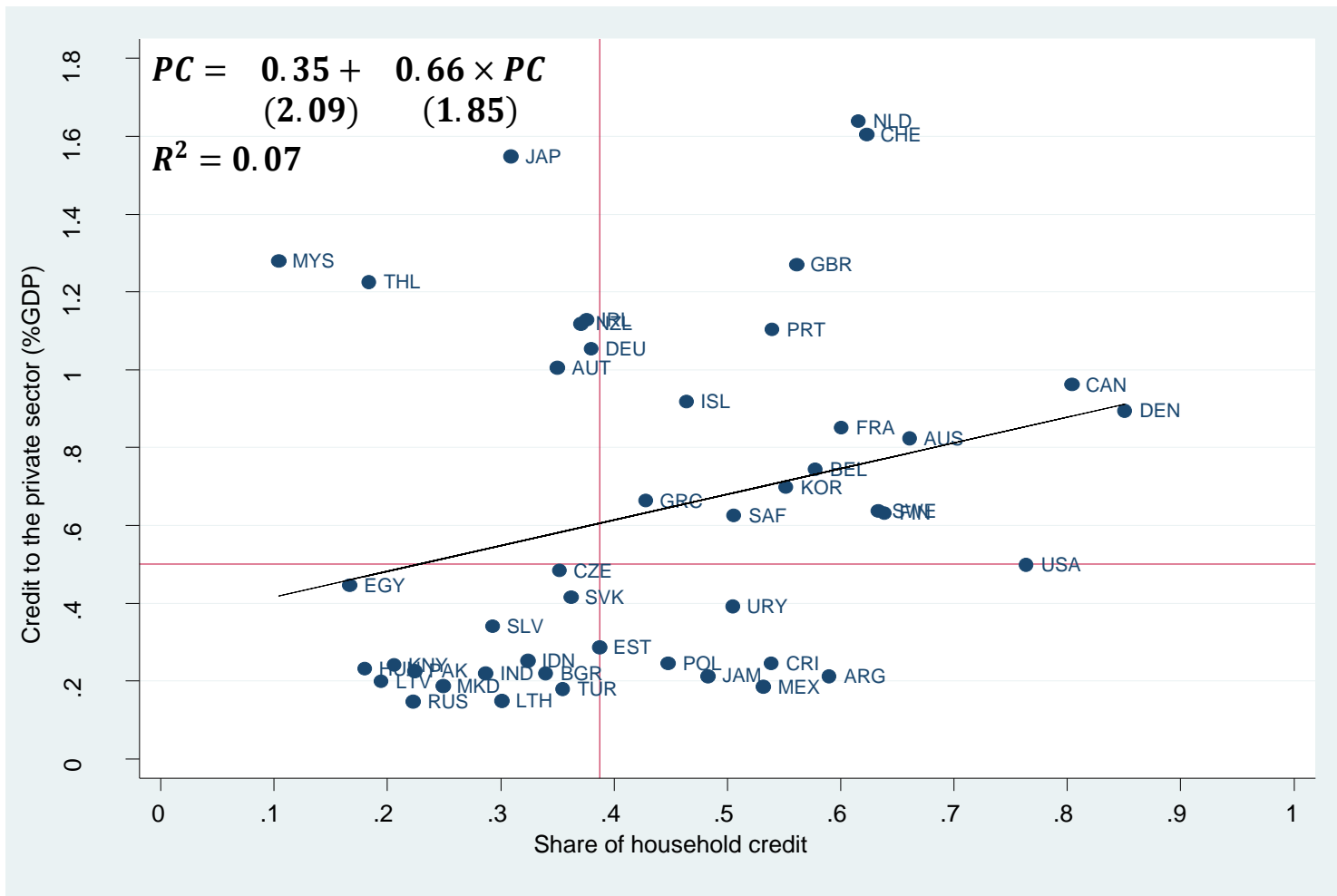
# Too much finance?



Source: Arcand et al. (2012)



# Who gets the credit?



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

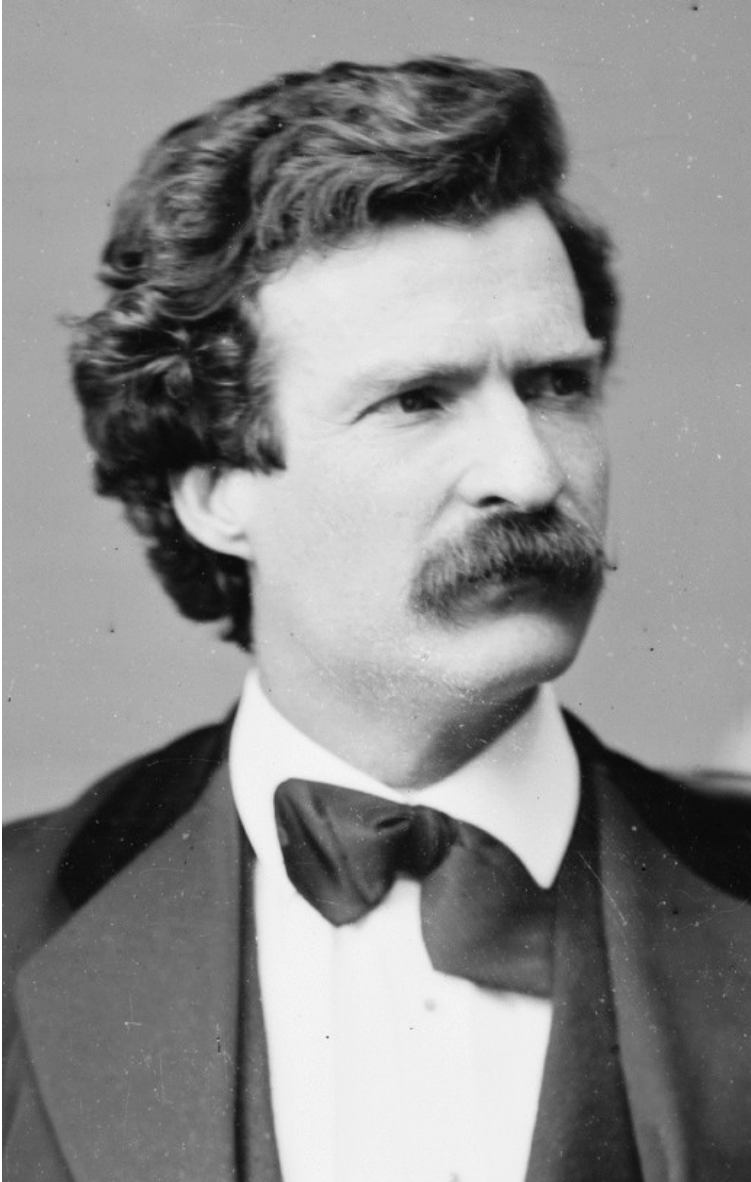
# Known Knowns (3)

- 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***

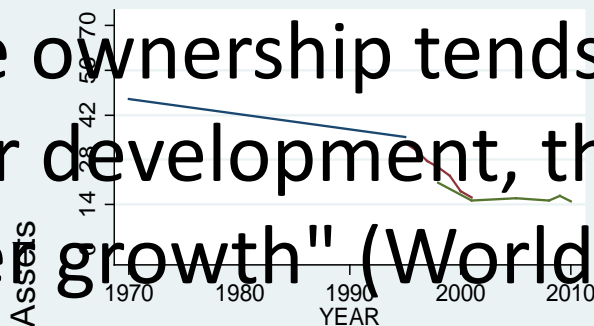
Attributed to Mark Twain

# Unknown Unknowns

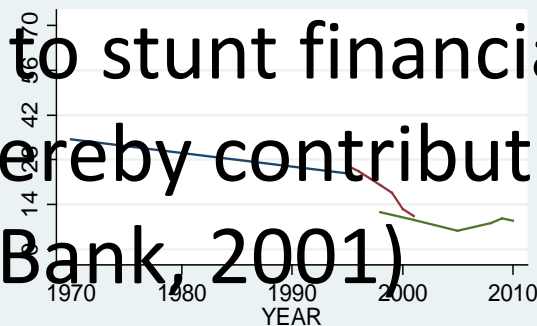
- State-owned banks remain important
- But the profession does not love them
- "state ownership tends to stunt financial sector development, thereby contributing to slower growth" (World Bank, 2001)
- What do the data say?
- Are the profession's views internally consistent?

Government Ownership of Banks

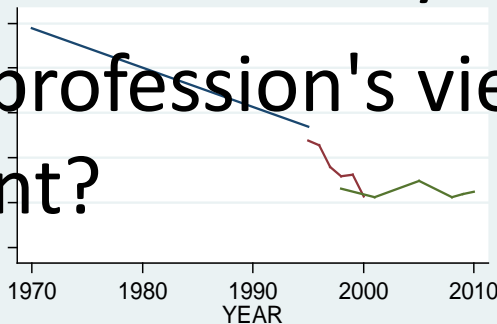
All Countries



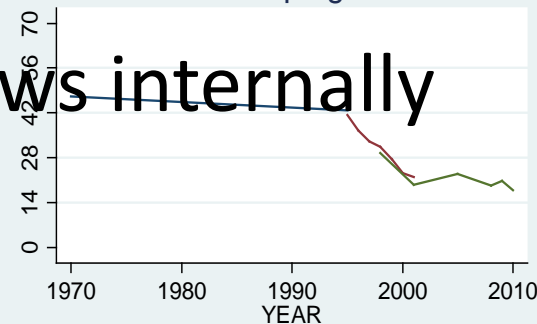
Advanced Economies



EMAC



Other Developing Countries



# 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)

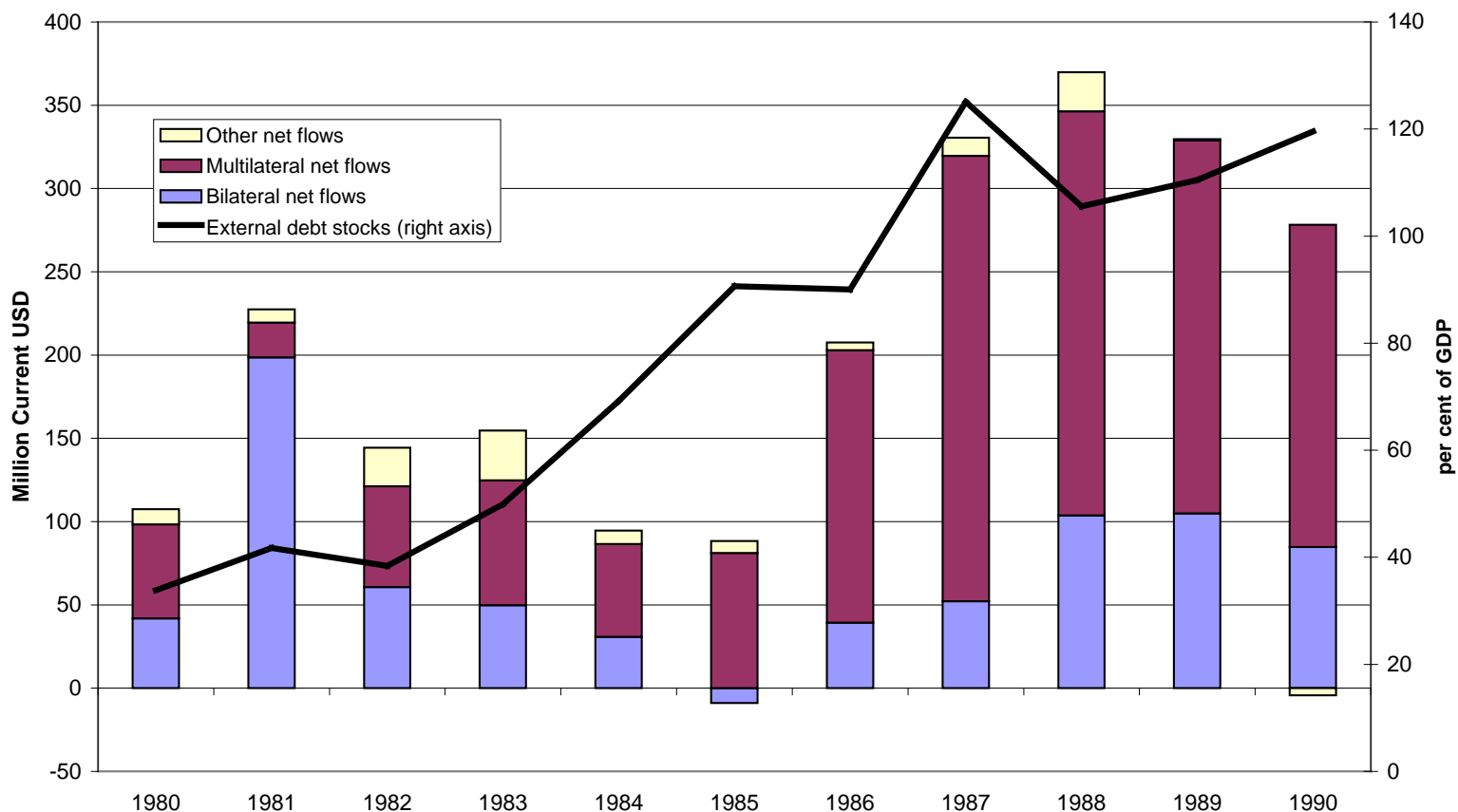


# A different-type of state-owned bank, similar empirical evidence

- 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)
- Ronald Reagan (1986)
  - 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

Zaire: Net Financial Flows and External Debt to GDP Ratio

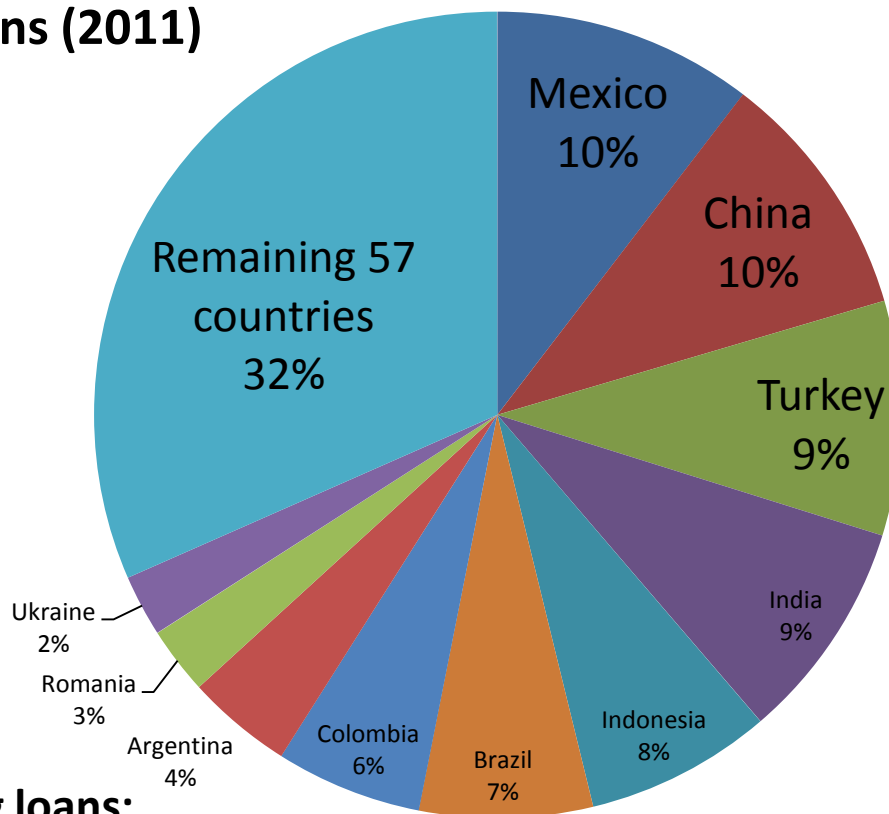


# A different-type of state-owned bank, different evaluation criteria

- 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 countries 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)



**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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