

# Growth, Finance and Crises

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*Disclaimer! The views presented here are those of the author and do NOT necessarily reflect the views of the IMF or IMF policy*

# Praise for the Paper

- Very comprehensive review of (role of) finance
  - All aspects: growth, crises, access, policy, reform
  - Theoretical; historical and recent evidence
  - Many countries' experiences and facts
- Focused on the issues of interest to GCF
  - Globalization, inequality, financial inclusion, poverty, income distribution
- Concrete policy advice and areas of unknowns

# My Reflections

- Finance largely good, for:
  - More economic growth, less volatility, lower inequality, less poverty, through various channels
- But at times can have adverse side effects
  - Too “concentrated” or “too much” finance can be inefficient, worsen inequality
  - And increase risks of costly financial crises
- “Solutions” of two types
  - Better policy design and sequence of reforms
  - Improved governance and oversight

# Areas for Policy Change

## Governance and Oversight

- Areas for Policy Change
  - Financial sector development
  - Crises prevention
  - Crises management
  - Making finance work for more
- Governance and Oversight
  - National
  - International
  - Changing governance

# Financial sector development

- Market-driven: still largely best model
  - But acknowledge more explicit many market failures
  - And large (implicit) role of state in financial sector
    - Regulation, moral hazard, GSEs, state-owned banks, etc.
- Consider more explicitly reform sequencing
  - Conduct dynamic portfolio approach to reforms
    - “Optimal” financial repression, rents, competition, reforms, given effects on incentives, risk-taking, services, etc.
  - Identify thresholds for specific liberalization/reforms

# Crises prevention

- At minimum, avoid new countries having old crises
  - E.g., frontier markets not to suffer emerging crises
- Consider structural dimensions...
  - Seek more robust systems, configurations. E.g.:
    - Are some structures better? Scope of activities (Volcker, Vickers, Liikanen)? Concentration? Types of capital flows? Foreign bank presence better than cross-border lending? Etc.
- Macroprudential, capital flow management
  - Renewed interests, yet still early days
    - Many experiments, questions on interactions with other policies, institutional designs, political economy
  - But could help mitigate crises' occurrence/impact
    - Practical: e.g., can one design optimal externality “taxes”?

# Crises management

- Crises will still remain....
  - “This is different” syndrome likely to prevail
  - Costs of poor management large, with direct and indirect impacts on inequality, distribution, poverty
- How to do better crisis management? Lessons on:
  - Both national and international (including sovereign)
  - Ex-ante: limiting TBTF, moral hazard, contagion, increased transparency, market discipline
  - Ex-post: how to do faster, stronger, more efficient, less creditor-biased resolution, restructuring, “SDRM +”?

# Making finance work for more

- Less emphasis on “financial system” reforms
  - Not just standards & models, e.g., Basel III, other “FSB” (often limited analytical foundations and captured)
  - More transparency, more views in rules setting
  - Allow for different models: mobile, e-finance, informal
- More emphasis on legal, institutional reforms
  - Good legal, judicial, information systems and competition policies eventually, also for private sector development
  - These reforms maybe less subject to financial capture
    - But need to differentiate property rights -- vertical (against expropriation) from horizontal (for market transactions)



# Governance and Oversight

- National
- International
- Changing Governance
  - Stakeholders and Processes

# National Governance: Problems

- Capture is a big problem, comes in many ways
  - Subtle: through rents, higher costs of services
  - Blatant: through corruption, misallocations
  - Ex-post: bailout, moral hazard
- Regulators, and many others, often “fail”
  - In their public policy roles, with little ex-post costs
  - Other whistle-blowers (audit/accounting, rating agencies, investors, financial markets) limited too
- Yet, public in general little involved
  - Poorly informed, not easily mobilized, ex ante or post

# National Governance: Solutions

- Retain bias towards open financial systems
  - Competition still remains important, but more balance
- Better design of rules
  - More transparency in rules setting. But how?
    - “FDA”-approval? More CFPBs? A “Sentinel”? Informed, expertly staffed, independent to evaluate regulations for public
- And better, perhaps new institutions
  - More attention to governance of supervisors
    - Independency, accountability, integrity, transparency
  - Not just ex-ante, but also ex-post
    - Financial crises commissions too ad hoc. “National Transportation Safety Boards” to investigate/report “failures”

# International Governance: Problems and Solutions

- International regulators and supervisors
  - Often “fail” as well in their surveillance and other roles
  - More attention being placed on their governance and legitimacy, but proven hard to fix (e.g., IMF)
  - Greater transparency surely called for (including data)
- Better processes and other/new institutions
  - Move away from assessing “standards” to assessing countries’ “governance” and “processes”
  - Open up standard setting processes, w/ public support
  - Greater role of other, broader agencies (WTO, UN?)

# Changing Governance: Stakeholders, Processes, Static and Dynamic

- Who are the stakeholders, how well represented?
  - Providers well represented, users (notably households, investors) much less so
  - Advanced countries more, emerging markets less (e.g., BRICs not unified), low-income countries hardly
- What are their objectives? How can they coalesce better? How can others (public) be mobilized?
  - In formulation of standards, ways of assessments, etc.
  - Harness NGOs, “99%” movements, others (better)
- Political economy experts help design better ways