

Comment on the IMF Staff's “Rethinking Financial Deepening”

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FinDev Index vs Private Credit %Y

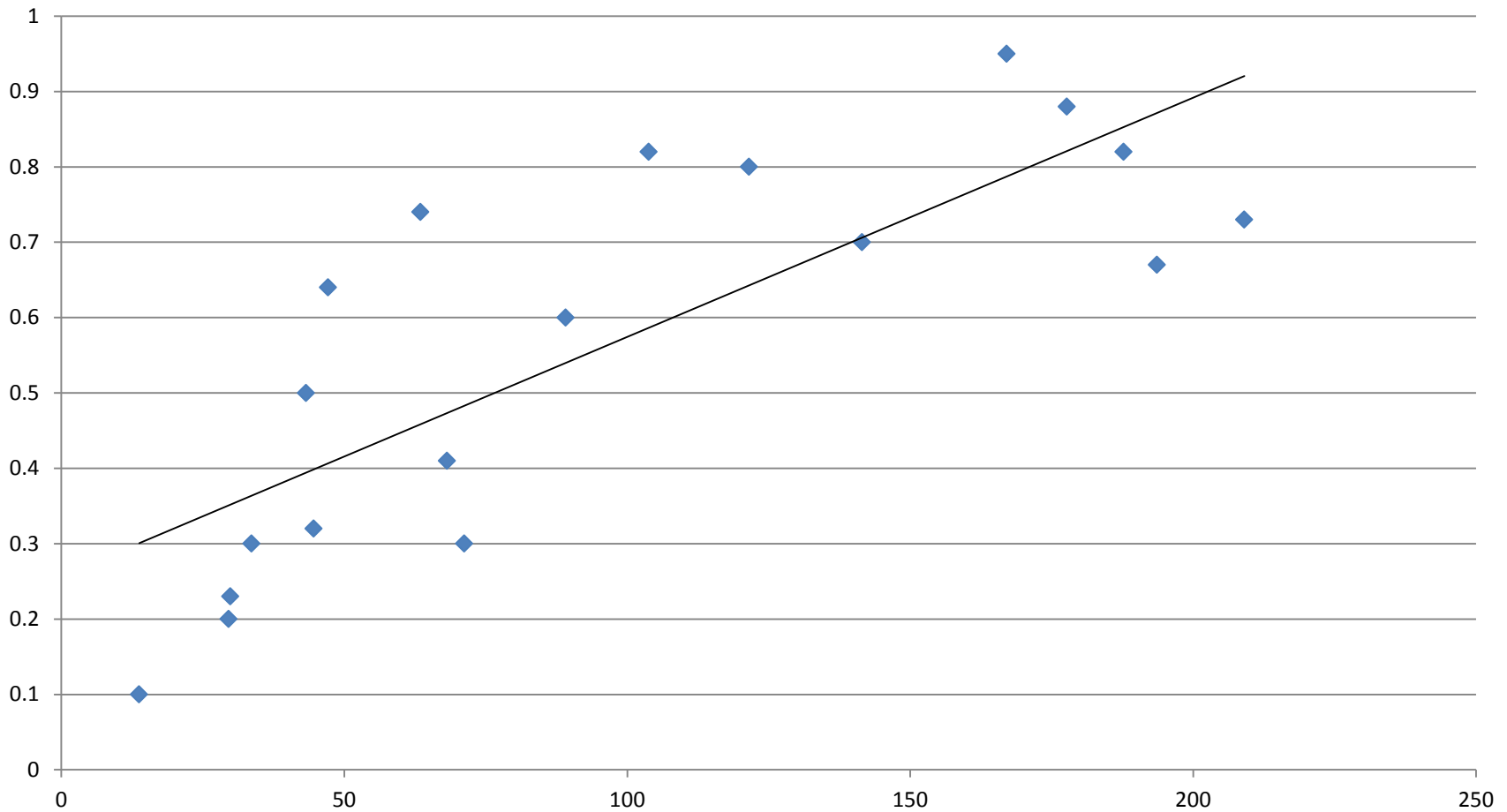
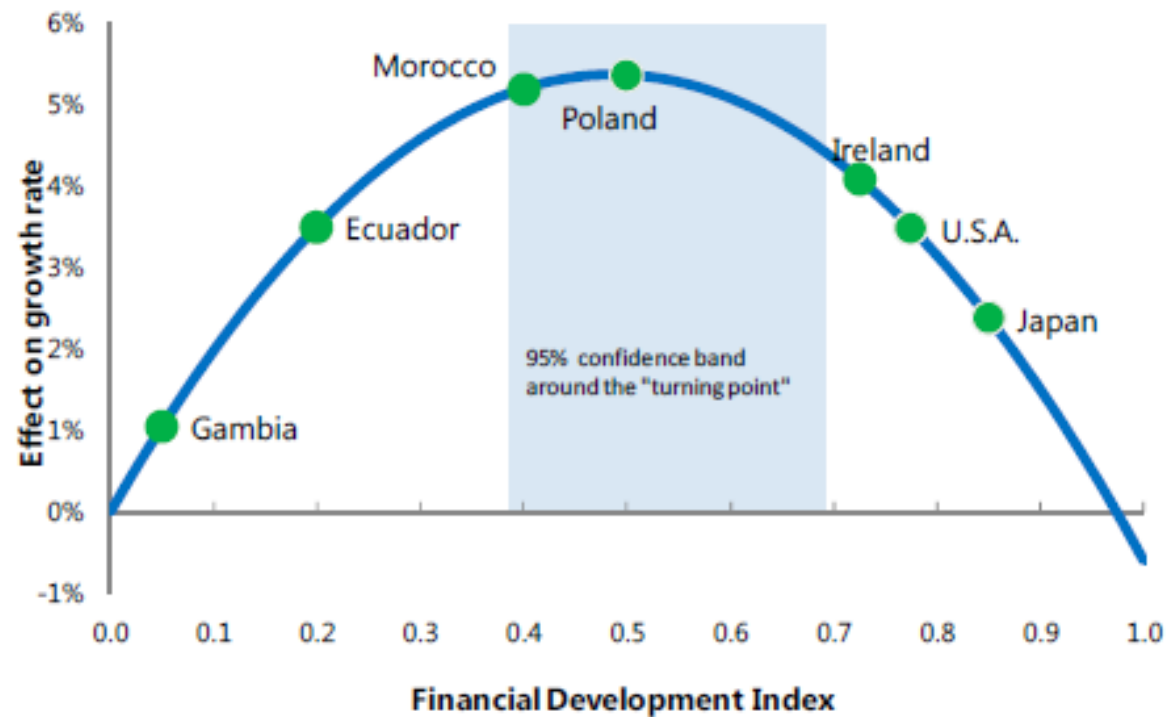


Figure 7. Financial Development Effect on Growth



Source: IMF staff estimates.

Annual Growth Loss from Too Much Finance (%)

	IMFStaff12		Cecchetti-Kharroubi	
	FDI	Loss	PCRB%Y	Loss
Optimal:	0.50	0	94	0
India	0.64	0.54	47	-0.43
South Africa	0.70	1.05	68	-0.14
Brazil	0.74	1.48	56	-0.29
China	0.80	2.26	121	0.15
US	0.82	2.56	53	-0.34
Germany	0.82	2.56	104	0.02
Japan	0.88	3.56	105	0.02
Switzerland	0.95	4.93	167	1.04

Spurious growth causality of too many:

Doctors:

$$1)g = 7.4 - 0.640 \ln y_0^* + 0.960 D - 0.227D^2$$

(4.3) (-2.8) (+1.7) (-2.0)

Telephone lines:

$$2)g = 19.799 - 2.279 \ln y_0^* + 0.208 T - 0.00196 T^2$$

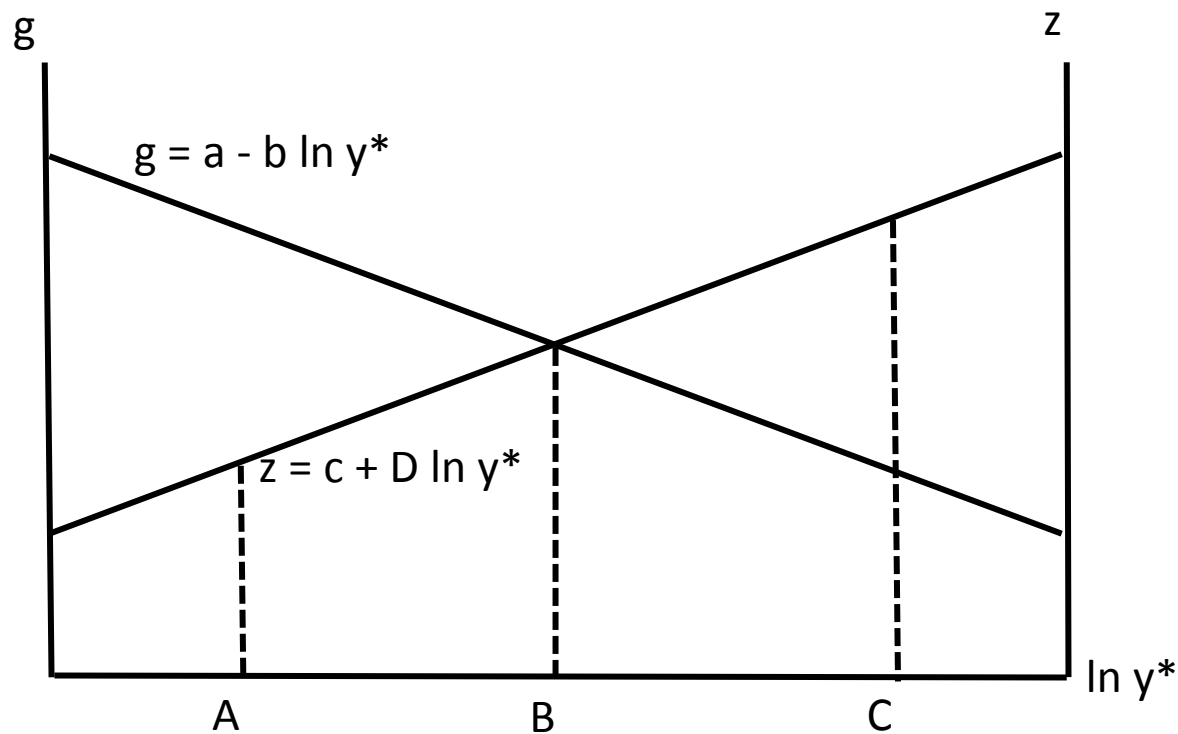
(7.8) (-6.9) (5.4) (-4.2)

R&D technicians:

$$3)g = 20.07 - 2.039 \ln y_0^* + 0.164 RND - 0.0020 RND^2$$

(5.7) (-4.9) (3.9) (-3.9)

Growth and (z=finance; doctors) as function of log per capita income



Spurious negative coefficient on quadratic term of parallel variable “z”

$$1) y = \alpha - \beta x$$

$$A2) z = \gamma + \delta x$$

$$A3) \hat{y} = \lambda + \eta x + \pi z + \theta z^2$$

...

$$A7) \theta = \frac{-0.5\beta - \pi\delta}{2[\gamma + \delta x]\delta}$$

Policy Implications

- Should there be a tax on the financial services sector when FD index > 0.5 ?
- Not if “Too Much Finance” is a statistical illusion
- Should better quality (e.g. improved regulation) be avoided when FD > 0.5 ?
- NO!

Policy Implications (2)

- Instead: make sure that incentives are not distorted, causing over-investment in finance relative to other sectors. Otherwise the market should allocate sectoral expansion decisions.