

**CAREC Institute Research Program  
Center for Economic Research**

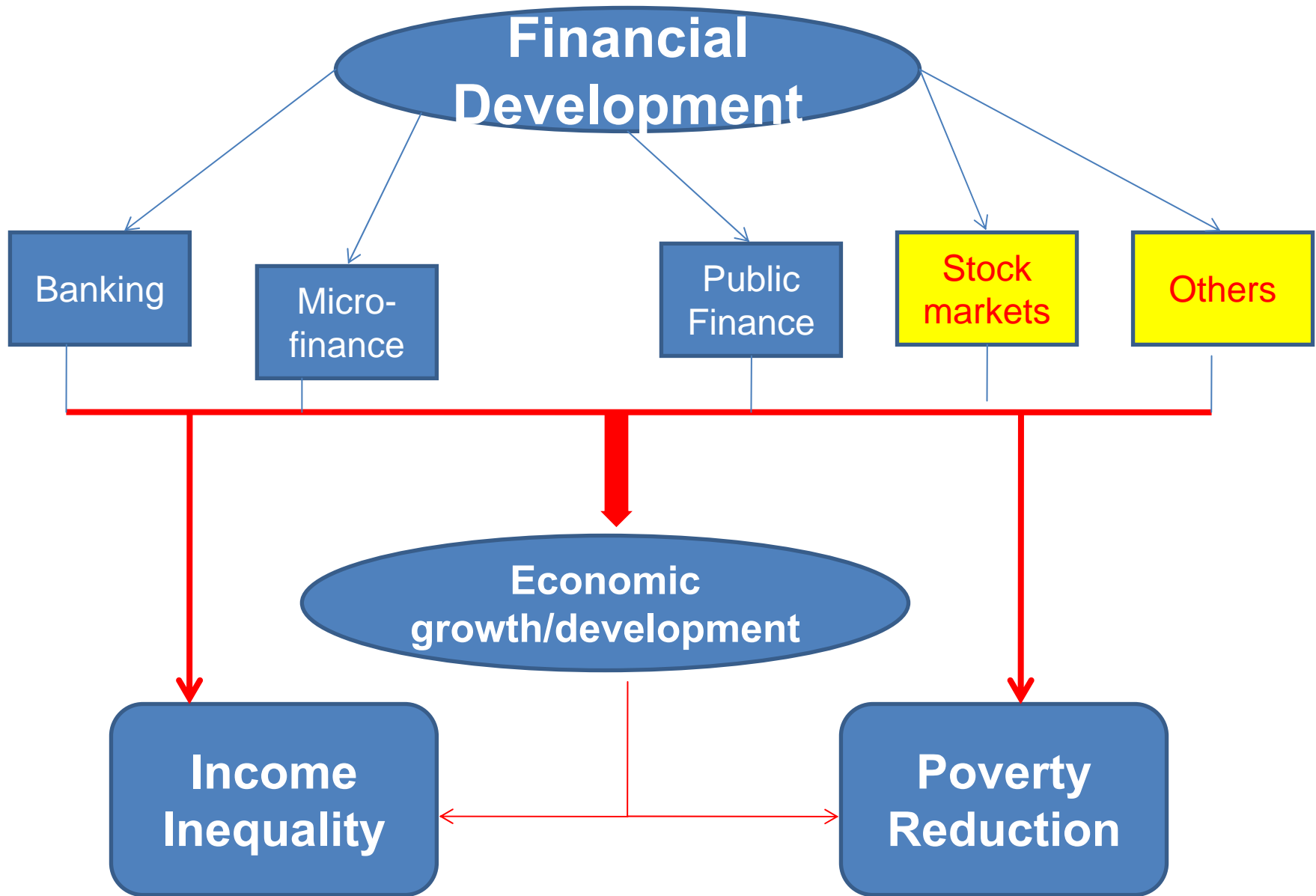
# **Financial Development, Inequality and Poverty Reduction**

**Janna Fattakhova  
Orzimurad Gaybullaev**

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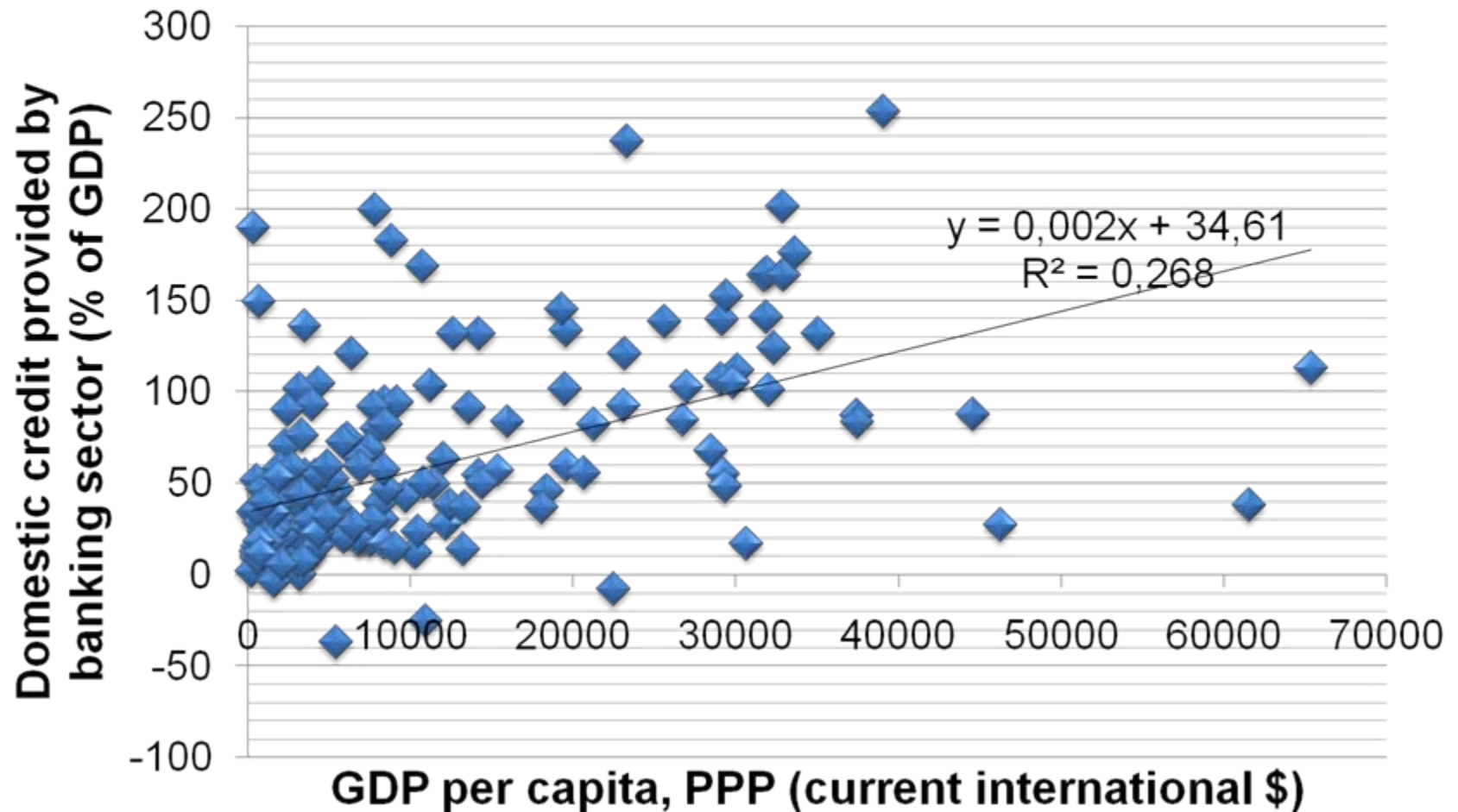
# Objectives

- The goal of this study is to assess the links between **Financial Development** and the main indicators used to measure qualitative changes in poverty dynamics, namely **Poverty rates** and changes in **Income distribution**

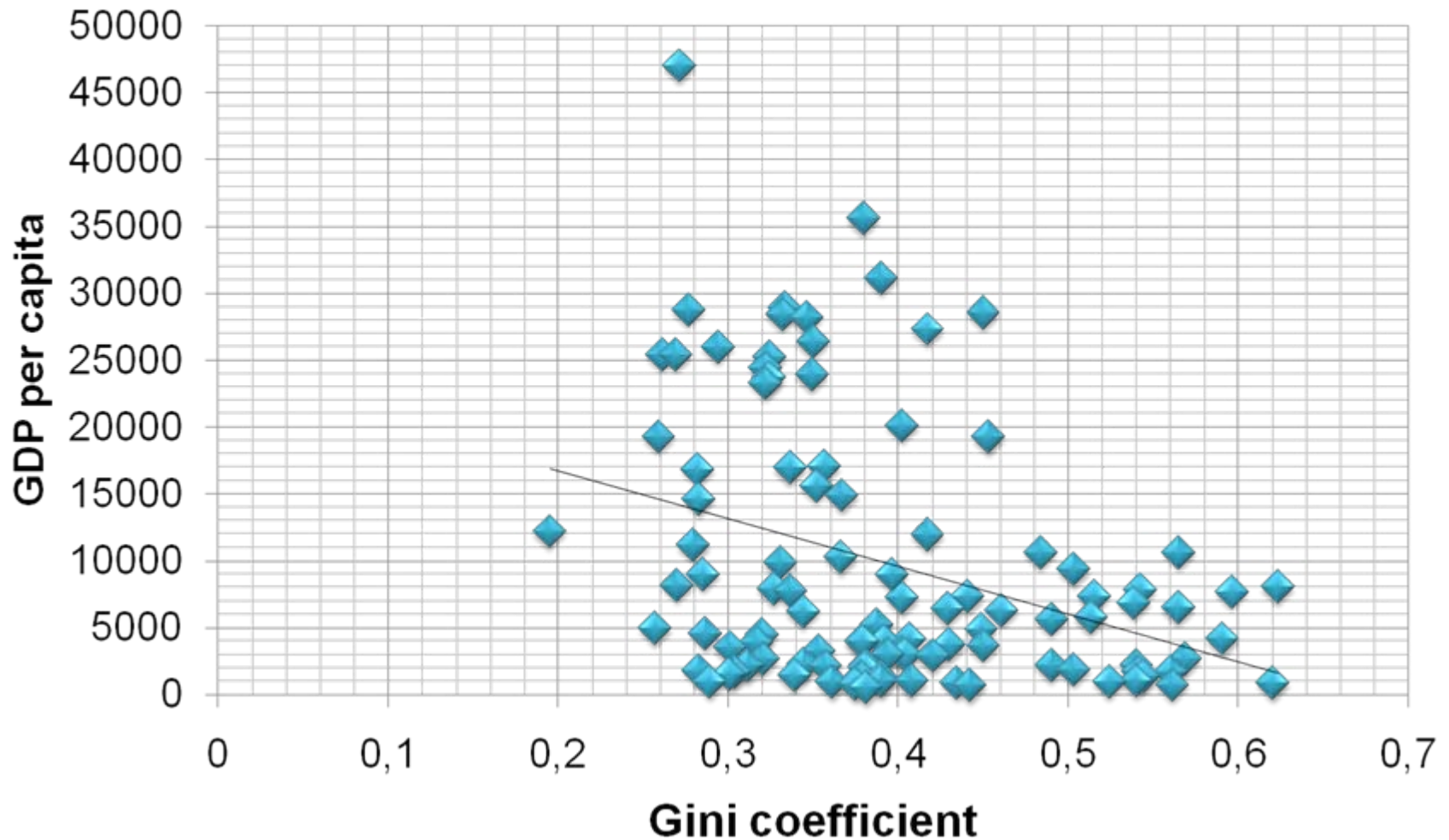


# **Some cross country correlations**

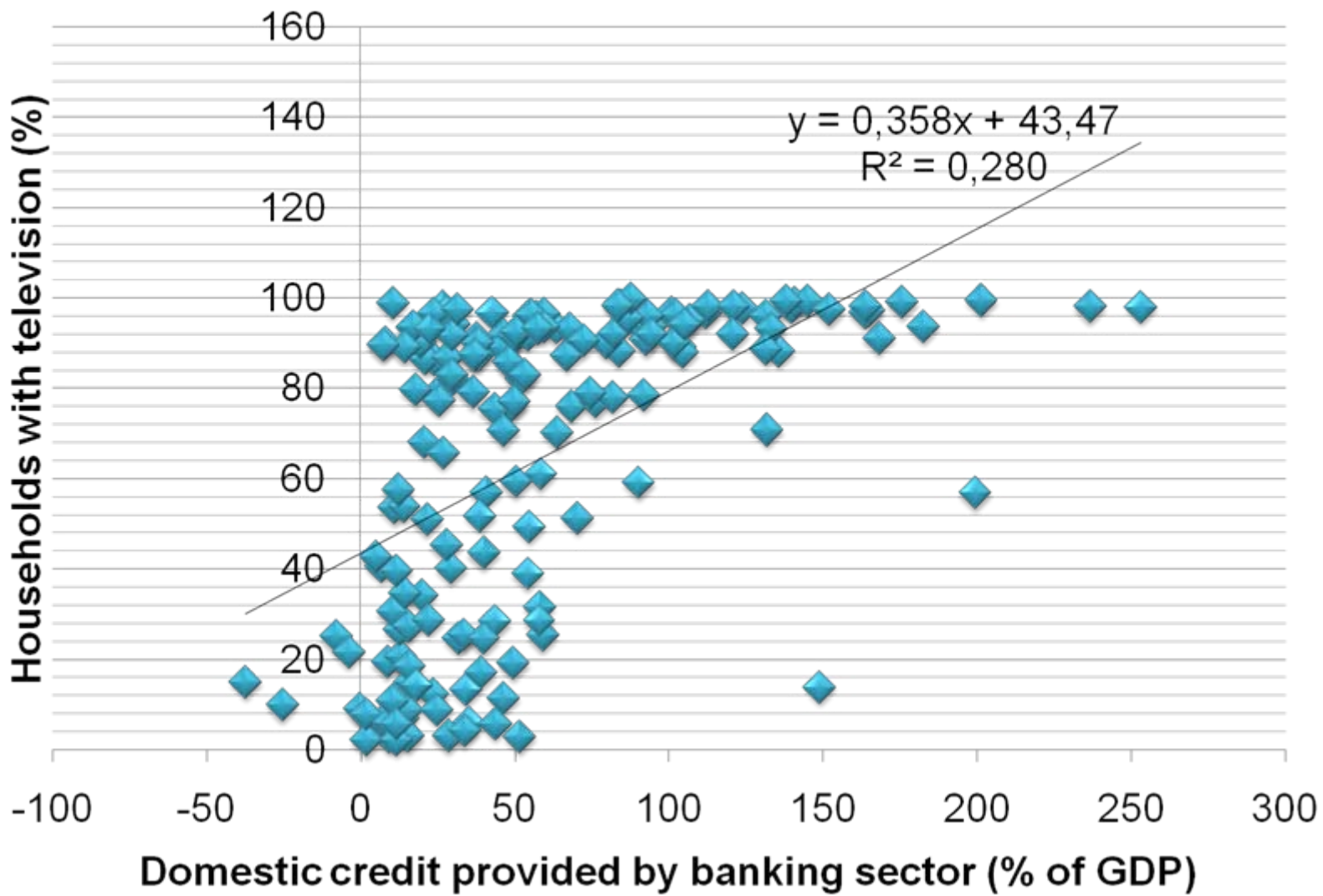
# Bank credit and GDP per capita



# Gini and GDP per capita

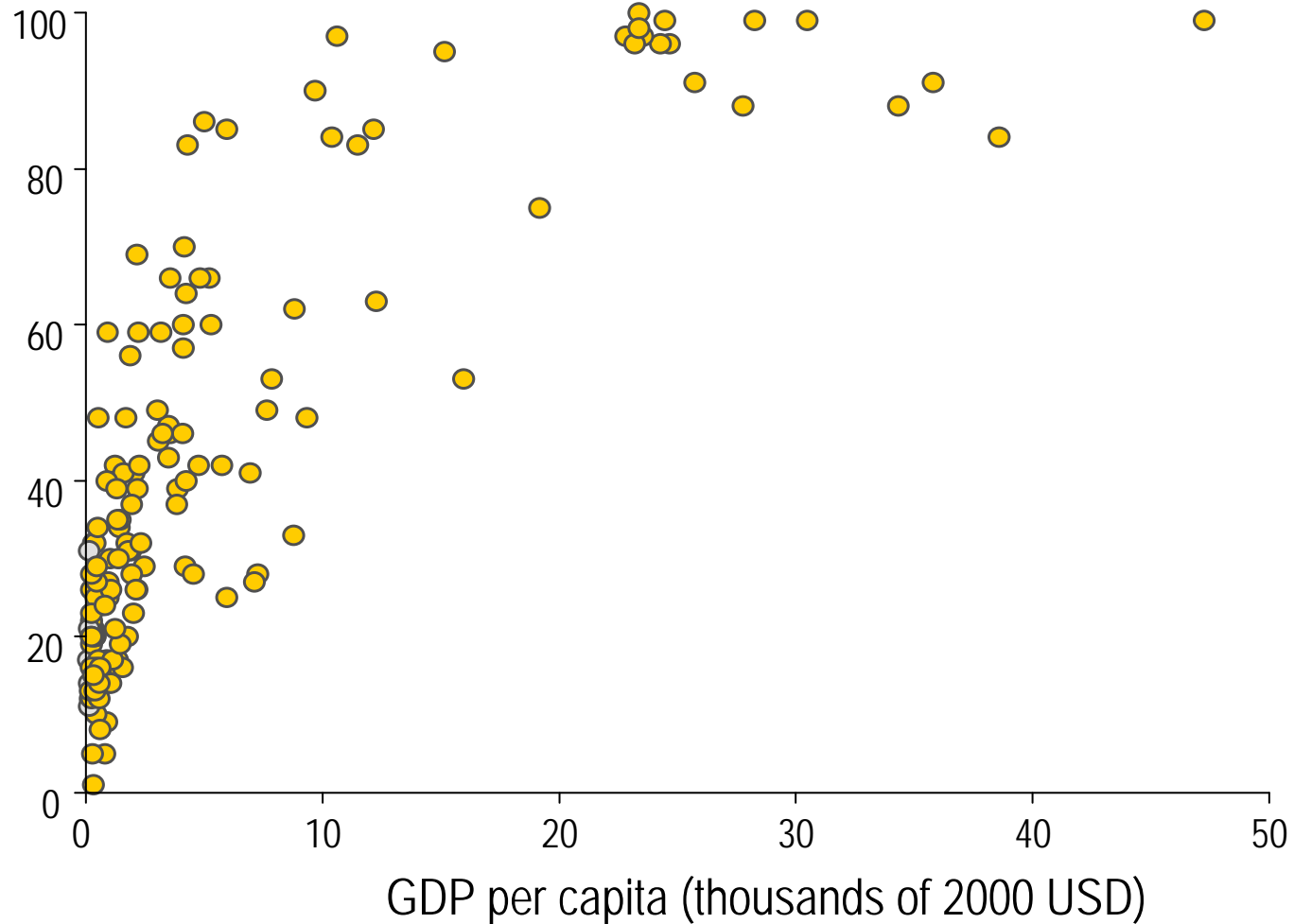


# Bank credit and Households with TV



# Fraction of households with an account

Households using financial services (percent)





# Financial depth predicts future growth

Per capita GDP  
growth, 1960-98

3%

2%

1%

0

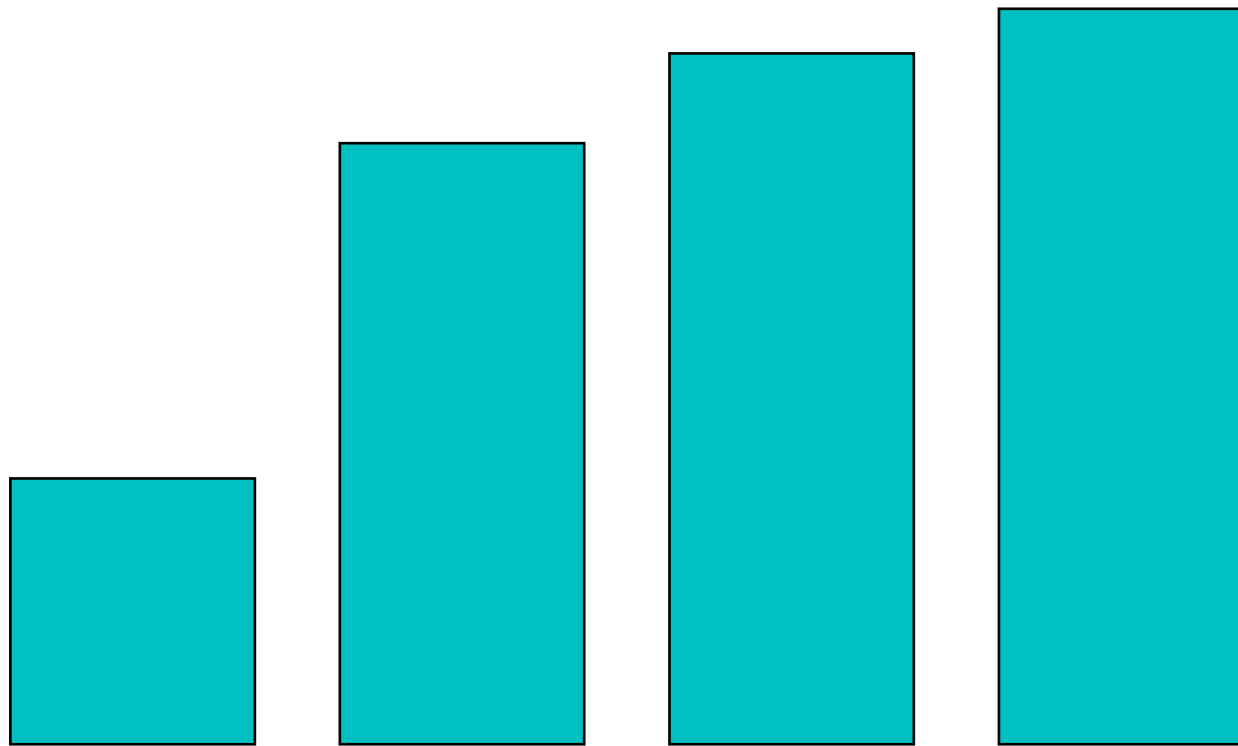
11%

22%

33%

65%

Financial depth, 1960

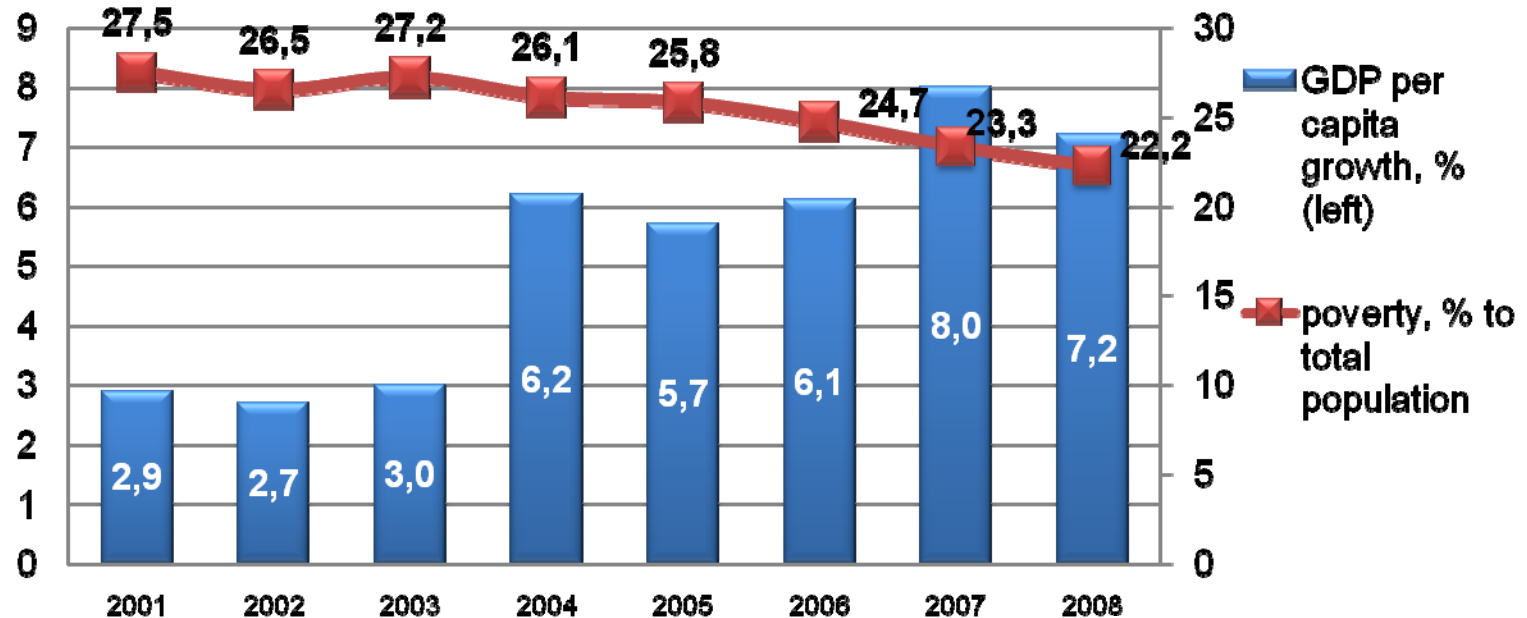


# **Correlations**

## **Uzbekistan's case**

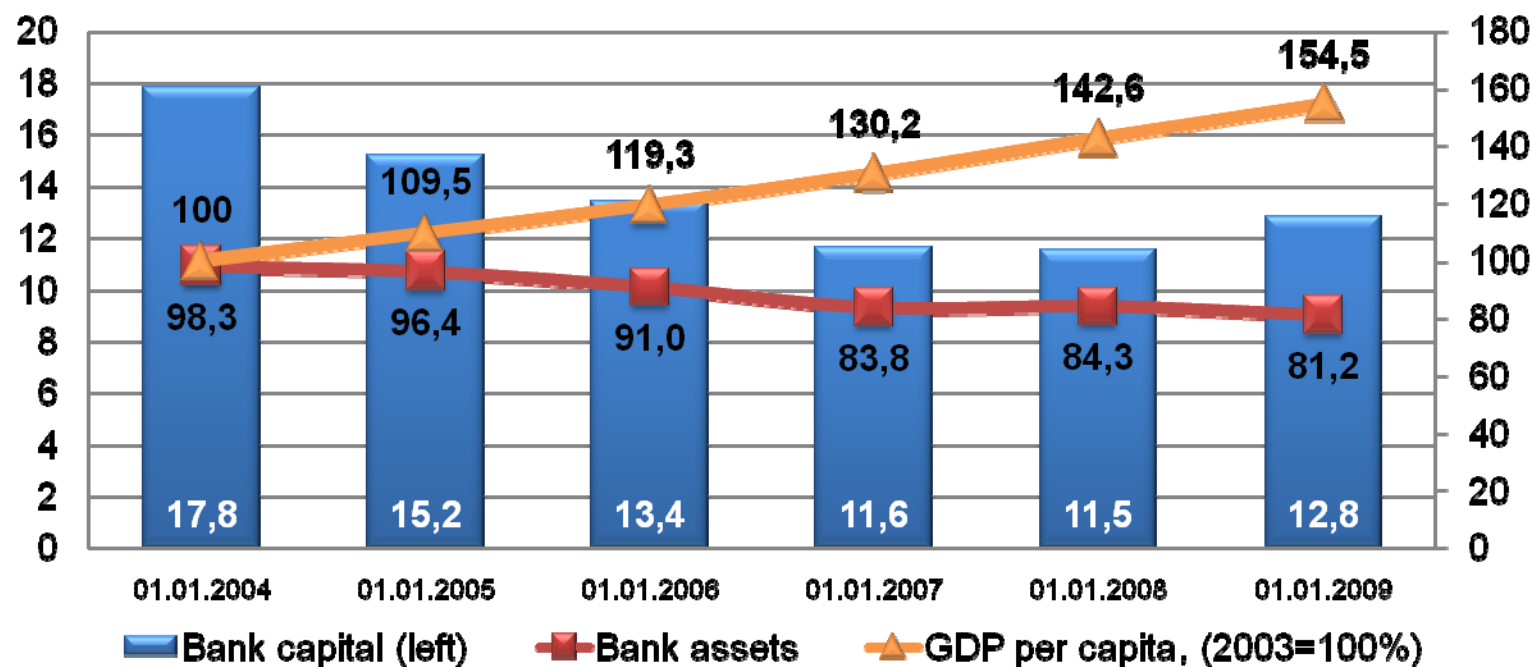
### **(Balances and Imbalances)**

# GDP growth and Poverty



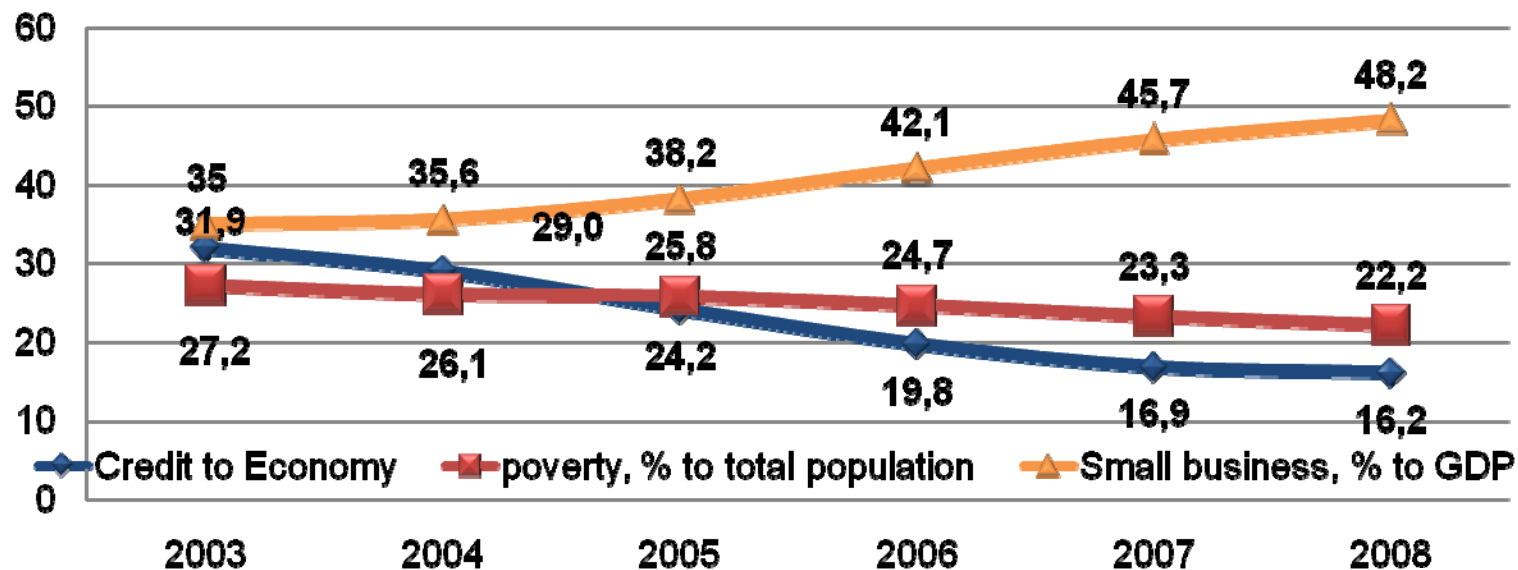
- GDP per capita growth in 2001-2008 was 5.2% (GDP growth – 6,6%, population growth - 1,3%).
- Poverty rate decreased from 27.5% in 2001 to 22.2% in 2008

# Bank Assets and Bank Capital (% to GDP)



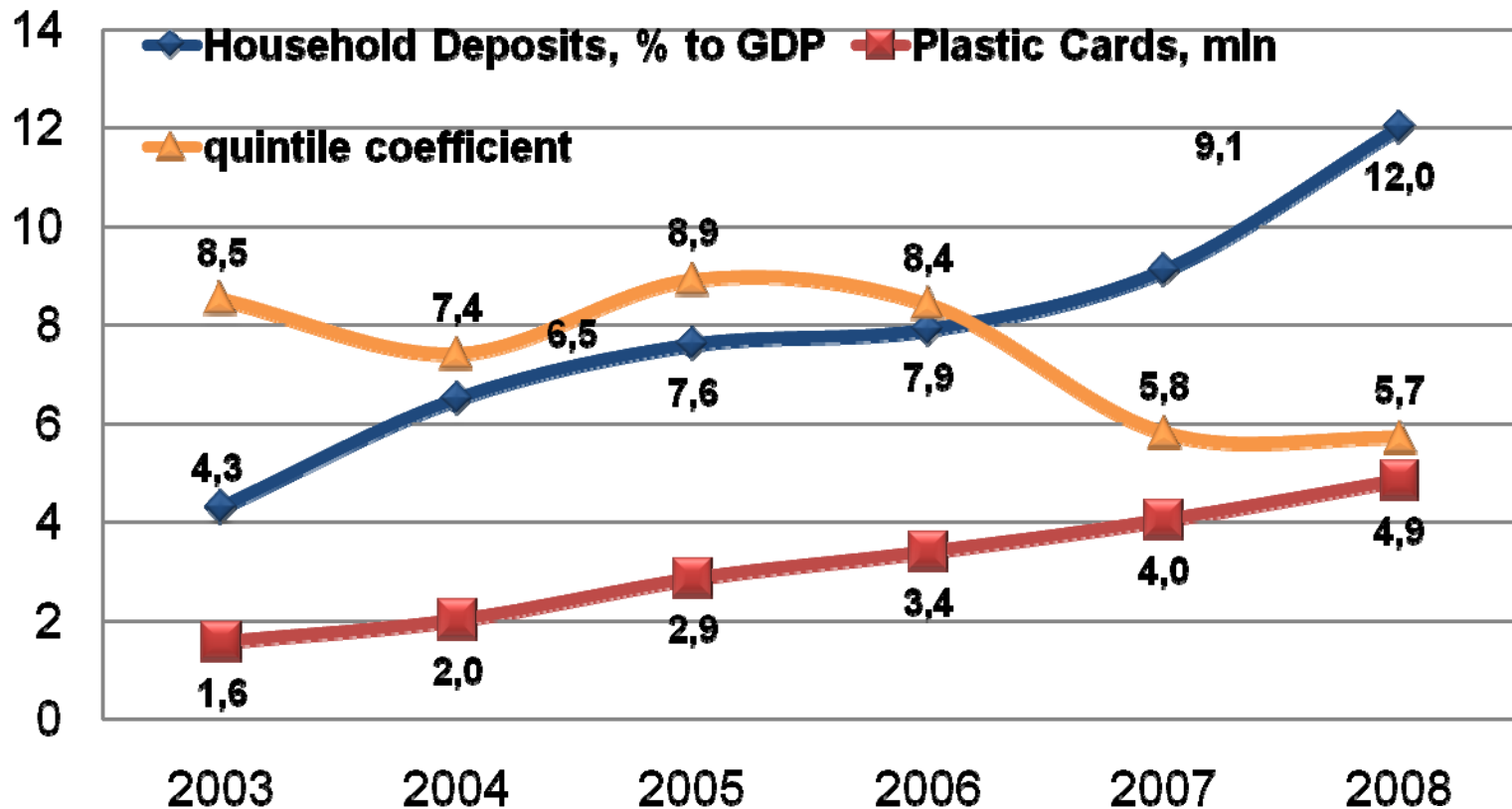
- Bank assets to GDP decreased from 98.3% to 81.2%
- Bank total capital to GDP decreased from 17.8% to 12.8%
- GDP per capita increased 54.5% compare with 2003 value

# Bank's credit to Economy and Small business share (% to GDP)



- Credits to Economy decreased from 31.9% to 6.2%
- Small business share increased up to 48.2% to GDP

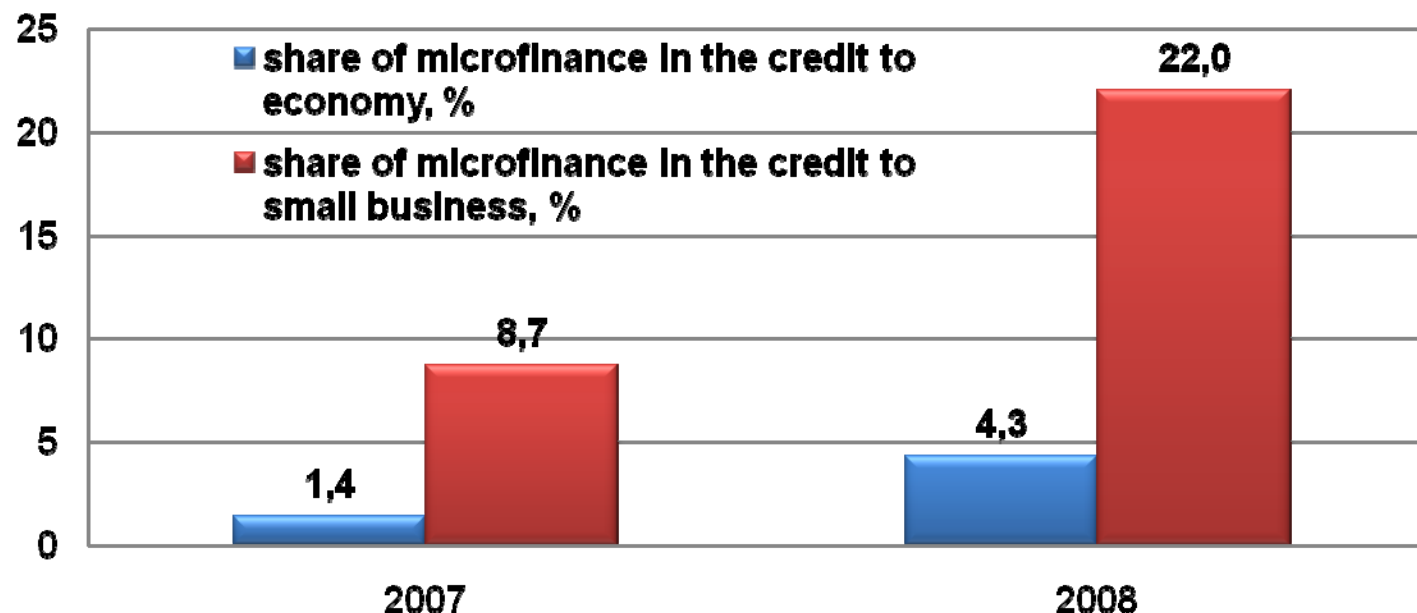
# Household Access



- Household Deposits volume and Bank account (Plastic) Card holders quantity are increasing, Quintile coefficients (Ratio of 20% Rich to 20% Poor) is decreasing

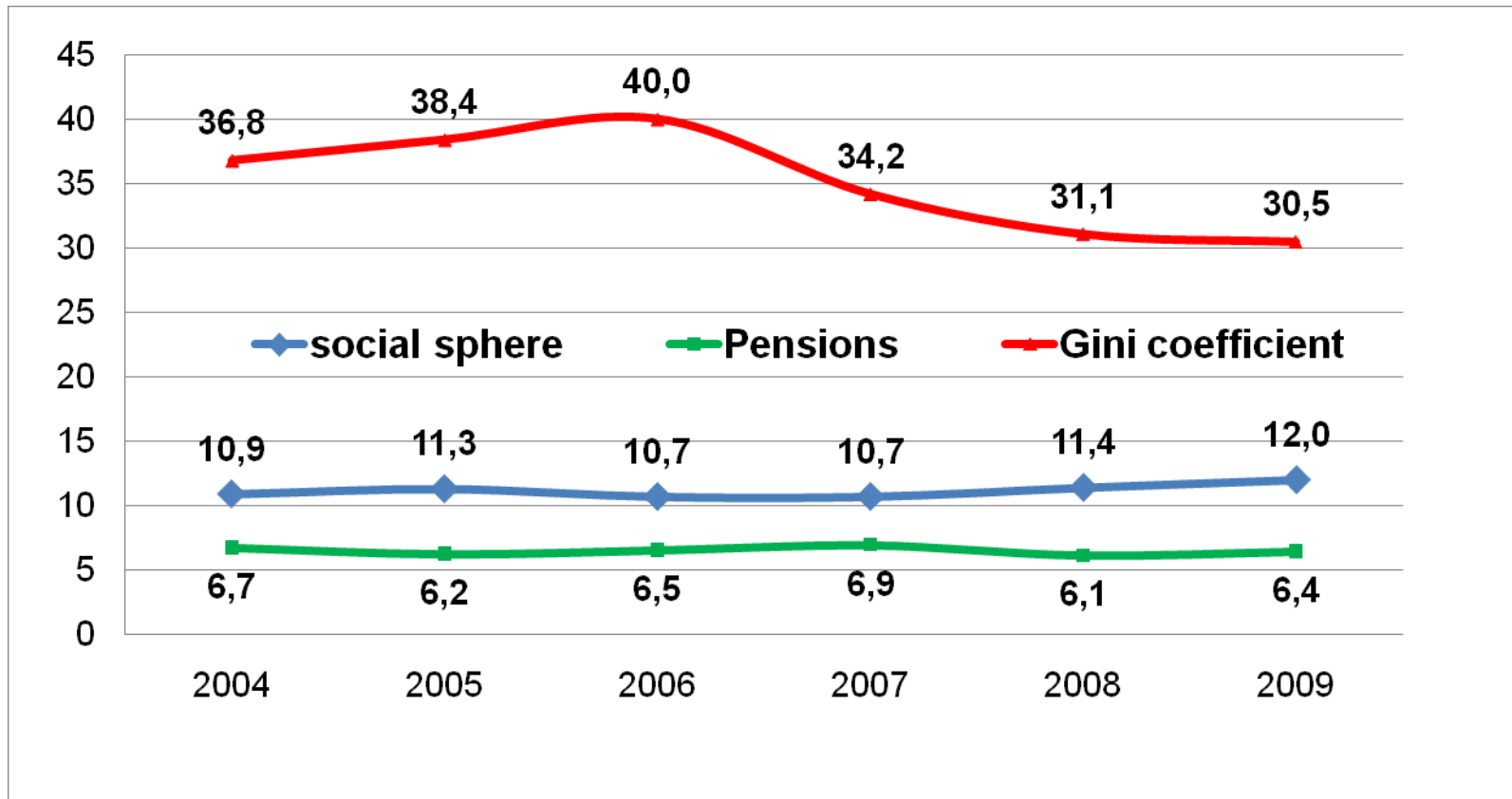
# Share of Microfinance

(% credit to small business and to economy)



- The share of MFIs (MKO, CU and Mikrokreditbank) in the credit to economy increased up to 4.3% and in the credit to small business – up to 22%
- In 2008 with the help of microcredits more than 206,000 new jobs were created

## Budget expenditures in social sphere (% to GDP)



- High concentration of budget expenditures on social sphere, free access to basic education and basic healthcare, targeted social protection did not allow poverty rate to rise sharply



# **Literature Review (Causality, Evidences)**

# Literature review (direct effect)

- World bank (Finance for All, 2008) - **direct impact on the households or enterprises and the whole economy**. If very poor do not themselves gain access to financial services, they may benefit substantially from increases employment and other opportunities resulting from the activities of less-poor entrepreneurs whose access has improved
- Beck, Demirguc-Kunt, Levine (2007) – **40%** of the income growth is the result of reductions in **income inequality**, **60%** is due to the impact of financial development on aggregate **economic growth**.
- Berthelemy, Varoudakis (1996) - an **underdeveloped financial system created a so called “poverty trap”**, and became a serious obstacle to growth even when other prerequisites for sustainable economic growth (macroeconomic stability, liberal trade environment, educated population, etc.) were already present in a country

# Literature review (through firms growth)

- World Business Environment Survey (1999-2000, more than 10,000 respondents) – **constraints in the access to finance** is a main reason which causes slow output growth
- Beck, Demirguc-Kunt, Maksimovich (2005) – **financing constraints reduce firm growth** by 6 percentage point for large firms and 10 percentage points for small firms.
- Robert Barro (1999) – **inequality first increases and later decreases** during the process of economic development

# Literature review (through growth)

- View 1: **Finance promotes growth** – «banks are the happiest engines that ever were invented for creating economic growth» (Hamilton-Bagehot-Schumpeter);
- View 2: **Finance hurts growth** «banks have done more harm to the morality, tranquility, and even wealth of this nation than they have done or ever will do good» (Adams)
- View 3: **Finance follows growth** - “... where enterprise leads finance follows” (Robinson)
- View 4: **Finance doesn't matter** – «growth is mainly due to technological progress, leaving little role for finance» (Solow Growth Accounting)
- View 5: **Finance matters** because there are **crises** (IMF/Worldbank)

# Finance → Poverty Alleviation ... Big!

- If Peru had the level of financial development as Chile 13% vs. 54%, then
  - 2% living on less than \$1/day
  - Actual level: 15%

## ...with significant indirect effects

- Welfare impact of direct access of the poor – mixed results
  - Aggregate studies – that take into account spill-over effects - suggest stronger impact
  - General equilibrium models and natural experiments also suggest indirect effects of financial development may be quite significant for the poor – i.e. having jobs and higher wages
- ⇒ To promote pro-poor growth it is important to improve access for all excluded (not only the poor)

# Literature review (long term growth)

- Goldsmith (1969) – 1) there is **parallel between economic development and financial development**; (2) periods of faster economic growth are usually accompanied by faster growth rates of the financial system
- King & Levin (1993) - **there is a link** between the **base level** of financial development and future long-term growth
- **The main conclusion of all these studies is – well-functioning financial systems: *improve capital allocation and help to economic growth; reduce income inequality and lower poverty***

# Hypotheses (case of Uzbekistan)

- There is no direct link between financial development and per capita GDP
- Targeted state social protection programs have the greatest impact on poverty alleviating
- Financial development reduces inequality in income distribution
- Microcredit institutions (MFIs) play the most effective role in poverty reducing



# Theoretical model

**Poverty and Income distribution=**  
**A0 +**  
**A1\* (economic growth indicators) +**  
**A2\* (financial development indicators) +**  
**A3\* (budget social expenditures)**

# Expecting results

- Describe the nature and impact of financial development on the poverty and income distribution
- Find financial development models required by Welfare Improvement Strategy for 2008-2010
- Conduct comparative analysis CAREC countries data, attempt to determine general and specific features of the impact on poverty
- Develop policy recommendations to the Government

# Data description

	Indicators
Poverty rate and Income distribution	GDP per capita, disposable income per capita, poverty (less than 1,500 kcal per day and 2,100 kcal per day), quintile coefficients, Gini coefficient, etc
Macro	GDP growth, CPI, savings, investments, tax burden, birth rate, small business share, etc
Financial development	Bank assets, Bank capital, credits to economy, M2/GDP coefficient, interest rates, quantity of plastic cards, bank accounts, ATM, household deposits, microfinance institutions, etc
Budget expenditures	Budget expenditure for education, health, social protection, pensions, etc

# Data description

**Sources:** State Statistical Committee of Uzbekistan, Central bank, Ministry of Finance, other ministries and agencies, data from International organizations like World bank, ADB, IMF, UN, ILO and others

**Period:** 1994-2008

# Open questions or problems

- Quality and lack of data (short period of time, there are no exact poverty indicators, credit to private sector, high share of grey economy)
- Lack of time series econometric analysis in Central Asia (as well as in CAREC) on the poverty issues (there are mostly cross-section analysis)
- how can CAREC Institute help with data and methodologies?

# Thank You