G24 SPECIAL WORKSHOP ON GROWTH AND REDUCING INEQUALITY

Panel on: Financial and Monetary Policies

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Comments on Pierre Monnin, "Monetary policy, macroprudential regulation and inequality

Monnin's paper reviews research on the relation between monetary policy and inequality of income and wealth and on that between macroprudential policy and the same indicators. The conclusion of this research is that neither policy is neutral in its relation to inequality. But the mainly econometric results surveyed do not enable much generalisation as to the character of these effects.

As Monnin says, whether inequality is increased or decreased by changes in monetary policy depends on economies' structures – in particular on the structure of households' income and wealth. This conclusion is not surprising. The relation between monetary policy and the distribution of income and wealth is clearly an integral part of the effects of macroeconomic policy more general, and extracting the effect of the monetary policy constituent is not easy.

In view of the much increased interest in macroprudential policy the paucity of empirical work on its effects is a little disappointing. But this too is unsurprising in view of the problems of separating the impact of such policy from other effects of regulatory regimes. Responsible policy makers none the less have to take decisions in this area, sometimes in crisis situations. So it is worth summarising major problems which they face, and why these problems are so recalcitrant to analytical generalisation.

When one considers the appropriate policy for systemic financial instability (the target of macroprudential measures), it is convenient to treat the subject under the headings of emergency measures and of prevention.

Emergency measures crucially concern the provision of liquidity to the institutions threatened by, and threatening to contribute to, a financial crisis and thus, *inter* alia, to the continued functioning of the economy's payments system through which financial contagion can spread. But situations of potential systemic instability are difficult to manage and require knowledge of the working of the economy's banks and other financial institutions of a sort not available from second-hand reports – though in principle available to regulators. Distinguishing in practice between the illiquidity and insolvency of banks can be difficult, especially during the early stages of a crisis. Moreover identification of the appropriate time for emergency action is not straightforward, but decisions will generally be necessary at short notice. Moreover the emergency support may require not only liquidity support – generally the responsibility of the central banks – but also a bail-out involving government financing (and thus tax payers' money).

These circumstances are best understood through case studies rather than econometrics, though econometrics may help in the disentangling crises' causes.

Prevention involves much of the regulatory framework of the financial sector. This can be illustrated by the response of Franklin Roosevelt's administration to the banking crisis at the time of his inauguration as president. The emergency measures of the new administration included shutting down and then reopening the banking system, and the Banking Act of 1933 which introduced federal deposit insurance and largely separated commercial and investment banking. The objectives of these measures as well as of other subsequent reforms such as those involving securities markets were not limited to the avoidance of systemic financial instability but were none the less strongly influenced by experience of it in the early 1930s. Although at this date the term macroprudential was not yet in common use, arguably the New Deal reforms had an important macroprudential dimension.

The sheer range of emergency and preventive – macroprudential – policy indicates why statistical assessment of its effects on, for example, the distribution of incomes and wealth - evidently an important consideration in the current agendas of regulatory reform - is so complex.

Comments on Ayse Demir and Victor Murinde, "How does financial inclusion affect economic growth, poverty and income inequality ? Here is Africa's story".

This is a useful start for analysis of its subject. As a reader I should have liked to see more discussion of the different vehicles for providing financial inclusion (micro-institutions, telephones, etc.). I should also have liked to see more discussion of the distributions of the variables included in the econometric analysis. I should be interested in the sample's outliers (if any) as well as which countries (?) had estimates that conformed most closely to the overall results of the regressions.

Comments on Davide Furceri, "Financial globalization, monetary policy and inequality"

This paper suffers from excessively summary descriptions of key indicators or variables included in the analysis. This is particularly true of "financial globalisation". The term seems to be taken here as equivalent to opening of the capital account. Such a procedure facilitates econometric analysis since it makes possible use of discrete dummy variables to denote "financial globalisation". But it is surely an oversimplification which limits the range of the paper's conclusions.

"Financial globalisation" does obviously include the freedom of cross-border movements of capital, but the IMF's own annual reports on Exchange Arrangements and Exchange Restrictions make it clear that opening the capital account is a complex concept not necessarily easily captured by discrete events. Some features arguably relevant both to the process of "financial globalisation" and to its potential effects on distribution follow.

1. The geographical area under consideration of "financial globalisation" has been expanding since the 1970s. 2. The process has been accompanied by increases in the cross-border exposures of both financial institutions and countries. 3. The combination of innovation and liberalisation of regulatory regimes has affected distinctions between financial products. 4. Securitisation and derivatives have increased the importance financial markets as opposed to banks – with effects both on the distribution of different classes of cross-border financial flow. 5. Partly as a result of 3.

and 4. there has been a large increase in trading activities in relation to other measures of economic activity. 6. There has also been a large increase in the importance of institutional investors (various categories of investment funds and insurance companies) in cross-border finance.

Inclusion of such features in econometric estimates is unlikely to be straightforward partly owing to variation in their historical importance at different stages of "financial globalisation". But they should figure in discussion of "financial globalisation", including that of its effects on the distribution of income and wealth. And they do so figure in the UNCTAD paper with its reliance on heuristic approaches to the subject.

Schlarek, and Michael Brei, "The Future of National Development Banks"

1. (This comment is pertinent in a number of places in the paper.) Clear definitions – if they are possible - should be provided as to the distinctions between National Development banks (NDBs), public banks, national public banks, and private banks. The distinctions should cover legal objectives, permissible activities, ownership and financing. Ideally the definitions should be part of the introduction.

1a. In the introduction (I, p.3) it might be a good idea to say whether all NDBs fill the five roles specified or whether there is variation among countries in their specified goals.

2. (II, p.7) Was this argument concerning the inefficiency of development banks based on evidence or a priori considerations ? Nobody would deny that NDBs and public-sector banks are sometimes inefficient and guilty of making politicised loans. But they were being compared with private-sector banks with their frequently long history of speculation and other shortcomings, including politicised lending and corruption.

3. (II, p.8) The Stiglitz arguments need fleshing out. Lack of transparency is a frequent characteristic of all financial institutions, public-sector as well as private. This is partly because information furnished by such institutions to supervisors as well as to investors – which may include the relevant entities through which the government's role as investor is carried out - is often extremely difficult to decipher, sometimes intentionally. In many developing countries loan concentration can be difficult to identify owing to the concealed character of family and business links between borrowers. In principle this should be an argument favouring public-sector banks (including NDBs), which should have superior ways of getting at key information compared to private banks but I am not sure that this is generally true.

4. (II, p.9) It is not just a question of the uncertainty of returns on certain projects. Private banks will often finance projects with uncertain returns provided the returns are high enough and there are good opportunities for exiting from their commitments or otherwise minimising the probability of incurring losses.

5. (III, p.22) The sources of the higher equity and long-term funding of NDBs should be specified ?.

7. (III, p.26). I presume that it is the lowest NPL ratios which are "very positive" but the drafting could be tightened.

8. (IVB) The section would benefit from more discussion of what is covered by innovation and structural transformation respectively. There is clearly overlap here but the two concepts are none the less distinct.

9. (IVB, p.33) What is “blue sky R&D” ?

10. (IVC) Under financial inclusion I think that there should be more attention to the roles of NDBs as participants in direct financing and direct provision of other financial services, on the one hand, and as supporters of smaller microfinance institutions with a closer relation to potential beneficiaries, on the other. There is of course a substantial history of roles played by microfinance institutions in advanced as well as developing economies, principally during earlier stages in their development. Moreover information as to these roles will presumably be included in the case studies.

11. (IVC, p.36) “Social capital” could be more fully defined.

12. (IVC) In some recent discussion the heading of financial inclusion has been extended to the impact of so-called “derisking” by banks in advanced economies on the withdrawal of correspondent banking relationships, which often play an important role in facilitating developing countries’ access to trade finance and thus their participation in international trade. “Derisking” is a response by such banks to the cost and complexity of Know Your Customer (KYC) and Anti-Money-Laundering (AML) regulations as well as to risks associated with armed conflicts and the incidence of economic and trade sanctions, and has a particularly negative impact on several low-income developing countries. Even when banks do not actually withdraw from correspondent-banking relationships, “derisking” often leads to large increases in fees charged for trade-financing services. It may be argued that this is not an appropriate subject for the operations of NDBs. But it is also possible to envisage a role for such banks as facilitators when “derisking” threatens correspondent banking relationships and thus trade financing.

(IVE, p.46) Some might argue that the distribution of climate finance - including that which NDBs may make available in the future - disproportionately in favour of mitigation as opposed to adaptation fails to take proper account of the likely effectiveness of action under these two headings. Even if the targets of the Paris Climate Accords are met – and this is a big “if” -, there will probably still be an increase in certain categories of natural disaster and upheaval. Moreover the incidence of such events may well be significantly greater if the Paris targets are not met. Arguably this enhances the case for concentrating greater efforts on adaptation in the utilisation of climate finance, and such efforts using NDBs and other national policy measures may prove easier than initiatives targeting mitigation for several countries.