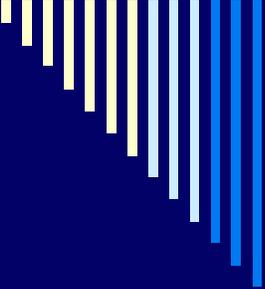


# Persistent Poverty: The Forgotten Role of Finance

Ross Levine  
Brown University

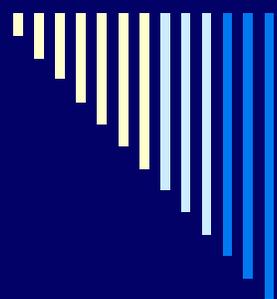
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# Introduction

- Financial development boosts growth
    - By improving capital allocation
    - In developing countries and the US states
  - But, does finance help the poor?
    - Does it primarily help the rich?
    - Does it support balanced growth?
    - Does it primarily help the poor?
-



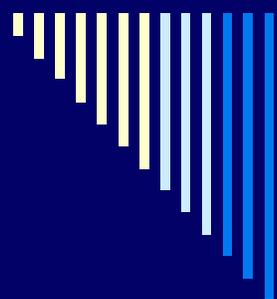
# Who cares?

## □ Human suffering of destitution:

- 50% live on less than \$2/day.
- 25% lack clean drinking water.

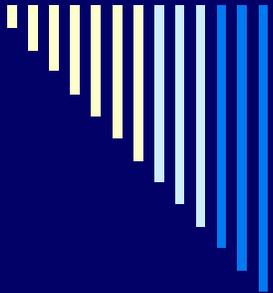
## □ Relative Income differences ...

- Poorest 20% earn less than 2% in many countries.
- USA: Inequality grew by 30% during the last 30 years.
- USA: Median wages grew 10%. Wages of top 1% grew 100%.
- May hurt social commitment to growth policies.



## Who cares?

**“My major problem with the world is a problem of scarcity in the midst of plenty ... of people starving while there are unused resources ... people having skills which are not being used.” – Milton Friedman**



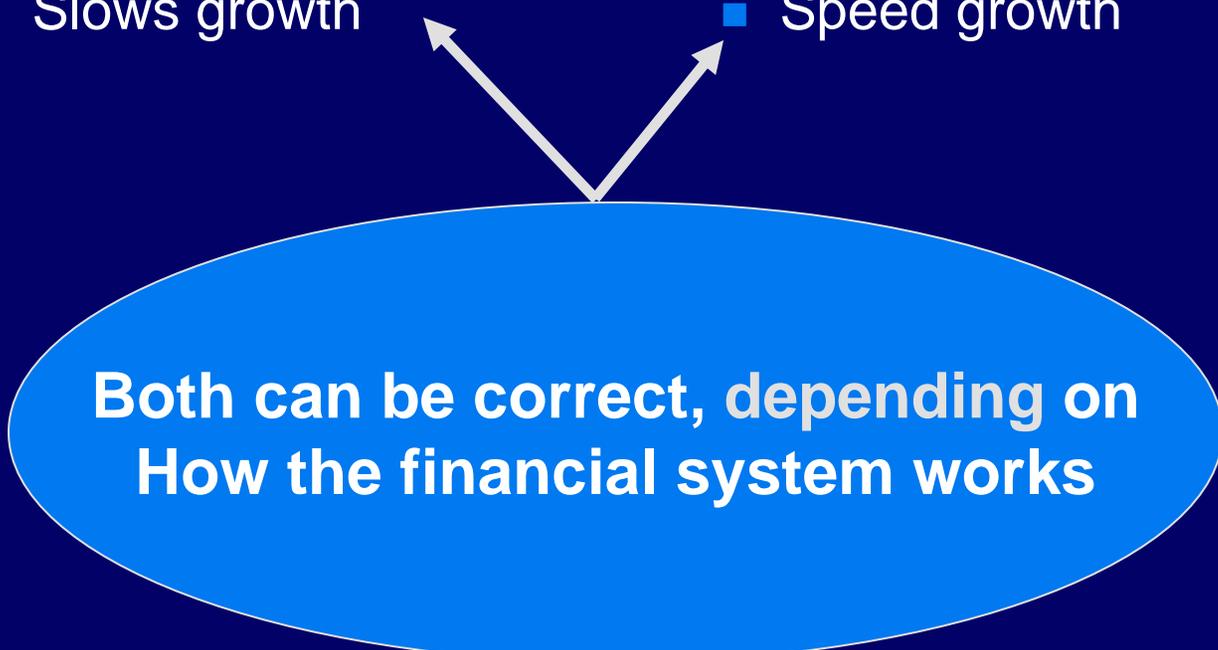
# How might finance fit?

## □ Funds connected

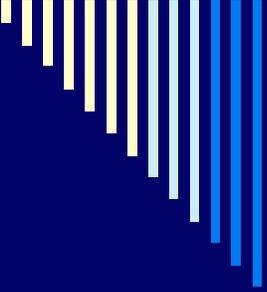
- Intensifies inequality
- Slows growth

## □ Funds best projects

- Equalize opportunity
- Speed growth



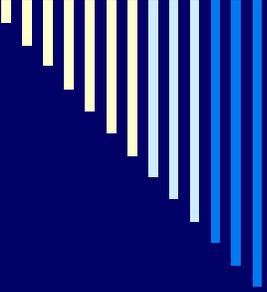
**Both can be correct, depending on  
How the financial system works**



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# How does financial policy fit?

- World Bank is de-emphasizing finance.
    - Accept: Finance → growth link
    - Question: Finance → poor link
  - What do the data say?
-



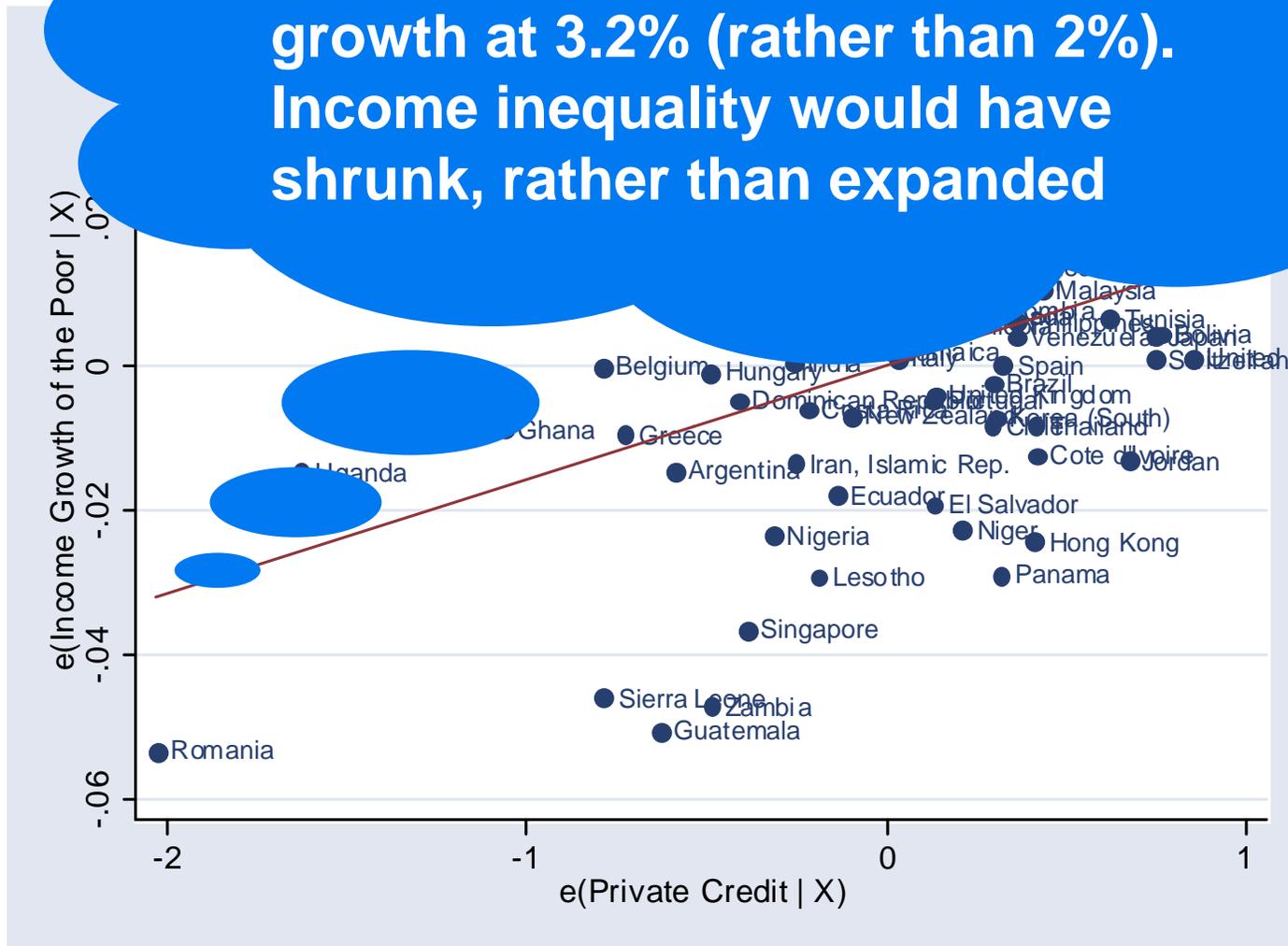
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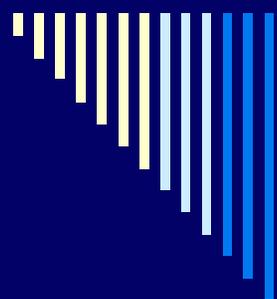
# Question #1

- Does banking development disproportionately help the poor?
    - Examine poorest 20%
    - Control for average growth
    - Control for other country traits
    - 1960-2001
-

# Banking dispre

If Brazil had Korea's banks,  
income of the poor would have  
growth at 3.2% (rather than 2%).  
Income inequality would have  
shrunk, rather than expanded

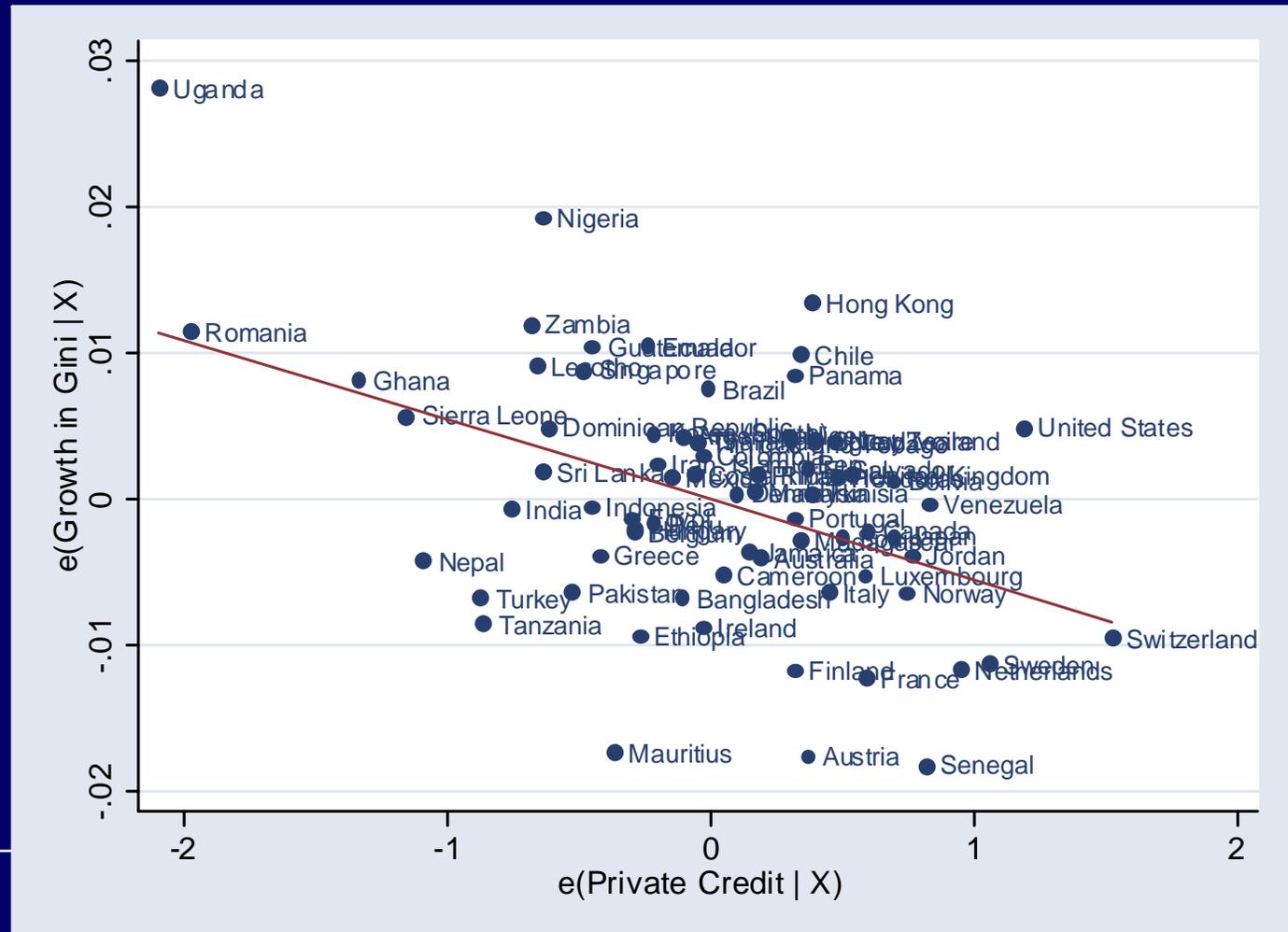


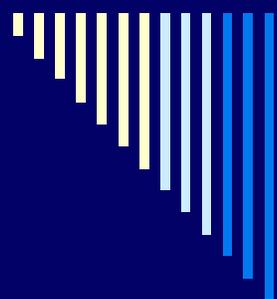


## Question #2

- Does banking development reduce income inequality?
  - Control for average growth
  - Control for other country traits
  - 1960-2001

# Banking development reduces income inequality

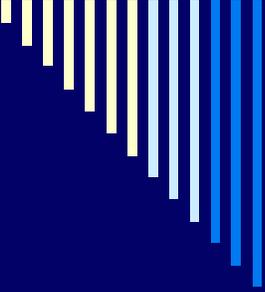




## Question #3

- Does banking development reduce destitution?
  - Control for average growth
  - Control for other country traits
  - 1980-2000

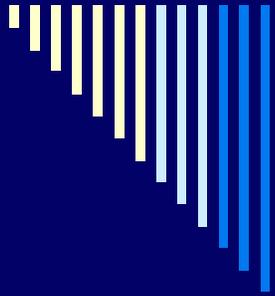




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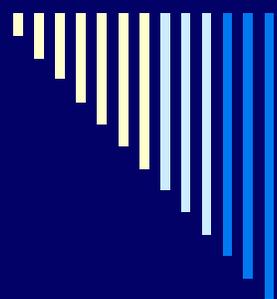
## Around the world ...

- Banking development:
    - Boosts overall growth
    - Disproportionately helps the poor
    - Asides:
      - Other policies do not have this impact
      - Government banks do not work
      - Government SME programs do not work
  
  - But, what about the USA?
-



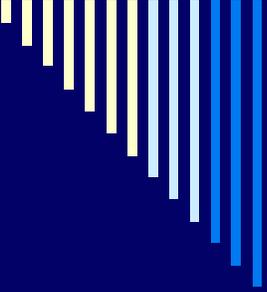
# US States

- Most US States had restrictions on intra-state bank branching for much of the 20<sup>th</sup> century.
- This reduced competition.
- Starting in the 1970s, individual states reduced these restrictions.
  - Competition increased.
  - Bank efficiency improved.
  - Growth accelerated.



# Bank Branching Deregulation

- What impact did branch deregulation have on the distribution of income?
  - Overall, income inequality rose.
  - But, did bank branching deregulation accelerate, or slow this trend?



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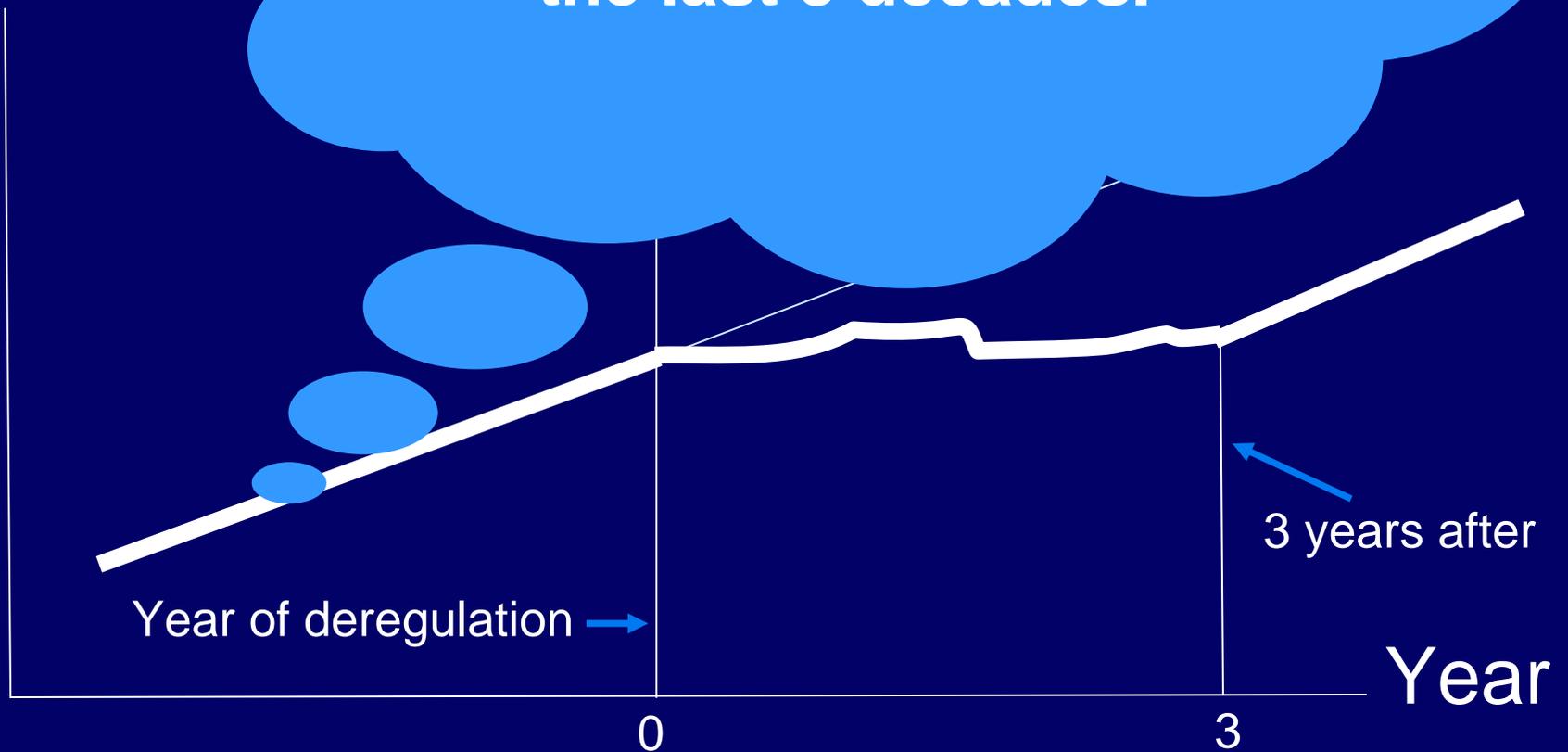
## What we did ...

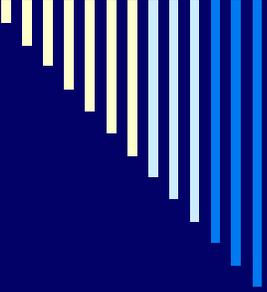
- Family income
  - Each US State: 1970 – 1994
  - Control for
    - State fixed effects
    - State welfare programs
    - State growth
    - State taxes and expenditures
    - Time trend
-

Bank Breakdown  
Pre-Post

Inequality:  
Log (Gini)

Reduces inequality by  
10% of its growth during  
the last 3 decades.





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# Conclusions

- Broad political enthusiasm for
    - Entrepreneurship
    - Equal Opportunity
  - Financial development can affect
    - Equality of opportunity
    - Poverty
  - Development policies need to catch-up to theory and evidence
-