“Emergence of Asia: Reforms, Corporate Savings and Global Imbalances”

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Main Finding

Increase in corporate savings is significantly larger for state owned enterprises (SOE) in emerging market economies:

- one point increase in financial reform index results in about 20% higher SOE net savings on average.

Estimating equation:

$$y_{icjt} = \beta \left(SOE_{icj} \, x \, Reform_{ct} \right) + \phi_{jt} + \mu_{ct} + \alpha_i + \epsilon_{icjt}$$

Country-level data on reforms (up to 2005); firm-level data on savings and SOE (during 2001-2011); 11 Asian countries (4 of which have no time-series variation in the reform indicator)

Relation to Literature

Common view is that current account imbalances are due to financial market imperfections. Focus on credit constraints that arise at the firm side:

--> growth of credit constrained (self-financing) firms creates lack of domestic investment opportunities for the financial sector

--> domestic savings are invested abroad

According to the above view, reforms that loosen credit constraints should lead to *less* savings of private firms that were credit constrained *relative* to firms that had easy access to credit (SOEs).

Implication for Aggregate Savings?

It is unclear from the paper's findings of what is the overall effect of financial sector reforms on aggregate savings.

Empirical findings show that a reform has a larger (positive) effect on savings for SOEs than for private firms. This finding would be consistent with the reform:

i. increasing savings for both SOEs and private firms, but less so for private firms
ii. increasing savings for SOEs and decreasing savings for private firms
iii. decreasing savings for both SOEs and private firms, but more so for private firms

What are Root Causes of Financial Market Imperfections?

Institutional view:

- credit market imperfections arise as a consequence of weak institutions.

Consider, for example, countries where there is a weak rule of law. In the presence of an ill functioning legal system, the likelihood of contract enforcement is very low. So the risk of loss on a loan is high in countries with a weak rule of law.

The key question is why these institutional differences exist?

Answer: powerful interest groups.

Institutional View (Continued)

If (financial) market imperfections are on outcome of powerful interest groups, then (financial sector) reform can occur without the overall degree of (financial) distortions being significantly altered; in fact, the overall degree of (financial) distortions may increase as powerful groups struggle to strengthen their grip on society.

Analogy: Acemoglu, Johnson, Robinson, and Thaicharoen (JME, 2003) "Institutional Causes, Macroeconomic Symptoms: Volatility, Crises and Growth"

So according to the above view, one specific financial market reform (removal of interest rate controls, security market liberalization) might not have a significant effect on aggregate savings.

Technical Comments

1. Timing of the Effect.
   - Estimating equation β captures impact (contemporaneous, year t) effect.
   - Are there lagged effects (i.e. it takes time for reforms to have effects on savings)
   - Are lead effects (in)significant?

2. How Much Do Financial Reforms Explain?
   - Abstract: "...increase in corporate savings...was due *in large part* to SOEs"
   - Although β is both economically and statistically significant, the overall R-squared of the regression does not appear to be strikingly large (between 0.03 to 0.1).
   - Partial R-squared on (SOE*Reform)?