Regulation of Financial Systems and Economic Growth in OECD Countries: An Empirical Analysis

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Summary

- Do industries that rely more heavily on external financing grow more rapidly when regulation encourages competition in banking and financial markets?
  - Banking Regulation - Sources:
    - WB Bank, Regulation and Supervision Database
    - Golub, 2003 for FDI restrictions
    - La Porta, et al., 2002 for government ownership of banks
  - Securities market regulations from Doing Business Database (2005)

Summary

- In panel regressions, the dependent variables represent output growth, productivity growth, entry rates

- Findings:
  - Pro-growth variables:
    - Financial development, venture capital market, developed securities market regulation
  - Con-growth variables:
    - Lack of efficiency in banking, barriers to entry in banking, government ownership
  - Stable through use of different growth measures

Suggestions/Comments

- Potential additional variables that might affect growth and entry rates:
  - Investment tax credits, subsidies to start-ups/growth firms/industries, etc.
- Authors speak of striking the right balance between sufficient legal infrastructure and freedom fostering efficiency
  - Should regulatory variables be non-linear?
- Use of knowledge and prior literature as an alternative to random weights technique
  - e.g., Luxembourg could have either the highest or the lowest barriers to banking competition

Suggestions/Comments

$$GROWTH_{c,i} = \beta_1 + \beta_2 INITSH_{c,i} + \beta_3 (REG_c * EXDEP_i) + \sum \alpha_{1,c} Dcountry_c + \sum \alpha_{2,i} Dindustry_i + \varepsilon_{c,I}$$

$$ENTRY_{c,i,t,} = \beta_1 + \beta_2 GAP_{c,t} + \beta_3 (REG_c * EXDEP_i) + \sum \alpha_{1,c} Dcountry_c + \sum \alpha_{2,i} Dindustry_i + \sum \alpha_{1t,} Dyear_t + \varepsilon_{c,i,t}$$

- Should EXDEP alone also be included?
  - Industry dummies will work only partially in observing the marginal effect of regulation for a given level of EXDEP

Suggestions/Comments

- Use of US as a measure of external dependence
  - EXDEP = (CAPEX – CF from operations)/CAPEX (follows Rajan and Zingales, 1998)
  - Is US industry X as capital-intensive/capital-dependent as Czech Republic industry X?
    - Int'l differences in product life cycle a concern (Rajan and Zingales)
  - How well does Worldscope cover CAPEX (for small firms in particular)?
  - Unlike Rajan and Zingales, large firms (>1000 employees) excluded

Suggestions/Comments

Table A.3. **Industries' dependence on external finance**

Industry	Dependence on external finance
Wood and products of wood and cork (ISIC 20)	−0.45
Fabricated metal products except machinery and equipment (ISIC 28)	−0.25
Construction (ISIC 45)	−0.19
Other non-metallic mineral products (ISIC 26)	0.00
Pulp paper, paper products, printing and publishing (ISIC 21-22)	0.09
Electricity gas and water supply (ISIC 40-41)	0.12
Manufacturing n.e.c.; recycling (ISIC 36-37)	0.17
Machinery and equipment n.e.c. (ISIC 29)	0.19
Textiles, textile products, leather and footwear (ISIC 17-19)	0.19
Other transport equipment (ISIC 35)	0.19
Motor vehicles, trailers and semi-trailers (ISIC 34)	0.20
Transport and storage (ISIC 60-63)	0.43
Basic metals (ISIC 27)	0.44
Food products, beverages and tobacco (ISIC 15-16)	0.53
Rubber and plastics products (ISCI 25)	0.56
Hotels and restaurants (ISIC 55)	0.64
Wholesale and retail trade; repairs (ISIC 50-52)	0.75
Coke refined petroleum products and nuclear fuel (ISIC 23)	0.78
Electrical and optical equipment (ISIC 30-33)	1.62
Post and telecommunications (ISIC 64)	1.67
Real estate renting and business activities including computer and R&D services (ISIC 70-74)	3.35
Chemicals and chemical products (ISCI 24)	6.20

Opposite effect of REG in interaction terms

No effect of REG in interaction terms

Why should these be treated differently?