



Saving, investment and international capital mobility in East Asia[☆]

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Abstract

This paper estimates the degree of international capital mobility in East Asia using the saving–investment correlation originated in Feldstein and Horioka [Feldstein, M., Horioka, C., 1980. Domestic saving and international capital flows. *Economic Journal* 90, 314–329]. We apply the empirical method used in Kim [Kim, S.H., 2001. The saving–investment correlation puzzle is still a puzzle. *Journal of International Money and Finance* 20, 1017–1034] to control for cyclical effects in estimating a time-series saving–investment correlation of 10 Asian countries from 1980 to 2002. Our conclusion is that the saving–investment correlation in East Asia steadily decreases over time but is still higher than that of the OECD countries over all studied periods. These results are consistent with the fact that capital mobility in East Asia is lower than that in the OECD countries. In addition, regional saving and investment data demonstrate that investment in East Asia is largely financed by regional savings.

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1. Introduction

During the 1990s, a number of East and Southeast Asian countries liberalized their financial markets to foreign capital by reducing restrictions on inward and outward capital flows. As a result, net private capital inflows to this region in the mid-1990s were conspicuous in the postwar

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period in terms of the size of the flow to emerging markets. This paper attempts to measure the degree of international capital mobility in East Asia using a saving–investment correlation (S–I correlation hereafter). Since the seminal paper by Feldstein and Horioka (1980, denoted by FH hereafter), numerous economists have attempted to quantify the degree of international capital mobility using both a cross-sectional and a time-series S–I correlation. Under perfect capital mobility, national saving and national investment should not be correlated as domestic agents search for worldwide investment and saving opportunities regardless of the nationality of capital. Therefore, a high correlation between national saving and investment would imply a low degree of capital mobility. However, since many factors other than capital mobility can simultaneously affect saving and investment, it is difficult to interpret the S–I correlation as a correct measure for the degree of capital mobility.¹

This paper adopts the empirical method in Kim (2001) to estimate the time-series S–I correlation after controlling for business cycle shocks, to provide an accurate measure of capital mobility. We remove the cyclical effects from saving and investment data by using the residuals from the regressions of saving and investment on cyclical shocks including productivity shock, fiscal shock and the terms of trade (TOT) shock. In this paper, we test whether this newly estimated S–I correlation correctly reflects the liberalization of capital markets in East Asia. In particular, we compare the S–I correlation in East Asia with that of the OECD countries to examine the differences in the degree of capital mobility.² We also investigate whether country differences such as the size of the GDP and the non-traded sector have any systematic relationship with S–I correlation. Finally, we use regional saving and investment data to investigate how much of the investment in East Asia is financed by regional savings. The data used originates from panel data of saving and investment from 10 East Asian countries between 1980 and 2002. For panel data regression, we use the GLS estimation of the SUR system to control for cross-country heteroscedasticity and cross-country correlation in the error term.

The estimation results illustrate that the cross-sectional S–I correlation steadily decreases over time (0.76 in the early 1980s to 0.53 in the late 1990s) but remains high in absolute terms. This result follows previous papers, including the original FH study. Panel data regression shows that the time-series S–I correlation in East Asia is approximately 0.88 and slightly decreases after controlling for cyclical shocks. These estimates are higher than those of OECD countries (0.70 before controlling cyclical shocks), which is consistent with the fact that capital mobility in East Asia is lower than that among the OECD countries. Country differences do not significantly impact the S–I correlation. Finally, aggregate regional data of saving and investment show that investment in East Asia is largely financed by regional savings.

The following is a layout of what follows in this paper. In Section 2, we provide an overview of prior empirical studies on the S–I correlation. Section 3 explains the empirical methodology that we adopt in this paper. Section 4 reports the main statistical properties of the saving and investment data and estimation results including cross-sectional and time-series panel regressions. Finally, Section 5 offers our conclusion.

¹ This endogeneity problem has been a main econometric concern since the original paper by Feldstein and Horioka (1980). They assumed that population structure is the main source of endogeneity problem in cross-sectional regressions, while business cycle shocks are the main source of endogeneity problem in time-series regressions.

² Estimation results for the OECD countries are taken from Kim (2001).

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