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Pursuing the Unknown

How Does Culture Shape Financial Policies? A Macro-Level Analysis Using Instrumental Variables

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What shapes countries' financial polices?

- **Left vs. right wings** (Brooks and Kurtz 2007; Quinn and Inclan, 1997).
- **Regime type** (Brune et al. 2001).
- **Diffusion** (Simmons and Elkins 2004).
- **Crises** (Rancière and Tornell 2016).
- **IMF stabilization program** (Mukherjee and Singer 2010).

Cultural Finance

Micro analysis

- Home vs. foreign bias (Karolyi 2016).
- Individuals tend to allocate a greater endowment to their cultural peers (Chuah et al. 2009).
- Individuals tend to trust foreigners with whom they share cultural characteristics (Sapienza and Zingales, 2012).
- Trust is important in stock market participation (Margalit and Shayo, 2020).

Theoretical Framework

The Micro explains the Macro

- States are not seen as actors in their own right but acting through people.
- Policymakers, that decide whether or how fast to liberalize financially, belong to the same cultural environment as other individuals in their society.
- If culture is known to shape individuals' tendency to integrate financially with foreigners, policymakers should act in the same way.

Theoretical Framework

Cultural Distance (interstate)

- Cultural distance stands for the level of cultural commonality between two countries.
- Cultural differences are measured by three factors: religion, ethnicity, and language.

Hypothesis 1:

<u>Monadic:</u> Countries closer to the US in terms of religion, ethnicity, language tend to be more open financially.

<u>Dyadic:</u> Countries with the same religion, ethnicity, and language have greater financial integration.

Theoretical Framework

Cultural Homogeneity (intrastate)

- Cultural homogeneity is the degree of uniformity of values and norms shared by a group of people.
- A country is considered culturally homogenous when most of its residents belong to the same in-group.

Hypothesis 2:

The more a country is culturally homogeneous, the lower the level of international financial liberalization.

Data & Method

- Panel data of 181 countries between 1970-2018.
- Using between and withing estimates.
- Controls - regime type, right-left wings, ERS, GDP, GDP per-capita, veto players, IMF program.

DV-Financial Liberalization

- **De-jure (KAOPEN)** – Index of four indications of financial openness (presence of multiple ER, restrictions on current and capital account transactions, and surrender of export proceeds)
- **De-facto (KOF)** - Index of five indicators (FDIs, portfolio investments, international debt, international reserves, international income payments)

IV 2SLS

- To avoid reverse causality and deal with the problem of omitted variables, IV 2SLS estimator will be used.
- For this purpose, I use genetic factors and pathogen prevalence as the instrumental variables.

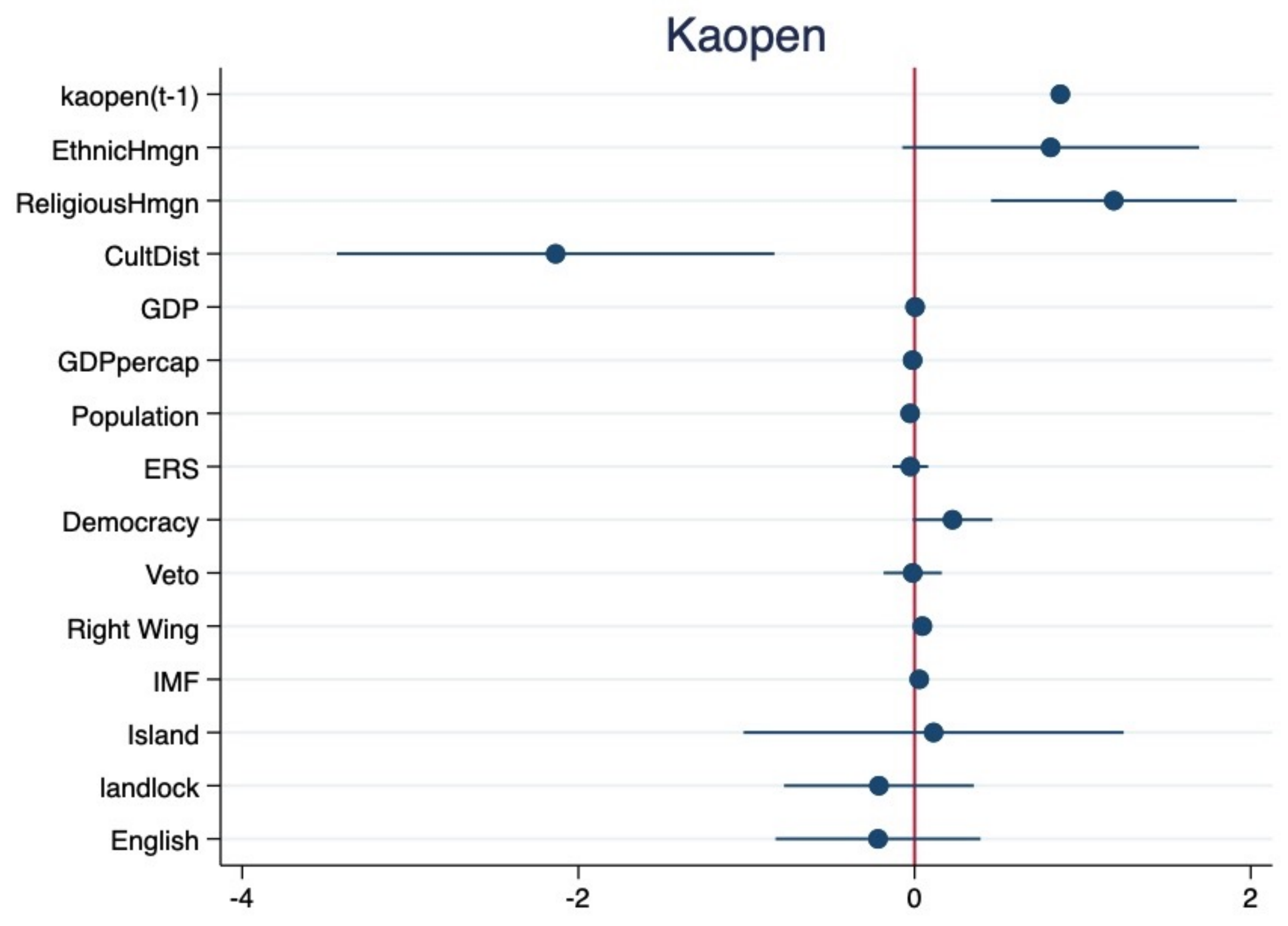
Exclusion Restriction

- Genetic factors and pathogen prevalence are "as good as random".
- Financial liberalization is unlikely to affect genetic pools for many generations nor the prevalence of pathogens.
- Linked with personality traits (e.g., happiness) but not with evolutionary fitness (e.g., physical or mental disabilities) (Inglehart et al. 2014).
- It is unlikely that depression and anxiety can directly affect financial liberalization, except through cultural distance and homogeneity.

Results

Table 1

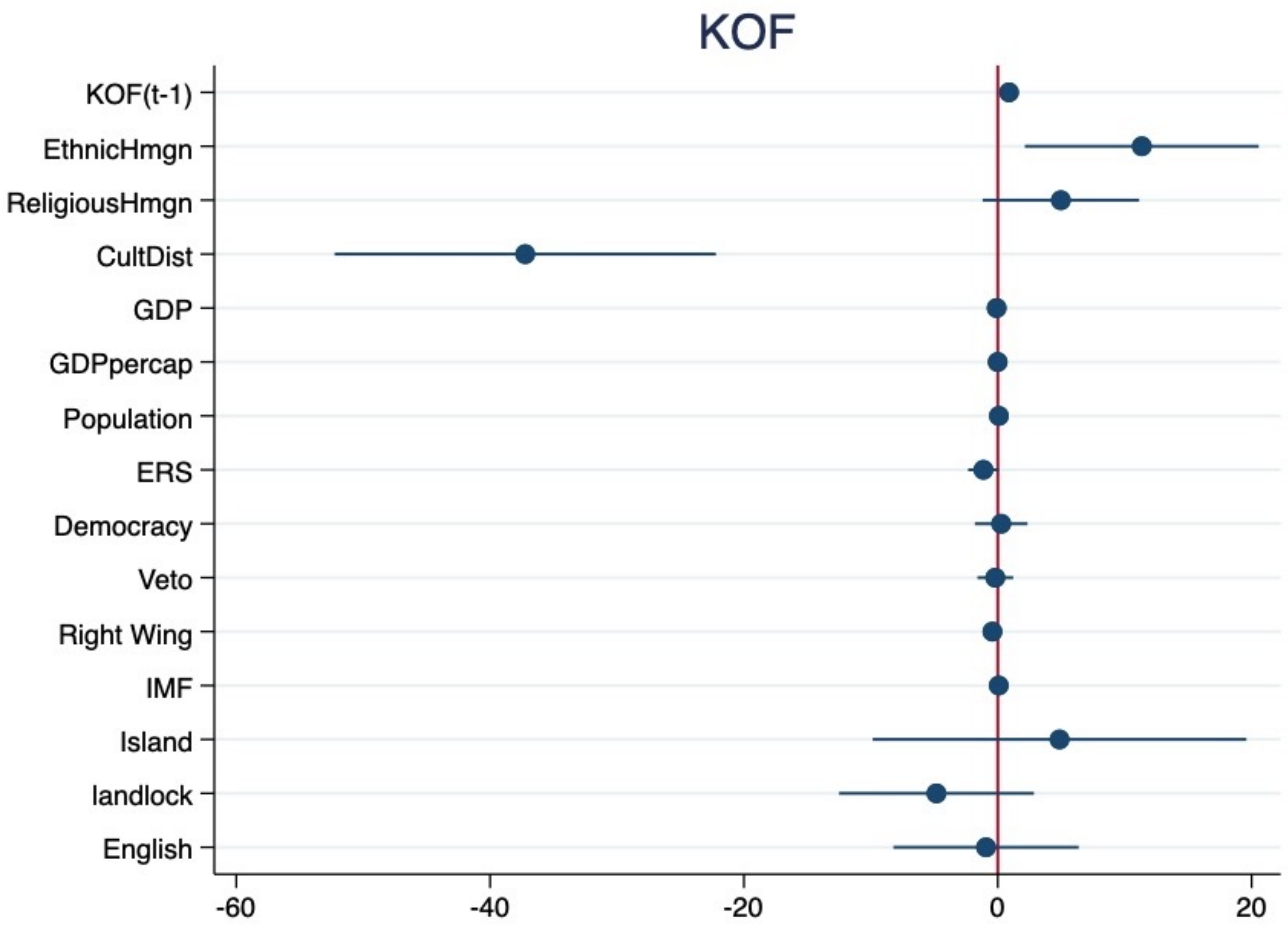
Does Culture matter?



Results

Table 2

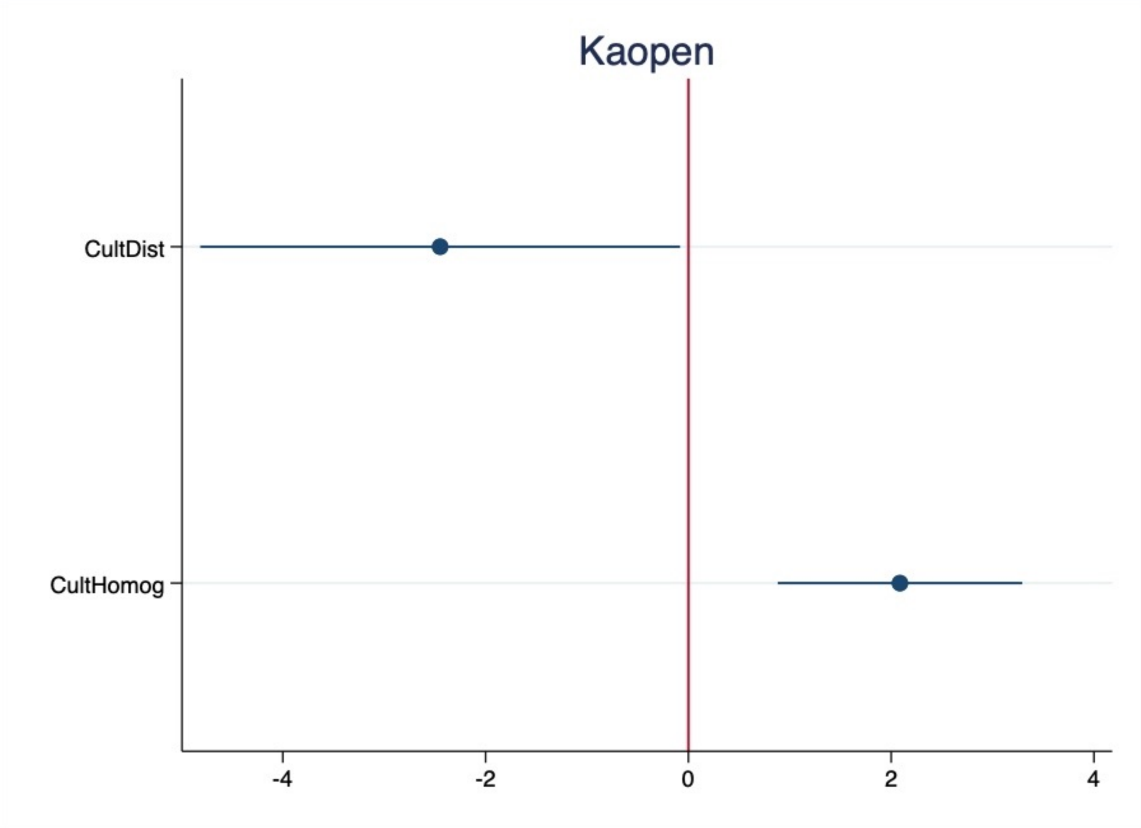
Does Culture matter?

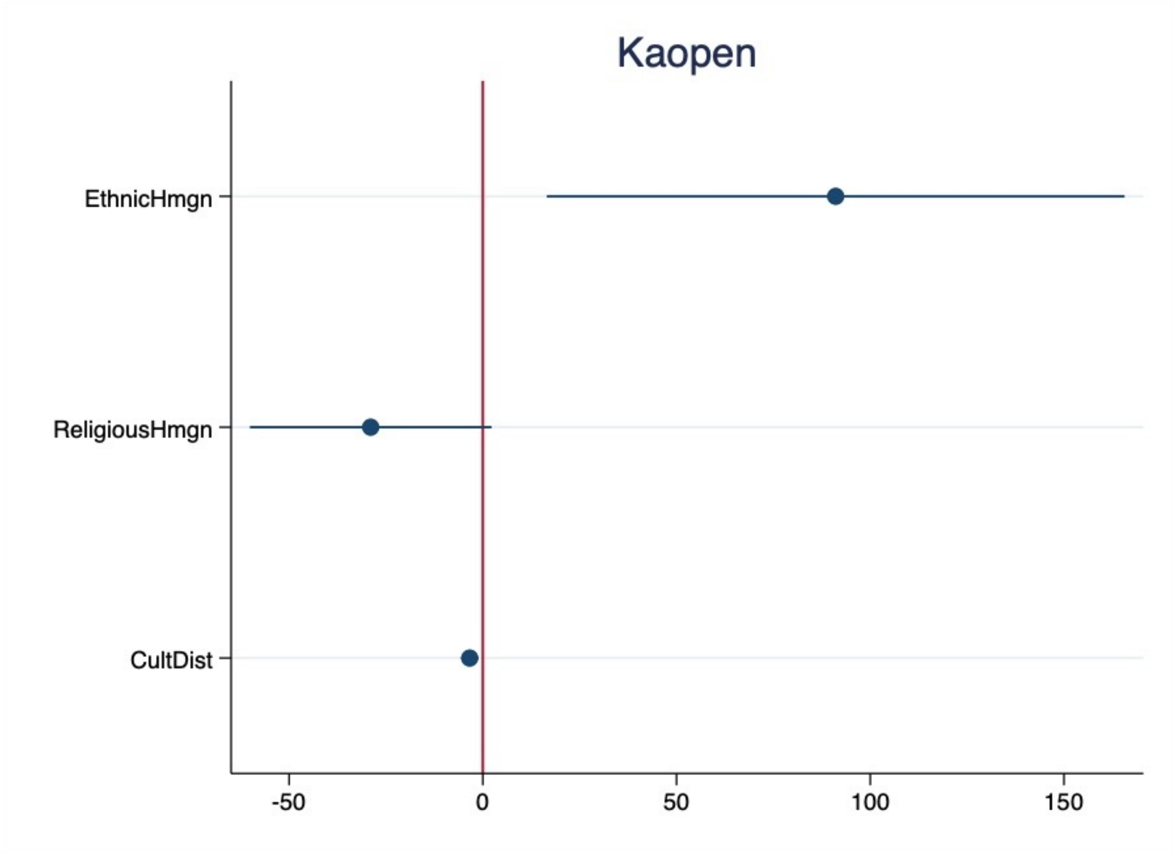


Results

Table 4 - IV 2SLS

Does Culture matter?

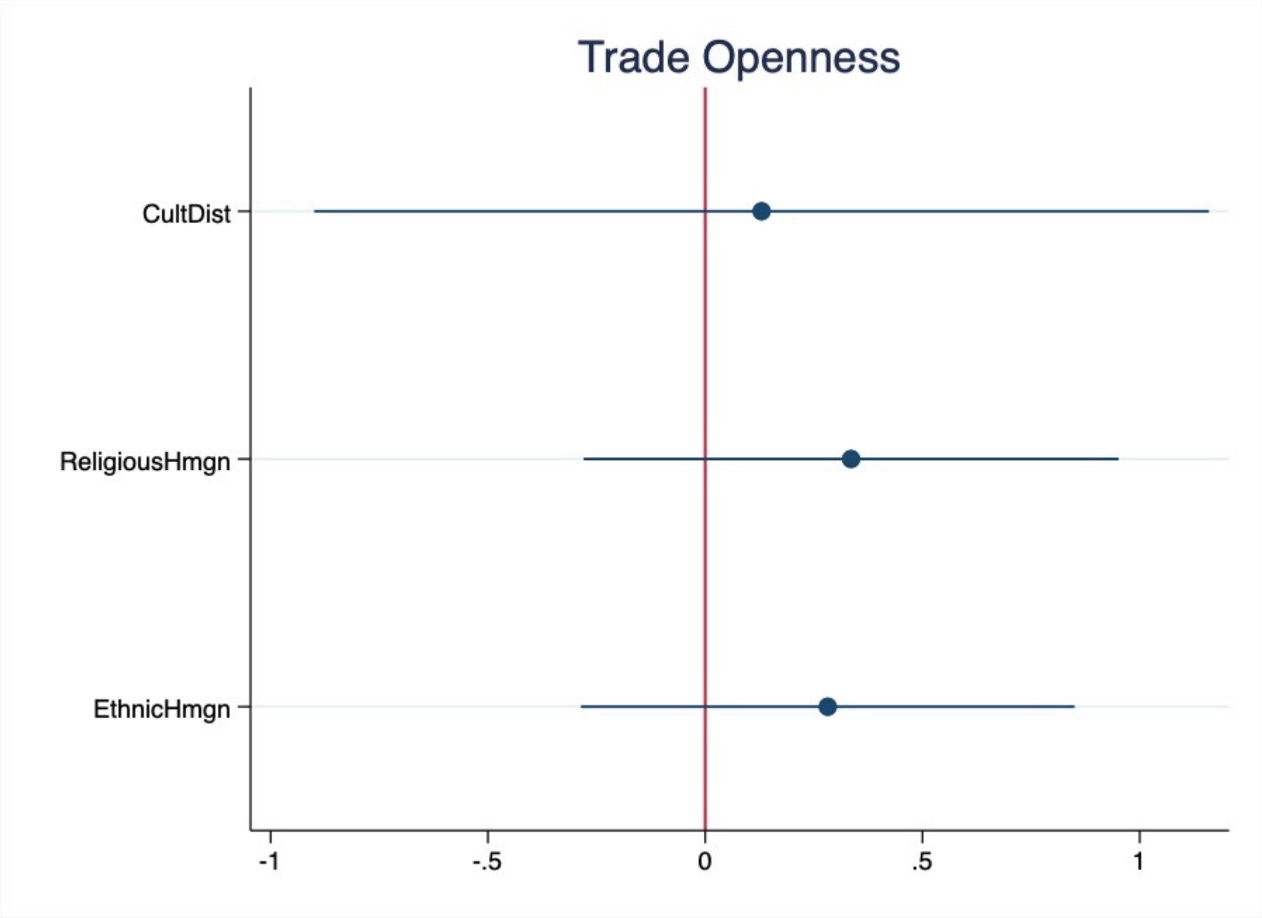


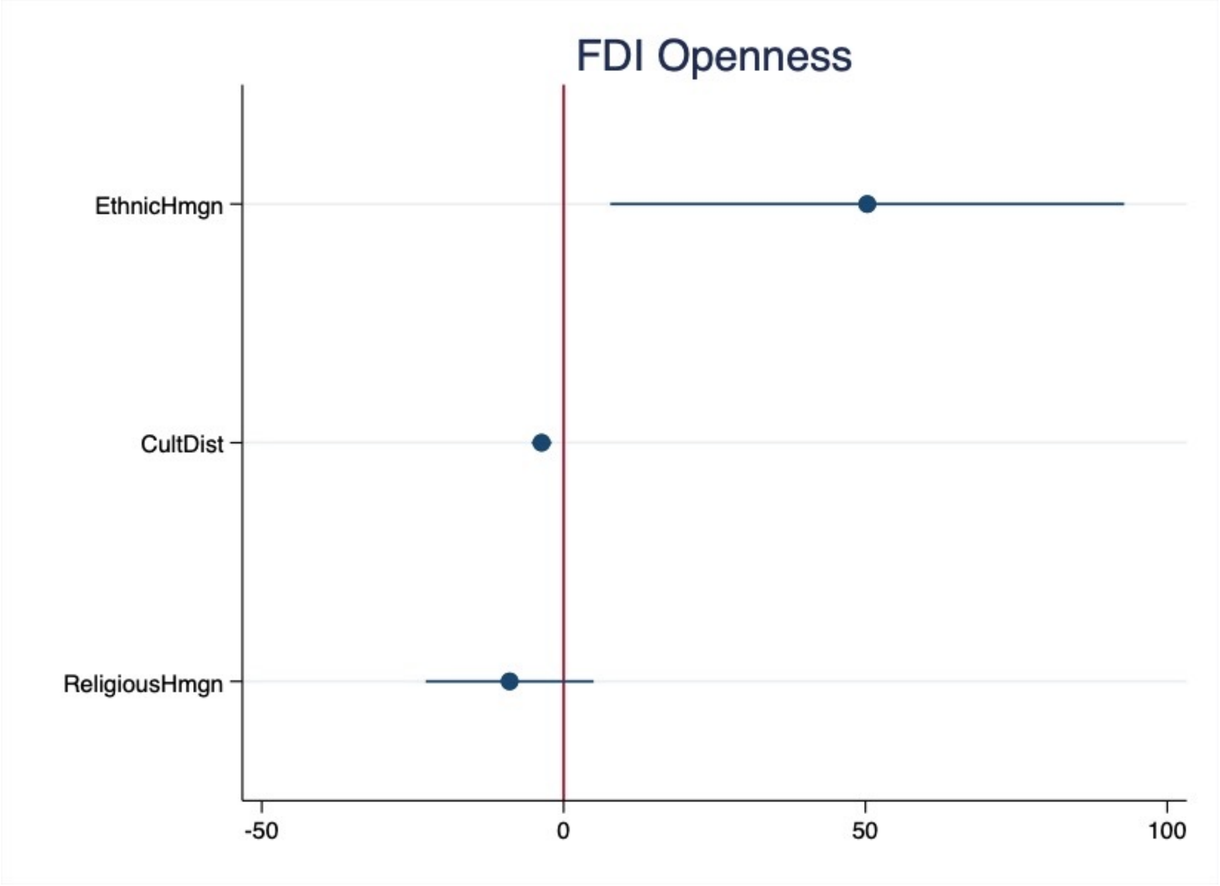


Results

Table 5

Culture, Trade Openness, and FDI Openness

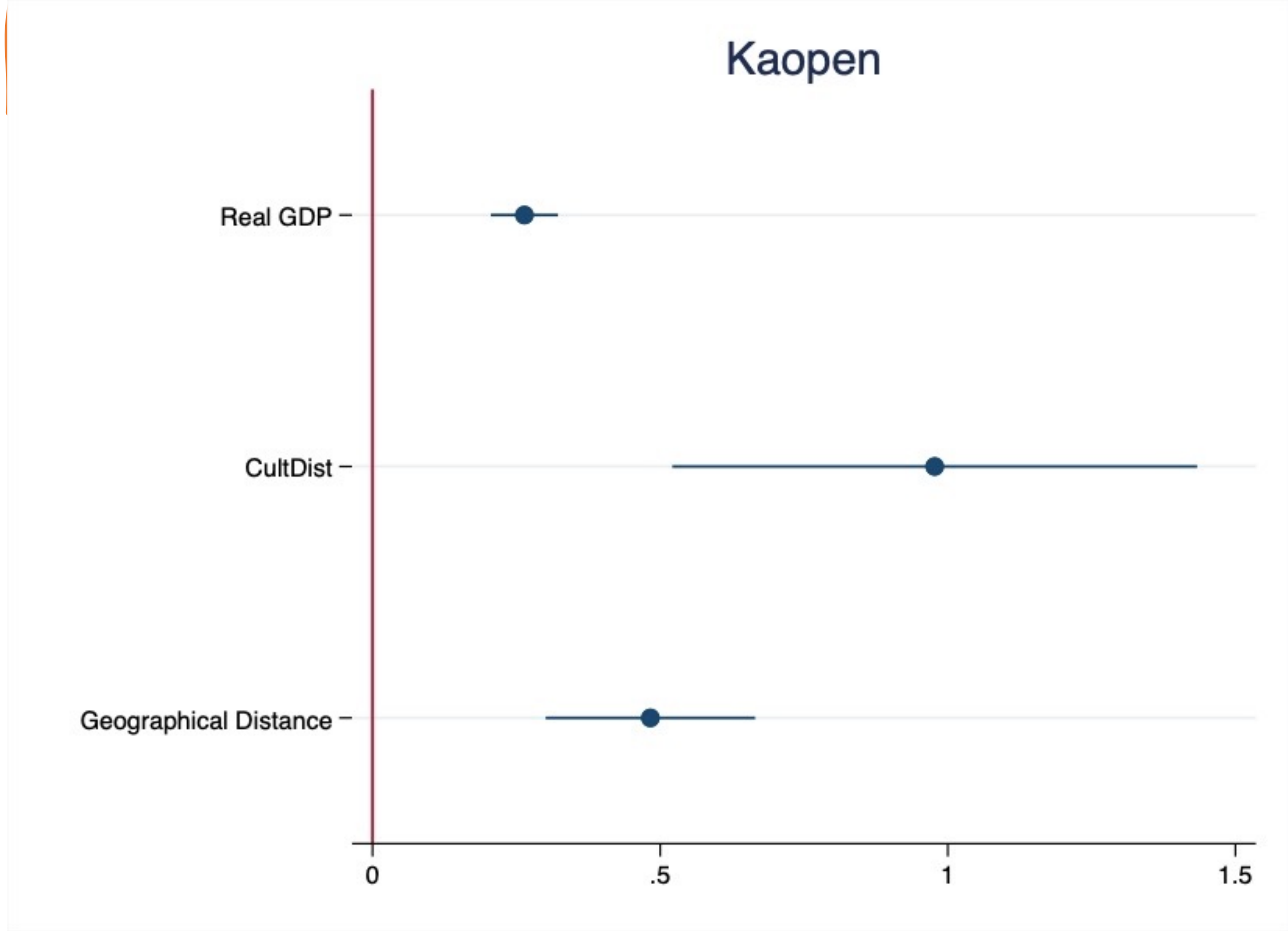




Results

Figure 8

Gravity Model



Conclusion

- Culturally homogeneous countries are less likely to liberalize financially and be open to FDIs.
- Results also show that when a country's cultural distinctiveness from the US increases, it is less likely to liberalize financially. The dyadic data support this finding.
- Results indicate that culture does not play a significant role in explaining countries' trade openness policy.

Thank you!

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Broader questions

DISCUSSANT THOUGHTS

Theoretical advances?

- What do we want to know?
- Explaining the macro-level with micro-level insights.

Methodological advances?

- Using a case study to emphasize the role of trust in different economic exchanges (finance vs. trade).
- Improving the dyadic regression analysis.

Empirical insights?

- How to reconcile results regarding control variables?
- What do we want to observe?