An Evaluation of Financial Institutions: Impact on Consumption and Investment Using Panel Data and the Theory of Risk-Bearing*

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Abstract
The theory of the optimal allocation of risk and the Townsend Thai panel data on financial transactions are used to assess the impact of the major formal and informal financial institutions of an emerging market economy. We link financial institution assessment to the actual impact on clients, rather than ratios and non-performing loans. We derive both consumption and investment equations from a common core theory with both risk and productive activities. The empirical specification follows closely from this theory and allows both OLS and IV estimation. We thus quantify the consumption and investment smoothing impact of financial institutions on households including those to be particularly helpful in smoothing consumption and investment, in no small part through credit, consistent with its own operating system, which embeds an implicit insurance operation. Commercial banks are smoothing investment, largely through formal savings accounts. Other institutions seem ineffective by these metrics.