Revisiting the Finance-Growth Nexus: Empirical Evidence from High and Middle Income Countries

Sedef Şen
Kastamonu University,Turkey
ssen@kastamonu.edu.tr

Abstract

The hypothesis that financial development promotes economic growth has significant support in the literature. However, the overwhelming studies employ a simple measure of finance such as private credit to GDP ratio or stock market capitalization. To quantify the functioning of the financial system, Čihák et al. (2013) developed several measures of four broad characteristics of financial institutions and markets: (i) financial depth (the size of the financial system), (ii) financial access (the degree to which individuals can and do financial system), (iii) financial efficiency and financial stability. This study estimates endogenous growth model with comprehensive financial development indicators in financial institutions (such as banks and insurance companies) and financial markets (including stock markets, bond markets, and derivative markets). The analysis is based on a panel data set comprised of 34 high-income and 42 middle-income countries over 1995-2017 and a generalized method of moments (GMM) approach. The results show a robust positive link between financial development and economic growth in middle-income countries but weak evidence for high-income countries.

Keywords: Economic Growth, Financial Development, Panel Econometrics

JEL Codes: E44, O42, O16