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Extended Abstract

The Role of Financial Sector on Economic Growth: Theoretical and Empirical Literature Reviews Analysis- Hamad Omar Bakar- Universiti Sultan ZainalAbidin (UniSZA), Malaysia

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Abstract

This article reviews literatures on effect of financial development on economic growth. The samples of literatures from different time frames were taken into consideration to ensure the mixture of ideas and results. The results, implications and discussion were presented at each category. It seems that, the effect of financial development on economic growth is subject to selection of time frames selected, sample of countries, list of variables and proxy. However, in most cases it seems that the impact of financial sector is more significant and positive to the developing countries compared to developed countries. Given the recently development of methodologies in terms of econometrics methods and use of proxy such as Financial index, it is important to apply in the future research. This will help to determine the effect of financial sector on economic growth in more advanced way, rather than relies on past proxy and methodologies.

Financial sector attracts deposits and provide loans from surplus to deficit side. The overall impact of financial sector in economy is to ensure sustainable growth. It helps to mobilize savings and direct funds into production sectors. As results, it facilitates efficient allocation of resources and increases overall productivity. It also facilitates delivery of products and services, management of risks, easier payments. In addition, it ensures the availability of different instruments, such as insurance packages, and information that facilitates trade activities. Financial development promotes growth via increasing capital accumulation together and improving marginal productivity consequential from it. Despite the fact that, conventional idea is financial sector promotes economic growth, but the empirical literatures have no consensus to date.

This article described the discussions from the quantity of literatures into four categories so that to capture the discussions on the different results provided from the different researches. The samples of literatures from different time frames were taken into consideration to ensure the mixture of ideas and results. The paper categories the discussions into four main sections, first and second sections described by considering the Effect of financial sector whether it is positive or negative. Third part explains the Effect of financial sector to higher income and lower income countries. The Fourth part explains the transmission channels of financial sector on economic growth. Further subsections to each part are explained within the articles.

Effect of Financial Development on Economic Growth is Positive

The Effect of financial sector has said to be positive which implies that financial sector promotes and is more significant on economic growth. These article has been categorized for the into two subsections, which conducted to the groups of countries (Panel and Cross Sectional) and Individual countries (Panel and Time Series).Generally, it is argued that most of the studies focused on cross section and panel data support the view that, finance influence growth even after take into account growth covariates, biases, omitted variables as well as unobserved country specific effect

According to the level of income

Moreover, the existing evidence also demonstrates that this relation between finance and growth varies due to the level of income in some certain countries. It is explained that, financial development is more significant and benefit in developing economy countries. However, this assumption also is debatable due to mixed result found in the literature. Despite this mixed result never the less many study exhibited that less developing countries profited more on financial development compared with developed economies.

Effect of Financial Development by Income Groups

The existing evidence also demonstrates that, the relation between finance and growth varies due to the level of income in some certain countries. It is explained that, financial development is more significant and benefited in developing economy countries. They suggested that, in developed countries overall volume of financial development is operated outside the banking sector which result slight Effect compared to middle- and low-income countries where financial system still dominated by banking sector.

The Transmission Channels of Financial Development and Economic Growth

Most of the literature in the 1980s and 1990s examined the effect of financial development either directly or indirectly ignoring the process of transmission channels. Nevertheless, recent empirical studied the financial development growth enhancing channels. For example, author classifies slow-moving institutions (culture, beliefs, and social norms) tend to

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change gradually and fast-moving institutions (political institutions) do not necessarily change often but can change quickly. The interaction between these two institutions can shed light on institutional change and hence economic growth and development.

Conclusion This article described the discussions from the quantity of literatures into four categories so that to capture the discussions on the different results provided from the different researches. The sample of studies into different time frames was taken into consideration to ensure the mixture of ideas and results. The paper categories the discussions into four main sections, first and second sections described by considering the Effect of financial sector whether it is positive or negative. Third part describes the Effect of financial sector to higher income and lower income countries. The Fourth part explains the transmission channels of financial sector on economic growth. Further subsections to each part are explained within the articles. The results, implications and discussion were presented at each category. It seems that, the Effect of financial development on economic growth is subject to selection of time frames selected, sample of countries, list of variables and proxy. However, in most cases it seems that the impact of financial sector is more significant and positive to the developing countries compared to developed countries. Given the recently development of methodologies in terms of econometrics methods and use of proxy such as Financial index, it is important to apply in the future research. This will help to determine the Effect of financial sector on economic growth in more advanced way, rather than relies on past proxy and methodologies.

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