

Financial Development and Economic Growth: Assessing the Evidence

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The Economic Journal, Volume 107, Issue 442, May 1997, Pages 783–799,
<https://doi.org/10.1111/j.1468-0297.1997.tb00043.x>

Published: 30 January 2012

Extract

In this paper we take a fresh look at the empirical evidence on the relationship between financial development and economic growth with a view to identifying outstanding issues and offering some suggestions about how these may be addressed in the future. To illustrate our suggestions we also present some new evidence utilising the proposed approaches.

We examine the empirical literature from two angles. The first is the issue of whether, how and to what extent the financial system can contribute to the process of economic growth. Questions about the association amongst financial deepening, investment, and the efficiency of capital fall in this category. The question of causality between finance and growth can also be considered from this perspective. The second angle relates to the question of whether financial liberalisation can stimulate investment and growth. Evidence on this question has been adduced from countries where financial reforms took place. There is, also, a voluminous econometric evidence purporting to address this question by examining interest rate elasticities in saving, investment and growth equations.

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