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Financial Development and Economic Growth: An Egg-and-Chicken Problem?

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Abstract

This study uses a Granger causality procedure to investigate the relationship between financial development and economic growth. The authors estimate a vector autoregression (VAR) model for nine OECD countries and China. They argue that a time-series approach is superior to a cross-sectional one and that the VAR framework avoids technical problems common in other time-series models. Evidence is presented of bidirectional causality between financial development and growth in half of the countries and reverse causality in three others. There is little support for the hypothesis that finance "leads" growth, and caution must be exercised in making general conclusions about this relationship.