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Financial development, investment, and economic growth

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Abstract

In this article, I use a multivariate vector-autoregressive (VAR) approach to examine the effects of permanent financial development on domestic investment and output in 41 countries between 1960 and 1993. The VAR approach permits the identification of the long-term cumulative effects of financial development on the domestic variables by allowing for dynamic interactions among these variables. The results reject the hypothesis that financial development simply follows economic growth and has very little effect on it. Instead, there is strong evidence that financial development is important to growth and that investment is an important channel through which financial development affects growth.

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