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Stock Market Liquidity and Economic Growth: a Critical Appraisal of the Levine/Zervos Model

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Abstract

Levine & Zervos (1998) presented cross-country econometric evidence showing that, in a sample of 47 countries, stock market liquidity contributed a significant positive influence on GDP growth between 1976–93. We show that the Levine–Zervos results are not robust to alternative specifications because of the incomplete manner in which they control for outliers in their data. We show that when one properly controls for outliers, stock market liquidity no longer exerts any statistically observable influence on GDP growth.

Keywords:

Stock market | economic growth

Notes

See also, for example, Arestis and Demetriades (1997), Arestis et al. (2001), Atje and Jovanovic (1993) and Harris (1997).

Levine (2003) surveys the full range of his research with various collaborators on the relationship between national financial structures and economic growth. This paper acknowledges some general methodological problems with the econometric techniques used in his 1998 paper with Zervos. But the overall thrust of his survey is supportive of both the techniques and the specific results of the 1998 paper. Our current paper replicates only this 1998 Levine/Zervos study. But we suspect that Levine's related work surveyed in his 2003 paper may suffer from similar problems of fragility due to inadequate controls for outliers and inattention to the unique growth experiences of the East Asian 'Tigers'.

Levine and Zervos cite Belsley et al. directly in their 1996 working paper. In their published 1998 paper, their only reference on the methodology of controlling for outliers is the textbook by Greene (1993). But the discussion by Greene is itself derived from the work presented in Belsley et al., and is clearly referred to as such.