





Reprints & Permissions





### Read this article

Figures & data

References

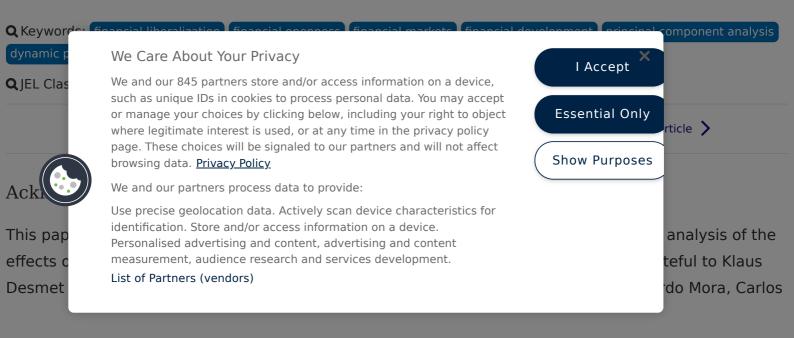
Full Article

### **Abstract**

This paper examines the link between financial openness and financial development through panel data analysis on advanced and emerging market countries. Using indices, financial openness together with institutional and educational variables explains a large part of the variation in financial development across countries and over time. Our analysis demonstrates that different indexing strategies serve to find better measures for financial openness and financial development in comparison with the individual indicators used in the literature. Our principal-component-type financial openness index conveys a positive effect on financial development independent from the lag structure or specifications used.

**66** Citations

**Metrics** 



Velasco and Ulrich Wagner for useful comments and suggestions. I would also like to thank the editor and the anonymous referee for many helpful comments.

## Disclosure statement

No potential conflict of interest was reported by the author.

# Notes

- 1. Non-debt-creating portfolio equity flows are defined as the sum of country funds, depository receipts, and direct purchases of shares by foreign investors (World Bank 2007).
- 2. The literature suggests the use of gross foreign direct investment, gross private capital flows, and some de jure type indices as measures of financial openness. Gross private capital flows are excluded from our analysis and are replaced by portfolio investment flows due to their discontinuity by the World Bank.
- 3. We only report the results for one of the most frequently used de jure type indices; the Chinn and Ito index of capital openness, for comparison reasons. We believe that these results guide in demonstrating the strength of our de facto type financial openness index in comparison with the individual de facto measures by the literature.
- 4. Chinn and Ito (2006) argue that the logarithm of GDP per capita is important in accentuating the link between financial deepening and rising income levels.
- 5. Given the close linkages between different dimensions of financial openness, excluding some variables and choosing one individual variable to portray a relationship can severely bias the coefficients of the estimated regression (Dreher 2006). The need for an overall measure of financial openness as well as financial development calls for the use of index measures.
- 6. By using an index measure for financial openness we can represent the gradual process of financial

integrati express, complex

7. For m

coefficie

using m

We Care About Your Privacy

We and our 845 partners store and/or access information on a device, such as unique IDs in cookies to process personal data. You may accept or manage your choices by clicking below, including your right to object where legitimate interest is used, or at any time in the privacy policy page. These choices will be signaled to our partners and will not affect browsing data. Privacy Policy

We and our partners process data to provide:

identification. Store and/or access information on a device. Personalised advertising and content, advertising and content measurement, audience research and services development.

List of Partners (vendors)

Use precise geolocation data. Actively scan device characteristics for

n and Ito (<u>2008</u>) **I** Accept or the **Essential Only Show Purposes** eighted and . Furthermore, milar results. ckson (1991).

9. For a Duntem

- 10. The principal component methodology of Bo and Woo (2008) is similar to that proposed by the United Nations Conference on Trade and Development (UNCTAD) for constructing the Trade and Development Index (UNCTAD 2005). Bo and Woo (2008, 2010), Nagar and Basu (2002) and Klein and Ozmucur (2002/2003) provide different approaches in constructing indices analogous to the Trade and Development Index (TDI) with minor alterations.
- 11. This method makes use of all eigenvectors and proposes to use weights depending on the eigenvectors and eigenvalues.
- 12. We restrain from using the system GMM estimator due to the weak instruments problem. The number of instruments used in the estimations is large enough to create weak results for the serial correlation tests and the Sargan test of overidentification when using the system GMM estimator. Therefore, we rely on our first difference GMM estimates.
- 13. Any influence of financial openness is now conditioned on the history controlled by the first differenced lagged dependent variable (Huang 2006). This model is a restricted version of the static fixed effects specification and it includes dynamic effects through the lagged dependent variable that is included as a right-hand-side regressor.
- 14. To test for overidentifying restrictions we perform Sargan tests. We do not include the lag of the dependent variable as an instrument. We utilize the Arellano-Bond two-step estimator to avoid any panel-specific autocorrelation and to obtain better diagnostics results.
- 15. In the benchmark dynamic GMM estimations, all variables other than the lags of the dependent variable are treated as exogenous.
- 16. The missing observations for bond market development indicators could be the reason behind the non-significant results.
- 17. Similarly, the missing observations for the bond market development index could explain the negative coefficient for the financial openness index. The variation in the banking sector can directly affect the coefficient-of-variation-type banking sector development index, which depends on standard deviations. Hence, the negative coefficient for financial openness on banking sector development could be a result of the increased volatility that primarily affects the banking sector across countries.

We Care About Your Privacy

18. We v

have po

19. The

construc

sector a

21. One

link b

We and our 845 partners store and/or access information on a device, such as unique IDs in cookies to process personal data. You may accept or manage your choices by clicking below, including your right to object where legitimate interest is used, or at any time in the privacy policy page. These choices will be signaled to our partners and will not affect browsing data. Privacy Policy

We and our partners process data to provide:

identification. Store and/or access information on a device. Personalised advertising and content, advertising and content measurement, audience research and services development.

List of Partners (vendors)

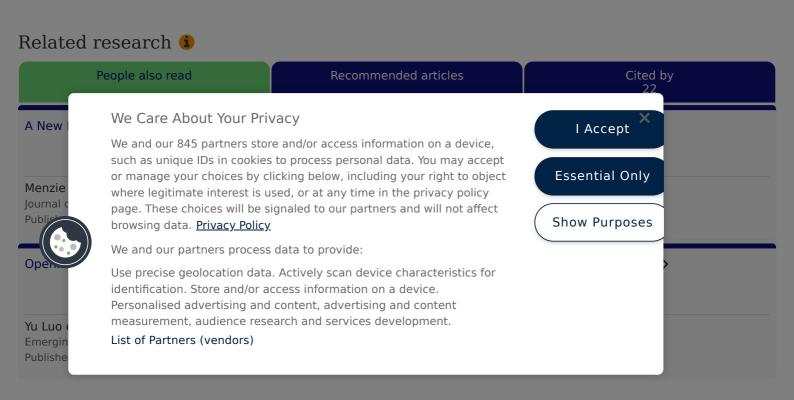
Use precise geolocation data. Actively scan device characteristics for

show that we I Accept **Essential Only** examine the lection bias. Show Purposes openness index market, banking nt disappears as

in the case with equally weighted indices.

- 22. Depending on the choice of the individual banking sector development indicators, Baltagi, Demetriades, and Law (2007) find altering coefficients for the interaction term. This agrees with our finding of a positive coefficient using comprehensive indices, which are composed of various individual measures used in the literature for financial openness and banking sector development.
- 23. The same partial derivative evaluated at the minimum level of financial openness index is 0.005, and evaluated at the maximum value is 0.006. Alternatively at the minimum level of trade openness, the partial derivative of financial development index with respect to financial openness index is 0.48 and it is 0.489 at the maximum level of trade openness.
- 24. The long-run coefficient for financial openness using the banking sector development index is 0.643. The coefficients for financial openness using the bond and stock market development indices are 0.505 and 0.107 whereas for the overall financial development index, the coefficient is 0.715.
- 25. The results are available upon request.
- 26. We rely on the World Bank's income group definition when splitting our data set into developing and advanced countries.
- 27. Comparing the results from our developing country sample with those of the advanced countries, financial openness is found to be positive and significant for most cases with the exception of the banking sector development for advanced countries.
- 28. The results are available upon request. Comparisons to the literature should be taken with caution for a variety of reasons. Both the models used in estimations, the choice of years and the countries widely differ across studies. The underlying research materials for this article can be accessed at <a href="https://docs.google.com/viewer?">https://docs.google.com/viewer?</a>

a=v&pid=sites&srcid=ZGVmYXVsdGRvbWFpbnx6ZXluZXBvemtva3xneDo2NTM2OTkwZDU3N2RkMThk>



Information for

Authors

R&D professionals

**Editors** 

Librarians

Societies

Opportunities

Reprints and e-prints

Advertising solutions

Accelerated publication

Corporate access solutions

Open access

Overview

Open journals

Open Select

**Dove Medical Press** 

F1000Research

Help and information

Help and contact

Newsroom

All journals

Books

## Keep up to date

Register to receive personalised research and resources by email











Copyright © 2024 Informa UK Limited Privacy policy Cookies Terms & conditions Accessibility



Registered in England & Wales No. 3099067 5 Howick Place | London | SW1P 1WG

### We Care About Your Privacy

We and our 845 partners store and/or access information on a device, such as unique IDs in cookies to process personal data. You may accept or manage your choices by clicking below, including your right to object where legitimate interest is used, or at any time in the privacy policy page. These choices will be signaled to our partners and will not affect browsing data. <a href="Privacy Policy">Privacy Policy</a>



We and our partners process data to provide:

Use precise geolocation data. Actively scan device characteristics for identification. Store and/or access information on a device. Personalised advertising and content, advertising and content measurement, audience research and services development.

List of Partners (vendors)



Essential Only

**Show Purposes**