The relationship between the Financial Development and the Economic Growth. The case of Gulf Countries

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Abstract

The role of the financial development in promoting economic growth has been largely studied by many authors. Theoretical and empirical papers show that financial development can boost economic growth by mobilizing saving, exerting control, allocating resources and improving innovation.

Over the last two decades, the arab countries have experienced a wave of liberalization in the financial sector (Ben Naceur et al., 2008). The financial liberalization has an objective to reduce the government intervention on the banking system, liberalize interest rate, promote market allocation of the financial resources, which enhance financial development and, in turn, promote economic growth (McKinnon, 1973; Shaw, 1973).

The aim of this paper is to empirically investigate the nature of the relationship between financial development and economic growth for the case of Gulf countries over the period 1981-2008. Indeed, empirical results show that there is no clear consensus on the direction of causality between financial development and economic growth in gulf region and it is also shown that the findings are country specific (Bolbola et al., 2005 ; Kar and Ağır, 2010). Hence, we extend the analysis to test several measures of financial development which have been proposed by the literature. However, very little is known about the nonlinearity in the association between financial development and growth in the gulf region. This paper contributes to this literature by three aspects. Firstly, analyzing the threshold effect in the impact of the financial development on growth would thus deepen our understanding of financial development process in this region. It would also help clarify financial policy to develop growth. Secondly, in contrast to previous works on the gulf region, we use longer sample period which provides the necessary time frame for a through analysis of the threshold effect. Third, we utilize recent innovations in panel literature as the dynamic behavior of dependant variables and Hensen (1999) methodology which allow us to identify endogenously the structural break.

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