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ECONOMIC GROWTH, FINANCIAL DEVELOPMENT, AND INSTITUTIONS: A REVIEW OF THE LITERATURE

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ABSTRACT

Economic growth is affected by financial development, spurring researchers to engage in studying the indicators as well as the extent of the effect of financial development. However, the effect might differ between countries because of unique institutional quality in term of corruptions level, government bureaucracy, law and order, and risk of investment. Hence, the main aim of this study is to look at the effect of financial development on economic growth and the effect of institutions in interacting with financial development. To achieve the aim, theoretical and empirical studies are reviewed focusing on the effect of institutions and financial development on economic growth. The findings revealed that in general, indicators for financial development can be associated with the banking sector, stock market or trade openness. Upon interacting with institutions, the effect becomes more significant depending on the level on the countries' institutional quality. Further studies are necessary in looking at the effect between countries and to assess the impact by contemplating the institutional quality.

Keywords: Economic growth, financial development, banking sector, institutions, institutional quality

INTRODUCTION

In gaining economic growth (EG), financial development (FD) is becoming increasingly influential. Previous works of literature such as Bagehot (1962), Demirgui-kunt and Levine (1996), Greenwood, Sanchez, and Wang (2013), Hicks (1969) Levine and Zervos (1998), and Samargandi, Fidrmuc, and Ghosh (2015) have stressed the importance of FD and the positive link between the FD and EG. The role becomes more prominent when it comes to the issue of increasing the capital as one of the major factors of productions.

With the positive effect of FD towards EG, policymakers started to focus on ways to develop it further such as through financial reforms and promotion of the financial sectors (Voghouei, Azali, & Jamali, 2011). However, the main issue here is that the results varied between countries especially for the developing countries even when the steps taken were quite similar. Many factors contributing to the outcomes have been widely discussed and results such as the financial sectors' sizes, geographical aspects, and even institutional quality have been depicted contribute to the result for the development of the FD and EG.

This paper reviews the previous work of literature in term the theoretical aspects as well as the empirical findings of three main areas, EG, FD, and institutional effectiveness. Focus is made on the determinants used and interaction of institutions on FD and EG. So, discussion on EG, FD and institutions will be discussed separately before interaction between the ares are presented.

Vol. 16. No.8 (1-16) ISSN: 1823-884x

Economic Growth

To measure the performance and economic activity, EG is normally being used as the measuring stick. It becomes one of the main elements to be considered in outlining the macroeconomic policies. Apart from that, countries that manage to attain high and stable growth will become a model for other countries in achieving the same objective.

The commonly used indicator for EG is the growth in Gross Domestic Product (GDP), which calculated by summing up final goods and services produced for a certain period of time (Dasgupta, 2009). It takes into consideration all of the personal consumption expenditure, as well as the government expenditure, net export and capital formation (Vaghefi, Siwar, & Abdul Ghani Aziz, 2015). The goal of growth is to maximize the well-being of the citizens and take care of national and individual welfare. The advantage of using GDP is the standardized procedures used in calculating the GDP will enable comparison between countries to be made (Wesselink, Bakkes, Best, Hinterberger, & Brink, 2007).

However, using GDP as an indicator for EG possess its own weaknesses as GDP is unable to measure a number of things such as the citizen's well-being, happiness and standard of living (Wesselink et al., 2007). But, despite the weaknesses in using GDP as an indicator for progress, abandoning GDP may not an option because it may cause difficulties especially in outlining a country's economic policy (Schepelmann, Goossens, & Makipaa, 2010). GDP is also an indicator that objectively indicates the country's economic condition, size, and strength (World Bank Group, 2015).

Hence, since individuals seek to maximize utility and income (Ivković, 2016), per capita GDP (PCGDP) is now commonly used as the indicator for EG. Studies by Law, Kutan and Naseem (2017), Samargandi, Fidrmuc and Ghosh (2014), Zhang, Wang, and Wang (2012) also utilized PCGDP as the indicator for economic growth and with the rising interest in FD, this area should be the next focus.

Financial Development

In discussing the factors that contribute to GDP per capita and EG, capital plays a very significant factor. Hence, macroeconomic policies are outlined towards increasing the capital, which can be done through savings and investments. So, the number of financial institutions like banks and stocks markets has increased in term of their numbers and facilities provided to meet the objective of capital increase.

Financial system itself has undergone a number of changes to cope with today's need and challenges. From a simple intermediaries that accept deposits to intermediaries that reallocate the funds, i.e. from surplus to deficit units (Gurley & Shaw, 1955) or from passive savings to active investment (Bagehot, 1962), they help to promote and pool the funds from numerous surplus units (Diamond & Dybvig, 1983) to a sizeable investment amounts (Allen & Gale, 2004) while maintaining a stable source of financing (Sibindi & Bimha, 2014). The financing facilities provided can be for a short term or long term. The increase is due to the rise of the need for financial services and financing facilities required by the consumers including individuals, private sectors and even the government. Financial institutions act as intermediaries to individuals or private sectors that require short and long term financing. Also, they help to finance a large project that requires a huge amount of financing facilities like the one made by the government to support major development projects. So, their role in assisting the development of EG becomes increasingly important (Greenwood et al., 2013) and their inability

Vol. 16. No.8 (1-16) ISSN: 1823-884x

to properly allocate the resources would lead towards disturbance in growth process (Sethi, 2018).

Hence, FD is referred to the development in the financial systems and facilities in term of the contributing factors, policies as well as institutions that make financial intermediations become more effective. Also, the development will make the services provided becomes better and more accessible (Pradhan, Arvin, Hall, & Bahmani, 2014). The development that took place will promote a higher rate of return but is not a guarantee that the savers will receive higher returns (Greenwood et al., 2013). FD is also a good indicator of EG and contributes to EG itself (Bencivenga & Smith, 1991; Levine, 1997). In defining financial intermediaries, the banking sector and stock markets are the most important variables and key factor (Greenwood & Jovanovic, 1990; Pradhan et al., 2014) due to its importance towards EG.

However, a change in government policies or government intervention in financial intermediaries may create a distortion (Allen & Gale, 2004; Bencivenga & Smith, 1991). McKinnon (1973) and Gurley and Shaw (1955) also indicated that legislation and government regulation play an important role especially towards FD across countries. So, the issue of institutional quality arises.

Institutions

The role of institutions, which defined as humanly devised constraints or rules of the game (Tun, Azman-saini, & Law, 2012), is important in ensuring a smooth flow of financial intermediaries and EG. Institutions also include the constitutional, as well as social limits, rule of law and property right, impose in ensuring equal opportunity (Acemoglu, Johnson, Robinson, & Thaicharoen, 2003) which is hindered by corruption and government bureaucracy (Karimi & Daiari, 2018). In addition, good institutions will reflect a good state of regulatory in term of the legal framework practiced and supervisory institutions (El-Wassal, 2013; Karimi & Daiari, 2018). Apart from that, the risk of investment or termed as investment profile is also important in reflecting the institutional quality. The risk includes the ability of the government to uphold the viability of a contract or expropriation, repatriation of the profit and delays of payment (Knack & Keefer, 1995).

The role of institutions contributes towards the well-being of the political structure and social interaction that would influence a country's economic structure. Institutions affect FD and growth (Voghouei et al., 2011) and also a good indicator of EG (Bockstette, Chanda, & Putterman, 2002; Vedia-Jerez & Chasco, 2016). In order for a country to expand its FD either domestically or to cross-border transactions, the role of institutions becomes increasingly important (Chinn & Ito, 2006). Apart from helping to increase the amount needed for investment; the cross-border transaction will boost productivity through the mobilization of resources and transfer of technology. In return, EG can be promoted.

However, with rising issues of corruptions, government bureaucracy, law, and order as well as issues related to the risk of an investment that affects institutions and EG, the issue needs to be revisited and studied. The issues related to institutions will cause a drop in political accountability, transaction costs, investors' security, and reduce the respect towards property right. Hence, these factors will cause the distortion in FD and EG.

Vol. 16. No.8 (1-16) ISSN: 1823-884x

THEORETICAL FRAMEWORK

Financial Development and Economic Growth

Private sectors would require funds to finance production, consumption and for capital accumulation needs. The demands would lead to the increasing need for financial intermediaries (Lohmann, 1992) and in return would create a formation of a new market (Greenwood & Smith, 1997). The market should be able to provide assistance to help finance a production need or capital accumulation. In addition, to increase corporate financing, banks and stocks markets are considered as the medium in increasing corporate financing (Demirgüç-Kunt & Maksimovic, 1996). Banks and financial or stock markets exist to meet such requirements (Allen & Gale, 2004) and its functions is to accumulate and allocate the funds, i.e. from surplus to deficit units (Bagehot, 1962; Gurley & Shaw, 1955) or to prospective firms or investors (Allen & Gale, 2004; Greenwood et al., 2013; Gurley & Shaw, 1955; Merton & Bodie, 1995). Apart from aiding the transition of funds from surplus to deficit units, financial institutions also help to assist organizations requiring aids in making the right decisions to invest or to expand the businesses. They also provide trading facilities between customers that help to ease up the trading of goods and services as well as the financial contracts. Hence, organizations and individuals within a developing economies country will experience positive consequence through the enhancement of FD (Anwar & Nguyen, 2011).

In discussing the role of financial intermediaries, previous literature embarked their journey from either finance-led or growth led. Schumpeter (1934) highlighted the importance of finance and established the idea that technological advancement and EG is caused by a well-functioning financial system. Through a well-develop and functioning system, resources can be allocated diligently from unproductive units to productive units. Therefore it promotes growth (Law & Singh, 2014; Rioja & Valev, 2004).

On the other hand, Robinson (1952) opposed the view and indicate that EG is the contributing factor towards FD as growth creates the demand. This growth-led view also indicate that through the development in the EG it will strengthen financial intermediaries (Yu & Gan, 2010).

However, generally, it is agreeable that FD is important and previous literature have depicted a positive, significant relationship between FD and EG (Choong, Yusop, Law, & Liew, 2005). As for the causality relationship between FD and EG, whether it is finance-led or growth-led, it is still controversial. As for this study, the focus will be given towards the effect of finance towards EG, or simply, finance-led growth.

In explaining the role of financial intermediaries, Levine (1997) indicate that the existence of financial intermediaries is due to market frictions caused by high costs in obtaining information and engaging in the transaction. In his research, the function of financial intermediaries is classified into a few major activities such as saving mobilizations and resource allocations. Also, financial intermediaries must properly allocate the resources and exert corporate control to secure the resources allocated while act as a medium to help facilitate risk and promote trading. In return, the intermediaries will facilitate the capital accumulation and promote technological advancement to boost EG. Pagano (1993) on the other hand ruled out that financial intermediaries can also be classified into three, i.e. to raise the amount channel from saving to investment, expand the marginal productivity of labour and alter private saving rate.

Vol. 16. No.8 (1-16) ISSN: 1823-884x

In conclusion, financial systems and financial intermediaries positively affect capital accumulation by altering the rate of savings or from their decision in allocating the resources to different corporations. The decision in allocating the resources may vary and cause by other factors in which institutional quality is considered as one of the major factors. Proper allocation and policies implemented by financial intermediaries will positively affect EG. So, the role of institutions risen as it may influence the decision by financial intermediaries.

Institutions, Financial Development, and Economic Growth

Implementing and safeguarding the role of institutions is one of the main agenda of government intervention and will promote FD and secure any financial transaction. The rules of institutions are something that needs to be enforced collectively because individually, it will be impossible to be materialized. Also, a proper commitment must be made by the government to secure the establishment of the rules or the set of rights outlined. A number of studies have discussed the relationship and the role of institutions towards economic development and performances and the results indicate a robust relationship between the two. Hence, in theory, we can say that by enhancing the role that institutions play would contribute to promoting more economic activity.

In defining institutions, North (1991) and Tun et al. (2012) stated that it is the formal and informal constraints devised on humans' interaction covering the aspect of politics, economics, and even social interaction. An informal constraint is the set of rules devised for the set of rules such as customs, tradition or even code of conduct. Whereas formal constraints would include constitutions, laws and property right. It also includes the constitutional, as well as social limits, imposes on the elites and politicians, the rule of law, property right, mediating social cleavages and equal opportunity (Acemoglu et al., 2003).

Acemoglu, Johnson and Robinson (2005) stated that institutions affecting EG can be classified into three interrelated concepts; i.e. economic institutions, political power and political institutions. However, economic institutions would include governing factors influencing the incentive structure in society as well as in the distribution of resources. The incentive structures include the decision that economic actors make in investment, accumulate factors, making the transaction, property right, and contract laws which affect economic performance.

Political power on the other hands relates to the groups with the ability to making the decision on the resource administration and policies implementation. It would reflect the economic institutions' structure and quality. In return, political institutions govern the responsibility of the institutions in allocating political power among the desired groups. They are associated with the government's characteristics and constitutional design. Also, political and institutional structure affects foreign investment (Vedia-Jerez & Chasco, 2016). Favorable political institutions, as well as institutions as a whole, are an important factor for income growth since they stimulate productivity and capital.

FD also being influenced by the legal institution and legal environment (Fergusson, 2006). To increase capital, firms or institutions would normally turn to banks or capital market, i.e. either through the increase or debt through borrowing or by issuing more stocks. In return, either the investors or the creditors would require some protection through legal means. Studies have been done in evaluating the effect of protection towards the investors such as Burkart, Gromb, Mueller and Panunzi (2014) and Leuz, Nanda and Wysocki (2003) which shows that by imposing better laws to protect the investors, it assists in reducing the cost of capital and lead to an increase in investment and growth and reduce the impact of negative shocks.

Vol. 16. No.8 (1-16) ISSN: 1823-884x

Moreover, capital increase through investment also depends on the legal environment. These two elements would contribute towards robustness of the increase in external financing which then lead to an increase in the capital market or financial sector development.

The main agenda of financial intermediaries is to reduce transaction cost as well as managing the risk. So, they should possess useful information about the markets and investment opportunity. However, institutions matter as it is the fundamental roots to the transaction costs and in managing the information and risk (Fernández & Tamayo, 2015). Also, the effect that institutions play is not only towards boosting the EG, but it is essential indicators for the investors to gain their confidence before committing in any investment, especially for the foreign direct investment. Institutions also would lead to the consolidation of financial markets (Fergusson, 2006) and the effect of institutions quality is more prevalent in the long run compare to short-run (Siddiqui & Ahmed, 2013). Low institutional quality would contribute towards negative behavior in seeking profit such as through the exploitation of natural resources, misallocation of public funds and an increase in corruption (Vedia-Jerez & Chasco, 2016). While stable institutional quality would attract more capital inflows; either through banks or stocks markets, secure a more stable EG and reduce resource misallocation. Putterman (2013) added that good institutional quality not only contributes towards the increase of productivity and EG but also the performance should be paralleled with advance social capabilities. Hence, the interaction that institutions caused should be carefully studied towards the indicators involve.

Interaction Term and Economic Growth

In a closed economy, EG will mostly concern about saving and investment. However, the study of EG is a complex study that consists that cannot be simplified using only a few indicators. Sometimes, to allow for a broader concept to conceptualize, the interdisciplinary approach needs to be taken into consideration. This would result in linking the interactions between the indicators such as EG, factors of productions, institutions, political and macroeconomic stability and even government policies (Kibritcioglu & Dibooglu, 2001).

In discussing growth also, economist indicates that the factors influencing EG may result from exogenous factors such as trade openness and foreign direct investment. In looking at the relationship between EG and FD, Rajan and Zingales (2001) have layout evidence indicating that the firms' dependency on external finance is important as it manages to boost the industrial growth faster. Financial turmoil leading to unstable financial conditions of banks or financial problem faced by foreign parent banks would cause firms and depositors to put a constraint on their credit access, which in return would also affect banks' balance sheet conditions (Popov & Udell, 2012). These basically illustrate the need to consider the interdisciplinary approach to look at EG.

EMPIRICAL FRAMEWORK

Financial Development and Economic Growth

FD plays a very important role in boosting EG. It is a good growth indicator not only for EG as a whole but also for capital accumulation, technological change (Lohmann, 1992) and industrial expansion (Merton & Bodie, 1995). Levine (1997) stated that it is crucial to look at the system as a whole, not only at money or banks but also at the financial instruments, markets as well as

Vol. 16. No.8 (1-16) ISSN: 1823-884x

at the institutions related to the structure. The study also highlights that financial system is a crucial part of EG and provide a positive result towards it (Abosedra, Shahbaz, & Sbia, 2015; Bilquess, Mukhtar, & Sohail, 2011; Greenwood et al., 2013). Therefore, to have a better understanding of EG as well as to help in outlining a better economic policy, it would require a better understanding of the structure and of the development of the financial system.

In looking at the impact of FD on EG, different countries may yield different results. In addition, previous work of literature regarded at the effect of financial intermediaries from different approaches such as by looking at it as a whole, by countries or even by state or provinces in a country. Also, in measuring the effect of FD, different determinants have been used. So, the findings showed that results may vary from one country to another as well as depending on the determinants used.

Anwar and Nguyen (2011) conducted a study focusing on 61 provinces in Vietnam over a decade, from 1997 to 2006. The study employed the endogenous growth theory and consists of 610 observations. Data were analyzed using the generalized method of moments (GMM). The finding can be classified into three. First, it recognized the contribution of FD and the credit ratio over gross provincial products towards EG. Second, the findings also stated the indirect effect of additional investment in financial market development as it substantiates the impingement of foreign direct investment towards Vietnam's EG. Then, in term of the measures used, the findings also stated that a greater link between FD and EG is revealed when alternative measures of FD are employed.

Zhang, Wang, and Wang (2012) also studied the effect of FD towards EG, and they directed their focus towards 286 Chinese cities in China over 5 year's periods starting from 2001 to 2006. Using cross-sectional regression and GMM estimators, the findings indicate that most of the determinants used for FD are positively related to EG. The indicators used are the total loans to GDP ratio, deposits to GDP ratio, the share of fixed asset investment financed by domestic loans relative to that financed by state budgetary appropriation and the corporate deposits to total deposits in the financial system ratio.

In contrast, the findings for Malaysia revealed some differences. Anwar and Sun (2011) stated that FD led to an increase in domestic capital stock but the impact on Malaysia's EG is statistically insignificant. Compared to Anwar and Nguyen (2011) the study focused on Malaysia over a period of 37 years, which is from 1970 to 2007. The study also used the endogenous growth model and data were also analyzed using the generalized method of moments (GMM).

The findings are also quite similar to Greenwood et al. (2013) and Levine (1997) which stated that FD not only helps to escalate capital accumulation and achieve EG but through the investment, technological advancement can also be achieved.

The effect of FD towards EG is also being looked from resource-dominated economies. Samargandi et al., (2014) for example, studied the effect of FD towards EG in Saudi Arabia from the year 1968 to 2010 and analyze the data using Autoregressive Distributed Lag (ARDL) approach. Their findings stated that the financial system development would be constructive towards the non-oil sector only but it is either negative or insignificant towards oil-based sectors.

In measuring the FD, Chinn, and Ito (2006) stated that financial openness and trade openness are among the important determinants to consider. Financial openness is important as it will promote equity market development. However, the development will only happen if the legal system has been strengthened and achieve a threshold level. The findings were made based on the analysis from 108 countries which include Asian. The data was from 1980 to 2000. In relation to this, Ang and McKibbin (2007) stated financial policy is one of the factors that would

Vol. 16. No.8 (1-16) ISSN: 1823-884x

determine whether a country is adopting financial openness or repression. Their study utilizes the data for Malaysia from 1960 to 2001, to look at the relationship between FD and EG, or vice versa, have indicated that financial repression is an unfavorable condition to Malaysia's FD. This is because financial repression would implicate a detrimental effect on financial system development. Their study also indicates that these would actually result from the financial policies implemented within the country.

Bilquess et al. (2011) conducted another research involving eight Developing countries namely Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan, and Turkey. The data for the analysis was taken from the year 1985 to 2008. The findings again indicate that trade openness is an important determinant for FD along with capital flow and institutions. However, the real interest rate is insignificant towards FD. In addition, Voghouei, Azali, and Jamali (2011) indicate that financial flow and trade openness should link together as the smooth financial flow will facilitate better trade.

Next, Zainudin and Nordin (2017) conducted another study in determining the determinants for the FD for Malaysia, Singapore, Thailand and Philippine. Two estimation techniques were conducted namely Pooled Ordinary Leased Square (POLS) and Seemingly Unrelated Regression (SUR) techniques. The results from the first analysis yield that trade openness and real incomes are an imperative determinant of FD for all four countries. However, the second analysis indicates that real income is only significant towards Singapore and Thailand. Trade openness, however, is important towards Malaysia and Philippine.

The discussion on the relationship between FD and EG is an on-going topic among economists for many years. However, few consensuses were achieved. The results from the discussion still vary based on a number of reasons such as comparisons between countries to countries, time, the model used or specified, and the methodology used or even based on the proxy chosen in measuring FD. Despite the argument above, Hassan, Sanchez, and Yu (2011) stated that even though a country possesses a well-functioning financial system, it may not be sufficient to achieve steady-state EG, especially for developing countries. In addition, in measuring FD, previous literature uses different indicators and constructs to measure FD. However, in general, the research can be separated into three classes. The first class would use banks and its indicators to measure FD and its effect towards EG (see (Adu, Marbuah, & Mensah, 2013; Al-Zubi, Al-Rjoub, & Abu-Mhareb, 2006; Law & Singh, 2014; Petkovski & Kjosevski, 2014)). Second class use stock markets and the related indicators (see (Aigbovo & Izekor, 2015; Bernard & Austin, 2011; Boubakari & Jin, 2010)) while the third class use both, banks and stocks market indicators to measure the effect of FD towards EG (see (Nyasha & Odhiambo, 2016; Pradhan et al., 2014)).

In addition, in order for developing countries to boost their economic development, it would require a strong legal and information system and stable macroeconomic policies that will produce positive effects (Hassan et al., 2011). However, Ayadi, Arbak, Naceur, & De Groen (2015) stated that robust legal institutions, respectable democratic governance and acceptable implementation of financial reforms must be presented collectively to ensure a substantial positive impact on FD. So, governments have to play a significant role in assisting the access to and for financial services in making sure the services are more vibrant and able to reach every households and firm, as well as sectors in the economy in promoting healthy competition between institutions.

Vol. 16. No.8 (1-16) ISSN: 1823-884x

Institutions and Economic Growth

In achieving EG, specialization, and division of labors is important and considered as a key to increasing productivity. This will have to come along with technological change, technological advancement, and proper resource allocations. Hence, comes the financial intermediaries with the objective of reducing the transaction cost, decrease information friction and help in making the proper resource allocations. So, when transaction cost comes into the equation, institutions matter and being considered as the key to economic performance (North, 1987). Also, by understanding the nature and norms of institutions, it will help us to understand more about growth-inducing activities.

In studying the effect of institutions, North (1991) stated that better economic performance must be accommodated with proper and effective enforcement of institutions, along with proper technique. Also, it depends on how well the political and economic systems in a country is being operated. For that, North has identified a number of indicators for institutions. The first indicators would be the government's ability to enforce property right, followed by the share of GNP as well as the established regulation. The indicators significantly affect the country's economic system.

To establish the importance of institutions over other aspects, Rodrik, Subramanian, and Trebbi (2004) extended the study made by Acemoglu, Johnson, and Robinson (2001) and utilized the measure of institutional quality by Kaufmann, Kraay, and Zoido-lobatón (2002). The study was conducted to look at the contributions that institutions, geographical aspect as well as trade integrations play in determining the income level. The study extended the data used by Acemoglu et al. (2001) for 79 countries to 139 countries and analyzed using OLS regression. The findings indicate that institutions matter the most and even exceed neither geographical factor nor trade.

Huang (2010) on the other hand viewed the consequence of institutions from the political point of view. The study utilizes a panel dataset from 90 develop and developing countries. The data observed was from 1960 to 1999. The criteria that these countries possess were that the countries were undergoing political reforms that lead to an improvement in institutional quality. With that, East European countries were not included. The data for institutions were taken from POLITY IV and Freedom House Country Surveys. The data was then analyzed using the OLS technique. The result indicates that positive improvement can be seen in FD as a result of institutional improvement. This result is true especially for lower-income countries in the short run. Hence, this is in line with findings by (Lohmann, 1992) who stressed the importance outcome from the legal system and political institutions. During the growth process, these factors will place FD and also economic development at critical junctures.

Siddiqui and Ahmed (2013) revisited North (1981) theoretical framework to examine at the effect of institutional indicators for 84 countries over a period of five years. There are thirty-one indicators being used and was classified into three categories; institutional and policy rents, political rents and risk-reducing technologies. Due to the large data that they used, OLS has been used as well as GMM-based estimation. The finding indicates a positive effect of institutions on EG. For the developing countries, institutional and policy rent, which access the ability of the institutions to curb rent-seeking opportunities that prevent right allocation of innovation and resources, affect more than the other two categories.

Also, Karimi and Daiari (2018) revisited the issue to look at the effect in 10 ASEAN countries. Instead of using OLS techniques, the study applied the GMM based estimation technique. The data was taken from World Development Indicators (WDI) from 1996 to 2014.

Vol. 16. No.8 (1-16) ISSN: 1823-884x

For the institutional quality, the indicators were taken from Worldwide Governance Indicators (WGI). The indicators used are voice and accountability, Political Stability and Absence of Violence/Terrorism, Government Effectiveness, Regulatory Quality, Rule of Law and Control of Corruption. The findings illustrate that institutions and EG are positively related in selected ASEAN countries. But, the study does not outline which countries possess a positive relationship.

There are a number of other research that dictates the importance of other nonfinancial factors such as institutions and its contributions to FD and EG. Most of the indicators for institutions will linger around property right (Vedia-Jerez & Chasco, 2016), political stability (El-Wassal, 2013), rule of law and even political freedom (Adu et al., 2013). The changes and improvement made in the institutional environment are being reflected in macroeconomic conditions (El-Wassal, 2013).

Interaction Term and Economic Growth

In measuring the effect of institutions, Vijayaraghavan and Ward (2011) applied four measures to evaluate institutional infrastructure in their study and as proxies for the institutional environment. The measures used were the security of property rights, governance, political freedom, and government consumption. Hoff and Stiglitz (2005) on the other hand viewed security of the property right dimension only varied in society's legal structure. They also defined the rule of law as a well-defined and enforced property right. Also, those right must be easily accessible and have predictable rules which are uniformly enforced, in case a dispute occurs.

Fernández and Tamayo (2017) revisited the connection between institutions, FD, and EG. The authors outlined four major indicators for institutions that will affect FD and consequently, towards resource accumulation and allocation, which are the proxies use for EG. The indicators are; property rights, enforcement of contracts, macro, and financial stability, and informal institutions. These indicators will affect FD through information or financial friction. These frictions will then determine the supply of external finance, incomplete risk-sharing, shortage in liquidity and misallocation of resources to indiscipline borrowers.

Knack and Keefer (1995) conducted research to analyze the influence of property rights on EG. For that purpose, data for institutional indicators were taken from private international investment risk services, namely International Country Risk Guide (ICRG) as well as Business Environment Risk Intelligence (BERI). These data is chosen as it manages to provide detailed rating even when the samples intended are large. The data from ICRG consists of *Expropriation Risk, Rule of Law, Repudiation of Contracts by Government, Repudiation, Corruption in Government* and *Quality of Bureaucracy. Expropriation Risk* and *Rule of Law* are used as proxies for the security of property and contract rights. *Expropriation Risk* is used to measure the risk of expropriation while the *Rule of Law* is used to measure whether there are establish peaceful mechanisms for adjudicating disputes. *Repudiation of Contract by Government* is an indicator used to measure the accountability of the government to honor a contract that they have with private parties. Whereas *Repudiation* indicates government credibility or reliability. The last two indicators, *Quality of Bureaucracy* and *Corruption in Government* are the indicators for the general efficiency when comes to government services and to measure the length and deterioration from the rent-seeking behavior. Their findings revealed a positive and significant relationship between the indicators used for institutions and EG.

Vol. 16. No.8 (1-16) ISSN: 1823-884x

In looking at the interaction of institutional quality towards FD and EG, Effiong (2015) conducted a study on 21 Sub-Saharan African Countries. The sample was taken from 1986 – 2010 using OLS and GMM estimators. The analysis started by analyzing the direct effect of FD towards EG before looking at the effect of institutional quality towards EG. The first findings indicate that FD does not affect economic achievement in Sub-Saharan African countries. The reason for such result is due to the problem faced in banking institutions such as excess liquidity, short term lending and holding of government securities. In addition, they also dictate that initiatives are taken by the government to install financial deepening as not successful, and hence do not contribute towards EG. However, the result of the effect of institutions yields a different result, as it provides a positive and significant effect. This is because effective institutions will help to facilitate property right protections and put a constraint on government or other groups. So, it will create a conducive environment for market interactions. As for the interaction effect of institutions and FD on EG, it depicts a positive finding but not statistically significant. This is due to the low effect of FD, dragging the interaction with institutional quality to become lower.

Chinn and Ito (2002) revisited the issue concerning the nexus between FD-growth and capital liberalization-growth. In this study, the focus was given towards the connection between capital liberalization and FD. Data from 105 countries for the period of 1970 to 1997 was utilized. FD indicators were divided into two sets, one for banks and the other for equity markets. Liquid liabilities over GDP, the ratio of private credit from deposit money banks to the private sector were used as the indicators for FD. As for the equity market, they used the total value of traded stocks ratio, stock market capitalization ratio, stocks market turnover ratio, and equity issues to GDP ratio. For the capital control, index from IMF measures of exchange restriction was utilized and modified to indicate the intensity of capital control. Based on the first analysis, the result indicates that only private credit creation as well as stock market activity, which measured by market capitalization ratio, is connected with capital control, but the strength varies according to measure used and country's development level. Next, the interaction between FDs and institutions was introduced. Using legal and institutional development as indicators, they found that the existence of these two indicators will make the nexus between financial openness and FD becomes clearer.

Chinn and Ito (2006) extended the previous study to examine whether financial openness induces FD for 108 countries using panel data from 1980 – 2000. Apart from that, they also tried to illustrate how a financial system with better legal and institutional development will attain more benefit from financial liberalization. From the study, they identified that the source for better legal and institutional development derived from shareholders protection and better accounting standard. To extend the previous study further, they also include studies on the development in banking and equity market. Since the data was extended from the previous study, so the indicators used for FD was also the same. The results showed that an increase in financial openness will enhance the development in the equity market. But only the level of legal development is at the threshold level. And, for the flow of development, they found that banking system development is a prerequisite for the development in the equity market.

Based on Chinn and Ito (2002, 2006), it is shown that institutions provide a positive interaction with FD. The level of effectiveness of the interaction between the indicators might be different between countries. Also, other than legal and property right, institutions also interact with social capabilities and it goes hand in hand (Putterman, 2013). So, further study should be made to examine the relationship further.

Vol. 16. No.8 (1-16) ISSN: 1823-884x

CONCLUSION AND RECOMMENDATIONS

Despite numerous indicators used in measuring FD, previous studies indicate a positive effect of FD on EG. However, the results vary depending on a number of reasons such as the indicators used, the focus of the study; either for the state, province or countries and even status of the countries such as developing or developed countries. The indicators used are either associated with banking sectors, stock markets or trade openness. As further studies been made, it showed that institutions become a pressing issue as countries possess the different rule of laws, legal and property right, political freedom and stability and level of corruptions. Hence, the interaction will cause for the findings to be unique between countries.

This survey reviewed some of the previous work of literature on the effect of FD on EG as well as the effect on institutions. Although most studies depict a significant effect of the indicators used for either FD, EG, and institutions, further studies are required to assess the impact thoroughly. Especially in comparing the effect between countries as each country is uniques and may reveal different results that could be used to outline a better policy in achieving better institutional quality, stable FD and higher EG.

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