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FINANCE AND ECONOMIC GROWTH: THE CASE OF GREECE 1960-2005

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Abstract

For the last twenty years the financial economics literature has been dominated by analysis of the interdependence between financial institutions and the real economy. One strand of this literature employs theoretic tools to investigate the channels through which financial institutions and markets might affect economic growth. Other papers approach the issue empirically, attempting to assess whether there exists a long run relationship between financial and macroeconomic variables.

With a few exceptions, the majority of these studies, both theoretical and empirical suggest that finance exerts a positive influence on economic growth. While important in its own right, this is a very general assessment, a benchmark we may say, that does not account for cross-country differences. Indeed, due to a combination of income and institutional differences and differences in the overall financial development, the finance - growth nexus appears to show significant variation across countries.

The recognition that the finance-growth relationship does not evolve uniformly across countries has an important research implication: questions about the exact impact of finance on an economy's growth rates or about policy priorities regarding the financial sector can only be addressed in the context of country-case studies. From this perspective, an increasing number of studies that apply time series methods for individual cases have proved important in establishing stylized facts about the role of finance in economic growth.

This book follows directly in the footsteps of this literature. Specifically, the principal purpose is to explore and document in the greatest possible detail the interactions between the financial and the real sector of the Greek economy over the period 1960-2005. Is there any long-run relationship between the financial and the real sector of the Greek economy? Does causality run from financial development to economic growth or vice versa? Is it financial intermediation or markets that play the predominant role in providing growth-enhancing financial services? To answer these questions, we employ annual observations on indicators of real economic performance and measures of banking and stock market development and we apply time-series techniques (i.e. cointegration and causality analysis). Our results

indicate that there is a long-run equilibrium relationship between finance and growth. Our findings also suggest that it is the financial sector that causes the real sector in both the short and the long run.

Although the book is dedicated to the evaluation of the Greek financial system as a growth-enhancing mechanism, the study begins with a critical survey of the related theoretical and empirical literature. The aim is to bring together in a convenient form the most influencing papers so that the reader will have easy access to a relatively integrated body of material. It is our belief that this survey will promote a wider understanding of the finance – growth nexus, and simultaneously, it will provide the foundations for some of the later material on the Greek case.