Long-Run Growth and Contribution of Financial Sector and its Policies

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Abstract

This study aims to clarify the people's mindsetswho doubt that financial sectors and their policies have zero impact on the country's economic growth with the help of evidence and regression analyses. This paper gives essential information into the purpose of the advancement of the budgetary section nearby its relationship among store and improvement.The study contains a brief discussion on financial development, its policies and growth, which is tested with 5 different methods. The effect of financial development, the financial sector and its policies on economic growth is tested in various methods. These include panel technique, GMM analysis and regression, industry-level studies. Moreover, all the regressions are then represented with the help of tables and figures.There is a consistent story produced by observational research that presumes that the course of action of cash-related system organizations has an immediate and long-time prior run impact on money-related improvement. Furthermore, it is found that budgetary instruments and markets impact the cost of trades and information in the necessary disclosures. Budgetary structure and systems may affect the saving rate, decisions on adventures, the advancement of development and monetary improvement rate as they put imprisonments on facing administrators and changes the concessions to animate increasingly conspicuous yield.

The main conclusion, which is observed after testing the relationship between growth and financial sector policies, is that these two components are directly associated with each other. Moreover, pool saving must be encouraged to minimize the transaction cost, and investors should be made comfortable by middle man and banks to give up their savings. Similarly, financial sector policies should be made in a manner that aims to benefits the country's economic conditions. Finally, it should be strictly followed and reviewed periodically, according to the country's growth condition.

Keywords : Long-Run Growth, Financial Sector, GDP Growth, Role of Government

Introduction

A conceptual mind is where financial systems are considered casinos where the rich play their bets (Arena & Kutner, 2015). Also, there is a thing in people's minds that there is an impact on the financial framework's services on long-term economic growth (Arikan& Bloom, 2019). However, most economists seem to resist this statement, whereas development economists do not even pay attention to exploring finance (Kahl et al., 2019). There are collectively many essays that talk about the development of economics, however, finance growth and another related topic of financing are still missing. Many others, including Aryeetey &Nissanke (2017), think that financial growth's contribution is way too predictable for economic growth and serious discussions should be avoided. Moreover, famous authorsAsongu& De Moor (2017), conclude their study, "By the growth of literature, the financial role in the growth of economics is "overburdened." The main aim behind this study is to resolve this debate along with helping the researchers and those under the effect of this conceptual thinking, policymakers, recognize and endorse suitable financial sector policies (Bösch et al., 2019).

This paper provides a detailed insight into the growth of the financial sector and its association between finance and growth (Bournakis et al., 2018). The paper follows a proper structure and previous literature support to justify the theories of the given topic. Also, the study is a complete analysis of the concerns that include financial development that positively impacts economic growth in the long run (Burn et al., 2017). Moreover, in the main findings, it is found that the cost of transactions and information is affected by financial instruments and markets (Chapman et al., 2017). Financial framework and systems may affect the saving rate, decisions on investments, the innovation of technology and economic growth rate as they put restrictions on facing agents and changes the concessions to stimulate greater output (Colombo &Caldeira, 2018). There is a constant narrative produce by empirical research, which concludes that the provision of financial system services has a direct and long-run impact on economic growth. There are various methods to determine the core result and production of the data sets (Cordero et al., 2019). First, external financing constraints by which firms and industrial expansions are delayed are ease down by implementing the best functioning financial system. Second, rapid growth in countries follows the development and follows the best financial systems (Correia,2019). Lastly, being bias does not support the aim of the results. It is observed that there is a way to enhance and uplift the growth, which can be obtained by easing down the financial constraints and increasing the expansion of the firms (Dogan &Turkekul, 2016). There are multiple shortcomings on the given methodologies that showcase the significance of adopting various approaches and their strengths and weaknesses to pull out the precise conclusions about the financial influence on the economic growth factor (Duarte et al., 2017). The study primary enlightens three empirical studies and these are:

- Regression analysis in pure cross-country growth
- Panel techniques which aim to explore the cross country along with other dimensions; time series.
- Micro-level studies, which include firm-level studies

All the studies mentioned above show the common result that says that financial development and economic growth stay together and are directly linked with one another (Durusu-Ciftci et al., 2017). Also, it is strongly believed that transaction cost is reduced because of financial contracts and market; therefore, to smoothen evaluation of the firm, effective financial services should be considered (Ekiaby et al., 2018). Government plays a massive role in shaping financial system operations and access is given to officials to an extent to offer financial services (Gomes et al., 2017). After the introduction and literature review, the study proceeds with methodologies that include charts and tables for better comprehension (Garthwaite et al., 2015). The next part comprises findings, and the last parts sum up the paper.Factors of financial development discussed in the literature reviewinclude; corporate governance, pool saving, risk allocation, financial sector policies. Also, the significance of the study is defined in the topic. The impact of financial development, financial sector and its policies on economic growth is tested in various methods; these include panel technique, GMM analysis and regression, industry-level studies(Gomes &Goplan, 2017). Moreover, all the regressions are then represented with the help of tables and figures.

Literature Review

Financial Development:

According to Guo et al. (2016), financial development is the process that follows with the improvement in providing information on investment possibilities, risk allocation and its management, firms performance monetizing, capital allocation, exerting corporate governance, and trading. Naturally, the financial system is able to reduce and manage the market friction by allocating the resources properly at a given time frame and space. For example, allocations of credits will be visible undoubtedly by the banks (Haliassos et al., 2017). Likewise, people are diverted to allocate their savings if they are confident by the investors to get the best return on investment. The fundamental point behind this investigation is to determine this discussion alongside helping the analysts and the individuals who are under the impact of this calculated intuition, policymakers, to perceive and underwrite reasonable money related segment arrangements. According to Heger et al. (2017),there are various modes of market frictions that directly influence the growth of the economy. This study reveals 5 broad functions of financial development. These are:

- Resource and capital allocation and providing precise information on investment possibilities.
- Investment monitoring and application of corporate governance.
- Risk optimization, and improvement in trading.
- Encourage pool savings
- Facilitate providing an exchange of goods and services.

Holland et al., (2017) describe financial development as, "the involvement of production of information on investment opportunities, implantation of CG and investment monitoring, trading and reducing chances of risk by properly managing it, encouragement of pool savings, and facilitation of exchange of goods and services."

Exerting corporate governance and monitoring firms

As per Hughes et al. (2016), corporate governance is a fulcrum for comprehending the major role of financial factors and their effects on economic growth. Basically, CG is a framework that is followed by companies that directly affects their performance, helps shareholders for capital allocation, and assists creditors and shareholders in firm performance monitoring (Kahl et al., 2019). CG also helps the firm improve its efficiency by targeting managers to uplift the firm's value. CG also influence savers to invest more and improve finance production and innovation willingly. The core responsibilitiesof CG,according to Masson et al., (2016) include:

- Business supervising
- Helping the firm in setting its strategic aims
- Helping shareholders in appointing efficient directors and auditors for their own satisfaction
- It helps the company to uplift its worth.

According to the academic literature by Lewbal (2019), it is concluded that well-governed companiesare more productiveand more successful in commercial terms. Diffuse shareholders are kept by various market friction from effectively practising CG. This permits the managers to profit themselves rather than the company at a large scale (McCahery et al., 2016).

Easing exchange

This mainly aims to focus on the money and minimizing the cost of transactions (Ziegler, 2019). Also, it promotes technological innovation as it is really helpful in lowering the cost of transactions. The widely recognized medium should be introduced for exchange as it is impossible to calculate the exact worth of the goods as the barter system is highly expensive (Zhang & Wang, 2019). Because of continuous financial innovation, a fall in the cost of transactions and managing information is expected. When the economist considers money, they do not expect to mark a one-time fall in the transaction cost. According to Zhang et al. (2019) all the factors, exchange, specialization and innovation, are directly associated with each other. More transactions are required for more production. The financial framework that cuts down the transaction cost will help to maximize specialization as transactions are already very costly. This is how productivity growth is observed in those markets that appreciate exchange (Yermack, 2017). Also, it is assumed that the development of the financial market is associated with an increase in productivity. Higher-income / capita is applied to the fixed cost, which is not burdened as per capita income of share. This is how; development of the financial market totally relies on economic development (Viale et al., 2018).

Risk Allocations:

Along with the cost of transaction and information, other factors like financial contracts and market tend to facilitate the process trading, therefore, increases the chance of risk in growth, development and resource allocation (Valickova et al., 2015). The main risk that a firm may encounter includes

- Cross-sectional risk.
- Intertemporal risk.
- Liquidity risk.

Risk can occur anywhere, be it in companies, individual projects or even countries (Neybauer& Lank, 2016). Anything which follows the financial framework and involves some sort of investment is associated with risk. Risk is diversified and increased when funds are released by banks or the security market (Nguyen et al., 2018). The risk can never vanish and therefore, effective strategies should be built and effectively implemented for its control as it directly impacts economic growth in the long run. This can be done by resource alteration and saving rates alteration (Omri et al., 2015). Savers, in general, do not like risk-taking; therefore, they usually do not tend to invest in projects that offer high returns than low return projects. This is why risk diversification is made easier by the financial market to the people who look forward to outing their investment in projects that offer high ROI (Tricker & Tricker et al., 2015).

Pool Saving

The voluntary process encourages people to deposit their savings, which is later invested in any project that gives a high return. This process helps in overcoming the cost of the transaction (Patel et al., 2019). Also, it helps reduce the informational stress directly linked with making savers agreeable to give up their control of savings. The pooling may also occur through brokers or middlemen, as many people trust them with their money. Later, they invest in multiple companies. For this reason, savers should be convinced effectively by mobilizers for the benefits they would get in return for their investments (Kahl et al., 2019). Often, brokers and middlemen care about their reputation the most as they have to live in that market. Therefore, they are able to convince the savers easily (Tchamyou&Asongu, 2017).

Role of policies

All of the historical forces remain at their place, but the fact is that the Government announced policies, and their designed infrastructure has its own value (Peres, 2016). These policies have a positive influence in shaping the financial systems. The financial contracting environment is deeply affected by the following factors.

- Political stability.
- Macroeconomics stability
- Information system operations.
- Legal operations
- Regulatory operations.

Moreover, the Government's ownership of financial institutions is deeply influenced, including all the domestic and foreign sources (Kahl et al., 2019). This process affects the functioning of the financial framework and the accessibility of the financial services given to the people.

The research aims to help and provide future benefits to all the researchers and policymakers to make effective financial policies that emphasize the growth and development of the country's economy. Also, it defines that there is a direct influence of financial development, sector and its policies with economic growth, therefore, Government should focus on industrial development, lowering down transactions cost, encourage pool saving and easing exchange and bringing foreign entries in the country to support and uplift the economic conditions. The study aims to motivate each country to work on its financial infrastructures and create and implement effective financial policies that aim to generate unlimited profit in long-run growth. Also, these policies should be periodically reviewed and strictly followed.

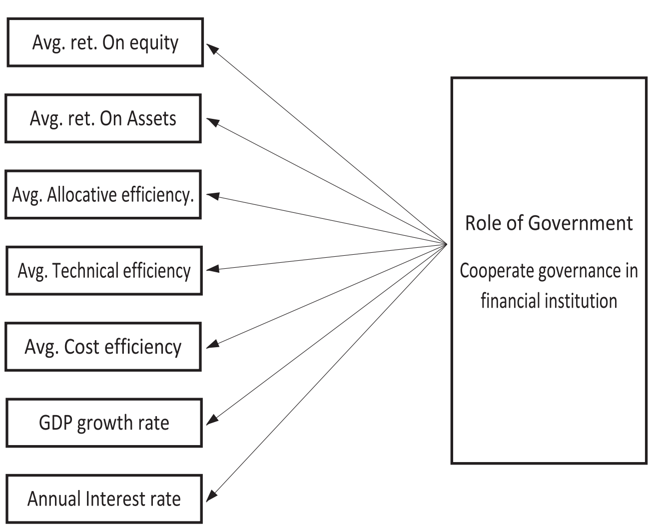
Hypothesis Development:

H1: Instruments are not correlated with the residual.

H2: Errors that occurred in the firstdifference shows no difference in second-order serial.

Structural Equation Modelling:

The technique used for statistical analysis and definesthe structural relationship between dependent and independent variables is known as the structural modelling equation(Dogan &Turkekul, 2016). From the above theories, it is observed that financial policies significantly contribute to the economy's long-run growth if few factors are considered. Also, cooperate governance in financial institutions plays the independent variable on which few of the variables are dependent(Dogan &Turkekul, 2016). These dependent variables that affect the economic condition and corporate governance in financial institutions are average return on equity, average return on assets, average allocative efficiency, average technical efficiency, average cost efficiency, Gross Domestic Product (GDP) growth rate, and annual interest rate. These variables are discussed in detail in the next chapter; research methodology. In this paper, cooperate governance in the financial institution is taken as the independent variable whereas, all the other factors apart from corporate governance are taken as dependent variables



Structural modelling equation on financial policies role and its effect on long-run growth

Research Methodology

There are 5 ways to study and determine the relationship between financial development and growth. Each method is described in detail.

1- Cross Country Studies:

Peleg Lazar &Raviv (2018) used DEPTH for determining financial development. He studied the DEPTH relationship from 1960-1989 period and three growth indicators also averaged over the 1960-1989 period, G The equation which is used in calculating the DEPTH is:

$$G(j) = a + bDEPTH + cX + u.$$

Dep. Var	DEPTH	BANK	PRIVY
Real growth of GDP per capita	2.41** {0.007}	3.22** {0.005}	3.22** {0.005}
R^2	0.5	0.5	0.52
Real growth of capital per capita	2.21** (0.006)	2.21** (0.008)	2.51** (0.007)
R^2	0.651	0.621	0.641
produc. Growth	18** (0.026)	2.60** (0.011)	2.50** (0.0061)
R^2	0.41	0.42	0.44

Dep. Var.	DEPTH (1960)
growth of GDP per capita,1960-89	2.80** (0.001)
R^2	0.610
Real per Capita Capital Grth, 1960-89	1.90** (0.001)
R^2	0.630
produc. Growth, 1960-89	2.20** (0.001)
R^2	0.580

Growth and Initial Financial Depth, 1960-89

Dependent Var. (1976 -93)	Independent var (76)		
	BC	Turnover	R^2
/ Capita GDP Growth	1.32**	2.68**	0.5
	(0.021)	(0.004)	
/ Capita Capit. Growth	1.49**	2.21**	0.53
	(0.026)	(0.025)	
Produc. Growth	1.12**	2.02**	0.41
	(0.01)	(0.029)	

Stock Mark. and Bank Dev. Predict Growth, 1976-1993

2-Using instrumental variables

This method is used to study the relationship between growth and finance (Schmitt et al., 2015). For this purpose, instrumental variables are required, which are also used in the previous method, cross country but should not correlate with growth and financial development.

Usually, GMM method, which stands for Generalized Methods of Moments, is used to determine regressions.

G(j) = a + bF(i) + cX+ u.

G(j) is real per capita GDP growth over the 1960-95 period. The legal origin indicators for the measures of financial development, F(i). X is treated as the exogenous variable

1- Dep. Var: per capita GDP growth						
					sargan test	Ser. Correl. Test^3
est. proced.	Priv. Credit	count.	observations	OIR-test^1	p-value	p-value
Iv cross country	2.1**	63	63	0.578		
est. proced.	(0.003)					
GMM panel	2.41**	77	365		0.184	0.517
	(0.001)					
2- Dep. Var: produc. Growth						
					sargan test	Ser. Correl. Test^3
est. proced.	Priv. Credit	count.	observations	OIR-test^1	p-value	p-value
Iv cross country	1.51**	63	63	2.037		
	(0.004)					
GMM panel	1.34**	77	365		0.204	0.771
	(0.001)					
3- Dep.Var: capital per capita growth						
					sargan test	Ser. Correl. Test^3
est. proced.	Priv. Credit	count.	observations	OIR-test^1	p-value	p-value
Iv cross country	2.84**	63	63	6.85		
	(0.006)					
GMM panel	3.45**	77	365		0.167	0.015
	(0.001)					

3-Panel technique

This method contains 3 advantages and 1 disadvantage compared to the cross-cultural approach(Kahl et al., 2019). To observe the same the equation which is used for regression is as follows

y(i,t) = aW1(i,t) + bW2(i,t) + C(i) + T(t) + u(i,t)

Here y is denoting growth W1 shows lagged explanatory variables W2 is contemporaneous exp. var., C representsthe count. Specific test which is unobserved, T stands for time, u is time varied, i and t is country and time period.

Dep.Var ,: Real / Capita GDP Growth						
					sargan test	Ser. Correl. Test^3
est. proced.	bank Credit	TO	count	observations	p-value	p-value
OLS cross-count	1.47**	0.79**	40			
	(0.001)	(0.025)				
GMM panel	1.77**	0.98**				
	(0.001)	(0.001)	40	146	0.489	0.611

Panel GMM and OLS, 1975-1998

4-Finance has a direct effect on growth

The following equation is used to determine the impact of financial development on growth

PROPORTION_FASTER = a + bFD(i,t) + cCV(i,t) + u(i,t)

Here, FD is used for measuring the various factors in financial development, CV is used for control variables and u is the error.

Dep. Variable: Propo. of firms that grow faster				
Mark.cap/GDP	TO	BankAsset/GDP	AD.R^2	Count.
0.1070	0.312**	0.163**	0.48	26
(0.059)	0.071	0.05		

Excess Growth of Firms and External Financing

5-Industry level studies

Svirydzenka (2016) used the following equation to determine if financially developed economies impact industries that are naturally utilizers of external finance.

Growth(i,k) = aC + bI + cShare(i,k) + d[External(k)*FD(i)] + u(i,k)

Dep. Var.	Growth of value-added of Industry k in country i, 1980-1990			
Share i,k of industry k in country i in 1980	Externalk * Total Capitalizationi	Externalk * Accounting Standardsi	R2	Obs
(0.913)	0.068		0.3	1217
(0.247)	(0.024)			
(0.644)		0.156	0.4	1067
(0.205)		0.036		

Industry Growth and Financial Development

Findings

Many methodologies were used to deeply examine the relationship and connections between finance and growth, considering all the factors, including strengths and weaknesses. It is observed in the above mention regressions that countries that develop and follow effective financial framework and structure, along with strict financial policies which have only one aim; to provide benefit and economic stability, tends to grow faster (Tappin et al., 2016). Also, it is found that economic growth has a strong and positive impact closely linked with the banking system and the stock market's liquidity. Furthermore, the result cause is not affected by simultaneity bias (Kahl et al., 2019). This paper gives a nitty-gritty knowledge into the point of the development of the budgetary segment alongside its relationship among fund and development (Bournakis et al., 2018). The paper pursues an appropriate structure and past writing backing to legitimize the hypotheses of the given theme. Additionally, the examination is a finished investigation of the worries which incorporates money related advancement positively affects monetary development over the long haul (Burn et al., 2017). In addition, in the fundamental discoveries, it is discovered that the expense of exchanges and data are influenced by budgetary instruments and markets (Chapman et al., 2017).

Budgetary structure and frameworks may affect the sparing rate, choices on ventures, the development of innovation and financial development rate as they put confinements on confronting operators and changes the concessions to invigorate more prominent yield (Colombo and Caldeira, 2018). There is a steady story produce by observational research that presumes that the arrangement of money related framework administrations has an immediate and since quite a while ago run effect on monetary development.From the above speculations, it is seen that budgetary approaches have a great deal of commitment over the long-haul development of the economy if scarcely any elements are considered. Likewise, participate administration in monetary foundation plays the autonomous variable on which not many of the factors are reliant (Dogan and Turkekul, 2016). These needy factors that impact the monetary condition alongside corporate administration in money related organizations are normal profit for value, normal profit for resources, normal allocative effectiveness, normally specialized proficiency, normal cost productivity, Gross Domestic Product (GDP) development rate, and yearly financing cost. These factors are examined in detail in the following section; inquire about the system. In this paper, participation administration in the money-related establishment is taken as the free factor while the various factors separated from corporate administration are considered a reliant factor. The financing stress that influences industrial expansion can be lowered easily by developing and following the best functioning financial framework. Therefore, the medium observed and can be easily utilized for industrial growth and expansion is financial development, as it matters in growth. The above-mentioned findings are concrete and could be easily utilized and helpful if required in the future.

The study also clarifies the misleading concept of the economists with all the clarity and observations exerts that economic growth is directly linked with the country's financial policies and its development procedures (Sun &Tchegten, 2019). The study aims to motivate each country to work on its financial infrastructure and implant the best policies, which only helps to uplift and maximize economic growth. Also, it is found that financial policies are also a great source to improve the country's economic condition. The above study examines financial development factors used to direct laws and shape financial framework along with political historians and instrumental determinants (Kahl et al., 2019). Some of the points that are observed when studying the financial policies are listed below.

- A strong information system along with the best macroeconomic policies is required for establishing the financial system. These policies should be overviewed periodically and should be improved if required (Sherwood, 2016).
- Bank regulations should be implanted with some restrictions and given more freedom. This is significant for efficiency, accessibility and depth improvisation. This requires some occasionally improvements in privatization policies and freedom in international and domestic, including foreign entry (Kahl et al., 2019). To

encounter risk which naturally occurs in formation and openings and is generally a way to higher should be synced with the refinement in financial institutions.

- Government plays a dominant role as a regulatory authority. But according to the empirical result of the regression, it is observed that the best practice for regulations is one which makes the market strong. Powerful regulators, especially government authorities, are usually subjected to corruption and tends to destroy and takeover industries on political games, which should be avoided. A strong market plays an important role in providing effective and accurate information exactly when it is required. For market participants extraordinary performance, they should be rewarded with incentive and appreciated for their efforts as they monitor market movement day and night. The research is also helpful to find the effect of implementing the financial development countries to developing countries (Schuetz et al., 2017). These regulations are considered weak and effective often. As many of the big fish who work for financial development might be involved in corrupting or forgery cases in developing countries, effective measures should be taken to make the actual financial framework strong and strictly implemented in financial institutions.
- In broad access to financial services, an impressive role is played by the Government. These facilities include industrial expansion, and expanding the viability of several financial services in firms, industries and sectors in the economy. Establishing good financial institutions and encouraging a competitive environment should be the primary emphasis of the Government (Kahl et al., 2019). Also, foreign entry in industrial development should be encouraged by the Government.

Conclusion

In the end, financial sector policies, financial development and economic growth go hands in hands, and the Government should encourage making strict policies that aim to benefits the country's economic growth. All the above notice shows the basic outcome that says that budgetary advancement and monetary development remain together and are legitimately connected. Additionally, it is emphatically accepted that exchanges cost is decreased in light of monetary agreements and the market; in this way, so as to smoothen assessment of the firm compelling budgetary administrations ought to be brought into thought. There is an enormous job thatGovernment plays in forming monetary framework activities. The deliberate procedure urges the individuals to store their sparing, which later is put resources into any task that gives exceptional yield. This procedure helps in conquering the expense of the exchange. There is always room for improvement, therefore, it cannot be said financial policies and development is not required in any established or non-established country. Alongside the expense of exchange and data, different elements like monetary agreements and market will encourage the procedure exchanging, which builds the opportunity of hazard in development, advancement, and asset designation. Financial polices need revisions and improvement periodically and each policy should be revised, keeping the country's economic growth in mind. Also, the Government should appreciate the foreign entries as it brings a high return on investment, and pool savings should also be encouraged and should be well allocated to gain maximum profit.

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