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DISENTANGLING SIZE AND EFFICIENCY EFFECTS OF FINANCE: NEW EVIDENCE FROM TRANSITION COUNTRIES

Abstract:

This paper aims to shed light on the role of financial development on the growth dynamics of transition countries. Particularly, the impacts of several financial development indicators (in terms of size and efficiency) on the income level in 25 transition economies and two subgroups with varying intensities of socio-economic development are empirically examined. The countries of interest tend to have weaker financial system in comparison with the advanced markets. Subgroups are formed for 16 Central and Eastern Europe (CEE) transition economies and 9 former Soviet Union (CIS) members in order to conduct panel data estimations with a time period of 1990 - 2012. Findings, clearly suggest that, improvements in the financial system (size measurements) are highly associated with rising income levels for all country groups. Increase in liberalization of interest rates, private credit and banking lending affect the income level in the CEE lower than in the CIS. According to results, high interest rate spreads (efficiency indicator) negatively affect economic growth and remains statistically significant even if size measurements are included in the regression for both group of countries, indicating that an unsubstantial increase in the size of financial intermediation does not affect growth unless it is also followed by banking efficiency developments and rising competition in the banking sector.

Keywords:

economic growth, transition economies, panel data, financial development

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