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The determinants of financial development in developed and emerging countries: A review of the literature

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Abstract
This paper reviews studies that investigated the determinants of financial development in different countries using panel and time-series models. The results showed that financial development is statistically influenced by many variables.

Keywords: Financial Development, Economic Growth, Panel Models, Time-Series Models

Introduction

An extensive body of literature implies a strong and positive association between financial development and economic growth in both developed and developing countries. This association has encouraged policymakers in many developing countries to proceed towards financial reforms and elevation of financial development. In fact, the well-functional financial system promoting economic growth (see for example, Schumpeter, 1912; Patrick, 1966; Mackinnon, 1973; Shaw, 1973; King & Levine, 1993; Levine, 1997; Levine & Zervos, 1998; Ragan & Zingales, 1998; Beck & Levine, 2002) [38, 35, 39, 14-16, 36, 40]. A financial system includes institutions such as insurance companies, banks, and stock exchanges. The banking system is a group of institutions that accept current and future deposits, savings deposits for individuals, businesses, and government and then re-use them for their own account in granting credit and other financial operations to non-bank economic units. However, banks operate in changeable political environments and uncertain economic conditions. Therefore, many factors might affect the performance and development of the banking system. The selected factors are gross domestic product (GDP) per capita, inflation rate (INF), international trade balance (TB). The questions that need to be answered in this research paper are: what accelerates a well-developed banking system in Jordan?, and what impedes the development of banking system in Jordan?. However, a developed banking system is strongly needed to finance and increasing economic growth in Jordan. Thus, the main objective of this paper is to determine the key variables that affect the development of banking system in Jordan.

Literature Review

It is well established from a theoretical perspective and previous studies that finance and growth are connected. A positive relationship between financial development and economic growth is documented. That is, finance advances capital allocation and increases investment returns. Botev *et al*. (2019) [8] estimated the determinants of financial development (i.e., economic growth, physical capital, human capital, population growth, trade openness, and innovation intensity). The results showed that financial development is positively affected by its determinants. Abubakar and Kassim (2018) [1] investigated the institutional and macroeconomic determinants of financial development in 50 OIC member countries for the period, 2003 - 2011. They employed the dynamic panel approach-system-GMM. The results showed that the institutional and macroeconomic determinants significantly influenced financial development. Chen *et al*. (2019) [3] examined the effect of financial development on the composition of government expenditures using a large sample of 105 countries over 1984 – 2009. The results showed that countries with higher financial development had lower productive expenditures. Eren *et al*. (2019) [11] investigated the impact of economic growth and renewable energy on financial development in India over the period, 1971 – 2015. The authors employed VECM and the results showed a long-run equilibrium relationship among variables. The causality test results suggest that renewable energy and economic growth were financial development driven in the long-run.

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