DOES THE INTERACTION FACTOR OF FINANCIAL DEVELOPMENT * FDI HAVE POSITIVE IMPACT ON THE ECONOMIC GROWTH OF ISLAMIC COUNTRIES?

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Abstract

The subject of economic growth has been one of the controversial topics among the researchers and policy makers so that most the researchers such as Shaw (1973); King and Levine (1993) believe a positive relationship between the economic growth and financial development. In other hand, some specialists like Locus and Patrick don't versify such a positive relation. This is while the grater of the researchers has not examined the relationship through the impact of interactions factors such as foreign direct investment. Hence, this paper aims to examine the main relationship by focus on interaction factor, Financial Development * FDI for the some Islamic Countries during the period 1999 - 2009 using the Dynamic Panel Data technique. The results confirm that the interaction has positive and significant on the economic growth of the Islamic countries.

Key Words: Economic Growth; Interaction Factor; Financial Development; Islamic Countries.

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Introduction

The relationship between the financial development and economic growth has been highlighted during the recent years. The relationship between the economic growth and financial development at the first time back to the study of *Schumpeter*' (1934) which he considers the services of financial intuitions as a basic framework in the path of economic development. Almost the related patterns are classified in the New *Schumpeter*'s models in which the financial institutions affect the sustainable economic growth through capital accumulation and rate of innovation. The main difference of such models with endogenous growth models is related to the position of innovation changes (Rasekhi and Ranjbar, 2009). The economists believe several economic policies affect an economic growth that development of financial sector is one of the determinants. The specialists of endogenous growth models by modeling the financial services attained a positive relationship between the financial intermediates and sustainable economic growth besides, a negative effect of government intervention and economic growth (Galli, 1999). King and Levin (1993) state that financial development firstly leads to prioritize the investment projects appropriately secondly expends the financial instruments and finally provides a possibility of receiving innovation for new approaches. Thus, the financial development helps economic growth through expanding and creating financial markets; instruments and intuitions, the financial institutions have efficient effect on investment process and economic growth through transfer of domestic and external savings towards investing firms. In other hand, there is a contrary notion about the relationship. For instance, Locus (1988) believes that the economists have overstated the relation of financial sector and economic growth. This adverse view of the relationship also has been confirmed by Patrick (1993).

This paper aims to examine the main relationship by focus on interaction factor, Financial Development * FDI during the period 1999 - 2009 using the Dynamic Panel Data technique for the some Islamic Countries including Iran; Egypt; Turkey, Bahrain, UAE, Qatar; Kuwait; Malaysia and Pakistan.

Literature Review

James (2008) in a study entitled "the Mechanism of relationship between the financial development and Economic growth in Malaysia" examined the impact of financial development on the country economic growth. He estimated sixe equations so that the findings indicated that the financial development has a positive relationship with the economic growth through raise of

saving and private investment in the country. The results also showed that the hypothesis of endougenouty of finical development and the growth was verified (cited in Kazeroni, 2003).

Salmani and Amer (2007) in their research entitled "financial development and economic growth of Egypt" investigated the relationship between the financial development and economic growth for the period 1960-2001. The results raised from the VAR approach showed a mutual relation of financial development and economic growth in the country. They also resulted that the financial development through raise of financial resources for investment and increase in the efficiency of investment has caused an economic growth in Egypt. The finally suggested that long run the economic growth increases if the financial reformers which has been begun form the 1991 be accelerated.

El Khoury & Savvides (2006) studied the effect of liberation of services trade and economic growth using the Panel Date during the period 1990-2000 for 60 countries. The chief hypothesis is that the liberation of services trade on the economic growth depends on the level of development. Their findings indicate that the relationship between the liberation of trade of communication services and economic growth for 23 countries, low income countries, is positive and significant while the relationship for two variables of economic growth and liberation of financial services is not significant. In other hand, the relationship for the 37 countries with high income was contrary so that it was not verified a significant relation for two variables of economic growth and liberation of trade of communication services.

Ben Naceur and Ghazouani (2007) according to a unbalanced panel date model and using the GMM estimators examined the relationship between the development of financial markets and economic growth for 11 countries of Meddle East and North Africa. The outputs showed that there is not a significant relationship between the development of bank sector; stock market and economic growth in the countries so as the dependency of development of bank sector and economic growth was not positive even after control of the stock market development. Lack of this relation is related to the backwardness of markets and financial systems in the region. Hence, the performance of financial systems and institutes should be improved in order to have more economic growth.

Kazeroni (2003) studied the relation between the financial development and economic growth using the Johanson Method in Iran. He employed some indices like share of foreign assets of banks out of total assets and share of services of monetary and financial institutes to the GDP as

two proxies of financial development indicator. The findings indicate that there is not a long run relationship between the financial development and economic growth statistically. The *Granger causality* test also verified a unidirectional causal relation of the indicators which runs from financial development to economic growth.

Solaimani and Amiri (2009) investigated the impact of financial development and economic growth during the period 1960-2004 in developing countries using the unbalanced panel date. The findings showed that the financial development has a positive and significant impact on the economic growth in the countries. The outputs showed that the gained results not change even by entering new variable and proxies into the main model for the countries.

Empirical Results

This study through the following endogenous growth is going to estimate the relationship between the indices. The model below comprises a dynamic variable, $Y(-1)$, which is essence of usage of GMM technique as follows:

$$y_{it} = C_0 + C_1 GHPI_{it} + C_2 Y(-1)_{it} + C_3 FDI * FD_{it} + C_4 FD_{it}$$
$$+ C_5 GINV_{it} + U_{it}$$

y_{it} is the proxy of economic growth for country i in time t. $GHPI$ is the growth of proxy of human capital stock. FD is the proxy of financial development such that this index comprises the ratio of M3 to the GDP of country i for time t. This study uses the rate of enrolment in elementary level. $FDI * FD$ is the interaction factor in which FDI denotes foreign direct investment and FD is financial development. $GINV$ is the growth of ratio of investment to the GDP of the country i for time t.

Table1: final released output of eviews software

Variable	coefficient	prob
GHPI	0.35	0.099
Y(-1)	0.714	0.001
FDI*FD	0.29	0.097
FD	0.099	0.065
GINV	0.33	0.061

Source: author's findings

According to the above outputs can be said that all indicators have positive and significant impact on the economic growth. For instance when the proxy of growth of human capital raises one percent leads to enhance the economic growth around 0.35 percent at 10 confidence level. The financial development also has a positive and significant relationship with the economic growth so as if this indicator rises one percent leads to up the economic growth almost 0.99 percent directly. The main goal of this study is to identify the relationship between the interaction factor and how much the relationship influences the economic growth. The findings indicate a positive and significant impact of the indicator $FDI * FD$ on the economic growth such that the economic growth of the Islamic countries through foreign direct investment can be strengthen so that if the value increases one percent causes to expand the growth near to 0.29 percent at 0.97 confidence level.

Conclusion

The paper attempted to examine the relationship between the economic growth and financial development by focus on the interaction factor, $FDI * FD$, for some Islamic countries for the period 1999 2009 using the GMM technique. The findings indicate that all indicators including growth of proxy of human capital stock; the proxy of financial development; indicator $FDI * FD$; Financial Development index and growth of ratio of investment to the GDP have positive and significant impact on the economic growth. Hence it is suggested that the countries focus more on the human capital since this index significance has a boundary significance. Emphasis on the financial markets; instruments and institutions through collaboration of policy markets and consecutive official should be programmed. Enhance of FDI is necessary for the growth of economic growth that can be noticed by removing the extra regulations.

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