

Essays on Financial Market Development and Economic Growth

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Dissertation submitted to the Faculty of
Virginia Polytechnic Institute and State University
in partial fulfillment of the requirements for the degree of

DOCTOR OF PHILOSOPHY
IN
ECONOMICS

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April 28, 1998

Blacksburg, Virginia

Key words: Credit Markets, Growth, Asymmetric Information, Credit Rationing,
Screening.

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(ABSTRACT)

This dissertation is a collection of essays on financial market development and economic growth. In contrast to existing literature, which considers credit for investment along, we investigate the relationship between credit market development and economic growth in the framework where both investment and consumption are financed via credit markets. The environment developed on this dissertation creates a role for each kind of credit to play. First, credit market conditions of entrepreneurs and consumers are related and depend on each other. Second, the interactions between consumers and entrepreneurs are of importance for economic growth.

The first chapter considers this issue in an endogenous growth model. By representing a decrease of the screening cost as credit market development, the mutual dependency of the equilibrium contracts to consumer and entrepreneurs and the growth rate are highlighted. We find that the relationship between credit market development and economic growth is ambiguous. In particular, in some stages of development the growth rate decreases as credit markets develop. Furthermore, in some situations development in the entrepreneur credit market is shown to have no effect on credit conditions of entrepreneurs and economic growth but influences credit conditions of consumers. The model is empirically relevant, as it can explain why the effect of credit market development on economic growth appears to differ between high-income and middle- and low-income countries.

The second chapter considers this in a neoclassical model. Our innovation is to show the mutual dependency of the equilibrium contract to consumers and entrepreneurs and the growth path, and that both credit markets and the capital stock jointly evolve over time. We

show that as capital is accumulated, credit rationing of entrepreneurs and consumers may be reduced as more financial intermediaries choose to acquire information about borrowers' types. The decrease of credit rationing of entrepreneurs is shown to favor capital accumulation but the decrease of credit rationing of consumers has an adverse effect, so that the relationship between credit market development and the growth path is ambiguous. Moreover, some interactions between consumers and entrepreneurs are examined. Specifically, the decrease of credit rationing of consumers could benefit entrepreneurial credit, and this interaction is shown to hurt capital accumulation, even though credit conditions of entrepreneurs are improved.

The last chapter is an empirical study. We study the empirical relationship between economic growth and levels of credit market development, as proxied by a global measure of credit market development: total domestic credit to the private sector divided by GDP. We find that, by distinguishing the high-credit countries from low-credit countries, there exists a structural change in the relationship between credit market development and economic growth. Specifically, the effect of credit market development on economic growth is positive in the countries with relatively less-developed credit markets and negative in the countries with relatively developed credit markets. This conclusion is robust to changing the criteria for distinguishing the high-credit and low-credit countries. The findings support our theoretical implications provided in two previous chapters.

Acknowledgments

I want to express my most sincere gratitude to Prof. Cothren, my co-advisor, for his excellent guidance, patience, and encouragement. The completion of this study would not have been possible without his constant and hearty attention. I am also grateful to another co-advisor, Prof. Verbrugge, for his excellent guidance and inspiration on my last chapter.

I would like to thank Prof. Ashley, Prof. Feltenstein, and Prof. Salehi-Isfahani for their support as members of my committee. Moreover, my research is benefited from the discussions with other graduate students in the department, especially Robert Bowles and Patrick Ho.

I own everything to my parents, my brother, and other family members for their endless love and support. Without them, I will never be able to study aboard and finish my degree.

Finally, I want to dedicate this dissertation to my wife, Susan Liao. Every time when I felt frustrated she was always there to cheer me up.

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