

BOOK REVIEW

Financial Structure and Economic Growth: A Cross-Country Comparison of Banks, Markets, and Development, edited by A. Demirgüç-Kunt and R. Levine
The MIT Press, Cambridge, MA, 2001, 436 pp. and a CD containing the Financial Development and Structure Database, ISBN 0-262-04198-7

This book provides a comprehensive collection of recent empirical research on the links between financial development, financial structure and economic growth. Part 1 sets a very clear guiding framework to motivate the book in terms of the questions originally raised in the classic *Financial Structure and Development* by Raymond W. Goldsmith (1969). These key questions centre on how financial systems change as economies grow and on whether financial development and financial structure influence economic growth.

By proposing new perspectives on these complex issues, the editors—who are also authors of some of the contributions and who have written extensively on these topics—summarize the main conclusions in Part 1. The new research, reinforcing Goldsmith's study, suggests that financial systems become more developed and more market-oriented as economies develop. Addressing the earlier, inconclusive evidence on the causality of this relationship, the new findings also suggest the presence of a link from financial development to economic growth. The results draw on not only cross-country evidence but also industry- and firm-level data analyses. Interestingly, despite the book's title, the relevance of the structure of financial systems—the distinction between bank- and market-based systems—for economic growth receives little support from cross-country evidence. Rather, the importance of the overall financial development, as well as of legal and regulatory institutions, is underlined throughout the book. To be fair, the authors acknowledge that the results on the limited role of the financial structure, though robust across various measures and exercises, may be influenced by definitional issues, and they call for further research in this direction.

Nine papers in the book are devoted to various aspects of the relations between financial development, financial structure and economic performance. Two chapters of Part 2 deal with the measurement and descriptive issues of financial systems and their structure, and also address the link between economic and

financial development by presenting broad cross-country comparisons and some interesting stylized facts. The Financial Development and Structure Database is introduced and explored in detail (and is also provided on a CD). It is a unique database that covers a wide range of variables characterizing various features of financial markets and their structure (the size, activity and efficiency of financial intermediaries and markets) for 175 countries for varying periods extending up to 1997.¹ The authors of the database should be congratulated on their efforts in creating and maintaining the database, which is an exceptionally useful source of information for researchers interested in cross-country analyses of financial systems and development.

Part 3 of the book contains the main cross-country results, while Part 4 looks into the evidence from country studies. In particular, the opening chapter of Part 3 gives a detailed analytical overview of the issues related to the role of financial structure and development in project financing and firm performance. Importantly, financial structure is viewed here broadly in terms of the specific functions it is designed to perform (the so-called financial-services view). The overview emphasizes that the efficient functioning of *both* markets and banks is key to successful firm formation, business investment and economic growth. While the real-world examples in the analytical section are limited mainly to US and Japanese corporate finance practices, the following chapters expand the country coverage and derive the key empirical conclusions. Overall, the following general observations emerge. The first one is related to the link between analytical and empirical analyses. The discussions in the book point to the importance of further research on corporate finance in developing countries aimed at strengthening the theoretical underpinnings for deriving testable predictions and explaining broad empirical findings. Second, in combination with the accurate description of the data, the availability of various panel databases makes it possible to further apply advanced econometric techniques and thoroughly exploit cross-country information.

This book, published more than 30 years after Goldsmith's monograph, admirably bridges the gap between the real-world and research developments throughout the intervening period. It also succeeds in presenting them as a synthesis of two main outcomes: comprehensive research related to financial development

and economic growth on both macro- and microeconomic levels, and a wide range of newly documented stylized facts available thanks to a number of novel databases offering interesting research and policy questions and directions.

NOTES

1. The time span could have limited the usability of the data for further research. However, the updated database through 2001 (recent revision: October 28, 2003) is available on the World Bank website at <http://www.worldbank.org/research/projects/finstructure/database.htm>.

2. The views expressed in this review are those of the author and should not be interpreted as those of the International Monetary Fund.

REFERENCE

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