Regional Financial Integration, Financial Development and Economic Growth in the Belt and Road Initiative Countries (BRICs): Does Institutional Quality Matter

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Highlights: For Review

- We explore the co-integration relationships between regional financial integration, financial development, institutional quality, and economic growth.
- This study uses four different indicators of financial development and 10 indicators of institutional quality to investigate the cointegration relationships and Granger causality nexus between regional financial integration, financial development, institutional quality, and economic growth.
- The principal component analysis is used to form two composite indices for both financial development and institutional quality.
- Our aim is to assess whether institutional quality plays a role in financial integration, financial development, and economic growth nexus.
- We study the relationship between the Belt and Road Initiative Countries (BRICs), a group that has not been studied in the literature – here we explore of institutional quality can leapfrog these countries to a higher stage of regional financial integration and financial development, and high economic growth trajectories.
- The study will be undertaken for the period 1980-2022 and we employ the panel vector auto-regressive model for detecting the direction of causality between the four.
- Our advanced panel data estimation methods allow us to identify important causal links among the variables, both in the short run and in the long run.
- The study will explore co-development strategies and policies pertaining to regional financial integration, financial development, institutional quality, and economic growth for the sample BRICs.

Abstract

Regional economies seek to promote growth through financial integration and literature suggests that developing the financial system, integrating the financial system within a sound institutional framework can promote economic growth (Pradhan et al., 2023, 2020). This study fills the gap by examining the impact of institutional quality on financial development-regional financial integration-economic growth nexus on BRICs. This study assesses whether regional financial integration and financial development have a stronger effect on the economic growth of BRICs that have high level of institutional quality than it does in countries with lower level.

In this paper, we examine the Granger causal relationships between financial integration and financial development, institutional quality, and economic growth in the BRICs over the period 1980-2022. Using principal component analysis for the construction of the financial development and institutional quality indices, and a panel vector auto-regressive (P-VAR) model for testing Granger causalities, the study finds the presence of both unidirectional and bidirectional causal links between the variables. Our investigation leads to a better understanding of interrelationships between the variables, both in the short run and long run. Based on the empirical findings, the study will examine the role of institutional quality in enhancing regional financial integration, financial development and long-run economic growth in the BRICs. The study finds strong endogenous relationships between these variables in the short-run and long-run. Hence, policy-makers in these countries should give careful attention on co-development policies and strategies pertaining to institutional quality, financial integration, financial development and the sustainable economic growth. Lessons from the BRICs case study may be valuable for policy-makers from other economic groups/regions, who are designing policies and strategies to enhance institutional quality, regional financial integration, financial development, and sustainable economic growth.

Keywords: Institutional quality, regional financial integration, financial development,, economic growth, P-VAR, BRICs