Bank Loans Types and Economic Growth - Literature Review

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Abstract

For the economic and financial stability of a country, the banking sector also has a very important role. The importance of this sector in maintaining stability was further confirmed during the presentation of the global financial and economic crisis of 2007, wherein the following years greater attention was paid to it in terms of the regulation (Basel III) of operation of the banking sector in order to avoid financial crises. With the evolution of human society, with the evolution of money forms and the growth of international trade transactions, the development of the financial system took on an ever-increasing role in the growth and development of the economy. Considering this, the aim of this paper is to review and analyse the theoretical and empirical work related to the impact of bank loans on economic growth. According to the theoretical literature, the development of the financial system accelerates economic growth. In this study, the empirical work related to the impact of short-term and long-term loans on the economy, the impact of loans in a particular sector of the economy, but also the impact of aggregate loans on the economy was reviewed. For the effect of loans on the economy to be greater, credit placement must be oriented towards productive projects. Also of particular importance is policy reform in this sector.

Keywords: Banking system, economic growth, bank loans, types of loans

Introduction

In history of economics, banking emerged with development of exchanger stores in the 15th and 16th centuries. Banks demonstrated development within historical process and became institutions that were assistant to economic and commercial

activities and even more regulatory institutions for them in the 19th century (Korkmaz, 2015).

Banks are one of the most important parts of any country. In this modern time money and its necessity is very important. To attain development there should be a good developed financial system to support not only the economic but also the society. Commercial banks are one source of financing for small businesses. The role of commercial banks in economic development rests chiefly on their role as financial intermediaries. In this capacity, commercial banks help drive the flow of investment capital throughout the marketplace (Kalpana, Rao, 2017).

By providing the necessary funding, competitive financial institutions not only permit high-return projects to be undertaken. If these institutions are efficient and not subject to excessive taxation, they pass on the returns to their creditors, who may thereby be induced to save. Such institutions can thus potentially both enhance the efficiency of investment by allocating it properly and increase its volume (Montiel, 1995).

Historically, commercial banks provided shorter-term loans to firms for wages and other production activities, as well as to finance inventories, while investment banks provided long term loans for firms financing positions in capital assets. Commercial banking needed to be relatively low risk because commercial bank liabilities—deposits—needed to maintain par against currency. With typical leverage of equity and cash (largely reserves) commercial banks could not survive losses on loans above a few percentage points without calling into question their ability to maintain par; questions about the health of a bank generate liquidity problems and runs on cash assets. At the same time, investment banks could play the risk-return trade off, making enough profits on their good deals to cover losses on the bad ones (Mazzucato, Wray, 2015).

Worldwide, much of commercial credit consists of four distinct types of loans: (1) asset-based loans, (2) cash flow loans, (3) trade finance agreements, and (4) leases. All of these loans are senior and secured; however, they differ in the type of collateral that backs them (or, to be precise, the net recovery from the sale of collateral). This separation of commercial credit is widely acknowledged in practice, but has only been partially recognized in academic research (Ivashina, Laeven, Moral-Benito, 2020).

Recent years, in mainstream macroeconomics, have seen a growing interest in the study of credit markets and their interrelation with the rest of the economy. Such an interest grew significantly in the aftermath of the worldwide financial and economic crisis of 2007. Such a development certainly represents an advance on a recent trend in economic theory that has focused largely, but not entirely, on business cycles at the expense of their coupling with financial ones. However, it would be inaccurate to hold that, before the crisis, mainstream macroeconomics ignored the role of credit markets and their interactions with the real economy altogether (Bianco and Sardoni).

The provision of credit in economically advanced countries has come to be as public-possibly more public in its nature-as the issue of money by governments. Hence there is no escaping the demand that a credit system shall be managed in the interest of all the people, that credit supplies shall be available on equitable terms to all sections and to all economic groups. A central banking system which tries to limit its operations to particular types of credit advances is only functioning imperfectly. The credit policy of the future must recognize responsibility for seeing that a balance is maintained among all types of demand for credit (Youngman, 1922).

Schumpeter argued in 1911 that the services provided by financial intermediaries mobilizing savings, evaluating projects, managing risk,monitoring managers, and facilitating transactions stimulate technological innovation and economic development (King, Levine, 1993).

Concerning the relationship between money and credit, between money supply and credit

creation Schumpeter (1954) was the first to sort out two classic analyses with different logi,.the monetary theory of credit and credit theory of money. The monetary theory of credit attempts to explain the roles that various monetary instruments (money and quasi money) play in the two separate processes of transaction and intermediation and their interrelations. The credit theory of money is the opposite, which holds that defining credit should come before defining money, so credit should be used to explain and analyse money (Yang, Liping).

According to (Schumpeter 1954: 318) banks exert a very strong influence on economic life. This power stems from two factors. First, Schumpeter assumes that the two spheres of the money market are interrelated. Therefore, the markets for short-term loans, and long-term assets do not function separately, but we interact within a single money market in which purchasing power is exchanged. Second, the 'scope of accumulation reserves' depends heavily on banks as the latter can manipulate the volume of liquidity available through lending. This means that banks cannot be described as passive intermediaries as in the case of sustainable growth as they now play a key role in the distribution of economic resources, cited in (Festré, Nasica, 2009).

In developing countries, development banks have emerged and evolved over time to play a similar role, namely providing long-term capital to support growth and economic transformation. That is, such banks are key in those countries embarking on accelerated economic growth and thus facing challenges in terms of financing for capital-intensive projects and maintaining institutions that can anticipate new needs, overcome technical and entrepreneurial limitations and help coordinate multiple investments taking place simultaneously. However, although in most cases such banks have shared such common goals and functions, they can be seen as a diverse group in terms of ownership, funding structure and the types of projects and activities

they specifically support. Development banks may have broad or specialized mandates. Those with broad mandates often provide finance for a wide range of sectors and activities that are in line with their mandate of supporting a country's socioeconomic development. Specialized banks focus on specific sectors, such as agriculture or export activities, or on specific market segments, such as small and medium-sized enterprises (UNCTAD, 2016).

Theoretical aspects

Keynes clearly adopts a chartalist position vis –a-vis the origin of money. It is the State or a hierarchic authority that discretionarily imposes the unit of account and the things that must be used as means of settlement. However, because of this distinction between State money (or money 'proper') and Bank money (acknowledgements of debt), he has to study the origins of both. He is then led to conclude that money results from an interaction between the private and the public sector (Tymoigne).

The monetary analysis of Kalecki and Minsky emphasises the endogeneity of money through capitalist reproduction, rather than through the mechanisms connecting central bank money to credit creation in the banking system. This provides the link between the monetary theory of Kalecki and Minsky and modern circuit theory (Toporowski, 2012).Minsky has clearly argued from an endogenous money perspective when he says: "most of the banker's assets is financed by the issuance of the banks own debt." Banks do not lend their deposits (or central bank reserves). Rather, they create the deposits as they acquire loans (and other assets). However, the liquidity of their asset portfolio is substantially less than that of their liabilities-creating a potential liquidity problem and their leverage ratio is very high because net worth is small relative to assets (Wray, 2015).

Standard theory has paid much attention to the interest rate and very little to the primary mechanism through which monetary policy affects the economy, quantity and conditions (including non-price terms) in which credit is available. In normal times, money and credit represent both sides of a bank's balance sheet, so they can be very interrelated. But in general, and especially in times of crisis, credit can be weakly linked to either the money supply, or even the T-bill interest rate (Stiglitz). One of the most important from theoretical and practical point is possible consequence of currency crisis for economy that implies introduction of appropriate stabilization programs (Antczak, 2000).

In the General Theory, the reasons for the non-neutrality of money are identified by highlighting the store of wealth function of money, and this approach has been adopted by most Keynesian, The neo-classical theory of credit considers the presence of savers as a necessary precondition for the existence of a credit group, while the Keynesian theory of credit states that in an economy in which bank money is used, the credit market is based on the relationship between the bank and the firm, giving the entrepreneur new purchasing power. Based on Keynes' arguments, a credit

theory is presented that has the following characteristics: 1) the credit offer is independent of savings decisions; 2) the loan application depends on the investment firms' decisions; 3) the interest rate on the loan is not affected by savings decisions (Giancarlo, 2002).

Schumpeter (1954) maintains that whether from the perspective of practice or economic analysis, the credit theory of money is superior to the monetary theory of credit. Classical economists such as Walras, MacLeod, and Wicksell, and new Keynesians including Stiglitz, Greenwald, and Bernanke tend to view money problems from the perspective of credit. Hence, the credit theory of money has become one of the foundations on which many scholars have built their macroeconomic analysis frameworks. In the view of Schumpeter (1934), bank credit sustains the periodic developments of the real economy, and bank credit follows the course of creation and writing-off in turn, corresponding to the stages of boom and bust in economic development (Yang, Liping).

During the past century, three different theories of banking were dominant at different times: (1) The currently prevalent financial intermediation theory of banking says that banks collect deposits and then lend these out, just like other non-bank financial intermediaries. (2) The older fractional reserve theory of banking says that each individual bank is a financial intermediary without the power to create money, but the banking system collectively is able to create money through the process of 'multiple deposit expansion' (the 'money multiplier'). (3) The credit creation theory of banking, predominant a century ago, does not consider banks as financial intermediaries that gather deposits to lend out, but instead argues that each individual bank creates credit and money newly when granting a bank loan (Werner, 2016).

Current theories of intermediation focus on transaction costs and asymmetric information. Moreover, they are unable to satisfactorily explain the huge amount of risk management that is undertaken by intermediaries. They focus on products and services that are of decreasing importance to the intermediaries, while they are unable to account for those activities which have become the central focus of many institutions. The authors have suggested that theories of intermediation need to reflect and account for the fact that financial systems in many countries have changed substantially over the past thirty years. Over this period many traditional financial markets have expanded and new markets have come into existence. Transaction costs have fallen and information has become cheaper and more available. However, these changes have not coincided with a reduction in intermediation. In fact, quite the reverse has happened. Intermediaries have become more important in traditional markets and account for a very large majority of the trading in new markets, such as those for various types of derivatives. Standard theories of intermediation based on transaction costs and asymmetric information are difficult to reconcile with the changes that have taken place (Allen, Santomero, 1996). Theory suggests that

financial systems influence growth by easing information and transactions costs and thereby improving the acquisition of information about firms, corporate governance, risk management, resource mobilization, and financial exchanges. Too frequently empirical measures of financial development do not directly measure these financial functions. While a growing number of country-specific studies develop financial development indicators more closely tied to theory, more work is needed on improving cross-country indicators of financial development (Levine, 2004).

The definition and the measurement of intermediation ratios and securitisation ratios are based on the concept of the economy as a set of sectors that interchange goods, services and most importantly financial funds. Accumulated over time these financial flows between economic sectors translate into financial claims of one sector and an offsetting liability item of another sector (Hackethal, 2000).

The economic and political rationale for putting ceilings on lending rates is to protect consumers from usury or to make credit cheaper and more accessible. If the primary rationale is consumer protection, ceilings are usually set at levels that only affect extreme pricing but leave the core market with minimal implications. In contr ast, if interest rate caps are used as a policy tool to achieve certain socioeconomic g oals, such as lower overall cost of credit, ceilings are set at "binding levels" inten ded to influence the market outcome. Analysis by authors, shows that at least 76 countries around the world, representing more than 80% of global GDP and global financial assets, impose some restrictions on lending rates. Of the countries with interest rate caps, a third introduced them to protect consu mers from usury. This rationale is particularly used by high- income countries. Since 2011, we find at least 30 instances when either new interest rate caps have been introduced or existing restrictions have been tightened. Over 75% of those changes occurred in low- or lower-middle-income countries (Ferrari, Masetti, Ren, 2018).

Theoretical models have identified a number of channels through which international financial integration can promote economic growth in developing countries. However, a systematic examination of the evidence suggests that it is difficult to establish a strong causal relationship. In other words, if financial integration has a positive effect on growth, there is as yet no clear and robust empirical proof that the effect is quantitatively significant. There is some evidence of a "threshold effect" in the relationship between financial globalization and economic growth. The beneficial effects of financial globalization are more likely to be detected when the developing countries have a certain amount of absorptive capacity. Preliminary evidence also supports the view that, in addition to sound macroeconomic policies, improved governance and institutions have an important impact on a country's ability to attract less volatile capital inflows, and on its vulnerability to crises (Prasad, Rogoff, Wei and Kose, 2003)

The empirical aspect

A substantial frame of empirical finance work and assesses, the impact of the functions of the financial system on the economic economy, if it is large, and if it concerns the financial system, eg, banks and stock markets, have an economic issue role particularly encouraged and increased in particular stages of economic development (Levine, 2004).

If higher levels of financial development are positively associated with economic development King & Levine, (1993) using data on over 80 countries over the 1960-1989 period, using cross-country regression to assess the strength of the partial correlation between financial development and growth indicators. Authors find that (1) indicators of the level of financial development - the size of the formal financial intermediary sector relative to GDP, the importance of banks relative to the central bank, the percentage of credit allocate to private firms, and the ratio of credit issued to private firms to GDP - are strongly and robustly correlated with growth, the rate of physical capital accumulation, and improvements in the efficiency of capital allocation; and (2) the predetermined or predictable components of these financial development indicators are significantly related with subsequent values of the growth indicators.

To study the relationship between bank loans for different sectors and economic growth Abdi (2017) used the methodology of Vector Error Correction (VECM), and Granger Causality Test, from the period 1980/81 – 2014/15. The Granger causality test reports the bidirectional causality of disclosure in total bank loans for all sectors and real GDP. The author identified short-term links between bank credit allocations for different sectors (agriculture, industry, services, and export) and real GDP in the Ethiopian economy. Empirical results establish the apparent efficiency of the health of banks in the main economic sectors and lags as such a role in the economy of Ethiopia, both in the short term and at that level.

Műller, Verner (2020), study the relationship between credit expansions, macroeconomic fluctuations, and financial crises using a novel database on the sectoral distribution of private credit for 116 countries starting in 1940. Authors test the prediction that lending to households and the non-tradable sector, relative to the tradable sector, contributes to macroeconomic boom-bust cycles by (i) fueling unsustainable demand booms, (ii) increasing financial fragility, and (iii) misallocating resources across sectors. The authors also tested that credit to non-tradable sectors, including construction and real estate, is associated with a boom-bust pattern in output, similar to household credit booms. In contrast, tradable-sector credit expansions are followed by stable output and productivity growth without a higher risk of a financial crisis.

Muthusamy, Dewasiri, Weerakoon, and Amarasinghe, (2018) study investigates the impact of sectoral distribution of commercial bank credit on economic growth in Sri Lanka based on data from 2005 to 2017. The Auto-regressive Distributed Lag (ARDL) model is used to investigate the short and long-run impact of sectoral distribution of

commercial bank credit on (GDP). The findings of the ARDL Error Correction model indicates that the commercial bank sectoral credit distribution is significantly explaining the short run economic growth. Moreover, ARDL long run form and bounds test shows that there is a long run relation between the variables. The industrial sector has a long run positive relationship with GDP while the other sectors are insignificant in explaining long run economic growth.

Shijaku, Kalluci, (2013) studied determinants of bank credit to the private sector in the case of

Albania. Using the Johansen methodology. (VECM), the study identifies a co-integrating relationship linking real bank credit to the private sector, real GDP, net wages, banking and financial developments, financial liberalization indicators, exchange rate, non-performing loans and interest rates. Also, in the long run, bank credit is positively related to the exchange rate and negatively to the crowding-out effect caused by government domestic borrowing. The results imply that lending is positively related to the economic growth.

To document the link between banks credit and economic growth, Sipahutar, Oktaviani, Siregar, and Juand (2016) estimate a VAR and ECM. The result revealed bidirectional causality between banks' credit and economic growth. Banks' credit promotes economic growth and economic growth affects credit depth and financial development. The estimation model explained that credit allocated by banks increases business escalation to the real sectors then promotes economic growth, decreases the unemployment rate through increasing labor demand, increasing income, and then decreasing poverty.

Duican-Moisescu, and Pop, (2015) analyse the relationship between credits, and GDP in the eight development regions of Romania for the period of 2005-2014, using the linear regression model. The study results indicate that credit has a significant influence on the evolution of GDP in the eight development regions of Romania.

To investigate the long-run relationship between financial development and economic growth in Brunei and its direction of causality Alliasim (2018) using data from 1975 to 2013,and several econometric techniques as : unit root tests, co-integration tests, and Granger Causality pairwise testing based on the VAR and the VECM frameworks. The main finding is that financial development does not have an effect on economic growth. The Granger Causality test results show that there is no bi-directional causality between economic growth (measured by inflation, domestic credit to the private sector and bank overhead costs to total assets in percentage), however, this study found significance at the long-run relationship between inflation and financial depth (measured by the domestic credit to the private sector).

Puatwoe, Piabuo, (2017) investigates the impact of financial development on Economic growth using time series data in Cameroon. Using the Auto Regressive Distributive Lag (ARDL) the technique of estimation, and OLS it was discovered that

there exists a short-run positive relationship between monetary mass (M2), government expenditure, and economic growth, a short-run negative relationship between bank deposits, private investment and economic growth equally exists. However, in the long run, all indicators of financial development shows a positive and significant impact on economic growth.

Takáts, and Upper (2013), find that declining bank credit to the private sector will not necessarily constrain the economic recovery after output has bottomed out following a financial crisis. To obtain this result, the authors examine data from 39 financial crises (before 1970 to 2007), as the current one were preceded by credit booms. In these crises, the change in bank credit, in real terms or relative to GDP, consistently did not correlate with growth during the first two years of the recovery. In the third and fourth years, the correlation becomes statistically significant but remains small in economic terms. Also according to the research results bank lending to the private sector and economic growth are essentially uncorrelated after those financial crises that were preceded by credit booms.

To see whether domestic credits created by banks for 10 chosen European countries have influenced economic growth and inflation variables, Korkmaz (2015) used annual data from 2006 to 2012. As a result of conducted tests, it was concluded that there were no problems of heteroscedasticity multiple correlation and auto-correlation. As a result of panel data analysis, it was proved that domestic credits created by banking sector for 10 European countries did not affect inflation but did affect economic growth.

To explore the impact of sectoral credit to the building and construction, agriculture, manufacturing, trade and transport, storage, and communication sectors on the growth of the economy by employing in Kenya, (Wambugu, 2012), used the associated ARDL approach and the endogenous growth model, using data from 1970-2017. This study established that lending to the agricultural sector had a positive and significant impact on economic growth in the long run. The long-term coefficient showed that bank lending to the productive sector has a significant and negative impact on economic growth. Bank lending for the trade and construction sectors and construction had no statistically significant effect on economic growth. Short-term findings indicate that only commercial bank lending to the building construction sector was found to have a significant positive impact on economic growth.

Hu, Lu, Zhang, Liu and Peng, (2021), examine a sample of 30 mainland provinces, autonomous regions, and municipalities for the period 2005 to 2017 in China. To investigate whether shareholding reform can promote agricultural growth, increase farmers' incomes and reduce the urban-rural gap through synergy between the agricultural production subsystem and the rural banking subsystem. The analysis shows only services from rural commercial banks can promote these modernized, and thus rural economic drivers. The empirical analysis is also done on the effect in a more Chinese province. Applying the coupling coordination degree model, the

coordination between agricultural production and rural banking development shows an obvious increase, especially after the formal implementation of shareholding reform on rural credit cooperatives. The empirical results indicate that the synergism between the two subsystems promotes agricultural growth and urban-rural income gap reduction significantly.

Saito, Bandeira (2010), investigated the use of trade credit by financing their customers as well as supplier financing by Brazilian public firms, using a sample of 263 public non-financial firms. The results provide empirical evidence that trade credit seems to signal a firm's good quality, facilitating access to bank loans. Therefore, trade credit can also facilitate access to credit for public firms.

To study the impact of commercial banks development on economic growth in Namibia from 2005-2016, Paavo (2017), used (ARDL) methodology in determining the existence of the short-run and long-run relationships. From the ARDL results, the study concluded that there exists of a positive short-run relationship between banking sector development and GDP growth, channeled through net interest income and funding liabilities of banks. The causality test indicated a bi-directional causality between economic growth and the banking sector development, entailing that development of the banking sector would enhance GDP growth and vice versa.

The aim of Maressa (2017), was to investigate the link between commercial banks sub- sectoral loans and advance distribution and operating profit over the period 2010-2016 in 16 private commercial banks in Ethiopia, using the OLS model. The regression results of random revealed that credit distribution to domestic trade and service, manufacturing sector, and import and export has a statistically positive effect on operating profit. On the other hand, credit for building and construction, and transportation has a statistically insignificant positive relationship with interest income. However, private banks credit to the agricultural sector has a statistically insignificant negative association with operating profit.

Praise (2020), examines the sectoral allocation of bank credits and economic development in Nigeria, from 1985 to 2019, using the Augmented Dickey Fuller model (ADF). The results of the analysis showed that bank credits to the manufacturing, mining, and general commerce sector contributed negatively to the human development index while bank credits to the public sector, real estate, and agricultural sector contributed positively to the human development index. The current risky business environment is affecting banks ability to lend to the manufacturing, mining, and general commerce sector which ought to drive development. The result obtained from the ECM led to the conclusion that the bank's credit to the private sector has a statistically significant effect on the development.

To determine whether small and large Indonesian government-owned banks differ in terms of their loan portfolio structures and performance.over the 2003 to 2011 period, Atahau & Cronje, (2014), applied the regression model. The findings showed

that the loan portfolios of small Government banks are more concentrated with a focus on the consumer sector whereas large Government banks have more diversified loan portfolios with more exposure to the trade and manufacturing sectors although a high level of concentration in the consumer sector in 2007.

According to Dell'Ariccia, Kadyrzhanova, Minoiu,amd Ratnovski, (2020),the shift in the composition of firms' assets towards intangible capital has reduced the efficiency of bank lending from 1984 - 2016, as judged from the perspective of US banks. Commercial lending is constrained by collateral-related frictions, while additional mortgage lending caused by the increase in intangible capital is riskier and less profitable, with negative consequences for the riskiness and profitability of banks' balance sheets.

Summary of theoretical and empirical work

There is quite extensive empirical literature on the relationship between financial development and economic growth. The empirical studies on the impact of bank credit on economic growth has not reached a consensus and remains controversial. These studies can be divided into two groups in terms of their results. These results are influenced by the technique and the data employed. The studies used time-series for a specific country in general generate contradictory results with those of the cross country studies (Abdi, 2017). Also, in the empirical studies, different econometric techniques were used, which may have different results regarding the role of loans in the economy. However, according to researchers, most empirical studies emphasize the positive impact of bank loans (aggregate loans and loans for individual sectors) on economic growth and development.

Theoretically, Schumpeter (1911) submits that a well-developed financial system catalysed technological innovation and economic growth through the provision of financial services and resources to those entrepreneurs who have the highest probability of successfully implementing innovative products and processes. Empirically, the permeating thesis emblazoned across most of the empirical findings on finance-growth nexus is that a more developed financial sector provides a fertile ground for the allocation of resources, better monitoring, fewer information asymmetries and economic growth (Shen and Lee, 2006) cited in (Adusei, 2012).

Theory illuminates many of the channels through which the emergence of financial instruments, markets, and institutions affect - and are affected by -economic development. A growing body of empirical analyses, including firm-level studies, industry-level studies, individual country studies, time-series studies, panel investigations, and broad cross-country comparisons, demonstrate a strong positive link between the functioning of the financial system and long-run economic growth. Furthermore, microeconomic-based evidence is consistent with the view that better developed financial systems ease external financing constraints facing firms, which illuminates one mechanism through which financial development influences

economic growth (Levine, 2004). Also, economic development is extremely important in increasing the size of the banking sector in a given country. Numerous empirical studies show that there is a two-way causality in the connection between bank loans and economic growth.

Most studies in the finance-growth nexus literature use data from several countries to conduct

their empirical analyses, which may be hard to interpret due to the diversity in historical experiences, cultural norms, and institutional contexts (Silva,Tabak and Laiz,2019). That the results of the impact of an economic economy from empirical research should be more oriented to the environment of a country, taking into account how economic, legal, and cultural can mutually linguistic.

It is not related to the importance of state-owned and private banks in the economy. While they may occur in some aspects, such as institutional arrangements and goals, it is an empirical question to test whether such differences can be complemented by each other and generate more pronounced rates of economic growth (Silva, Tabak and Laiz , 2019).

In the most empirical conclusion, the measurement of economic growth is done through the measurement of GDP, while the financial system is used for the basis of finance, financial depth, and the performance functions of the banking sector. However, since the results and analyses are related to the impact of loans on the economy of more specific data, empirical studies should be oriented more on the impact of loans that are allocated to each separate sector of the economy.

Globalization, in principle, can finance at a rate of growth, the growth of another channel. Some of this information on the determinants of economic growth. Indirect channels, which in some cases they can be even more important, which are important than direct ones, which are important because of good risk management and improvements in both macroeconomic policies and criticism external from competitive pressures or the "disciplinary effect" from globalization" (Prasad, Rogoff, Jin Wei, Kose, 2003).

Conclusions and Recommendations

Theory and empirical evidence make it difficult to conclude that finance simply – and automatically – responds to economic activity, or that financial development is an insignificant addition to the process of economic growth. Furthermore, the compelling evidence that the financial system affects long-run economic growth will advertise the urgent need for research on the political, legal, regulatory, and policy determinants of financial development. To better understand the relationship between financial development and economic growth, research has used both industry- and firm-level data in a wide cross-section of countries. These studies aim to resolve issues of causality and document in more detail the mechanisms, if any,

through which finance affects economic growth (Levine, 2004). So, the continuous evolution of the banking system in the provision of various products and services, made it necessary to reform the policies in this sector, in order for the effect of loans on economic growth to be greater.

Because of the mutual interdependence between financial development and growth, identifying innovations in financial development is not a trivial matter. Changes in financial sector policies, however, are an identifiable source of such innovations. At a given level of income, and thus at a given stage of financial development, the efficiency of the financial system depends, among other things, on the policy environment (Montiel,1995).

Empirical studies show that countries with developed financial systems have faster economic growth. However, due to the increase in the volume of defaulted loans, these loans must be used productively in order for the default of loans not to cause an increase in inflation in the economy of a country. Likewise, future empirical studies should use the inflation variable more in their analysis, to assess its impact on the economy which may be caused by the increase in credit placements.

Future empirical studies should also focus more on research that the impact of bank loans on economic growth is higher in countries where the financing of the economy is done through the financial system based on banks or the financial system based on capital markets.

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