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Financial Development, Islamic Banking and Economic Growth Evidence from MENA Region

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Abstract: In this paper we assess the relationship between the financial development and growth in some countries in the Middle East and North Africa (MENA) region. We try to check the specific effect of Islamic sector on the economic growth using the amount of credit issued to the private sector by Islamic banks as measures of Islamic financial development. There are three main findings. First, empirical results show an insignificant relationship between banking and growth which reinforce the idea that banks don't spur economic growth. Besides, we find that credit to private sectors affect negatively with economic growth. Second, Islamic banks don't make the exception in the financial markets and show a weak relation with growth but it tends to act positively as theoretically demonstrated. Third, there is evidence that this relationship is quite heterogeneous across MENA countries where financial development does not cause economic growth in MENA countries without oil windfall and the relationship is negative for Petroleum Exporting MENA Countries.

Keywords: Financial Development, Economic Growth, MENA Region, Islamic Banking.

INTRODUCTION

The literature on the relationship between the financial development and economic growth is well documented. The theoretical underpinning of this relationship can be traced back to the works of Schumpeter (1912), Gurley and Shaw (1960), McKinnon (1973), Shaw (1973). According to the theory, the development of the banking industry is favorable to the economic growth

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