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FINANCIAL INTEGRATION AND FINANCIAL DEVELOPMENT IN TRANSITION ECONOMIES: WHAT HAPPENS DURING FINANCIAL CRISES?

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Abstract

This paper provides an empirical analysis of the role of financial development and financial integration in the growth dynamics of transition countries. We focus on the role of financial integration in determining the impact of financial development on growth, distinguishing “normal times” from periods of financial crises. In addition to confirming the significant positive effect on growth exerted by financial development and financial integration, our estimates show that a higher degree of financial openness tends to reduce the contractionary effect of financial crises, by cushioning the effect on the domestic supply of credit. Consequently, the high reliance on international capital flows by transition countries does not necessarily increase their financial fragility. This implies that financial protectionism is a self-defeating policy, at least for transition countries.

Keywords: transition economies, financial integration, financial crises, economic growth, threshold effects

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