



“FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH IN KUWAIT

(With reference to Financial Development Index (FDI))”

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ABSTRACT

Financial development involves improvements in such functions provided by the financial systems as: pooling of savings; allocating capital to productive investments; monitoring those investments; risk diversification; and exchange of goods and services. Each of these financial functions can influence saving and investment decisions and the efficiency with which funds are allocated. As a result, finance affects the accumulation of physical and human capital and total factor productivity-the three factors that determine economic growth. To the extent that financial development reduces informational asymmetries and financial constraints and promotes risk sharing, it can enhance the ability of financial systems to absorb shocks and reduce the amplification of cycles through the financial accelerator lowering macroeconomic volatility and inequality.

Financial markets have developed in ways that allow individuals and firms to diversify their savings, and firms can now raise money through stocks, bonds, and wholesale money markets, bypassing traditional bank lending. The constellation of such financial institutions and markets facilitates the provision of financial services. Furthermore, an important feature of financial systems is their access and efficiency. Large financial systems are of limited use if they are not accessible to a sufficiently large proportion of the population and firms. Even if financial systems are sizeable and have a broad reach, their contribution to economic growth would be limited if they were wasteful and inefficient¹. Keeping this in mind the researcher had decided to study financial development and economic growth in Kuwait keeping Financial Development Index (FDI) as the measuring stick.

¹ Levine 2005, "Finance and Growth: Theory and Evidence," *Handbook of Economic Growth*, in: Philippe Aghion & Steven Durlauf, *Handbook of Economic Growth*, edition 1, volume 1, chapter 12, pages 865-934 Elsevier.

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Key words: Financial Development Index, Financial Development, Economic Growth, Financial Market , Financial Institutions.

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I. INTRODUCTION

Kuwait has a leading position in the financial industry in the GCC; the abyss that separates Kuwait from its other GCC countries in terms of tourism, transport, and other measures of diversification is absent in the financial sector. The Emir has promoted the idea that Kuwait should focus its energies, in terms of economic development, on the financial industry. The historical pre-eminence of Kuwait (among the Gulf monarchies) in finance dates back to the founding of the National Bank of Kuwait in 1952. The bank was the first local publicly traded corporation in the Gulf. In the late 1970s and early 1980s, an alternative stock market, trading in shares of Gulf companies, emerged in Kuwait, the Souk Al-Manakh. At its peak, its market capitalization was the third highest in the world, behind only the U.S. and Japan, and ahead of the UK and France. It has a large wealth-management industry that stands out in the region. Kuwaiti investment companies administer more assets than those of any other GCC country, save the much larger Saudi Arabia. The Kuwait Financial Centre, in a rough calculation, estimated that Kuwaiti firms accounted for over one-third of the total assets under management in the GCC. The relative strength of Kuwait in the financial industry extends to its stock market. For many years, the total valuation of all companies listed on the Kuwaiti exchange far exceeded the value of those on any other GCC bourse, except Saudi Arabia².

In 2011, financial and banking companies made up more than half of the market capitalization of the Kuwaiti bourse; among all the Gulf States, the market capitalization of Kuwaiti financial-sector firms was, in total, behind only that of Saudi Arabia. In recent years, Kuwaiti investment companies have invested large percentages of their assets abroad, and their foreign assets have become substantially larger than their domestic assets. Kuwait is a major source of foreign economic assistance to other states through the Kuwait Fund for Arab Economic Development, an autonomous state institution created in 1961 on the pattern of Western and international development agencies. Over the years aid was annually provided to Egypt, Syria, and Jordan, as well as the Palestine Liberation Organization. In 1974, the fund's lending mandate was expanded to include all developing countries in the world³.

² "10 Most Valuable Currencies in the World". *Silicon India*. 21 March 2012. Archived from the original on 16 March 2017.

³ "Kuwait Investment Authority Profile Page". *Sovereign Wealth Fund Institute*. Archived from the original on 8 March 2017. Retrieved 12 March 2017.

II. CONCEPTUAL BACKGROUND – Financial Development Index (FDI)

Introduction

Financial development is a multidimensional process, and with the passage of time, financial sectors have evolved across the globe and modern financial systems have become multifaceted. Banks are typically the largest and most important, with investment banks, insurance companies, mutual funds, pension funds, venture capital firms, and many other types of non-banking financial institutions now playing substantive roles. Financial markets allows an individual and firms to incorporate their savings in investing in shares, bonds and money markets and earn profits. In the present era of Globalization any firms wants to diversify its operations need not look for traditional banking systems for loans and debentures with financial burden arising out of cost of capital this can be eliminated with raise of fund through venture capital, by going from private company to public company by issuing Initial Public offer of its shares and making the public investor to be the owners of both its assets and liabilities. This policy of opening of shares (IPO) to the public is game changer to go for diversification where by manufacturing industry going for software development and service sector areas reducing the burden on cost of capital. This type of investment measures widens the scope of reaching more sizeable investors population or firms and which in turn helps in maximising its resources with highest efficiency in planning and execution of firms process and leading to economic development of the country .The diversity of financial systems across countries implies that one needs to look at multiple indicators to measure financial development⁴.

Financial Development Index

Financial institutions include banks, insurance companies, mutual funds and pension funds whereas financial markets include stock and bond markets. Financial development is defined as a combination of depth (size and liquidity of markets), access (ability of individuals and companies to access financial services), and efficiency (ability of institutions to provide financial services at low cost and with sustainable revenues, and the level of activity of capital markets).

The Index used in this study was prepared by Katsiaryna Svirydzhenka, IMF Working Paper Strategy, Policy, and Review Department, “Introducing a New Broad-based Index of Financial Development (183 countries)”, Authorized for distribution by Petya Koeva Brooks, January 2016, he developed the index with the help of the index originally developed in the context of the IMF Staff Discussion Note “Rethinking Financial Deepening: Stability and Growth in Emerging Markets” by Sahay 2015.

⁴Cihak Martin, Aslı Demirgüç-Kunt, Erik Feyen, and Ross Levine, 2012. “Benchmarking Financial Development around the World.” World Bank Policy Research Working Paper 6175. World Bank, Washington, DC.

Fig: 1
Financial Development Index Pyramid

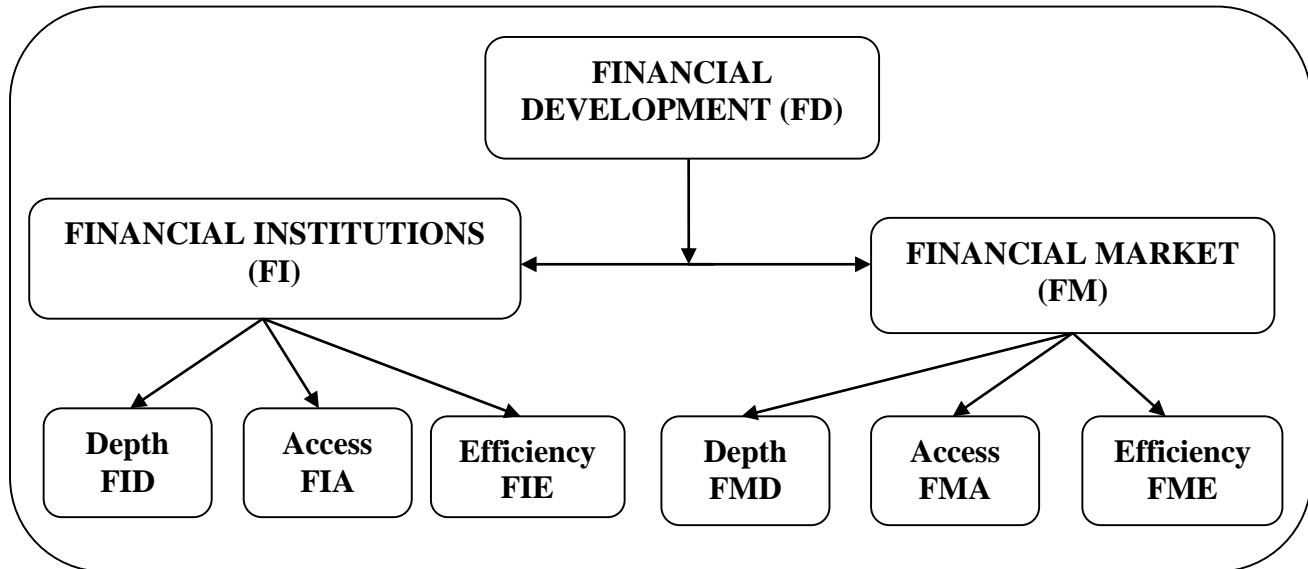


Table 1
INDICATORS OF INDEX and CODE

Category	Indicators	Code
Financial Institutions (FI)		
Depth (FID)	Private sector credit to GDP	FID 1
	Pension fund assets to GDP	FID 2
	Mutual fund assets to GDP	FID 3
	Insurance premiums, life and Non-life to GDP	FID 4
Access (FIA)	Bank branch per 100000 adults	FIA 1
	ATMs per 100000 adults	FIA 2
Efficiency (FIE)	Net interest margin	FIE 1
	Lending deposits spread	FIE 2
	Non-interest income to total income	FIE 3
	Overhead costs to total assets	FIE 4
	Return on assets	FIE 5
	Return on equity	FIE 6
Financial market (FM)		
Depth (FMD)	Stock market capitalization to GDP	FMD 1
	Stocks traded to GDP	FMD 2
	International debt securities of government to GDP	FMD 3
	Total debt securities of financial corporations to GDP	FMD 4
	Total debt securities of nonfinancial corporations to GDP	FMD 5
Access (FMA)	Percent of market capitalization outside of top 10 largest companies	FMA 1
	Total number of issuers of debt (domestic and external, nonfinancial and financial corporation's)	FMA 2
Efficiency (FME)	Stock market turnover ratio (stocks traded to capitalization)	FME 1

Source: FinStats 2019, IMF Financial Access Survey, BIS debt securities, Database and Dealogic Corporate debt database.

III. OBJECTIVES OF THE STUDY

- To study the concepts of Financial Development Index in detail
- To apply the index(FDI) for Kuwait for the year 2018-2019
- To analyse the relationship between the indicators of Financial Development Index
- To identify the association between financial development and economic growth in Kuwait

IV. FRAMED HYPOTHESIS

- There is no significant association between the indicators of Financial Development Index (FDI)
- There is no significant relationship between the financial development and economic growth

V. LIMITATIONS

- The study is confined to Kuwait only for the year 2018-2019
- The study is based upon the secondary data only, which is subject to recall bias – (*FinStats 2019, IMF Financial Access Survey, BIS debt securities, Database and Dealogic Corporate debt database.*)
- The findings may not be generalised as only FDI was adopted for studying financial development and economic growth in Kuwait

VI. FRAMEWORK OF ANALYSIS

Chart 1
Framework of analysis for FDI Indicators

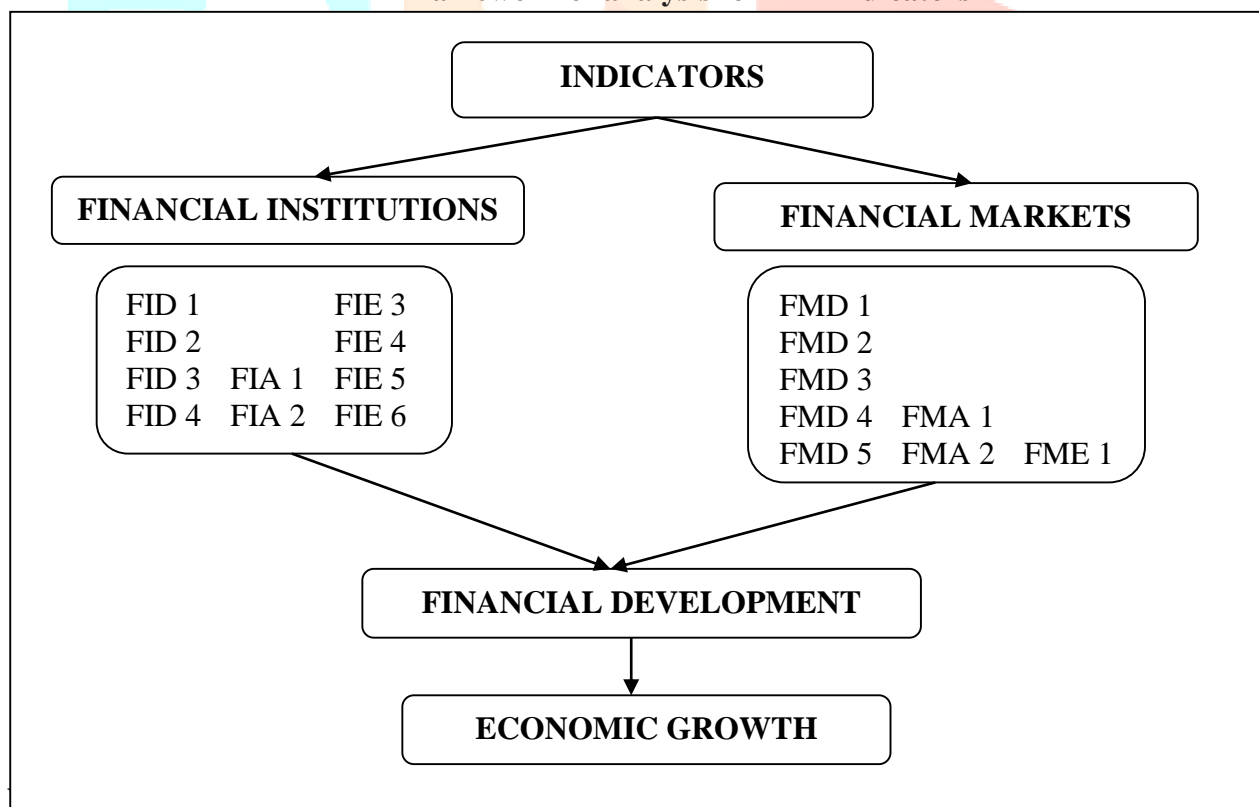


Table 2
Distribution on Financial Institution Indicators

Sl.no	Particulars	Mean	S.D	Rank
1	FID 1	39.00	2.32	8
2	FID 2	39.46	2.20	11
3	FID 3	39.44	2.27	9
4	FID 4	37.79	2.40	6
5	FIA 1	35.60	3.53	1
6	FIA 2	35.61	3.53	1
7	FIE 1	36.87	2.59	4
8	FIE 2	35.83	2.90	3
9	FIE 3	39.76	2.12	12
10	FIE 4	39.44	2.27	9
11	FIE 5	38.29	2.38	7
12	FIE 6	37.22	2.43	5

Source: Computed Data

Table 3
Distribution on Financial Market Indicators

Sl.no	Particulars	Mean	S.D	Rank
1	FMD 1	38.30	2.38	8
2	FMD 2	36.16	2.89	5
3	FMD 3	37.52	2.42	7
4	FMD 4	35.69	3.02	4
5	FMD 5	31.60	4.98	1
6	FMA 1	33.70	3.62	2
7	FMA 2	37.02	2.53	6
8	FME 1	35.59	3.33	3

Source: Computed Data

Table 4
Chi-square distribution on overall result of hypothesis testing @5% level of significance

Independent variable	Dependent variable		p-value	Result
	Financial Institution			
Financial Development	Depth	FID 1	0.002	Significant
		FID 2	0.013	
		FID 3	0.001	
		FID 4	0.008	
	Access	FIA 1	0.018	Significant
		FIA 2	0.048	
	Efficiency	FIE 1	0.000	Significant
		FIE 2	0.028	
		FIE 3	0.025	
		FIE 4	0.040	
		FIE 5	0.035	
		FIE 6	0.023	

Source: Computed Data

Table 5
Chi-square distribution on overall result of hypothesis testing @5% level of significance

Independent variable	Dependent variable		p-value	Result
	Financial Market			
Financial Development	Depth	FMD 1	0.042	Significant
		FMD 2	0.047	
		FMD 3	0.012	
		FMD 4	0.026	
		FMD 5	0.041	
	Access	FMA 1	0.048	Significant
		FMA 2	0.046	
	Efficiency	FME 1	0.047	Significant

Source: Computed Data

Table 6
Distribution on Component factor analysis for Financial Market and Financial Institution Indicators (Rotated Factor Analysis)

	FMD1	FMD2	FMD3	FMD4	FMD5	FMA1	FMA2	FME1	h ²
FID 1	0.425	0.665	0.316	0.655	0.684	0.613	0.677	0.581	0.747
FID 2	0.925	0.373	0.941	0.574	0.051	0.210	0.082	0.121	0.928
FID 3	0.858	0.358	0.970	0.523	0.082	0.073	0.161	0.250	0.915
FID 4	0.694	0.078	0.909	0.521	0.071	0.358	0.102	0.760	0.703
FIA 1	0.058	0.694	0.330	0.073	0.147	0.263	0.061	0.241	0.674
FIA 2	0.909	0.330	0.373	0.065	0.650	0.106	0.186	0.128	0.903
FIE 1	0.888	0.246	0.979	0.145	0.650	0.060	0.063	0.159	0.911
FIE 2	0.783	0.512	0.964	0.447	0.471	0.570	0.130	0.134	0.492
FIE 3	0.065	0.327	0.265	0.366	0.383	0.585	0.152	0.073	0.499
FIE 4	0.894	0.275	0.980	0.123	0.060	0.080	0.066	0.052	0.763
FIE 5	0.479	0.694	0.766	0.174	0.141	0.624	0.053	0.458	0.915
FIE 6	0.925	0.373	0.941	0.153	0.062	0.094	0.762	0.292	0.175
Eigen Value	4.073	2.147	3.263	4.160	3.548	3.648	2.003	2.108	
Percentage of variation	7.008	7.007	7.045	19.525	8.199	7.864	17.207	7.001	
Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalisation, A Rotation converged in 12 iterations									

Source: Computed Data

Table 7
Pearson correlation for Financial Development and Economic Growth

Particulars		Pearson Correlation	
		Financial Development (FD)	Economic Growth (EG)
FD	Correlation Coefficient	1.000	.559
	Sig. (2-tailed)	-	.356
EG	Correlation Coefficient	.559	1.000
	Sig. (2-tailed)	.356	-

Source: Computed Data

Table 8
Distribution on Index of Kuwait and its rank out of 183 countries (2018-2019)

Sl.no	Particulars	Value
1.	GDP, current US\$ billion	143.2
2.	GDP per capita, current US\$	33700
3.	Real GDP growth, at constant market prices	0.7
4.	Real GDP growth, at constant factor prices	-0.3
5.	Inflation (Consumer Price Index)	1.0
6.	Current Account Balance (% of GDP)	8.1
7.	Net Foreign Direct Investment (% of GDP)	-5.4
8.	Fiscal Balance (% of GDP)	-13.6
9.	Primary Balance (% of GDP)	-13.3
10.	Financial Development Index (FDI)	0.313(67)
11.	Financial Institution Index (FII)	0.447(73)
12.	Financial Market Index (FMI)	0.174(67)

Source: Secondary Data (*Financial Access Survey, 2019. International Monetary Fund, FinStats, 2018-19, World Bank.*)NB:FDI, FII&FMI is ranked out of 183 countries.

VIII. FINDINGS OF THE STUDY

Financial Institution Indicators (Ranking): Out of 12 indicators for Financial Institution Index it was found that FAI 1 (Bank branch per 100000 adults) and FAI 2 (ATMs per 100000 adults) is ranked first, it is clear that Access sub-indices is the important indicator for this index.

Financial Market Indicators (Ranking): Out of 8 indicators for Financial Market Index it was found that FMD 5 (Total debt securities of nonfinancial corporations to GDP) is ranked first, here Depth sub-indices is the important indicator for this index.

Financial Development and Financial Institution Indicators (Chi-Square): The chi-square value @ 5% level of significance showed significant relationship, thus the Ho is rejected and Ha is accepted, which means there is significant relationship between Financial Development and Financial Institution Indicators.

Financial Development and Financial Market Indicators (Chi-Square): The chi-square value @ 5% level of significance showed significant relationship. Thus the Ho is rejected and Ha is accepted, which means there is significant relationship between Financial Development and Financial Market Indicators.

Financial Market and Financial Institution Indicators (Rotated Factor Analysis): It is found that there is positive loading at 0.05 level of significance for the factor FMD 4 (4.160) and the highest loaded iteration is FID 2 with h^2 : 0.928.

Financial Development and Economic Growth (Pearson correlation): Pearson correlation for Financial Development and Economic Growth, the co-efficient are 1.000 and .559 respectively. The result for Pearson shows high positive correlation i.e. a perfect positive linear reliability is found between the factors, therefore the null hypothesis is rejected and the alternative hypothesis [H_a : there is significant association between Financial Development and Economic Growth] is accepted.

IX. CONCLUSION

The evolution of the FD index over the sample period (2018-2019) shows a pattern that generally confirms priors. There is significant difference in the financial development and financial market indicators. However, the gap in financial development has subsequently declined after the global financial crisis, reflecting deleverage. After the study the researcher found that the indicators are highly influenced to the index and on the other hand financial development of a country is highly associated to the Economic Growth of that country. This smooth growth rate in Kuwait has stuck after the Covid-19 issues and the researcher is recommending a comparative study of the Financial development of the country Before Covid and After Covid in future.

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