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Thesis Title: A Link between Financial Development and International Trade: Evidence from Developing Countries

Abstract

This paper explores a possible link between financial development and international trade in selected developing countries. We will examine the hypothesis that there is a strong link between financial development and international trade by using the data of credit to private sector as percentage of GDP and exports share of 50 developing countries over the period 1990-2017. Overall, we show that a country's financial development has a positive effect on its international trade. Three different regression models have been used in this study: the benchmark model (without dynamics or IV), the dynamic model (with dynamics but without IV for the financial variable), and the IV model (with IV for the financial variable but without dynamics). First, the results of the benchmark model i.e. the fixed effects model shows that one percent increase in credit to private sector as percentage of GDP leads to a change of 0.14 percent in exports as percent of GDP. Secondly, the results of the dynamic model (Arellano Bond) confirms that lag of exports is an important predictor for current year exports. Thirdly, for the IV model, 2SLS technique was employed by using valid and relevant IVs. The results after using IVs are consistent with the benchmark model. The coefficient of credit to private sector is 0.134 and almost the same as that of the benchmark model. This aggregated coefficient represents the relationship between exports and credit to private sector; using 27-years panel for 50 developing countries confirms that financial development has a significant positive effect on international trade. Hence, it is very important that less developing countries should focus on promoting and encouraging credit to private sector so that exports are also increased eventually and policy makers should consider the importance of financial development in their agendas.