

## Chapter 26

# The Relationship Between Financial Development, Innovation and Economic Growth

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### ABSTRACT

*Along with the globalization process, the relationship between the existence of an advanced financial system, financial development and economic growth has become one of the most debated issues. The financial system, development and development indicators, which play an important role in the overall success levels of the economy, are among the topics to be considered due to this importance. In this study, financial development, economic growth, and theoretical approaches are discussed. Moreover, the fact that the subject is empirically presenting evidence requires examination of this situation with studies in the literature. The presence of the findings obtained empirically, in particular Turkey's economy has made it necessary to include a large empirical literature. The generally accepted financial development indicators, which provide comparability in terms of countries, are examined in terms of financial markets and financial institutions in terms of depth, access, stability and efficiency during the period 2005-2015.*

### INTRODUCTION

The rapidly changing nature of economies with industrialization continues to change even more rapidly with technology. Increases in income levels and savings levels have led to the birth and development of the financial system. Today, the financial sector has become one of the important dynamics of economic growth. In the financial sector, the ability to quickly reflect the problems and opportunities that exist in the economy, the potential to influence the economy as a whole, suggests that the relationship between financial development and economic growth must be investigated. In addition, the increasing integration between the countries with the globalization process has led to many developments which

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can be regarded as positive and negative economically. Outsourcing in economic policies within the scope of outward development strategies has turned into an open economy model, which has led to the investigation of the effects of these policies on growth. With globalization becoming a concept shaping the world economy, the number of studies investigating the correlation between the level of openness and growth of countries has also increased steadily. In these studies, the answer to the question of how the countries influence the growth of trade openness and financial openness is sought.

Technological developments and innovations, considered as one of the important driving forces in the growth of an economy, underscore the concept of innovation which is gaining more importance especially after the 1980s. When innovation is called, it is desirable to describe a product or a process to be discovered according to the situation. It is the key to long-term growth and continuity of the economy in terms of economics, for the first time to introduce a product or a process. Developing economies and systems have led to the widespread adoption of the concept of innovation in the financial field and the search for the effects of the concept of financial innovation. Because financial innovations with a focus on technology are influencing the supply and demand of money in the economy and affecting growth. As the first financial innovations occur in the developed world's financial markets, Turkey has become the continuation of the implementation of financial liberalization process that began in the 1980s.

The phenomenon of financial liberalization, especially after 1980, led to the start of research on empirical investigations between financial development and growth (King & Levine, 1993). The relationship between economic growth and financial development has begun to be examined by establishing various models and adding variable or variables to the financial development indicators. Thus, the existence and direction of the correlation between financial development-growth has begun to take an important place in the literature. To affect the growth of financial innovation, to contribute to the saving of effects such as growth turns into investment, it increased the importance of this relationship. Because these effects are directly related to the financial intermediation activity. From this, it is possible to establish the relationship between financial development and economic growth as follows:

- Investments need to increase in order for a country's economy to grow.
- An increase in investments is possible with the increase in savings that will provide funds for investments.
- The greater the amount of savings collected in a country, investments will increase in that direction and the growth rate (*ceteris paribus*) will be that high.
- The provision of savings in the country depends on the existence of an advanced financial system.
- The transfer of savings to the economy depends on the safe investment environment and the acceptable rate of return.

If this relationship is successfully established; financial markets, which are key factors in ensuring strong economic growth, contribute to economic efficiency by directing resources from inefficient areas to productive areas (Durusu-Ciftci, Ispir, & Yetkiner, 2017: 291).

Together with the innovations and transformations that technology brings to economic life, the relationship between financial development and economic growth has become one of the popular topics to be considered in the literature. The aim of this study is the increasing importance of financial development for the economy in particular Turkey's economy, the theoretical explanation and empirical studies conducted in the literature refers to. Starting from the structure of the financial system, this study deals with this important issue by including both theoretical and empirical studies. Measurement of financial

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