

ABSTRACT

The world economy has reached the ecosystem of economic globalization where it is increasing, integrated and globalizing well in trade and finance. This phenomenon at least began to be felt in the last two decades, where most developing countries (capital poor) began to abandon the regime of financial repression and carry out domestic market liberalization/deregulation and open their capital account (Das, 2012). This is what makes financial openness was an important topic in the discussion of international finance. Klein et al., (2005) and Prasad et al. (2003) state that countries need to meet thresholds conditions to enjoy the benefits of capital account liberalization. The aims of this paper is to examine the relationship between financial openness and economic growth through the productivity of capital channel in 23 developing economies during the period 2002-2016. Specifically, this study highlights the role of institutional quality as an element of thresholds conditions in the process of financial integration. Furthermore, this study uses the dynamic data panel model of Arellano-Bond's GMM Estimator. This paper found that the interaction between financial openness and institutional quality has a positive and significant relationship to per capita GDP growth. Meanwhile, financial openness individually does not significantly affect economic growth. This result implies that the quality of institutions has an important influence on the relationship between financial openness and economic growth. In general, this study confirms that institutional quality plays a role in increasing the production efficiency of capital.

Keyword: Capital Account Openness, Economic Growth, Institutional Quality, Thresholds Conditions, Arellano-Bond's GMM Estimator.