1. GENERAL INTRODUCTION

The contribution of financial development to economic development has long gained the attention of economists, including Adam Smith. However, economists have not reached firm conclusions as to the link between financial development and economic growth. Views range from those who argue for the irrelevance of finance to those ascribing primary importance to the role of the financial system in economic development. This controversy has made it difficult to identify financial policies for developing countries for growth and industrialisation (Park, 1994: 9). No consensus has been reached on what kind of financial policy to pursue. During the last decade, financial policies in both industrial and developing countries have increasingly stressed market forces. But it has been pointed out that:

In developing countries, the main impulse behind liberalisation has been the belief based on the notion that interventionist financial policies were one of the main causes of the crisis of the 1980s, that liberalisation would help to restore growth and stability by raising savings and improving overall economic efficiency... However, these expectations have not generally been realised. In many developing countries, instead of lifting the level of domestic savings and investment, financial liberalisation has, rather, increased financial instability. Financial activity has increased and financial deepening occurred, but without benefiting industry and commerce. (Akyuz, 1993: 1)

In recent years, the World Bank has been actively involved in fostering stock market development in third world countries. This setting up stock markets in many developing countries in recent years is part of a general trend towards liberalisation, deregulation and privatisation. Nevertheless, recent research has pointed out that the cost of capital provided to firms is significantly higher when short-term financing is provided by banks and long-term
funding by capital markets than when both activities are provided by banks (see Dertouzos et al., 1990: 61-62; UNCTAD, 1991).

It is clear that several issues remain controversial. Is financial liberalisation or repression more appropriate for developing countries? Should industrial financing be provided by banks or by capital markets? An attempt is made to address these issues in this research paper. The remainder of the paper is organised into six sections. Section 2 briefly examines financial development policy from alternative perspectives, while section 3 briefly examines how the stock market affects economic growth and structural change. Section 4 highlights the recent theories of intermediation that explain why bank credit is vital for industrial growth. The next section studies finance-industry relationships in Japan, South Korea, and the former Federal Republic of Germany. An assessment of financial development and relations between finance and industry in Malaysia follows in Section 6. The paper ends with lessons drawn from these experiences.