TABLE 3—*Continued.*

C: Correlation Between Measures of Financial Development

	Total capitalization	Market capitalization	Domestic credit to private sector	Accounting standards	Accounting standards 1983
Market capitalization over GDP	0.79 (0.00)	—	—	—	—
Domestic credit to private sector over GDP	0.67 (0.00)	0.21 (0.18)	1.00 —	—	—
Accounting standards	0.41 (0.02)	0.45 (0.01)	0.25 (0.17)	1.00 —	—
Accounting standards (1983)	0.27 (0.17)	0.39 (0.05)	−0.14 (0.50)	0.68 (0.00)	1.00 —
Per capita income	0.26 (0.09)	0.04 (0.80)	0.48 (0.00)	0.56 (0.00)	0.28 (0.16)

Notes: Industry real growth is the annual compounded growth rate in real value added for the period 1980–1990 for each ISIC industry in each country. The growth in the number of firms is the difference between the log of number of ending-period firms and the log of number of beginning-period firms. The average size of firms in the industry is obtained by dividing the value added in the industry by the number of firms, and the growth in average size is obtained again as a difference in logs. The industry's share of total value added is computed dividing the 1980 value added of the industry by the total value added in manufacturing that year. External dependence is the median fraction of capital expenditures not financed with cash flow from operations for each industry. Cash flow from operations is broadly defined as the sum of *Compustat* funds from operations (items #110), decreases in inventories, decreases in receivables, and increases in payables. External dependence has been constructed using *Compustat* firms between 1980 and 1990, except for Canada where we use *Global Vantage* (Standard & Poor's, 1993) data between 1982 and 1990. Accounting standards is an index developed by the Center for International Financial Analysis and Research ranking the amount of disclosure of companies' annual reports in each country. In Panels B and C the *p*-values are reported in parentheses.

in the subset of countries for which it is available.

Both our measures of financial development, accounting standards and the capitalization ratio, are tabulated for the different countries (see Table 2). While more-developed countries have better accounting standards, there are exceptions. For instance, Malaysia scores as high as Australia or Canada, while Belgium and Germany are in the same league as Korea, the Philippines, or Mexico. Portugal has among the worst accounting standards.

Before we go to the summary statistics, note that for a country's financial development to have any effect on industrial growth in that country we have to assume that firms finance themselves largely in their own country. In other words, only if world capital markets are not perfectly integrated can domestic financial development affect a country's growth. There is a wealth of evidence documenting the existence of frictions in international capital markets: the extremely high correlation between a country's savings and its investments (Martin Feldstein and Charles Horioka, 1980), the strong home bias in portfolio investments (Kenneth R. French and James M. Poterba, 1991), and cross-country differences in expected returns (Geert Bekaert and Cambell R. Harvey, 1995). We have little else to say about this assumption other than noting that its failure would weaken the power of our test but not necessarily bias our findings.

Summary statistics and correlations are in Table 3. A number of correlations are noteworthy. First, the financial sector is more developed in richer countries. The correlation of per capita income in 1980 with accounting standards and total capitalization is 0.56 and 0.26 (significant at the 1-percent and 10-percent level, respectively).