NEXUS OF DEMOCRACY, FINANCIAL OPENNESS, AND FINANCIAL DEVELOPMENT:

A PANEL ANALYSIS OF SAARC COUNTRIES

BY

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Candidate of **Master of Philosophy** at the National University of Modern Languages do hereby declare that the thesis **Relationship between Democracy , Financial Openness and Financial Development: A Panel Data Analysis of SAARC Countries** submitted by me in partial fulfillment of MPhil degree, is my original work, and has not been submitted or published earlier. I also solemnly declare that it shall not, in future, be submitted by me for obtaining any other degree from this or any other university or institution.

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ABSTRACT

Financial development is a key for all developments in any countries .several proxies have been selected by numerous studies that play their part effectively in acceleration of financial development activities. To maintain the study at fix important variables including democracy, financial openness, and all the indicators of these variables

The current study explores the determinants of financial development process in selected countries of South Asian Association for Regional Corporation (SARRC) namely, Pakistan, India, Sri Lanka, Nepal and Bangladesh. Financial development is measured by financial openness and democracy. For empirical estimation, fixed effect model is used on panel data from the period of 1975to 2019.The empirical findings reveal that financial development will be effected by financial openness and democracy as in long run democracy will significantly affect financial development but in short run democratic situation will have negative reaction for financial development. In long run financial openness have negative impact but in short run it will significantly affect financial development. Democracy along with financial openness is positively related to financial development in short run as well as in long run.

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LIST OF ABBREVIATIONS

FO = Financial Openness

DEM= Democracy

WDI = World Development Index

FO*Dem= Financial Openness * Democracy

SAARC = South Asian Association of Regional Development

ADB = Asian Development Bank

NTBs = Non-Tariff Barriers to Trade

GDP = Gross Domestic Product

ARDL = Auto Regressive Distributed Lab

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This thesis is dedicated to my father for his love, endless support and encouragement.

CHAPTER 1

INTRODUCTION

BACKGROUND OF THE STUDY

Democracy and financial openness are considered as important aspects for the growth of financial development of any economy. Many professionals and economists in other fields defined democracy and financial openness in different way. At a fundamental level, this powerful set of institutions is often thought to be brought about by democracy, a political system characterized by popular participation, political competition for public office, and institutional constraints on the rulers. Democracy brings political checks and balances, responsiveness to citizen priorities, openness, self-correcting mechanisms, and other good institutions

A developed financial system includes banking sector, insurance companies, financial markets, market intermediaries, institutions and regulatory bodies; all acting as contrivance to achieve sustainable and balanced financial expansion and economic growth through efficiently allocating the resources among the savers and investors, it is imperative to explore the factors that are essential and contribute towards financial development. Economists still have an insufficient understanding of what brings about the emergence and development of financial markets. It is still an unknown fact that why in various countries having similar level of economic growth different financial systems prevail and what accounts for the differences in the level of financial development in countries like the SAARC member countries which have almost similar income levels and geographic conditions. Openness and competitiveness of a country's political system has a tendency to reflect itself in the openness and competitiveness of its financial system. Democracies, by promoting political participation and competition, limit the power of the state to control and repress the financial system, reduce the chance for both predatory and opportunistic behavior, and thus generate a more competitive and more efficient banking system .Countries with greater constraints on the government provide greater protection against expropriation and consequently have a better banking system and more developed stock markets .Democratic regimes encourage financial development by discouraging government ownership of banks the existing literature has stressed the role of political and legal institutions in promoting financial development, which is widely viewed as

crucial for economic growth . Institutions that respect the rule of law, protect property rights as well as contract enforcements, and put effective constraints on rulers are shown to be associated with higher levels of financial .The present study is intended to measure the financial development of SAARC countries by selecting the suitable measures from several studies. As financial development cannot be measured direct, to measure financial development several proxies used. It was observed in case of SAARC countries that research and development play the major role to take off the economy.

The present study emphasizes on the importance of financial development in SAARC countries and also to highlight the areas where financial development is in progress in SAARC countries and leads to accelerate GDP. This study also indicates the importance of democracy and financial openness to accelerate financial development. In2012 SAARC exports increased substantially to $354.6 billion from $206.7 billion in 2009.Imports too increased from $330 billion to $602 billion over the same period. But the intra-SAARC trade amounts to just a little over 1% of SAARC's GDP. In contrast to SAARC, in ASEAN (which is actually smaller than SAARC in terms of the size of the economy) the intra-bloc trade stands at 10% of its GDP.

SAARC intra-regional trade stands at just five percent on the share of intra-regional trade in overall trade in South Asia. Similarly, foreign direct investment is also dismal. The intra-regional FDI flow stands at around four percent of the total foreign investment.

The Asian Development Bank has estimated that inter-regional trade in SAARC region possessed the potential of shooting up agricultural exports by $14 billion per year from existing level of $8 billion to $22 billion. The study by Asian Development Bank states that against the potential average SAARC intra-regional trade of $22 billion per year, the actual trade in South Asia has been only around $8 billion. The non-captured potential for intra-regional trade is therefore $14 billion per year, i.e., 68%.Financial development deals with the policies, processes, and strategies to enhance the financial access, depth, and efficiency of the financial institutions and financial markets. Theoretical literature suggests that financial development can promote economic growth through the pooling of savings, risk reduction and risk management, facilitation of exchange via reduction of transaction costs, information sharing about investment opportunities, improvement of capital allocation, and the increase of investor's willingness to finance new projects through monitoring corporate governance . The debate about the relationship between democratic forms of government and the free movement of capital across borders dates to the 18th century. It has regained prominence as capital on a massive scale has become increasingly mobile and as free economies experience

continuous pressure from rapidly changing technology, market integration, changing consumer preferences, and intensified competition. These changes imply greater uncertainty about citizens' future income positions, which could prompt them to seek insurance through the marketplace or through constitutionally arranged income redistribution. As more countries move toward democracy, the availability of such insurance mechanisms to citizens is key if political pressure for capital controls is to be averted and if public support for an open, liberal international financial order is to be maintained. The author briefly reviews how today's international financial system evolved from one of mostly closed capital accounts immediately after World War II to today's enormous, largely free-flowing market.

The existing literature has stressed the role of political and legal institutions in promoting financial development, which is widely viewed as crucial for economic growth .Institutions that respect the rule of law, protect property rights as well as contract enforcements, and put effective constraints on rulers are shown to be associated with higher levels of financial development .At a fundamental level, this powerful set of institutions is often thought to be brought about by democracy, a political system characterized by popular participation, political competition for public office, and institutional constraints on the rulers. Democracy brings political checks and balances, responsiveness to citizen priorities, openness, self-correcting mechanisms, and other good institutions. Openness and competitiveness of a country's political system has a tendency to reflect itself in the openness and competitiveness of its financial system. Democracies, by promoting political participation and competition, limit the power of the state to control and repress the financial system, reduce the chance for both predatory and opportunistic behavior, and thus generate a more competitive and more efficient banking system .In the absence of competitive elections, political checks and balances are of crucial importance for property rights protection and contract enforcement .Countries with greater constraints on the government provide greater protection against expropriation and consequently have a better banking system and more developed stock markets .Democratic regimes encourage financial development by discouraging government ownership of banks. SAARC accounts for 3.8% (US$2.9 trillion) of the world's GDP, 21% of its people, and 3% of its territory.

Role of the university is widely considered by the world financial development engine. Universities in the world contribute to the development of countries and provide center for the education that provide its primary role. Of Pakistan has many world known universities that are producing high quality of research. They are also providing help in the transformation of

research into social well -being by creating a strong bond between a knowledge creator and knowledge consumers. Private and public sectors development highly depend on the factor of education attainment level, high level investment in research area, democracy or institutional development and free trade openness that will leads to financial sector development and also improve the living standard of the population of SAARC. South Asia Sub regional Economic Cooperation and South Asian Association for Regional Cooperation. The SASEC program brings together Bangladesh, Bhutan, India, Maldives, Myanmar, Nepal, and Sri Lanka in a project-based partnership to promote regional prosperity by improving cross-border connectivity, facilitating faster and less costly trade among member countries, and strengthening regional economic cooperation. ADB is the secretariat and lead financier and development partner of SASEC. The Secretariat has been regularly receiving requests from students in SAARC Member States and outside the Region for pursuing Internship at the SAARC Secretariat. On completion of their Internship at the SAARC Secretariat, they submit their research papers in varied areas of interests. On successful completion of the Internship, the internees are awarded a Certificate by the Secretary General.

1.2 SIGNIFICANCE OF THE STUDY

The basic reason of this study is to empirically analyse an impact of political regimes framework and financial openness and financial development of SAARC(South Asian association of regional development) This study is conducted to see the status of financial development in SAARC countries. There are numerous studies which show the impact of financial development and variables. But the significance of the study is to examine that how democracy and financial openness have impact on financial development. The aim of the study is to give direction to the sector that how institution can use this empirical result to find how democracy and financial openness can increase financial development in SAARC countries.

1.3 Problem statement

The literature has shown the results that democracy and institutional development plays an important role in financial development also financial openness accelerate financial growth and brings prosperity. SAARC are developing countries with the availability of many resources that still need to explore .Therefore the incentive of this study is to explore the conditional impact on financial development.

1.3 OBJECTIVE OF THE STUDY

This study has been conducted to achieve the subsequent key objectives;

1. To analyse the impact of democracy on financial development in SAARC countries.
2. To analyse the impact of financial openness on financial development in SAARC countries.
3. To analyse the conditional effect of financial openness and Democracy on financial development.

1.4 .RESEARCH QUESTIONS OF THE STUDY:

The main research questions which we will find after our research are

- What is the impact of democratic regime on financial development of selected SAARC countries?
- What is the impact of financial openness on financial development of selected SAARC countries?
- What is the conditional effect of financial openness and democracy on financial development?

1.5 The Statement of Problem

Financial development of the countries like Pakistan, India act are important ingredients of the economic system of the countries of South Asia like other European countries.

SAARC was developed in 1985.The main motive of this development was to improve the quality of life and to accelerate the economic growth by promoting all development indicators and also to provide opportunities to each individual of the country to use their potential. The main motive was to increase and promote self-reliance between all countries but all were almost fail to do that.

The literature have shown that every country have different political and autocracy issues regarding financial development ,some literature show that democracy is positively related to the financial development and is co-integrated with financial development. There is no leading study which shows us that in SAARC countries the financial development is low or higher because of democracy and how can we increase mutual financial development through democracy and by giving power to our financial system by promoting each other.

Hence the main role of the study is to see the impact of democracy and financial openness in SAARC countries. There are numerous studies available which examine such relationships.

This study fulfilled this research gap, at least to SAARC.This is the study which has highlighted the role of democracy and financial openness in development or financial development of SAARC countries.

1.6 STRUCTURE OF STUDY

The present study of the thesis is organized into 6 chapters. Chapter number one of the study is dealing with the introduction of the topic. Chapter number 2 deals with reviewing of the literature which includes the empirical and theoretical literature from national studies especially of relevant country and also from international studies and at the end the literature shows the recent countries past studies which help in in this study. Chapter number 3 deals with the variables in depth exploration and relation between the variables .Chapter number 4 of this study deals with the theoretical methodology, the method to measure financial development, econometrics techniques and also estimation of the model. Chapter number 5 deals with the estimations and at the end the tables are showing the results of the estimation done in the study. Chapter number 6 is dealing with conclusions of study that includes findings of the study, remarks and also policy implication and finally recommendations.

Chapter 2

LITERATURE REVIEW

Numerous theories or theoretical and empirical studies have been purposed that how and why democracy and financial openness have impact upon the financial development and how it will be done.

2.1 Democracy and financial Development;

Baltagi et al. (2009) addressed whether financial openness and trade openness are important factors to enhance the country's financial sector development. However, the study could prove partial evidence in Rajan and Zingales's favor that both types of openness are necessary for banking sector development. Falahaty and Law (2012) in an analysis conducted for the MENA region, found that trade openness and banking concentration matter for the financial sector development. However, it also identified the quality of institutions and macroeconomic stability as a vital factor to catalyze financial sector deepening. Many studies, including , and Chin and Lto (2006), also supported that institutions and their quality matters for financial development.

According to political theories of financial growth, in nations where a small elite controls political decisions, financial development may be blocked in order to deny potential competitors access to financing. Girma and Shortlan (2007) used panel data from 1995 to 2000 in their study.They looked into the political economics of financial development to understand how the characteristics of a country's democracy and regime change affect financial development.The findings suggest that regime stability and democracy both support and promote financial development, with fully democratic regimes providing additional benefits.Yoo and Menaldo (2007) have studied the same subject in their work, "Democracy, Elite Bias," . Between 1965 and 2006, they observed 22 different Latin American countries.They used Ordinary Least Squares (OLS) with Driscoll-Kraay standard errors to estimate a series of static fixed effects (FE) models to evaluate the association between regime transitions and financial development, as well as the GMM technique.The findings show that democracies having histories that inspire policymakers to appeal to the median voter, as measured by the adoption of their own constitution after transition, pursue financial policies that benefit the majority by increasing credit availability and keeping interest rates low.Elite-biased democracies, on the other hand, where economic elites were able to impose a

constitution that over-represents their interests prior to transition construct barriers to competition in the finance market and limit capital, increasing rents but decelerating financial and therefore economic and social development.Mandon and Mathonnat (2005) used data from 140 countries between 1984 and 2007.They discovered that strengthening democracies' effect on financial types of government, election systems, and territory form growth is influenced not just by democratic regimes, but also by government form (parliamentary) and, to a lesser extent, state form development (federal). The positive impact of democracy on economic literacy is dependent entirely on the organizational factors at work, particularly parliamentary governments and, to a lesser extent, federal states, therefore institutional specifics are crucial. As a result, our research adds to the debate over institutional design by indicating that promoting democratic regimes alone may not be sufficient to ensure economic success.

Standard political economists state that the process has moderate impact on inequality of income. But there was no empirical study to this effect.Gradstein et all (2001) have analysed the relationship between democracy and income inequality.He took data of about 126 countries from the year 1968 to 1998. He used Gini coefficient to estimate the model and variables. The empirical results suggest that democracy will affect the inequality directly. Democracy will work through the kind of political system. This kind of phenomenon has direct impact on the development.In Muslim societies and Confucian societies it had insignificant impact. Muslims and Confucian society have trust on informal transfers to reach the inequality level which they desire, while Judeo-Christian societies use political system because they have weaker family system.Populist approach suggests that inflation occurs due to public demands by tax inflation so the election will increase inflation But state approach says that inflation occurs due to elite pressure. Olofsgard and Yousaf (2003) analysed the relationship between democracy, inflation and inequality. He took data for this purpose about 100 countries from the year 1960 to 1999. He has used panel estimation methods to estimate the model. The empirical result suggests that lower level of democracy is associated with lower inflation in low-inequality countries but must have a higher rate of inflation in higher democratic rates. So democracy has a direct relation with inflation rate and financial development.Acemoglu et all (2005) analysed the relationship between income per capita and democracy. He took data from 1960 to 2000 of different colonies. He used OLs estimation, GMM, AR (2) test and the Hansen J test to estimate the model. The empirical result suggest that income has causal effects on

democracy—better democratic transition will cause rise in income and will create financial development.

Democracy may affect financial development, but the spill over impacts is difficult to understand and analyse theoretically.Persson and Tabellini (2006) analysed the relationship between democracy and growth and also development they took data off 15 countries over the period of 1960-2000. They used Robust standard errors test use to estimate the model. The results suggest that democracy has very weak relationship with economic growth. Democracy will influence the development but effects are not easy to identify with in country variation.Braun and Raddatz (2008) analysed the relationship between the Politics of Financial Development, evidence from Trade Liberalization. He took data to study 41 countries that were liberalized from the year 1996 to 2000.They have used the OLs method to estimate the model.The study found that the condition of political economy is mandatory for best policy convergence it is done automatically in any state.Policies that have liberalization effects are not enough they may have worsen effects.Democracy is a good game in which political regimes are interested in development. Khalid et al (2010) saw the relationship between Pakistan's democracy as well as economic growth.They used data from Pakistan from 38 annual observations.They empirically estimated the model using the ADRL approach.Democracy is favourably associated to growth and development, according to the study.In Pakistan, Abbas and Jawaid (2016) investigated the link between democracy and international financial integration. They used data from long-term time series from 1975 to 2013. To estimate the empirical data, they employed dynamic ordinary least square (DOLS), completely modified ordinary least square (FMOLS), and canonical regression (CR). They discovered that whether international integration or financial integration is more important depends on the size of the market of the economy and institutional system so democracy is positively related to International integrationLaw and Saini (2012) analysed the relationship between Governance and Financial Development. They took data of 51 countries of developed and underdeveloped countries from the year 1984 to 1996. They have used WGI or ICRG and GMM.The study was done to examine the role of influencing financial system, governance and role of institutions across the developed and underdeveloped countries. Study reveals that banking sectors are developed with the help of strong institutional quality and strong governance. Upturn in stock market and development is caused by the increase in the threshold level.

Recent political theories of financial development had no clear indications that how political regimes will impacts the growth, there was no direct negative or positive effects of democracy

on development no evidence of these all were present. Bodriga and Ghardallou (2014) analysed the relationship between democracy and financial development and institutions. For this they took data of 110 developed countries form the year 1984-2006. He used panel regression, pool regression and Hausmen test to estimate the model. Study concludes that democratic and institutional qualities will spur financial development. There is a certain level after that there will be a negative impacts on financial development so growth will increase in emerging countries.

Democracy can reduce income inequality when citizens will give votes to the parties which will give privilege to redistribution. Balcázar (2015) analysed the relationship between income inequality in long run and democracy. He took data of 9 Latin American countries from the year 1995 to 2009. He has used pseudo panel modelling to estimate the model. The empirical results suggest that high democratic institutions will have lower level of inequality and educational gap and lower level of democracy will have worsened impacts on inequality. If the change occurs in education output, political regimes democracy onto long-run changes may occur to the human capital distribution and after that contemporary changes may occur in income inequality. This will cause financial development in financial sector.As in past years the democratic countries have different financial development level and non-democracy had different level of development. Gharadallou (2016) analysed the relationship between democratic transition and financial development. He took data of 34 countries from 1974-2000. They used ordinary least square, Random effect model, generalized method of moments (GMM) to estimate the model. The study shows that adaptation of the democratic rules will

The financial development-democracy nexus, on the theoretical front in which most of the explanation upon the financial development-democracy nexus is found to be in the political economy theories of the financial development. According to La Porta et all (2009), a democratic system is more favourable to financial development, than any other choice since it limits governmental ownership of financial institutions. The findings suggest that common-law countries have the highest legal protections for investors, while French civil law countries have the poorest, with German and Scandinavian civil law countries in the centre. We also discover that shareholder concentration in the largest public businesses is adversely associated to investor protections, supporting the idea that small, diverse stockholders are unlikely to be influential in nations that do not defend their rights. The influence of democracy on financial development is projected to be favourable, based on the aforementioned considerations. Several

empirical research on the democracy-financial development connection have yielded mixed results.

2.2 Financial Openness and Financial Development

In the twentieth century, the relationship between financial development and economic performance was a major topic.Financial Development and Economic Performance were investigated by Li and Inghamand (2020). From 1971 through 2007, he compiled data on 67 countries.To estimate the model, they use both the autoregressive distributed lag (ARDL) and the cross-section ally augmented autoregressive distributed lag (CS-ARDL) models. The study concludes that financial development and economic growth are mutually beneficial.

In recent years, particularly throughout the 1970s and 1980s, inflation and financial openness have had a negative association.The link between Financial Openness and Inflation has been studied by Gender and Smith (2020). An Empirical Study. From 1996 to 2016, he collected data from 139 nations.To estimate the model, he employed the OLS estimation approach. According to empirical findings, trade has no systematic association with inflation. The link between the CPI and financial openness has deteriorated.Financial development promotes lower-cost capital entrepreneurs while also expanding economic activities and reducing inequality. Menaldo and Yoo (2015) investigated the relationship between democracy, elite prejudice, and financial development in Latin America using data from 25 Latin American and Caribbean nations between 1950 and 2006. To estimate the model, they employ ordinary least squares (OLS) using Driscoll-Kraay standard errors. According to the findings, democracy with its own constitution will have a sophisticated financial system.

Financial openness will have an impact on the banking and capital markets sectors of the economy. Yuanyan Luo et al. (2016) investigated the link between financial openness and financial development in China, using data from 30 provinces between 2000 and 2009. Financial openness has a beneficial impact on financial efficiency, but it may have a negative impact on the magnitude of financial development for all direct and indirect financial sectors, according to the study.Many developing countries have attempted to overhaul their economic and financial systems in case to increase an efficiency of their financial intermediaries and so boost financial development. The relationship between financial development, economic growth, and financial sector development was investigated by Jung-Suk Yuay et al. (2011). They gathered information from a variety of geographical areas. To estimate the results, they used Granger causality tests, unrestricted VAR and VEC, FEVDs, and IRFs.According to the

study, low-income nations may have delayed growth for up to ten years as a result of poorly implemented rules, but countries with well-enforced policies may see robust and rapid finance sector growth.

Aluko and Ajayi(2019) used a sample of 33 nations from 1991 to 2015 to investigate how openness and democracy deepen the banking industry in Sub-Saharan Africa. This article suggests that contemporaneous liberalization to trade and financial borders, as well as better levels in participatory democracy, develop the banking sector after controlling for the potential effects of some country characteristics. It also demonstrates that expanding financial openness without growing trade exposure leads to a deeper financial system, whereas increasing international competitiveness alone is sufficient to expand the banking industry, demonstrating that financial development and democracy are not strongly linked. The confluence of financial development and financial openness (liberalisation) may have either an augmenting or a retarding effect.

Liberalization supporters argue that restrictive policies such as setting deposit and lending interest rates below the market equilibrium reduce savings and, as a result, investment. Similarly, proponents of the market efficiency hypothesis argue that free capital flows facilitate the effective allocation of global savings and direct resources even their most productive means, hence boosting the economy, especially in capital-poor countries .Klein and Olivei (2012) have saw a relationship between " capital account and financial openness". They took data of 8 countries from the year 1985 to 1995.They contend that compared to the countries with capital restrictions, countries with open capital accounts are more financially developed. Different economic theories are providing different ways that can increase the access towards international financial flows that may enhance the growth production. There are numerous studies available that to understand the impact of financial openness on growth side of development. Studies are available to show the impacts of FO on the productivity but there are fewer studies available that can show the impacts of FO on productivity. M Ayhan kose et al (2008) has studied "Does Openness to International Financial Flows Contribute to Productivity Growth". They took data from the year 1966 to 2005 of 67 different countries that includes 46 developing countries and other 21 countries are industrial. They have used Blundell-Bond system GMM estimator to estimate the results of the study. The result of the author shows that domestic financial development will be promoted by the financial openness by raising the credit of banks and on other side by increasing the total assets, it also increase capitalization of a stock markets and also total value traded. It can help to reduce the margins of interest rates.

There are numerous studies available which promote financial development. Moreover, Rajan et all (1995) have seen the relationship between financial openness and financial development. They took data from the year 1980 to 2001 of low income countries, middle income countries and high income countries.They have used GMM and bond tests to estimate the econometric model. The results of the author's study shows that in middle income counties trade and financial openness create high financial development as compared to low income economies. Some opponents of the efficient market theory said that financial openness is a mean through which inflation can be accelerated, assets prices can be volatile and at last financial instability occur that leads to change in bop difficulties(balance of payments) it create change in financial development in middle economies.

Eryiit and Dülgerolu use spatial panel data analysis to examine data from 81 provinces from 2005 to 2009. They look at the main determinants of regional financial development in Turkey and find that social, physical, and human capital are all positively correlated with it. The degree of social capital, followed by physical capital and human capital, was found to best describe the level of financial development. Furthermore, it was shown that capital accumulations contributed above-average not just to the province's financial development, but also to that of the neighbouring provinces. Scott and Julius Ovuefeyen (2012) have analysed the relationship between Openness and Inflation on Commercial Banks' Profitability. They have used data of Nigerian commercial banks from the year 2005 to 2012. They have used Rem and ECM (Error Connection Model) model to estimate the model. Empirical results suggest that economic openness can boost the commercial banks profitability if banks are capable of using that source. So economic openness or financial openness will increase financial sector development. 12) The financial system in developing economies is concerned with efficiently distributing scarce resources. The relationship between openness and financial development in China was studied by Lou et al (2016). The "Political Economy of Financial Resource Distribution" is a book about the political economy of financial resource distribution. From 2000 to 2009, Lou at al. collected data from 30 Chinese provinces. To estimate the model, they employed the GMM approach. Financial openness has a positive impact on financial efficiency but a negative impact on the size of financial development for both indirect and direct financial sectors, according to the empirical findings. Financial development is likely to be hampered in economies where the trade sector is liberalized but the financial sector is not.As a result, the Chinese economy's financial development and reform must take several forms.The most essential component that will contribute to increased growth and GDP in developing countries

is industrialization. Do industrialization, democracy, and financial openness enhance financial development? Ackay (2019) used data from Turkey from 1975 to 2015. To estimate the model, he employed a bound testing strategy. The study discovered that financial development and its basics key drivers are intertwined, that democracy is positively connected with financial development, that financial openness creates lower financial development, and that industrialization is not even a good and a significant determinant. Financial development will be aided by democracy, which will also empower civilian liberty and political rights while maintaining financial liberalism. Finally, inflation will stifle financial progress.

SUMMARY OF ARTICLES

These recent studies are showing different results as they are showing different results in different countries because of the economic and democratic conditions of the country and cross border flow of cash and inflow are main cause for its studies showing that the democratic community will have strong system of governance and strong policy that leads to open up ways that cause strong financial system. In some countries Democracy leads to have a negative sign it means that democracy do not promote the financial development and financial openness. Cross border movement of cash flow is another cause of big investment and small industries growth. . The study discovered that financial development and its basics key drivers are intertwined, that democracy is positively connected with financial development, that financial openness creates lower financial development, and that industrialization is not even a good and a significant determinant. Financial development will be aided by democracy, which will also empower civilian liberty and political rights while maintaining financial liberalism. Finally, inflation will stifle financial progress.

CHAPTER 3

THEORETICAL FRAMEWORK

INTRODUCTION

This study explores the association between democracy and financial openness and their implications on financial development.

Dependent variable is financial development. We have democracy and financial openness as stimuli variables Democracy has the key role in all kind of growths and developments it depends upon all kinds of factors like educational system, investments methods and where the investment is done by what kind of infrastructure we have and how we build that, what kind of foreign remittances we have. Financial openness mainly depends upon cross border investment.

Interlinked relationship between Democracy, the financial development and financial openness

3.1 Financial Development and Openness;

While the foreign market offers great opportunities, the country's opening also attracts foreign competitors to the domestic market. Rents in the United States are reduced as a result of foreign immigration. Established enterprises with smaller profitability have lower internal cash flow, making them more reliant on external capital. External opportunities (or the necessity to safeguard the domestic market against superior foreign technologies) raise incumbents' need for further investment at the same time. Unfortunately, the requirement for external investment does not always convert into financial system reforms that promote transparency and accessibility. In reality, given their greater financial needs, industry incumbents may push for more financial restraint so that available funds flow easily to them. Financial creditors, on the other hand, may be unwilling to accept the increasing financial market rivalry for the additional industrial clients that reforms may bring (due to improved transparency and access). It may be far more beneficial to maintain existing relationships with industry incumbents and provide them with the additional funding they require. In the face of international competition, industry incumbents may ask the government for loan subsidies rather than improving the quality of the domestic financial system. Selective government action could increase the lack of transparency and access in the financial system. As a result, exposing the industrial sector to trade flows may not be enough to persuade one or both parties. System of banking Selective government action

in a country can reduce the openness and accessibility of the financial sector. It may not be enough to persuade one or both of the main interest groups to change their minds to support development finance. The only possibility of cross-border capital flows (or financial openness) is the latter. Due to open access, the largest and most well-known domestic businesses will be able to access international capital markets for investment. In the absence of domestic or international competition in the product market, however, these enterprises would require little outside investment. Furthermore, due to market information asymmetry, it is difficult for small domestic businesses to raise capital directly from international investors. While foreigners are unlikely to fund potential domestic participants, incumbents will have a financial motive to keep them by preventing financial development. Even if the domestic financial sector loses a significant portion of its income from providing finance and services to the greatest industrial businesses, these cross-border capital flows are unlikely to persuade both parties. Our interest groups work to help people improve their financial situation. Financial and industrial actors will have converging forces to support development finance when cross-border trade and money flows are unrestricted. Industrial incumbents will require funding to counter foreign challenges due to diminished profitability and the necessity for fresh investment. However, as cross-border capital flows become more unrestricted, the government's role in channeling loans to incumbents will become more limited. As product marketplaces become more competitive, the risks of lending will increase, as will the information requirements for lending. The risk of big credit errors will rise as the credit system becomes more centralized. Furthermore, as mobile capital compels governments to maintain macroeconomic prudence (see, for example, Loriaux, 1997), the government's ability to make huge subsidized loans to favored enterprises would dwindle, in the 1980s, a depiction of the restrictions on French engagement in domestic lending). The importance of financial development and its role in financial intermediation has been a source of debate, as it has played a significant role in economic advancement over the previous few decades and has assumed a prominent role in financial development. Many academics believe that financial development boosts economic growth by encouraging industries, investments, the distribution of loanable funds, and capital accumulation (Ahmad et al. 2020b). In fact, they claimed that it is necessary for emerging countries to have well-developed capital markets. Khalikov (2017), on the other hand, used economic analysis to argue that financial development and economic advancement are inextricably linked. However, because of the nature of their work , depending on the type of model, data, and empirical methods employed to analyze it, the nature of their relationship remains uncertain. The non-savings and credit markets in the developed world are driven by a number of variables. The

proper allocation of capital is largely determined by a country's economic advancement and the effectiveness of its production cycle, as well as the equitable distribution of income among all citizens. Furthermore, according to Pearson and Elson (2015), finance will have negative effects for social security if sufficient regulations and rules are not in place. Financial improvements tend to promote capital allocation productivity, improve equity risk management, efficiently diversify creditors' investments, and improve investment venture efficacy (Ahmad et al. 2021c). Such elements can improve capital's competitiveness. The research has established a bidirectional relationship between financial development and economic growth. In Greenwood and Ovanovic's (1990) model, financial institutions, on the one hand, foster financial development and efficient capital distribution, despite the fact that accessing them comes at a cost .On the other side, urbanization reduces the cost of entering the financial intermediation market. The financial system's performance. First, they look at the proportion of total credit that is issued by the private sector rather than the central bank. On the other hand, the second method calculates the worldwide fund composition for private enterprises. Both of these factors point to a more effective allocation of foreign capital in a market with higher corporate credit and private sector investment. A corporate bank, striving to maximize profits, will be more likely than the government to fund profitable infrastructure projects. are expected, the savings rate may fluctuate, increasing or decreasing as a result of greater income and replacement impact returns. n the case that you receive a lower score. Savings rates will fall as a result of better resource management and lower risk as a result of financial reforms (DeAngelo and Stulz 2015). Financial openness is expected to have a nonlinear effect on credit ratings based on domestic financial development for at least three reasons. First, when a government implements capital controls, a well-developed domestic financial system can fill both business and sovereign financing gaps. As a result, in less financially developed countries, the benefits of lifting capital account limitations should be greater. Second, according to the international finance research, capital account liberalization lowers risk premiums by improving risk sharing and market liquidity (Errunza and Losq, 1985; Bekaert and Harvey, 2000) and Chari and Henry,(2004) An issuer's default probability lowers when its cost of capital decreases, and its credit rating improves. Because issuers from well-developed local markets already enjoy significant risk sharing and liquidity, there is less room for improvement in this area than there is for issuers from less developed financial markets who have the opportunity to develop financial innovations that allow capital controls to be bypassed (Klein and Olivei, 2008ts.). Finally, more sophisticated domestic capital markets may offer opportunities.

The KAOPEN index is the first of four cross-border financial transaction limitations detailed in the International Monetary Fund's Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER). Multiple exchange rates, restrictions on current account transactions, restrictions on capital account transactions, and obligations concerning the surrender of export revenues' are all indicated by these constraints. Financial development cannot be harmed simply because a province has a high level of trade or financial openness. However, in areas with high levels of trade and financial openness, the opposition is weakened. These findings back up interest group theory when it comes to estimating inter-provincial variances and time-series changes in China's financial development. The incumbent opposition to financial development is predicted by the interest group financial development hypothesis.

RELATIONSHIP BETWEEN DEMOCRACY AND FINANCIAL DEVELOPMENT

The debate over democracy and growth has recently gained traction, as worldwide democratic progress has been countered by good economic success in some nations, such as China and Russia. At the same time, the global crisis of 2008-2009 raised doubts about the free-market model's viability and emphasized the need for government to play a larger role. In the contemporary global setting, it is frequently suggested that neither free markets nor democratic government can help foster economic activity and financial development, and that authoritarian democracy is better suited to accomplishing these aims

.Democracy is directly linked with financial openness through some channels.

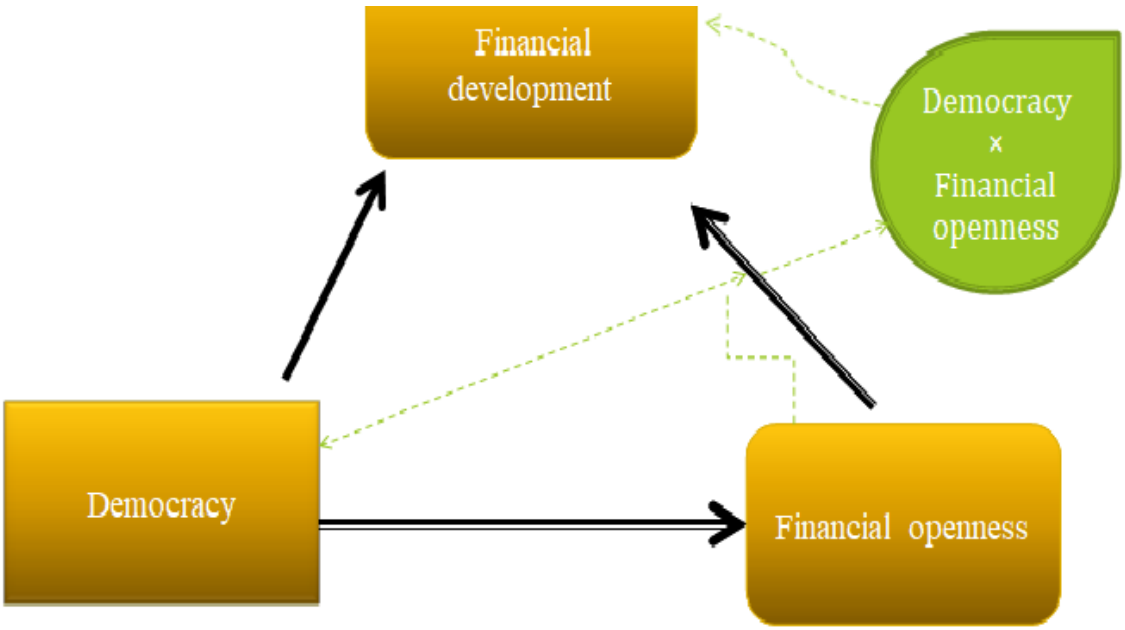

Figure 3.1a

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The duty of economic and political institutions is to give a shape and structure to economic development and financial development has been underlined in much of the literature (herein after referred to as FD). The economies which have better quality of institutions and more strong property legal rights spend more human capital and physical capital and employ it more effectively to increase income levels. Disturbances in institutional quality, on the other hand, might cause additional uncertainty, which sends the wrong signal to the market, resulting in skewed efficient financial growth (North, 1990). On the other side, there is a lot of discussion concerning the impact of political institutions on development, particularly democracy versus dictatorship.

Development theory emphasizes the need of building democratic institutions in promoting financial progress, whilst skeptics point to the inefficiencies of representative governments. In particular, if the quality of a country's institutions influences the effects of democracy on financial sector development. Finally, it presents fresh empirical findings that suggest that the type of democracy (rather than democracy vs. autocracy) has a significant impact on the adoption of long-term growth-promoting structural changes. The importance of democracy in boosting economic performance is emphasized in development theories. Indeed, democratic institutions, according to Wittman (1989), can improve the efficiency of financial markets, lowering cast of a transaction. Next redistribution, which is linked to democracy, does not have to be negative because investments can be funded by revenue taxation (Saint Paul and Verdier, 1993, Bourgouignon and Verdier, 2000). Next, democratic institutions open markets, attract more foreign entrants, and so assist new businesses in more effectively utilizing productivity improvements, leading in improved economic performance (Acemoglu, 2003). Furthermore, elite groups' interests are significantly better served in centralized and powerful political systems than in decentralized and competing governments from a political and financial standpoint (Olson, 1993, Acemoglu, 2003). Furthermore, Olson (1993) emphasizes democratic institutions' interest in safeguarding individual property and rights while downplaying the role of autocracies, which are associated with many difficulties in credibly committing to these rights. Indeed, gains from project and transaction investments are only transferred to the physical sector when the government suffers and is persecuted as a result of individual rights

violations. In fact, the author has established that the prerequisites for securing property rights are equally prerequisites for a long-term democracy.

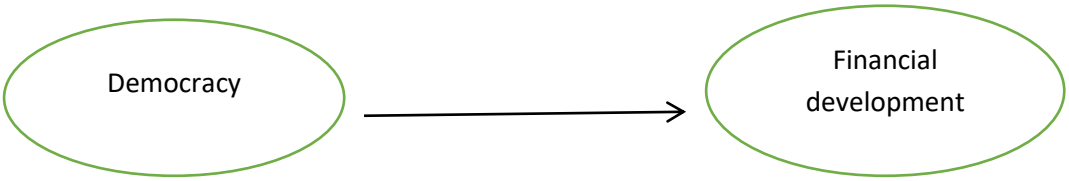


Figure 3.2b

Clague et al. (1996) stated that because democracy better protects individual and property rights, it will increase investment incentives. Finally, it is maintained that political power is positively related to political accountability; hence, more political power leads to higher political accountability. Furthermore, Buchanan and Tullock (1962) identified the issue of agency conflict between elected officials and the general population. They also suggest that a large state might be able to meet the requirements of the masses.

Huntington (1971) stated that democracies varied greatly in terms of how politically organized they are, and that these democratic countries were particularly vulnerable when the political role and participation is based upon political institutions. Furthermore, Zakaria (1997) distinguished between liberal as well as illiberal democratic societies. Only the rights to vote, create political parties, be elected, and compete in the political system are included in illiberal democracy, or the minimalistic definition of democracy. Liberal democracies, on the other hand, are defined by the law rules, freedom of speech, assembly, and the most important is religion, in addition to political liberties.

According to Zakaria, liberalism of constitutions, which emphasizes on the importance of a law, limits on the power of each branch of government, property rights, and freedom of speech and religion, is not always accompanied by democracy. Furthermore, the author contended that a democratic government's predisposition to feel it possesses sovereignty encourages it to concentrate its power through extra-constitutional means.. Zakaria went on to say that the most critical prerequisite for successful democratization is law and order. He pointed out that democracy with weak law and order deteriorates state institutional capacity by reducing the efficiency of government laws, especially tax rules.

Bordo and Rousseau (2006) found that representation ratio, regular suffrage, women's suffrage, and political stability all have large independent effects on the size of the financial sector. To

stimulate financial development, policymakers might use a variety of levers. Bank chartering can be liberalized, and bank branching permitted, cutting entrance barriers and forcing banks to compete for deposits and loans. This competition should increase loan availability and cut financial service margins, lowering capital costs. Improved contract enforcement, the introduction of property records, and modern bankruptcy law may encourage banks to lend more money by allowing them to reclaim collateral in the event of default. Modern accounting standards and increased transparency in information are also important; these measures help to reduce information asymmetry, allowing depositors and investors to better analyze risk and have confidence in the lending integrity of banks.

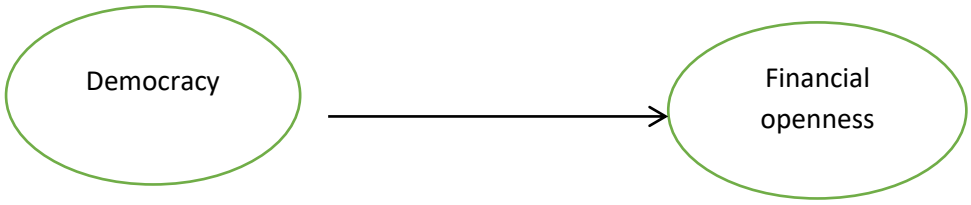
3.2 Relationship between financial openness and democracy:

The fact that they allow free capital movement across national borders has reignited debate over the relationship between democracy and financial openness. This debate has a long and illustrious history, dating back to the 18th century, but it has resurfaced in recent years as capital has become more mobile on a large scale and freer economies have come under increasing pressure from rapidly changing technology, market integration, shifting consumer preferences, and increased competition. Reflects the impact of advancements in communication and information technology, financial innovation, and targeted government initiatives that reduce barriers and limitations to capital and market mobility. In recent years, international finance has increased dramatically. International funding in the form of new medium and long-term bonds and bank loans hit a record high, compared with $0.50 in 1988 (BIS 1998). International financial transactions now account for more than five times global GDP, surpassing world trade. In 1995, the average daily turnover in the foreign exchange market was $1.6 trillion (up from $0.2 trillion in 1986), compared to $6.7 trillion per year for goods and services exchange.

While free capital mobility has roots in 17th and 18th century Europe, the worldwide triumphant spread of democracy as a desirable system of governance is a relatively recent phenomenon aided by a number of factors, including the rise of global civil society and the information age, as well as the collapse of state socialism.

The huge social and economic consequences of financial instability are intolerable, and they make a compelling case for financial innovation and better techniques to prevent future financial crises and mitigate the severity of those that do occur. As has been widely reported in both academic and policy circles, strengthening domestic regulation and supervision of banks

and other intermediaries, rebuilding the information infrastructure of financial markets, including accounting norms, and improving corporate governance are necessary first steps. But they won't be enough unless they're backed up by steps to keep public support for open capital markets strong. In democratic countries, securing public support for financial transparency will necessitate the provision of institutions that provide citizens with insurance is provided to citizens either through the market or by redistributive policy, such as public spending on education, health, and transfer payments. As with other public goods, public support may be subject to underinvestment, implying that appropriate provision would include addressing agency, moral hazard, and incentive difficulties



Figure

The debate about the relationship between democratic forms of government and the free movement of capital across borders dates to the 18th century. It has regained prominence as capital on a massive scale has become increasingly mobile and as free economies experience continuous pressure from rapidly changing technology, market integration, changing consumer preferences, and intensified competition. These changes imply greater uncertainty about citizens' future income positions, which could prompt them to seek insurance through the marketplace or through constitutionally arranged income redistribution.

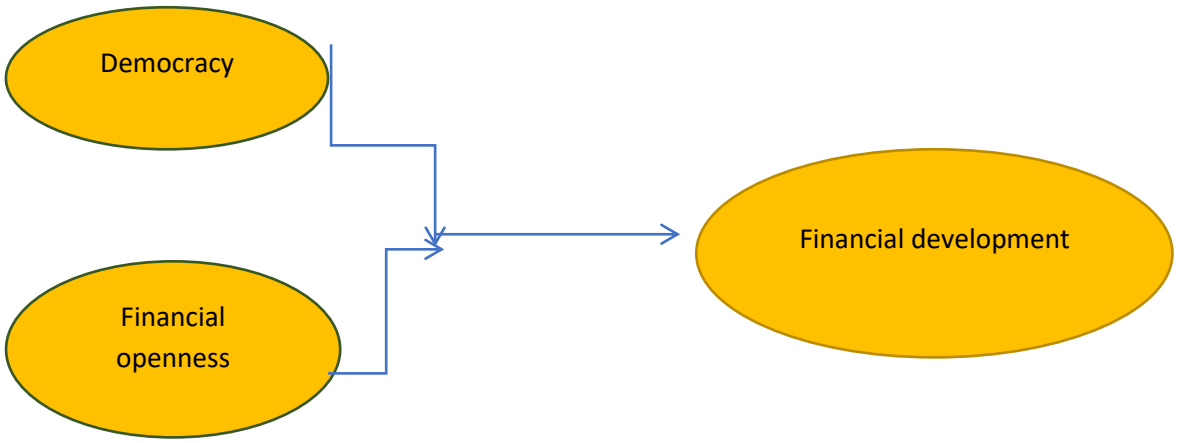
As more countries move toward democracy, the availability of such insurance mechanisms to citizens is key if political pressure for capital controls is to be averted and if public support for an open, liberal international financial order is to be maintained. Dailami briefly reviews how today's international financial system evolved from one of mostly closed capital accounts immediately after World War II to today's enormous, largely free-flowing market. Drawing on insights from the literature on public choice and constitutional political economy, Dailami develops an analytical framework for a welfare cost-benefit analysis of financial openness to international capital flows. The main welfare benefits of financial openness derive from greater economic efficiency and increased opportunities for risk diversification.

The welfare costs relate to the cost of insurance used as a mechanism for coping with the risks of financial volatility. These insurance costs are the economic losses associated with redistribution, including moral hazard, rent-seeking, and rent-avoidance. A cross-sectional analysis of a large sample of developed and developing countries shows the positive correlation between democracy (as defined by political and civil liberty) and financial openness. More rigorous econometric investigation using logit analysis and controlling for level of income also shows that redistributive social policies are key in determining the likelihood that countries can successfully combine an openness to international capital mobility with democratic forms of government. This paper - a product of Governance, Regulation, and Finance, World Bank Institute- is part of a broader research effort on The Quality of Growth

Members of liberalization obligations under The Code of Liberalization of Capital Movements were broadened to include virtually all capital movements, including short-term transactions by enterprises and individuals, and progress toward liberalization of capital controls accelerated, particularly in the 1980s. 12 As a result, in 1979, the United Kingdom removed all currency controls and achieved capital account convertibility. Japan finished this in 1980, whereas the remainder of the OECD took until 1992 to complete the repeal of capital controls, with Ireland, Greece, Portugal, and Spain being the latest to do so. By the early 1990s, OECD countries' capital accounts were accessible to a wide range of cross border transactions, Capital market securities, money market operations, forward operations, swaps, and other derivatives are examples of financial transactions. Because of this process of liberalization combined with the globalization of financial markets, borrowers in OECD nations may now obtain financing in their preferred currency at competitive rates, and investors can attain the level of portfolio diversification they desire. Financial openness has well-articulated and well-known economic benefits.

As a result, open capital accounts are widely accepted as providing several economic benefits to both individual countries and the global economy as a whole. Access to a bigger menu of investment sources, options, and instruments, as well as increased efficiency of domestic financial institutions, are major benefits for developing countries.

Joint effect of financial openness and democracy on financial development



FIGURE

Financial openness and democracy both have an impact on financial sector that is not shown in recent literature that is our topic of concern. Any alteration in one can automatically alter the other one. Financial openness is positively affect the financial development along with democracy that may have slightly negative sign in financial development

3.3 FINANCIAL DEVELOPMENT

It is often believed that rapid growth has to be connected to improved financial sector development. According to a 'conditional convergence' idea, however, the impact of a real growth can be reversed. Indeed, the hypothesis suggests that more industrialized countries are better off. i.e Countries which have higher GDP per capita may have lower the rates of credit growth (Levine and Renelt et al. 1992 and Easterly et al. 1997). As a result, countries with greater growth rates are more likely to have lower levels of FD. As a result, the result is equivocal. The World Bank database is used to acquire data on real growth. International trade openness policies, it is said, enhance the development of the financial industry. Indeed, trade liberalization will inevitably result in the entry of new enterprises into the local market, increasing competition and lowering incumbent operators' rental prices. After then, their cash flow this will help to boost the financial sector's growth (Rajan and Zingales, 2003). As a result, we anticipate a positive coefficient. This variable's data comes from the World Bank's database. Chinn and Ito established the capital openness index (2010). Theoretically, financial liberalization has a good impact on the FD. First, capital account liberalization should alleviate repression in protected financial markets, allowing real interest rates to increase to competitive levels. Second, financial transparency permits investors to engage in a wider range of activities.

Chapter 04

DATA AND METHODOLOGY

THEORETICAL MODEL:

Financial development, financial openness and democracy are better indicators of an economy. There are many indicators of financial development and democracy which are connected to financial openness. Financial development is a dependent variable which is correlated with democracy and financial openness. Due to such importance of development many scholars attempted to find different variables that affect financial development in one way or another. Some finds variables that directly affect financial development while other analyzes such variables that affect development through some channels and role of mediating variables. Political economy is one of the interesting areas of research in economics.

In long term and short term relationship complementarity between financial development and trade openness coexist with short run substitutionary between two policy variables.

The response variable is the annual ratio of liquidity, or M3, to GDP (as a proxy for financial development). In empirical studies, the ratio of liquid liabilities versus GDP, which reflects the size of financial markets and the level of monetization in an economy, is widely employed as a proxy for financial development (depth of financial system in many countries). The justification for choosing the M3 to GDP ratio, like Yu, Hassan, and Sanchez note, would be that it accurately captures the evolution of a financial sector in nations where money is primarily utilized for saving.

4.1 Analytical frame work

Democracy affects development in many ways. Some argues that democracy have influences on financial growth like Miner (1998), Roll et all (2003), Persson et all (2005). Similarly, Rodrik and Wacziarg et all (2005) and Persson et all (2006) also explores the within effects of democracy on growth and development. Some argued that there is effects but through indirect channels like Hann and Siermann (1996), Rivera-batiz (2002) and Baum and lake (2003). On the other hand one group of scholars suggests that democracy have no concern with growth rather growth depends on pro-growth policies and investments in stock of physical and human

capital. They argued that results are mixed like Weede (1984) and Prezworski and Limongi (1993). Helliwell (1994) argues that democracy has positive indirect impacts through investment and education but negative direct impact by combining the two contradictory effects leads to non-conclusive results and offset each other. Yuluo ET all (2016) have suggested that liberalized but the liberalized sector is financial sector. Mark ET all (2001) have argued about democracy will affect the inequality directly. Democracy will work through the political system we may have. This will have direct impact on the development it means strong democracy will enhance the financial development. Scott and Ovuefeyen (2005-2012).Financial sector will have significant impact of the financial or economic openness. Earlier research is so much fragile and contradictory with each other. The findings are somehow logical and robust but not up to the mark required for satisfaction. Still there is an attraction and space for researchers to investigate the relationship between democracy, financial openness and links with the financial development.

The existing literature has stressed the role of political and legal institutions in promoting financial development, which is widely viewed as crucial for economic growth (e.g. King and Levine, 1993, Levine and Zervos, 1998). Institutions that respect the rule of law, protect property rights as well as contract enforcements, and put effective constraints on rulers are shown to be associated with higher levels of financial development (e.g. La Porta et al., 1998, Rajan and Zingales, 2003, Acemoglu and Johnson, 2005, Haber et al., 2007).

At a fundamental level, this powerful set of institutions is often thought to be brought about by democracy, a political system characterized by popular participation, political competition for public office, and institutional constraints on the rulers. Siegle et al. (2004), for instance, argue that democracy brings political checks and balances, responsiveness to citizen priorities, openness, self-correcting mechanisms, and other good institutions. Haber et al. (2007) argue that the openness and competitiveness of a country's political system has a tendency to reflect itself in the openness and competitiveness of its financial system. Democracies, by promoting political participation and competition, limit the power of the state to control and repress the financial system, reduce the chance for both predatory and opportunistic behavior, and thus generate a more competitive and more efficient banking system (Haber, 2007). In the absence of competitive elections, political checks and balances are of crucial importance for property rights protection and contract enforcement (North and Weingast, 1989). Countries with greater constraints on the government provide greater protection against expropriation and consequently have a better banking system and more developed stock markets (Acemoglu and

Johnson, 2005). La Porta et al. (2002) also suggest that democratic regimes encourage financial development by discouraging government ownership of banks.

In sum, all these views point to a positive relationship between electoral democracy and financial development. Yet there is little empirical work directly testing the positive impact of democracy on financial sector development.

4.2 DATA AND VARIABLES:

Data on variables used in the study as the measure of financial development are taken from World Bank Data, Stata bank of Pakistan, International organization and some projects data. Annual data on exports ,imports ,Gdp per capita ,trade, investment, polity covers the period of 1975 t0 2020

4.3 ESTIMATION STRATEGY

In this research we will use Maddala-Wo test that is more appropriate model of panel data In addition, the impact of democracy and financial transparency on capital accumulation will be investigated.

$$\mathbf{FD_{it} = \beta_0 + \beta_1 Y_{it} + \beta_2 Dem + \beta_3 FOit + \beta_4\ Demit \times FOit + \ \theta X` + \delta_i + \gamma_t + \mu_{it}}$$

δ_i=It may show time and fix effects or fix effect of time and cross section. It represents the cross-sectional units.

γ_t=It gives time specific effect in our model. With the passage of time countries will be changed.

4.4 Financial Development:

Financial development is the variable in which we have instruments, institutions, and investments, as well as a financial system, through which we may allocate and employ resources in order to achieve better development. In our equation, financial development is a dependent variable. It will be demonstrated that financial development is influenced by democracy, institutional reforms, inflation, GDP, and other development elements such as banking sector investments, currency rates, and cross-border trade or financial openness. Financial development is aided by financial transparency, financial democratic governance, and robust legal institutions. It is an endogenous variable it will be effected by other exogenous variables.

4.5 Financial Openness

Financial openness refers to a country's desire to implement more liberalized business and trade laws. Financial openness refers to the lack of government control of private financial interests supported by the government sector, production methods, and the interaction between enterprises and their shareholders.

Financial development is the variable in which we have instruments, institutions, and investments, as well as a financial system, through which we may allocate and employ resources in order to achieve better development. In our equation, financial development is a dependent variable. It will be demonstrated that financial development is influenced by democracy, institutional reforms, inflation, GDP, and other development elements such as banking sector investments, currency rates, and cross-border trade or financial openness. Financial development is aided by financial transparency, financial democratic governance, and robust legal institutions**.**

Financial openness refers to a country's desire to implement more liberalized business and trade laws. Financial openness refers to the lack of government control of private financial interests supported by the government sector, production methods, and the interaction between enterprises and their shareholders

In the research, financial openness is cited as a key driver of financial development. Financial openness may have a favorable impact on financial development by spurring demand for new financial products to fund trade and development risks. Trade openness, relating to financial openness, stimulates competitiveness between domestic and international businesses, resulting in financial progress. We anticipate a positive relationship between financial openness and financial development. It is exogenous variable that will affect the financial development as it sometimes shows negative sign.

4.6 Dem= Democracy

Increased levels of development exhibit the consequences of democracy of institutional quality in other case democracy can hamper the financial development. Democracy is not positively related to stock market development.

Financial progress is facilitated by democracy. Democracy & development have a beneficial relationship (Benhua Yang, 2011). The effects of democracy are amplified by parliamentarian

forms of governance and higher political polarization. Democracy plays a direct role in in stimulating the financial development and enhance by higher levels of institutions.

4.7 FO× Dem;

It is a conditional impact of financial openness and democracy on financial development in SAARC countries. The debate about the relationship between democratic forms of government and the free movement of capital across borders dates to the 18th century. It has regained prominence as capital on a massive scale has become increasingly mobile and as free economies experience continuous pressure from rapidly changing technology, market integration, changing consumer preferences, and intensified competition. These changes imply greater uncertainty about citizens' future income positions, which could prompt them to seek insurance through the marketplace or through constitutionally arranged income redistribution. As more countries move toward democracy, the availability of such insurance mechanisms to citizens is key if political pressure for capital controls is to be averted and if public support for an open, liberal international financial order is to be maintained. Dailami briefly reviews how today's international financial system evolved from one of mostly closed capital accounts immediately after World War II to today's enormous, largely free-flowing market. Drawing on insights from the literature on public choice and constitutional political economy, Dailami develops an analytical framework for a welfare cost-benefit analysis of financial openness to international capital flows that have a effect on financial development.

4.8 CONTROL VARIABLES

The term control is used for the variables that are not the part of research but can affect the results unlike the error term. They are held constant in the research.

4.9 Inflation

It is a control variable like other countries SAARC are also developing countries, industrialization and democracy is main objective of SAARC. The main motive of the country is to sustain high development and economic growth with lower inflation rate. Some theories suggested that inflation have positive relation with the growth or financial development if it is lower and have negative relationship if it is high so it will not promote development.

4.10 Real GDP Per Capital

It will have a huge impact on development or financial development. Gross domestic product of increases it will cause increase in the financial development. So the study found that the real

GDP that is the proxy of Real GDP per capita will increase the development. Data of real GDP has collected from WDI (world development Indicators) per year. GDP is divided by the population to change the variable into per capita-income.

4.11 Trade Openness

Trade openness is a phenomenon of countries economy related o international trade to measure the degree of Trade openness the main scale is to see the imports and exports of the countries. Trade openness is an explanatory variable. Financial development has a positive relationship with trade by generating financial instruments and through trade financing system or by improving imports and exports.

4.12 Gdp per Capital

GDP or Gross Domestic product is the phenomenon of any country which shows the economy's output related to its individuals. GDP is divided by total population of the economy. Studies have shown that GDP per capita has significantly positive impact on the financial development in but in long run.

4.13 We have used different methods to estimate the model.

- Specify the Model
- Descriptive statistics
- Correlation Analysis
- Panel Unit Root Test
- Optimal Lag Selection
- Co-Integration Test
- Hausman Test
- Estimation the Model

a) Specify The Model

Model specification is a first step in panel ARDL estimation of panel data.

b) Descriptive Statistics

It show and explain the characteristics of each variable in the model and if possible as they relate to each group to engage a competitive analysis.

C) Co-integration Tests on Panels

To test co-integration in panel data is a difficult task since it must take into account the possibility of co-integration between sets of variables as well as within groups (known as 'cross-sectional co integration'). It's also feasible that the co-integrating series' characteristics and the number of co-integrating relationships vary from panel to panel. The majority of previous work has relied on a generalization of the Engle–Granger simple regression methods, which were pioneered by Pedroni (1999, 2004).

• Pedroni's strategy

It's fairly broad, allowing for independent intercepts with deterministic trends for each group of possibly co-integrating variables.

• Kao (1999)

Pedroni's approach was modified in that the slope parameters were supposed to be constant across groups but the intercepts were allowed to change. The ADF test regression is then applied to the term depending from the first-stage regression to see if the null hypothesis of no co-integration is valid. In contrast to the previous methods, Larsson et al. (2001) devised a test for heterogeneous panels that is essentially a generalization of Johansen's maximum likelihood based co-integration test**.**

d) Panel Unit Root Tests

- **Levin-Lin-Chu (LLC) (2002) test**

In the domain using panel data, this test is an extension of the Adf unit root test. Individual considered as a pooled ADF test, with varying lag lengths over the various regions of the panel.

• Im-Pesaran-Shin test (2003)

The main problem with the Bound test has been that it requires homogeneity across all variables. Im, Pesaran, and Shin (IPS) offered an alternate strategy to handle the aforementioned limitation.

• Maddala-Wu (Maddala-Wu) test (1999)

This test seems to have the benefit of allowing the stationary of an unbalanced panel to be checked. The p values linked with the statistical test are aggregated after unit root tests are run separately on each series in the panel.

e)Augmented Dickey fuller unit Root test;

The Dickey Fuller testing is used to assess the model to utilize for the study of variables. DF is a diagnostic test that is widely used to investigate the stationary of variables. It's being used to verify stationary for panel data. Non-stationary variables produce erroneous relationships that are unreliable, whereas data stationary indicates that the mean, variance, or covariance are constant, and the selected factor is time independent. The co - integration test is used to determine the order of variables. It also helps to understand both long and short run association between these two variables. The null for the unit root test is that no unit root exists**.**

f) Lag length selection criterion:

After reviewing the DF unit - root findings. The Johnson co - integration test is used to think about the long & short term relationships between financial development and other variables.

g) Hausman Test

To check the null hypothesis hausman test is applied

ARDL

ARDL is an acronym for Advanced Research and Development Laboratory (Auto distributive lag model). After looking at the results of DF and other unit root tests, the ARDL economic model is used to look at the long and short term relationships between variables.

We're utilizing the M3 to GDP and broad money to GDP ratios as proxy variables to assess the amount of financial development, as well as democratization and financial openness.

Data sources:

Our empirical analysis is based upon panel data which is secondary data of SAARC countries. We took data from the year 1970 to 2020.we have used IMF, WDI, State Bank ,World Bank ,polity 4 project data and some surveys and papers for our estimation of result.

TABLE 2; Description of variables

variables	Definition	Indicators	Data sources
Financial Development	Broad money, currency and deposit, electronic money, savings deposits, foreign, M2, currency transferable deposits, ,cheques, mutual funds	Annual ratio of liquid liabilities (M3 to GDP)	World Development Indicators(WDI
Democracy	polity iv project, Institutionalized democracy and autocracy ten point polity score,-10(auto) +10(demo)	Polity project	WDI
Financial openness	Restriction on cross border, transactions nations degree of capital account.	kaopen	Chin and Ito
Trade openness	Trade openness is a measure of economic policies that either restrict or invite trade between countries	Exports +imports/gdp	WDI
Inflation	Rise of prices that cause decline in purchasing power.	Consumer price Index	WDI
Industrialization	The process of transforming the economy of the nation from a focus on agri to a reliance on manufacturing	Mean value added	WDI

CHAPTER: 05

RESULTS AND DISCUSSIONS

The research was conducted using annual panel data from 1975 to 2019. Various literatures provide various metrics for measuring financial progress, which we employed as proxies in this study.

VARIABLES RESULTS

Variables include financial development, financial openness, democracy CPI, GDP per capita, imports, exports, Fo*DEM (conditional effect), proxy of financial development ,proxy of financial development, proxy of democracy.

In Model 1 it shows the variables which are estimated and their relationship with financial development. For this purpose financial development proxy M3 to GDP is used as dependent variable on other side of the model financial openness proxy (kaopen), GDP per capita, cpi, democracy proxy, import, exports Fo*DEM as independent variable

5.1 DESCRIPTIVE ANALYSIS

Descriptive analysis is done to explain the characteristics of each variable in the model and if possible as they relate to each subgroup to engage a comparative analysis.

Model 1; Descriptive analysis for model one in which M3 GDP is used as a proxy of financial development and other dependent variables are kaopen, polity, fodem, GDP and cpi and other control variables. Negative signed values show negative impact of variables on financial development, but the positive values show positive impact on the dependent variables.

Table 3; Descriptive analysis of variables

Variables	Means	St. deviations	Minimum	Maximum
M3 to gdp (financial development proxy)	45.43501	19.01984	8.353728	109.0495
Polity(proxy of democracy)	1.716981	6.67446	-10	9

Kaopen(financial openness proxy)	.4006214	.3248753	0	1
Inf cp(consumer price annual ratio)	7.516009	4.624056	-18.10863	26.14541
Fodem(financial openness*democracy)	1.42446	1.709113	0	8
Gdp (Gross domestic product)(in USS dollars)	1188.172	1745.048	98.543	10626.51
MenGdp(mean value to Gdp ratio)	12.65903	1.917136	4.44567	22.03697
Nimp(net imports)	1004733	2455657	6.11469	6497096
Nexp(net exports)	25.37616	2.895079	24.74658	166.3678
Outflow	1.221855	2.254008	-6.00803	17.03502

Descriptive analysis

This table shows the statistical results which shows that each variable have its own impact on financial development. As data shows that M3 have positive descriptive analysis with financial development. Net exports also have positive impact as exports are high more industries will develop and create more financial development as exports create internal means to finance. Kaopen data shows somewhere positive relation but also no impact it means that if openness is created free trade and outflow will increase that will create positive impact on development. GDP per USD also increase which increase financial development. Inflation is showing negative impact with value -18.10863.

5.2 CORRELATION ANALYSIS

This step shows that the repressor does not have perfect exact linear representation of one another. M3 to GDP shows by increasing liquidity financial development will tend to rise. Polity, the proxy of democracy shows that if we increase law and quality so financial development will increase with 1.0000. Financial openness shows a negative relation with financial development as it show as -0.0071 because if we open and remove all restriction local industries will have low growth. Inflation also has a negative relationship with 0.1997 0.20 -0.1066 1. 0000. When inflation will increase the level of financial development decline. The joint impact of democracy and financial openness shows the strong and positive relation with financial development it means that by increasing financial openness along with some laws financial development can be increase. GDP per capita shows a somewhere negative relation.

Table 4: Correlation Analysis of M3 to GPD Ratio

M3 To GPD Ratio	M3GDP	Polity2	kaopen	Infcp	FODEM	GDPUSS
M3GDP	1.0000					
Polity2		0.1454	1.0000			
Kaopen		0.2633	-0.0071	1.0000		
infcp		-0.1997	0.2044	-0.1066	1.0000	
FODEM		0.1497	0.5374	0.6848	0.0755	1.0000
GDPUS$		0.4421	0.1242	0.4139	-0.1449	1.0000

Table 4.1: Correlation Analysis of BroadMoney to GDP

Bmoney To GPD Ratio	BmoneyGDP	Kaopen	GDPUS$	FODEM	Infcp	Polity 2
BmoneyGDP	1.0000					
Kaopen		0.3700	1.0000			
GDPUS$		0.3356	0.3261	1.0000		
FODEM		0.2445	0.4837	0.3310	1.0000	
infcp		-0.0250	-0.0422	-0.1504	0.0475	1.0000

Polity2		0.0141	-0.2327	0.1541	0.5683	1.00

5.4 RESULTS OF UNIT ROOT TEST;

All panel data is initially configured. The ADF unit root test is used to check for the presence of a unit root in each variable at the levels, then at the very first level and first difference to estimate data stationary.

Table 5; Unit Root test

Variables	**critical values**	**T-statistic**	**probability**	**Durbin Watson**	**Value of I**
m3GDP(financial development)	-1.963972	-4.093666	.0000	1.89	l(0)
Bmoney GDP(broad money to Gdp ratio)	-1.86972	-8.1905	0.0000	1.98	1(1)
Kaopen(financial openness	-2.8677	-2.8454	0.0022	2.00	l(0)
GDP(p.c)	1.96379	-2.6856	0.3001	2.01	l(1)
Infcp(consumer price)	-1.86972	-4.7781	0.0000	1.90	l(1)
Fo*dem	- 2.8677	-0.5436	0.2934	2.00	l(1)
Polity2(Democracy proxy)	1.963972	-2.2921	0.0110	2.01	l(1)
Nimp(net imports)	-1.86972	-0.6345	0.2629	1.93	l(1)
Nexp(net exports)	-2.8677	-6.6220	0.0000	1.90	l(1)

Ho: All panels contain unit roots **Ha: Some panels are stationary**

Unit Root Results

The ADF Unit root test results reveal that all variables are integrated at first difference, and all are stationary at first difference, as evidenced by the probability level from less than 5% or the Durbin Watson value. Because the t-test statistic is less than the critical value at 5% significance, the unit root results indicate that we will reject the null hypothesis at 5% significance and embrace the alternate theory, which claims that all variables in the study are integrated of the same order one.

Step 5: Optimal Lag selection

By using unrestricted model and information criterion, decide the choice of lags for each country per variable then choose the most common lag for each variable to represent the lags for the model.

6.Hausman Test

M3GDP	Coe	Std. Er.	t	P>|t	[95% Con	Inter
Kaopen(financial openness	30.51821	11.91275	2.56	0.011	7.03808	53.99834
Polity2(democracy proxy	1.027424	.2726367	3.77	0.000	.4900547	1.564793
Fodem(financial openness* democracy)	-3.13007	1.456143	-2.15	0.033	-6.000138	-.2600018
Cpi(consumer price index)	-.022884	.2376202	0.10	0.923	-.4912351	.4454671
Gdp u$$ (gross domestic product in USS dollars	.0114654	.0013918	8.24	0.000	.0087221	.0142087

b = consistent under Ho and Ha; obtained from xtreg

B = inconsistent under Ha, efficient under Ho; obtained from xtreg

This favorable connection shows that financial liberalization, trade openness, integrated currency sector, relatively inexpensive of money transfer, rising disposable investment - related opportunities have minimized exchange rate volatility between SAARC countries, leading to more efficient financial sector, which has boosted regional economic growth and welfare. The overall population coefficient indicates that now the functional ageing population of SAARC countries is now on the rise, which may benefit national economy. As a result, democratic values of law are mutually exclusive. The mean value of financial deepening in the relevant country is represented by the subsequent values. The score suggests that explanatory variables responsible for 71.87 percent of the variance in the dependent variable. The F-statistic, which attempts to measure this same model's overall internal consistency, is statistically significant just at 1% level. The Hausman value is 0.03, indicating that there really is no heteroscedasticity problem.

Table 7: Hausman Test for Broad money

Broad money	**Coe**	**Std. Er**	**t**	**Z**	**P>|t|**	**[95%C**
Broad money(M1,M0)	7406.8	9190.8	0.398	0.85	-879378.8	2214192
Kaopen(financial openness)	1.29e+07	34864	3.45	0.001	556211	2.02e+07
Fodem(financial openness*democracy)	-1256406	70323	-0.40	0.692	-7470124	495731
Cpi(consumer price index)	-39703	16695.3	-0.55	0.580	-1801729	1007665

Gdp u$$(gross domestic product in USS dollars)	114.75	81.211	3.38	0.001	5507.716	20721.78
Polity 2(democracy proxy	14.5467	52.6758	0.4567	.569	1.567	209.87
Cons	854531	515905	0.471	0.72	-1.18e+07	2.55e+07

When high M2 to GDP and Quasi Money to GDP ratios were used to measure financial depth it not only increased the financial development, in other case programs to control the inflation also to stable the financial sector and in other case to accelerate real income.

It was observed that inter-temporal saving behavior of people restricted financial development in which could be addressed by improving saving rate and access of potential savers to bank.

Step 8: Estimate the Model

Panel ARDL for long Run:

Model 1:

1) Equation of the mode in short run;

$$\Delta FD_{it} = \beta_0 + \Sigma\Delta\beta_1 Y_{it} + \Sigma\beta_2\Delta Dem + \Sigma\beta_3\Delta FOit + \Sigma\beta_4\,\Delta Demit \times FOit + \theta X` + \delta_i + \gamma_t + \mu_{it}$$

2) Equation of model in long run;

$$\Delta FD_{it} = \beta_0 + \theta Y_{it} + \theta Dem + \theta 2 FOit + \theta 3 Demit \times FOit + \theta X` + \delta_i + \gamma_t + \mu_{it}$$

Model given above is used to check the long run relationship between variables.in which

FD=financial development

Y=GDP

Dem= Democracy

FO=Financial openness

Dem×FO= interactive term

While the coefficients β_0 β_1 β_2 β_3 β_4 shows the short run association among variables. And θ_1 θ_2 θ_3 θ_4 shows the long run association between the variables

Estimated Results of Short Run Coefficient

Table 8: short run coefficient result

Variables	COEF	STD. ER	T Statistics	Probability
COINTEQ01	-0.096656	2.263844	-0.076478035	0.0000
DEMO(democracy)	-0.801789	3.002945	-2.670008941	0.0000
KAOPEN(financial openness)	1.320342	3.334210	0.3965982946	0.0000
FO_DEM(financial openness*democracy)	-0.932533	1.861266	-0.501020702	0.0000
NIMP(net imports)	0.876581	4.235201	-2.435678957	0.0000
N_EXP(net exports)	-0.959131	2.543218	2.7659864331	0.0000
CPI(consumer price index)	0.322743	3.345076	-4.345667891	0.0000
C	-8.756769	2.867543	-4.367589221	0.0000

Coefficient result

Results in short run shows that short run is probably statistically significant almost at more than level 1 with negative sign. Hence it is showing the existence of long run relationship or co-integration among the variables. AS some authors mentioned that significant but high value of co-integration shows the presence of long run relationship among the variables . Co-integration value may use to represent the speed to adjust the equilibrium or to restore the equilibrium in dynamic model. Value of co-integration estimation is -8.756769 which shows the presence of equilibrium will be attained 87 percent.

Table 9: Coefficient Results

Variables	Coeff	Std. Err	t-Stat
COINTE	-0.111682	0.587689	-0.675437
DEMO(democracy)	-0.030896	1.866785	0.675849
GDP US$(gross domestic product in US$ dollars)	-0.030889	3.657498	-0.675939
NIMP(net imports)	-0.306269	4.875649	-0.00987
C	-9.263915	0.567483	-1.67895

When m3 is as dependent variable as a proxy of financial development than the estimation shows that the short run results are statistically significant more than 1 % with a negative value .It depicts that long run relationship is present among the variables or co-integration among them. It shows the more stability of long run relationship among the variables because of a negative sign. This co-integration negative value also represents the speed of dynamic equilibrium in the following year. As result shows that there is a co integration in long run between variables

Table 10: Coefficient Results

Variables	COEF	STD. ER	T Statistics	Probability
COINTE	-1.096656	2.85643	-0.338304	0.0000
DEMO(democracy)	-1.801789	18.05326	-0.00679	0.0000
KAOPEN(financial openness)	1.320342	4.523960	1.618119	0.0000
FO_DEM(financial openness*democracy)	-1.932533	23.45678	-0.03975	0.0000
NIMP(net imports)	1.876581	3.245678	0.270076	0.0000
N_EXP(net exports)	-1.959131	1.233456	-0.77759	0.0000

CPI(consumer price index)	1.322743	2.678947	0.120473	0.0000
C	-8.756769	1.887654	-4.63896	0.0000

When broad money which is a dependent variable as a proxy for measuring financial development. The results show that the short-run results are statistically significant or have positive relation more than 1% with a negative sign. This proves the existence of long-run relationship among the variables or co-integration among variables. It shows the more stability of long run relationship among the variables because of a negative sign. This co-integration negative value also represents the speed of dynamic equilibrium in the year.

Estimated Results of long Run coefficients:

Table 11: long run coefficient results

Variables	COEF	STD. ER	T Statistics	Probability
DEMO(democracy)	22.88731	4.534802	5.047037	0.0000
KAOPEN(financial openness)	-104.1441	18.05236	-5.769003	0.12300
FO_DEM(financial openness*democracy)	17.76411	3.368317	5.273882	0.0000
NIMP(net imports)	-11.64249	2.244567	-5.186967	0.0000
N_EXP(net exports)	20.84105	3.129359	6.659845	0.1120
CPI(consumer price index)	-7.404099	1.261266	-5.870371	0.0000

Results of ARDL model shows that there exist a long run positive relationship and also significant relationship among the variables in this table it shows a long run positive and significant relationship among m3 to GDP, democracy FO*DEM and net exports. It means that we can increase financial development by increasing rate of democracy, by increasing our imports, and by increasing net exports. There exist a long run significant but negative

relationship among some variables which shows that we can achieve financial development by reducing the indicators as by lowering the level of financial openness, by lowering down the net imports and cpi..

Table 12: Long run coefficient results

Variables	COEF	STD. ER	T Statistics	Probability
DEMO(democracy)	3.479284	1.218383	2.855657	0.0048
KAOPEN(financial openness)	-14.60661	7.309638	-1.998268	0.0473
GDP (GDP per US$ dollars)	0.070649	0.013235	5.337898	0.0000
NIMP(net imports)	5.055824	0.702621	7.195667	0.0000

This table shows estimated results in long run relationship of m3 to GDP with other dependent variables and other control variables. It shows positive but significant results of democracy, GDP and net imports that depicts that by increasing these we can achieve financial development. There also exist a negative but significant relationship among the dependent variables as well as independent variables like ka-open shows that by reducing the financial openness we can achieve financial development or increase m3 to GDP ratio

Table 13: Long run coefficient results

Variables	COEF	STD. ER	T Statistics	Probability
Democracy	22.88731	4.534802	5.047037	0.0000
Kaopen(financial openness).	-104.1441	18.05236	-5.769003	0.0000
FO_DEM(financial openness& democracy)	17.76411	3.368317	5.273882	0.0000

NIMP(net imports)	-11.64249	2.244567	-5.186967	0.0000
N_EXP(net exports)	20.84105	3.129359	6.659845	0.0000
CPI(consumer price index)	-7.404099	1.261266	-5.870371	0.0000

In this long run table, it shows the estimation of financial development when broad money is the proxy that is used to measure financial development and financial openness is measure by ka-open that is an independent variables and other independent and control variables. The table shows the existence of a long run but negative relationship among ka-open, net imports and cpi that depicts that by decreasing the rate of financial openness net imports and cpi we can achieve financial development. There also exists a long run positive relationship among variables when we use broad money as dependent variables for financial development that shows that by increasing net exports democracy and joint effect we can achieve financial development

Table 14: Long run coefficient results

Variables	COEF	STD. ER	T Statistics	Probability
DEMO(democracy	12.10756	3.586571	3.375803	0.0010
KAOPEN(financial openness)	27.14784	7.316016	3.710741	0.0003
GDP__US Gross Domestic Product In US dollars	0.120338	0.019989	6.020220	0.0000
Nimp (net imports)	2.715398	0.656195	4.138096	0.0001

Long Run Equation

In above table shows that in long run there exist a positive connection between variables. There exists a long run positive connection between variables. It depicts that by increasing the democracy the broad money will increase or financial development. By increasing kaopen or financial development.

As variables are integrated at first difference so co-integration must be used to check the long run as well as short run relationship among variables.

Auto Regressive Distributed Lag model:

We are using ARDL model because in our study some selected variables are showing that they are integrated at a level 1(1) but not even a single variable is integrated at level 1(2) so ARDL model is used to test the variable's long run and short run relationship.

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
		Long Run Equation		
DEMOCRACY	11.33322	3.012997	3.761445	0.0002
KAOPEN(FINANCIAL OPENNESS)	6.608610	4.926130 1.989999	3.740367	0.0303
FO_DEM	10.87371	31.261266	5.464179	0.0000
CPI	-7.404099	.	-5.870371	0.0000
GDP__USS_	0.048983	0.010202	4.801561	0.0000
ECM	-0.096656	0.064411	-15.22	0.000
D(DEMOCRACY)	-0.801789	0.165980	-1.82	0.500
D(KAOPEN(Financial openness)	7.320342	3,251300	3.23	0.010
D(Financial openness and democracy)	-2.032533	3.641640	-0.75	0.451
(GDP)	0.876581	3.74050	0.02	0.89
D(CPI)	0.322743	0.286000	0.01	0.170
C	-8.756769	0.591030	-1.37	0.170

As the results shows that short run and in long run variables have an impact on financial development. In short run the value of c is negative it means that they must have cointegration and have an impact in short run. In long run as results shows that democracy have a probability of 0.002 and financial openness have a probability of 0.003 it means they will have impact in long run on financial development.

The short run relationship of different variables and also long run relationship can be examined through the ARDL model. We are using M3 to GDP and broad money to GDP ratio because the proxy variables are used to measure financial development but we are using proxy of financial development because we cannot measure financial development directly along with democracy and financial openness. In long run we can see that ka-open that is the measure of financial openness is negatively relating to financial development.

Chapter 6

CONCLUSIONS AND POLICY IMPLICATIONS

6.1 CONCLUSIONS

This research examines causality relation between democracy, financial openness and financial development after estimation of all variables under empirical evidence. The current study checks whether there is financial development because of financial openness and democracy and what is the impact of democracy on financial development. This study also examines the relation and the impact of financial openness and democracy that is called as a conditional effect on financial development. In terms to explore the relationship between the financial development, financial openness and democracy, the model and estimation of the study ponders the variables democracy, polity2, polity, kaopen, GDP per capita, CPI, Financial development, financial openness, Net imports, net exports.

6.2 POLICY IMPLICATIONS:

If a government give friendly environment, resolves issues of the of power storage another condition which may help in future to boost the motivation level of an investor who can invest larger amount in SAARC countries so this may help to attract the FDI. Transfer of funds seems to be the 2nd greatest source and a means of foreign financing in the host countries. Many Pakistanis, Indians, Sri Lankans, and Bangladeshis perform in gulf nations and send large sums of money back to the house every month. Legislators should create policies that allow these workers to conveniently send money back to home country, allowing the economies to expand. The current regime also should adopt policies that favour the financial markets to foreign workers, as this will boost capital investments as well as the economy. Importing goods also can have a significant role in the economic development of host countries, particularly if they contain capital items such as technological advances, innovations, and infrastructure. Rather than importing consumables, such countries should concentrate on importing capital items and new technology. In order to use these massive amounts of debt in a constructive field and in a progressive fashion that yields large results, the government must create a suitable management system, debt management structure in a country, and decision-making process.

Cooperation and integration in the Economic, Trade and Financial sectors is the source and main key to achieve the objectives of promoting welfare of the people of a country. Therefore, deeper integration in Economic Field is the key that can cause financial development.

1) Remove all Non-tariff and Para tariff barriers and also reduce the items under sensitive lists with a view to promote intra-regional trade

2)As results showing that inter-temporal saving behavior of people in a restricted financial development can be addressed by improving saving rates and access of potential serves to the banks.

3)study shows that broad money to gdp ratio is a better indicator for financial development measuring along with net exports and strong democratic conditions.

Holding of activities on time as per approved calendar of activities initiatives to improve the efficiency in all sectors including the private and public sectors.

Next thing is democratic regimes depends upon a popular endorsement for their legitimacy. People in the region aspire to development and better life conditions and greater people to people exchanges ,free cross border movements peace and financial growth.

Only democratic politics will not create ways to enhance financial development ,political understands and social corporation will cause financial development.

Upon this basic principle of studies research evidences, some main conclusions for improving and bettering the concept of financial development throughout Sub - Saharan African countries have been suggested. First, because inflation is adversely affecting the effect of financial development, SAARC countries should bring harmony and strong connections in their own macroeconomic and fiscal policy initiatives to combat inflation as well as accomplish macroeconomic stability. Furthermore, SAARC Investments Consultation Agency for international investors should have been established, which could enhance financial openness to attract more FDI and portfolio investments. Furthermore, all education policies at the national level must be revised urgently and painstakingly in order to raise the literacy rate of SAARC countries. Fourth, in order to promote the rule of law, SAARC countries should eliminate inner conflicts, terrorism, as well as the main evil corruption. This improvement will have a significant effect on financial development process, and while sufficient data of banking indicators has become accessible, there will be a pressing need to collect comprehensive data on non-bank financial institutions (NFBIs) and financial market indicators. As a result, member nations of SAARC should produce regional ‘metadata' on financial and real variables to aid academics.

Our results have far-reaching consequences. From such a theoretical sense, this is part of a bigger issue of institutional transfer, and our research aims to help people understand it better. It lends direct assistance to democratically elected government growth theories to explain the positive qualities of representative democracy. In terms of policy, our findings suggest that countries should pay attention to the quality of the institutional environment in addition to establishing a democratic administration. While the political economy theory of FD holds that democratic systems may encourage FD through encouraging processes of political checks, protecting citizen's independent and ownership of property, and reducing power abusive behavior by interest groups.

In terms of policy, our findings suggest that countries should pay attention to the quality of the institutional environment in addition to establishing a democratic administration along with cross border openness. It is suggested that the government may open the economy for financial transactions and this will leads to more financial development.

The policymakers must be aware that a poor institutional structure is a cause for low financial sector development in the SAARC region. Hence, before implementing financial sector reforms and openness policies, to improve the financial sector must keep institutional complementarity effects into consideration. In general, as a pre-requisite condition, policies must be designed to flower government spending, and financial reforms particular to regulations and supervision. This will ultimately improve the banking sector efficiency and stock market development in this region, leading to overall financial sector advancement. In sum, institutional quality and governance structure are important for banks, dominant in the Asian financial system. Therefore, institutional reform and policies are vital for policymakers to accelerate economic growth; government policies to drive economic growth, reduce poverty and improve the financial sector must consider the legal system, political stability, and regulations.

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1.1: summary of articles

S.no.	Authors name	Title of Article	Variables	Year of publication	Econometrics Techniques	Conclusions
1	"Dennisp.quinn, Carla Inclan"	"The origins of financial openness ;A study of current and capital account liberalization"	Financial system and welfare cost	1997	Panel corrected standard error	Study found that any differences in political as well as institutional quality can have impact on financial openness
2	"Mark Gradstein et all"	"Democracy and Income Inequality : An Empirical Analysis"	Democracy ,income distribution	2001	Gini coefficient	Only democracy is a mean which can lead to remove inequality that create development
3	"Raj M desai et all	"Democracy ,Inequality and Inflation"	Inflation and democracy	2003	Dynamic panel method	The study found that higher democracy will have lower rates of inflation that leads to FD.
4	"Acemoglue et all"	"Income and Democracy"	Income democracy	2005	GMM, AR2 ,Hansen J test	The study found that higher democratic countries will show equality that leads to fd.
5	"Torsten Persson and "Guido Tabellni"	"Democracy and development: The devil in details"	Growth government	2006	Robust standard errors	Political democracy can influence the development but it depends

			consumption liberalization			upon county variations
6	"Barun Radatz"	"Relationship between the politics of financial development, evidence from Trade liberalization"	Trade Democracy Money	2008	OLS	Study found that democracy is a needed key along with liberalization
7	"Soing hook and Azman saini"	" Institutional quality ,governance and financial development"	Development Government and institutions	2012	WGI GMM	Study found that Upturn in the governance and stock market can significantly impact on fd.
8	"Oziengbe scott and ovuefeyen"	"Effects of economic openness and Inflation on commercial banks' Profitability"	Profitability Trade openness financial openness inflation	2012	Rem ECM	Financial sector will have significant impact of the financial or economic openness
9	"Wafa Gharadallou Abdelkader Boudriga"	democratic transition and financial development	Institutions, stock market, democracy index	2014	used ordinary least square, Random effect model, GMM	The study found that Adaptation of the democratic rules will foster the development of financial system
10	"carlos felipe"	"Long run effects of democracy on Income inequality and financial development"	Income gender education	2015	Pseudo panel modelling	Study found that Higher democratic have lower inequality lowers democratic will have high inequality.
11	"Wafa Gharadallou Abdelkader Boudriga"	"democratic transition and financial development"	institutions	2016	used ordinary least square, Random effect	Study found that adaptation of the democratic rules will foster the development of financial

					model, GMM	system.
12	"Yu lou zhang et all"	"Openness and financial development in china, political economy of financial development resources"	Infrastructure Trade openness Inflation GDP	2016	GMM	Study found that trade liberalization but in other case the financial openness is under liberalized condition.
13	"Seluck Ackay"	"Do industrialization, democracy, and financial openness promote financial development? Evidence from Turkey"	GDP economic growth capital cost foreign capital	2019	GMM	Study found that democracy is positively affecting the financial development.
14	"Zhenxiong Li, Hilary Ingham"	"Financial Development, Economic Performance"	Development	2020	ARDL	Study found that Economic performance will leads to F.D have positive relation.
15	"Alfred V. Guender Hamish McHugh-Smith"	"Financial Openness and Inflation: An Empirical Analysis"	Financial openness GDP Exchange rate	2020	OLS	Study found that Trade have no systematic relationship with inflation.
16	"victor menaldo et all"	"Democracy in elite bias, the financial development in Latin America"	Credit price stock market	2015	OLS	Study found that the democracy with their own constitutions will have sophisticated financial system.
17	"Ynayan luo et all"	" Financial openness and financial development in china"	Credit Stock exchange polity	2016	Bound test	Study found that financial openness will may be positively affect the financial Development

			Market efficiency			but the magnitude is inversely proportional to the Financial openness.
18	"La porta lopez-de si La et all ,"	"Government ownerships of banks"	Banks Stock currency	2009	index	The study found that high legal protection countries will have more protections to investors and development.
19	"Jung suk et all"	"Financial development, economic growth and financial sector development."	Income Banks Loans Credit	2011	VAR Granger	Study found that countries with enforced democratic policies have robust and faster financial growth systems.
20	"Girma and shortlan"	"The political economy of financial development"	Polity Institutions Banks	2007	Causality tests	Study found that regime stability and democracy supports Financial Development.
21	"Menaldo and Yoo"	"Democracy, Elite Biase	Consumption pattern Credit availability	2007	OLS FE GMM	Study found that financial policies with low interest rates and more credit availability create Financial Development.
22	"Mandon manthon"	"Forms of democracy and financial development"	Banks Polity4	2005	GMM	Study found that institutional quality is significantly affecting fd.
23	"Aluko et all"	"Determinants of banking sector development"	Education Credit federal taxes	2019	VAR	Study found that financial development and liberalisation have augmenting effect

24	"Rajan and zingalese"	"The great reversal of politics of financial development in 20th century"	Income levels Inflation Bop	1995	OLS	Study found that acceleration in inflation and Financial Development that cause financial development (FD) in a short run.
25	"Acikgoz et all"	"Determinants of financial development in Turkey"	FO Trade Inflation	2012	ARDL bond approach	They found that trade and Financial Openness can positively react to Financial Development.
26	"Khalid Mahmood Toseef Azid and Masood mashkoor"	"Democracy and economic growth in Pakistan"	Democracy Economic growth	2010	ARDL	Democracy will play positive role in growth.
27	"syed tehseen and Muhammad saleem"	"Democracy and international financial integration in Pakistan"	GDP Inflation IFI Top and DEM	2017	DOLS FMOLS and CR	Weak democracy can decline GDP. International integrations depend upon market size of Pakistan.
28	"Mansoor Dailami"	"Relationship between Financial Openness Democracy and redistributive policy".	Financial system welfare social cost	Logit method	1999	The study found that its will have a positive correlation between democracy and (FO) financial openness as well as policies.
29	"Dennis p quininn et all"	"The Origins of Financial Openness: A Study of Current and Capital	Current account capital account	Panel Correc	1997	Differences in both political institutional arrangements and

		Account Liberalization"		ted Standa rd Error		Types of political economy also account for part of the differences in7international financial regulations
30	"Aigheyisgi scott & ovuefeyn"	"Effects of Economic Openness and Inflation on Commercial Banks' Profitability: Panel data from Nigeria,"	Profitability Trade openness financial openness inflation	REM ECM	2005-2012	Financial sector will have significant impact of the financial or economic openness