The Impact of Financial Development on Economy of Pakistan.

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Abstract
This study aims to examine the impact of financial development on economy sector of Pakistan. Regional economic growth and financial development cycles can trace major global and unobserved factors evolved overtime. However, economic growth and financial development are explaining the fluctuations in the economy, which plays an important role for development of any economic sector. Whereas, Augmented Dickey Fuller Test (ADF) and Phillips Perron (PP) test are used to check the individual stationarity of each variable. Augmented Dickey Fuller test is used to estimate the unit root test. Johnson co-integration test is also used to check the long run relationship between the variables. The overall results shows a positive significantly impact of financial development on economic growth of Pakistan, expected some years of nineties when stock markets became in negative figure. However, F- statistics shows overall positive significant impact of the model.
Keywords: financial development, economic sector, fluctuations

Introduction

During recent decades, a great deal of attention has received the relationship between financial development and economic growth. The most productive sectors for investment both domestic and foreign savings are mobilizing by the process of financial development supports. In the financial intermediation, some variables have been used as a proxy. In term of size and efficiency different financial intermediaries in the whole financial development must relatively be significant by the selected variables. Mauro (1995) starts even though their stock markets have been relatively underdeveloped high saving rates and fast growth have experienced by Japan and continental Europe, their stock markets have been well developed by low saving and slower growth have been characterized by United States and United Kingdom.

Lartey and Farka (2011) found that the affect depends on the level of financial development and financial crises, which have a negative impact on economic growth. King and Levine (1993), Levine et al.,(2000; Lartey (2010); Gupta (1986), using various measures of financial development and finds that there is a significantly positive relationship between financial development and economic growth. Robert Lucas (1988) asserts that economists, in economic growth the role of financial factors "badly over-stress". Al-yousif (2002) finds that time-series and panel data are mutually causal based on financial development and economic growth in 30 developing countries.

However, financial sector indicator focused on the M2/GDP% by many empirical studies. As an alternative measure of financial intermediation use for private sector to GDP provided by the ratio of credit. The relationship between financial development and economic growth discovered by the pioneers to the study of (McKinnon-Shaw, 1911-1973) can be traced by the theoretical basis of this relationship. As a supply leading relationship between financial development and economic growth describes by Schumpeter (1911). On the banking system, imposing restrictions by the impact of direct government intervention on the financial sector investigates McKinnon-Shaw (1973). Hamper economic growth consequently, on the development of the financial sector have direct negative effects on interest rate ceilings and credit programs (M S Shabbir, 2014).

The reason is that, from the high competition with the lack of protection in most of these countries by the financial institutions. Moreover, in most developing economies on the financial sector by the dominance of a small number of commercial banks, and the efficient allocation of resources may undermine (Mohammad, 2008). Overtime, a great attention among economists and policy analysts has generated the relationship between economic growth and financial development, from 1980 to 2010 nexus focusing on the finance growth. Before 1980, high tax burden on financial earnings, reserve requirement ratios, high liquidity and negative real interest

rate by the system of financial repression. After 1980, the active part of the economy started by the financial markets.

In Turkey, the economic life constituted a turning point by the beginning of 1980. Consequently, in order to promote economic growth has a possibility to increase financial development. The relationship b/w financial development and economic analysis the financial liberalization process to evaluate by this study. The residual-based co-integration test has mainly used in the previous studies associated with Engle and Granger (1987) and maximum test based on Johansen (1988) and Juselius (1990). When the sample size is too small then co-integration techniques may not be appropriate (Nerayan and Smyth, 2005; Odhiambo, 2009).On the cross-sectional data relied some previous studies, the country specific issues may not satisfactorily address.

Literature Review

In the literature using different techniques has been investigated extensively by the relationship between financial development and economic growth. In the long run financial development promotes growth is usually more supportive for literature. In the United Arab Emirates, financial development and economic growth using time series data from 1978-2012 was examined by Marashdeh, Naziruddin and Al-Malkawai (2012), the model was estimated using E-views technique. A bi-directional causal relationship between financial development and economic growth show negative and statistically significant results. In the transition phase, economic growth will be able to promote the UAE financial system needs to reach a certain level of development. In Turkey for the period of 1975-2005, Ozturk, Ilhan (2008) investigate the causality b/w financial development and economic growth using a vector auto regression (VAR) framework. There is no long-run relationship between financial sector development and GDP growth shows the result of VAR and the study shows unidirectional causal relationship to financial development from GDP growth (Shabbir et al, 2016).

Erdal, Veli Safakli and Behiye (2007) studied the ordinary least square (OLS) technique by the causal relationship between financial sector and economic growth for Northern Cyprus. There is an insignificant positive effect of financial sector on GDP growth shows the results (M S Shabbir 2015). Ruda Pradhan (2009) examined in India using VAR technique by the causal nexus between financial development and economic growth. From market capitalization to economic growth VAR results revealed unidirectional causality. Neusser and Kuglar et al (1998) investigated financial depth and economic growth by the long-run relationship. Supply-leading phenomenon provided empirical findings. Xu (2000) revealed that a vector autoregressive (VAR) using the effect of financial development on output between 1960 and 1933 concludes that economic growth follows the financial development and has slight effect on it. Chang (2002) for Mainland china used the VAR model to test the supply-leading hypothesis and the demand following. There is no association between financial development and growth finds the Granger Causality test and GDP, financial sector indicators and trade provides co-integration test in the long-run relationship.

Jayaraman (2009) used determinant of financial sector development-growth nexus literature as a private sector and he concludes that private sector not a reliable indicator at all and is an inappropriate measurement of financial development. Thus ,the study developed a measure based on the most frequently use variables which include GDP, Exports, Government expenditure, M2 and Domestic credit to private sector. In Sierra Leone over the period 1970-2008 using Auto regressive Distributed Lag approach (ADRL) and studied the relationship b/w financial development and economic growth (Mohamed, Patricia et al, 2008). Financial development and economic growth indicate empirical positive results. Adeoye (2007) used five indicators to investigate the financial development nexus growth namely, exports, government expenditure, DPS, M2, and GDP indicated that there is negative and positive relationship b/w economic growth and financial markets.

Safiat A. Saber (2013) suggest that long and short-run dynamic relationship b/w Sudan economic growth and financial sector development investigation empirical studies. The result indicate that govt expenditure, M2 exert negative effects, while domestic credit to private sector and exports have positive effect on GDP. Songul Ka

and Ilhan Oz (2009) employed in sub-saharan Africa, GMM techniques and Pannel co-integration investigates the causality between financial development and economic growth. The causal relationship b/w GDP growth and the credit provide bi-directional empirical results by the banking sector. Emeka N.and Aham K. Uko (2013) examined that in Nigeria a positive effect of financial sector development on economic growth evidence found by the financial development growth. To accelerate growth, domestic credit to private sector and financial sector are fail and ineffective. It is noted from last ten countries in Sub-Saharan Africa, the long-run and causal relationship between economic growth and financial development to investigate by using the Vector Error Correction Model (VECM) and Anthony. Tajudeen RG.et la (2010) found that in the selected region countries there is a long run relationship b/w financial development and economic growth.

- **Financial Development may directly improve the well-being of the poor:**

This article investigates through a distributional effect, how financial development helps to reduce poverty through economic growth its indirect effect. Through the McKinnon conduit effect banking system provide saving opportunities and to facilitate transaction system for the well-being of the poor. This paper develops due to systemic growth processes persistent structural poverty from poverty passes naturally with time. Ben Rogaly (2010) suggest that micro-finance institutions to reduce poverty. In this sector, to increase resource allocation the current campaign has improved anti-poverty financial intermediation.

- **The relationship b/w Financial Development and economic growth:**

John Gurley and Edward Shaw (1955), James Tobin (1965) and Ronald McKinnon (1973) suggest that seminal contributions are based on finance and economic growth. Gurley & Shaw (1955, 1967) and Goldsmith (1969) explored in economic growth the importance of financial system. Calderon and Liu (2003) considered that for economic growth the financial development is the necessary condition. Chow, 1987; Xu, 1996; Balaguer and Cantuella- Jorda, 2002; Kletzer and Bardha, 1987; conclude that industrial sector of that country gives comparative advantage of financial development.

The purpose of this study is to find out the causal relationship and possible co-integration b/w exports, government expenditure, GDP, M2, and domestic credit to private sector (DPS) in Pakistan economy. Goldsmith (1969), King and Levine (1993) and Levine and Zervos (1998) to study the relationship b/w financial development and growth used cross-country analysis. Hassan and Bashir, 2003; Khan and Senhadji, 2003; Chuah and Thai, 2004; Al-Awad and Harb, 2005 finds that estimation methods, functional form of the relationship, data frequency and proxy measures are sensitive to the selected countries on cross-country analysis. Gross domestic product represented impact on economic growth about some conclusions and financial development indicators. Gurley and Shaw (1967), Gold smith (1969) and Jung (1986) finds that increasing demand for financial services who hypothesize in developing countries growth leads finance. Barro (1991) examined the financial variables and found significant relationship between subsequent growth in real per capita incomes and financial conditions. Levine and Zervos (1998) suggest that a significant positive influence on GDP growth would contribute both stock market and banking development liquidity.

- **Financial growth promotes economic development in china:**

Economic growth in china "leads" financial development to investigate the hypothesis by use this methodology in the first attempt. However, VAR is used for investigating the relationship between financial development and economic growth and with comparison to debate finance-growth in China. In the case of china where aim to promote further deregulation of china's financial system, sustain strong economic growth, reform in the financial sector, a swift change and opening domestic financial market has brought about significant financial development in china.

Over the last 20 years, in both political and economic institutions have been profound changes in china. In this paper, to study the role of legal institutions, political pluralism on growth rates and financial deepening use panel data for the Chinese provinces Paul Wachtel, and Minguning Zhou (2009). A transition economy for an institutional developments are the emergence and legalization of the market economy, the development of financial sector institutions and markets, the establishment of secure property rights, the liberalization of political institutions and the growth of a private sector. In regression models, explanatory variables are used to explain provincial GDP growth rates. Paul Wachtel (2009) evidence suggests that stronger growth is associated with the development of financial markets, awareness of property rights and political pluralism and legal environment.

In every region of china, we find that there is close relationship b/w economic growth and finance. Economic growth accelerates financial development and economic gap can partially explain the financial development gap. In the future, economic performance can partially explain initial financial development level. Economic growth has very close relation by the financial marketization. Financial development can promote financial opening.

- **Direction of causality between Financial development and Economic growth:**
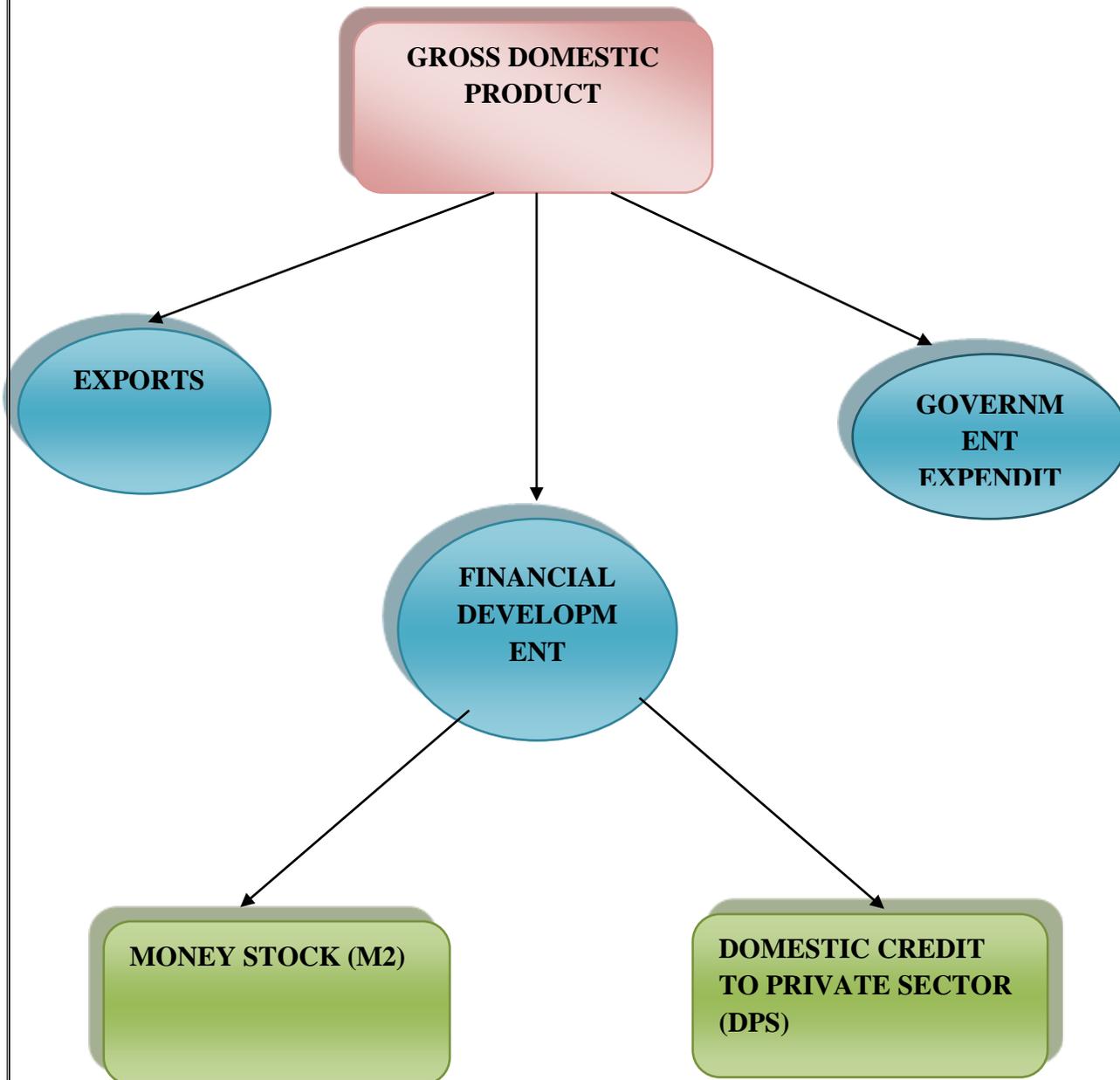
Cesar Calderon (2003) finds that economic growth generally leads to financial development. Economic growth from financial development to the Granger causality and the Granger Causality coexist the financial development from economic growth. In the industrial countries, financial deepening contributes more to the causal relationships than in the developing countries. On economic growth, financial development has larger effect and longer the sampling interval. A more rapid capital accumulation and productivity growth through economic growth propels financial deepening.

Dimitris K Christopoulous (2004) investigate that the financial depth and economic growth in the long run relationship and in the most efficient manner trying to utilize data in panel co-integration analysis and unit root tests. In small open economy, financial development leads to economic growth. In stimulating financial sector development has a favorable effect through removing the repressionist policies and financial liberalization. Calderon & Liu (2003), Fase & Abma (2003) and Christopoulos & Tsionas (2004) that economic growth promotes financial development. In developing countries, we find a positive relationship b/w economic growth and financial development.

- **Financial development and Economic growth in Turkey:**

In Turkey, paper explores the relationship between financial development and economic growth. A large empirical literature postulated a bi-directional relationship b/w financial development and economic growth has emerged testing this hypothesis (Levine, 1997). A number of countries using cross section or panel data techniques and frequently adopts a single measure of financial development and testing the relationship between economic growth and financial development (Jung, 1986), Rubini and Sala-i-Martin (1992), Demetriades and Hussein (1996) and Leuintel and Khan (1999). A particular country using time series techniques is to examine the hypothesis for empirical literature. (Murinde and Eng (1996), Lyons and Murinde (1994), Odedokun (1989).

Over 20 years of financial liberalization, in Turkey the relationship between financial development and economic growth is the first single-country study. Tohnasen (1988) and Johansen and Juselius (1990) finds that multivariate co-integration and vector error correction models (VECM) used in the methodology. Alternative proxies may give rise different causal relationship and financial development is different to measure. Demetriades and Hussein (1996) suggest that economic growth follows financial development. Different causal patterns between financial development and economic growth do give rise different measures of financial development. A single measure of financial development use only findings of previous study.

THEORETICAL FRAME WORK

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                    │     PRODUCT         │
                    └─────────────────────┘
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                     /         │         \
        ┌────────┐              │          ┌──────────┐
        │EXPORTS │              │          │ GOVERNM  │
        └────────┘              │          │   ENT    │
                                │          │ EXPENDIT │
                          ┌───────────┐    └──────────┘
                          │ FINANCIAL │
                          │ DEVELOPM  │
                          │    ENT    │
                          └───────────┘
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            ┌──────────────────┐   ┌──────────────────────┐
            │ MONEY STOCK (M2)  │   │ DOMESTIC CREDIT      │
            └──────────────────┘   │ TO PRIVATE SECTOR    │
                                    │ (DPS)                │
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Methodology

In this research we have focused on secondary type of data, all data is collected from World Development Indicator. To find the long run relationship between the variables we have used multiple regression analysis. In this study we have used the simple linear regression technique to analysis the model. Augmented Dickey Fuller Test (ADF) and Phillips Perron Test (PP) test are used to check the individual stationarity of each variable. The data for the variables such as Gross Domestic Product (GDP), Exports (X), and Government-Expenditures,

Domestic credit to private sector (DPS), Money and Quasi money (M2) are collected from World Development Indicator (WDI). Augmented Dickey Fuller test is used to estimate the unit root test. Johnson co-integration test is also used to check the long run relationship between the variables. Error correction model is also applied in estimation. GDP will be taken as dependent variable and Exports, Government-Expenditures, DPS and M2 are taken as explanatory variables.

The total market value of all final goods and services produced in a country in a given year, equal to total consumer, investment and government spending, plus the value of exports minus the value of imports. A function of international trade where by goods produced in one country are shipped to another country for future sale or trade. As a process that marks improvements in quantity, quality and efficiency of financial intermediary services. This process involves the interaction of many activities and institutions and possibly is associated with economic growth. Whereas, spending by the government sector including both the purchase of final goods and services or gross domestic product and transfer payments.

Econometric Model

$$GDP = \beta_0 + \beta_1 X + \beta_2 Govt\text{-}Exp + \beta_3 DPS + \beta_4 M2 + \epsilon_t$$
GDP = Growth rate
X = Exports
G.E = Government-Expenditures
DPS = Domestic Credit to Private Sector
M2 = Money and Quasi money.
Here B_0 is a constant while B_1, B2, B3 and B4 are the coefficients. GDP is dependent variable while exports, government-expenditures, DPS, and M2 are the independent variables.
 Data Analysis

Unit Root test at 1st difference

- **Augmented dickey fuller test**

Variables	T-Calculated	T-Tabulated	Region of Rejection at 1%
Gross Domestic Product: GDP	-3.487	-3.886	Non-Stationary. When $t_c > t_t$ accepted H_o non-stationary.
Exports: X	-3.785	-2.646	Stationary. When $t_c < t_t$ accepted H1 stationary.
Government-Expenditures: G.E	-1.207	-3.788	Non-Stationary. When tc $> t_t$ accepted H_o non-stationary.
Domestic Credit to Private Sector DPS	-0.801	-3.012	Non-Stationary. When tc $> t_t$ accepted H_o non-stationary.
Money and Quasi money M2	-2.222	-3.012	Non-Stationary. When tc$> t_t$ accepted H_o non-stationary.

Interpretation:

This table shows the results of augmented dickey fuller test. In this table all the t_c values are greater than t_t. So it means that the data is non-stationary and here we will accept H_o hypothesis and reject H_1. However, GDP, t_c value is -3.486979 that is greater than t_t that is -3.886751 so, this data is non-stationary because the value of t_c is greater than t_t. Whereas, in the case of Exports, t_c value is -3.785145 and the value of t_t is -2.646119 it shows that the calculated value of exports is less than the tabulated value so, H_1 is accepted and H_0 is rejected. In case of Government-Expenditures the calculated value t_c is -1.207470 is greater than t_t value of Government-Expenditures that is -3.788030 in this case H_o is accepted and H_1 is rejected. While DPS also shows that its calculated value is t_c -0.801103 and tabulated values t_t is -3.012363 so H_1 is rejected and H_o is accepted. The last variable M2 also shows that its calculated value is t_c -2.222167 and tabulated values t_t is -3.012363, so H_1 is rejected and H_o is accepted. All the variables are non-stationary but one variable is stationary at the 1st difference level.

Johnson Co- integration Test:

Eigen values		Null Hypothesis	Alternative Hypothesis	T-Statistic	0.05 critical value	Prob.
Pakistan						
Trace tests						
λ1	0.863	**r* = 0**	r > 0	78.562	69.818	**0.008**
λ2	0.619	**r ≤ 1**	r > 1	38.831	47.856	**0.267**
λ3	0.464	**r ≤ 2**	r > 2	19.480	29.797	**0.458**
λ4	0.220	r ≤ 3	r > 3	7.006	15.494	**0.576**
λ5	0.096	r ≤ 4	r > 4	2.029	3.841	**0.154**
Max Eigen tests.						
λ1	0.863	**r* = 0**	**r = 1**	39.731	33.876	**0.008**
λ2	0.619	**r = 1**	**r = 2**	19.350	27.584	**0.387**
λ3	0.464	**r = 2**	**r = 3**	12.474	21.131	**0.501**
λ4	0.220	**r = 3**	**r = 4**	4.977	14.264	**0.744**
λ5	**0.096**	**r= 4**	**r= 5**	**2.029**	**3.841**	0.154

Trace test and the Max Eigen experiment point to 1 Co-integration equation by the 0.05 point.

*indicate negative response of the theory at the 0.05 point.

**MacKinnon-Hag-Michelins (1999) p-values.

Interpretations

This chart shows the result of Johnson co-integration test. In Co-integration there are two tests which are Trace trial and Max Eigen value tests. In the above table we have five variables GDP, Exports, Government-Expenditures, DPS and M2. Where GDP is dependent variable and rest of variables are independent. We check the long run relationship through Johnson Co-integration test and result shows that in trace test T-statistic value

78.562 greater than critical value 69.818 at probability 0.008, it shows here is only single Co-integration equation exists at the 0.05 point of implication, where null assumption is rejected and interchange theory be established. However, at Eigen test T-statistics value 39.731 which is greater than the critical value 33.876, which shows that it is significant at the probability of 0.008. Eigen test indicates there is 1 Co integrating equation at the 0.05% point which indicates the negative response of the null theory at the 0.05 point.

Error Correction Model

	Coefficient	T-Statistics	Probability
C	-7.787	-0.658	0.524
D(DPS)	-0.098	-0.201	0.844
D(EXPORTS)	0.037	0.716	0.488
D(GOVT_EXP)	0.225	0.558	0.587
EXC(M2)	0.046	0.142	0.889
DPS(-1)	-0.028	-0.070	0.945
EXPORTS(-1)	0.103	1.134	0.281
GOVT_EXP(-1)	0.055	0.445	0.664
M2(-1)	0.222	0.526	0.608
GDP(-1)	-0.798	-2.009	0.069
R-SQUARED	0.506	1.251	0.056
ADJUSTED R^2	0.101	0.345	0.076
F-STAT	6.784		0.008

Interpretation
The above table shows the result of error correction model. This table shows short run relationship and long run relationship between the variable. There probability and standard deviation is also shown. The value of f test shows the overall significant of the variables whereas R2 also shows the good fit of the model. However, F-statistics shows overall positive significant impact of the model.

Conclusion
The purpose of this study is to find out the causal relationship and possible co-integration between exports, government expenditure, GDP, M2, and domestic credit to private sector (DPS) in Pakistan economy. However, Dornbusch and Reynoso (1989) argue that the evidence on economic growth for the positive effects of financial liberalization tend not to be supported by the strong assertions. In an intensive survey, Levine (1997) breaks five basic functions into the primary function of financial sector: exerting corporate control and monitoring managers, services and goods easing exchange, allocation of resources, pooling risks and hedging, and mobilization of saving. For the emergence of financial markets create incentives informational asymmetries and transaction costs that supply financial instruments. To satisfy illiquid high-return investments and demands on deposits investment undertake a mixture of liquid low-return and liquid deposits to savers can offer by Banks. Augmented Dickey Fuller Test (ADF) and Phillips Perron Test (PP) test are used to check the individual stationarity of each variable. The data for the variables such as Gross Domestic Product (GDP), Exports (X),

and Government-Expenditures, Domestic credit to private sector (DPS), Money and Quasi money (M2) are collected from World Development Indicator (WDI). However, at Eigen test T-statistics value 39.731 which is greater than the critical value 33.876, which shows that it is significant at the probability of 0.008. Eigen test indicates there is 1 Co integrating equation at the 0.05% point which indicates the negative response of the null theory at the 0.05 point. Overall F- statistics shows positive significant impact of the model.

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