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Examining the effect of economic freedom on financial development

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EXTENDED ABSTRACT

INTRODUCTION

The present study investigates the effect of economy openness on financial development in a sample of 152 countries from 1995 to 2015emphasizing on countries income level.

METHODOLOGY

After reviewing indexes used as proxies to financial development, we used liquid liabilities, the proportion of bank assets and the proportion of credits granted to private sector as proxies to financial development and after specifying different models, the effect of economy openness on each index was separately investigated.

FINDINGS

Results show that economy openness has a positive and significant effect on financial development. Despite resistance of these results to different financial development indexes, its impact is sensitive to the kind of index and the selected sample.
When liquid liabilities and granted credits to private sector are considered proxies to financial development, moving from the sample including low-income countries with incomes below average to the sample including high-income ones with incomes above average, the impact of economy openness on financial development increases. Moreover, if the proportion of banks assets is used as the proxy to financial development, moving from the sample including low-income countries with incomes

below average to the sample including high-income ones with incomes above average, the impact of economy openness on financial development decreases. Accordingly, although the impact of economy openness on financial development is positive, the level of this impact is sensitive to the selected index and consequently the kind of selected index is important in conclusion.

In this study, the impact of variables i.e. logarithm of GPD per capita, inflation and the degree of economy openness on financial development has been studied. The results indicate the positive impact of GDP per capita on financial development. This result is resistant to the sample and selected index for financial development. However, due to different indexes and samples, definite results have not been obtained regarding the impact of inflation and the degree of economy openness on financial development. The impact of these variables is sensitive to the selected sample and indexes.

CONCLUSION

Based on results, although economy openness has a positive impact on financial development, the level of this impact is sensitive to the selected index for financial development. Therefore, the selected index is of high importance for financial development.

Furthermore, results show that GDP per capita logarithm has a positive impact on financial development. This result is resistant to the kind of sample and selected index. However, definite results regarding the impact of inflation and the degree of economy openness on financial development have not been obtained and their impact is sensitive to selected samples and the kind of financial development index.

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