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Studying the Effects of Governance and Financial Liberalization on Financial Development: Evidence from Developing Countries

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ABSTRACT

Financial development refers to a situation in which presenting of financial services have increased by financial institutes, and if the financial institutions have necessary efficiency, they transfer capital from savers to borrowers. Therefore, resources have led to productive investments and results in optimum allocation of resources. Generally, many factors have effect on financial development that can be divided to two groups of economical and non-economical factors. The present research attempted to study the effect of good governance and financial liberalization on financial development during (1996-2013) for developing countries in revenue breakdown with dynamic panel data method in descriptive-analytical approach. Indicators that are used to release are indicator of capital account restrictions. The political stability indices, voice and accountability, rule of law, quality of legislation, and control of corruption are studied as good governance indices. The results showed that in all estimated models, components of governance indices and financial liberalization in developing countries with low income have positive significant effect on financial development that are consistent with experimental and theoretical expectations. For developing countries with high income, the results show that in all estimated models, good governance has positive effect on financial development, and financial liberalization of these countries in all models has positive effect on financial development, except models in which good governance indices are quality of legislation and general indicator of good governance.

JEL Classification: G23; G34; O16.

Keywords: Financial Liberalization; Dynamic Panel; Governance; Quality of Legislation.

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1. INTRODUCTION

Financial markets have an essential role in economic growth. We can say that they are the center of economic system. Financial efficient system transfers capital of savers to borrowers, then it leads resources to productive and profitable investment projects and results in optimum allocation of resources. Therefore, if financial systems become efficient and result in financial development, they can facilitate the economic growth. Therefore, with regard to importance of financial development in economic growth that is the most important aim of each economy, a study about financial development will become important. Generally, many factors have effect on financial development that are divided to two main economic factors (release, economic growth, and inflation) and non-economic factors (good governance, property rights, legal system, political pressure and so on that are mentioned as institutional factors). Suitable institutional basis is one of the most important factors of determination of performance in financial section as economic performance of countries during the time depend to their political, institutional, and legal environment and these institutions and policies determine the quality of good governance among countries. Along with financial development, policies of financial release can improve it as in which increasing of openness can develop the developing countries.

Whatever economy of the country is more dynamic than other countries, besides the increasing of economic exchanges; it will have technology and creation of other countries. And with increasing of return, increasing of motivation and factor of mobility are provided to investors and financial development is provided too. Then financial liberalization becomes more important. The research attempted to study the effect of financial development and financial liberalization on good governance in developing countries, that in spite of its importance, empirical evidence of this subject is almost less. Then recently the researchers pay more attention to this problem. The research attempted to study the effect of institutional non-economic in frame of good governance and economic factor of financial liberalization that in term of concept it is more congruent with the concept of financial development.

2. LITERATURE REVIEW

In this part the research attempted to explain financial development, then concept of financial linearization is cleared, and at the end, concept of good governance is discussed. Financial development refers to the situation in which presentation of financial services is increased by financial institutions and all people have wide selection of services. Accumulation of capital is one of the most important resources of economic continuous growth of the country. Through financial markets we can accelerate process of making capital and financial development (King, Levine, 1993). Economic liberalization means deregulation and reduction of bureaucracy, releasing of prices, and breaking of monopoly. In term of theoretical and experimental, economic liberalization studies different areas that are releasing of prices, trade liberalization, liberalization of the exchange rate, investment liberalization, capital account and department of finance liberalization, and financial liberalization in the following we will explain financial liberalization. In term of international institutes such as International Monetary Fund, World Bank, and World Trade Organization everything that reduces the control on free trade and goes to free economy is an action for economic liberalization. Now if liberalization happens in financial department and its related services, it is a financial liberalization.

World Bank describes the governance as method that based on it, use economic management of a country and its social resources to reach to development. Governments can improve their abilities by strengthening of institutes. This affair needs instituting of rules and norms that motivate government officials to consider the interest of all.
Good governance has six components that would be explain later. The right of comment and responsiveness illustrates the concepts such as political rights, freedom of expression, and political and social gatherings, press freedom, representing the board of governors from social classes, political rights, and political processes in elections that are the indices of democracy. Without political freedom people cannot be the member of groups and cannot make the ideas and illustrate them, but democratic governors support human rights and let people to participate more in institutions.

Definition of transparency international calendar of corruption is abuse of general power to personal interests; for example, paying bribery to governmental officials, blackmail embezzlement in public logistics or of public properties. This index measures the concepts of corruption in authorities, effectiveness of anti-corruption measures, its effect on absorb foreign investments, bonus or bribery to give economic licenses and so on. Political stability illustrates the concepts of social unrests, terror and political executions, coup, urban tumults, ethnic tensions, and smooth transition of power in the high level. Political uncertainty comes with political instability and probably it increases rate of time preference to venture investors. In response to this, substitutions rate of long term investments and probably with high efficiency increased by short term investment programs with low efficiency. Additionally, production inefficiency that is made by political instability final products decreases the corresponding production data. (Fosu, 2001)

Definition of United Nation about rule of law refers to principles of sovereignty in which all individuals and personal and governmental institutions (including the government itself) are responsible against laws. The laws that are published generally, are implemented equally. They are ruling independently and they are compatible with international human rights. Based on the definition of World Bank, rule of law attempts to limit the authority of the government and keep from abuse or arbitrary of authority. Rule of law is not just rules and regulations that are made by law, but it is guaranteed to freedom, human rights, and equal treatments against law (Watson, 2003). Quality of law illustrates the concepts like cumbersome regulations, Intervention of government in economy, competitive policies, tariff and non-tariff obstacles, and capital market access. Efficient regulations realize the aims of social welfare that are made by government, with less cost. Economic costs of administrative bureaucracy are shown in two overall shapes:

1- Direct costs of management of legislation system that is internalized in government through allocation of funds in regulatory frameworks.

2- Costs of compliance that is exogenous for legislator and it is paid by producers and consumers, are accompanied with rules or dodge the reception of them (Mobarak, 2013).

Efficiency or effectiveness of government with policy and implementation with government are noticed to keep market system. It is also pointed out to ability of government, arbitration of court, management decisions about rule of law, management and criminal justice such as responsibility and transparency. Additionally, it is illustrated the quality of provision of general services and independency of general services from political pressures and competence of brokers (Polterovich & Popov, 2007). With regard to definitions of financial liberalization in which the assets and foreign debts are percent of GDP, we can say that with financial liberalization the field of entrance of foreign capital to the country is provided that help the developing of financial markets. Financial liberalization can be effective on financial development through different ways. First. Financial liberalization maybe decreases the financial repression through increasing of interest rate in financial markets. Second, lack of control of investment results in encouraging of domestic and foreign investors to invest in different portfolio. Therefore, capital cost decreases and capital stock increases. Third, Financial market liberalization not only can increase efficiency of financial system through outside of inefficient financial organizations and increasing of pressure on financial restructuring, but also it can decrease asymmetric information (Classenset et al, 2001).

Index of comment and responsibility is an index of democracy. Girma and Shortland (2008) in the research showed that movement to democratic government has positive effect on financial development. In fact, because of institutional characteristics such as political competition and checks and balances system, democracy develops financial department. Political stability is the other promoting factor of good governance in the country. Political instability in the country prevent from institutional supporting of financial affairs such as supporting of investors. It may also castrate effective institutions. Primary supporter institutions of investors such as courts, rules and regulations, and supervisors cannot act in the good political instability environment. As a result, it results in lack of financial development (Siegel and Roe, 2011). Political instability causes that emergency institutions are not formed to financial development and have no necessary efficiency, they also decrease the economic activities and reduction of economic activity increases the demand to financial services (Siegel and Roe, 2011).

One of the effective factors on lack of financial development is insufficiency and complexity of rules and regulations. In other word, institutional environment with quality along with clear regulations increase the investment that increase demand to financial resources and development of financial department. Great financial markets not only need suitable legal framework, but the rights and constraints of parties of transaction must be respected and implemented. Otherwise, because of problems of asymmetric information, financial contracts may not be hold. Because lender cannot predict the behavior and motivation of borrower. Based on La Porta and et al's legal and financial theory (1997 -1998), legal systems are different with each other in development and expansion of ownership rights systematically. They reason that origin of legal systems have effect on behavior of creditors and shareholders and make efficiency in implementation of contracts. The results showed that in common law systems, they support more from the rights of private property owners. As a results, this subject causes that traders participate in the trading with more confidence that develops financial department. Rule of law index is used as scale to measure the protection of property rights and function of justice's system. Based on institutional theories, complete supporting and implementation of property rights is the vital principle in financial transactions, because despite of existence of risk of expropriation, potential investors do not like to investment. (Asiama and Mobolaj, 2011).

The present part attempts to study the literature review of the research. Lin (2012) studied the effect of policies and regulations (quality of regulatory rules) on economic development in 49 countries during 1990 to 2009. the results showed that measured index of economic development explains financial development well. Additionally, the results showed that countries with Spanish and French origins have no rate of financial development. While, countries with German legal origin have positive rate of financial development and as expected institutional development and financial development have positive correlation. the other results of study showed that democracy is a good factor to financial development. also economic liberalization has positive relationship with financial development. Roe and Siegel (2011) have studied the effect of political institutions on development of financial department. They showed that political instability is an obstacle to financial development. They believed that these policies can help to understand the happening of financial development better, because these policies are the cause of political instability.

Additionally, many of institutional factors are the key notes in financial development and backwardness. Huang (2010) has studied the relationship of improvement of political institutional quality and financial development. His aim in the present research is to study the question that does improvement of political institutions make promoting of development in financial department? For this reason, data of 90 developing and developed countries are used during the period of 1960 to 1990. The results showed that improvement of political institutional quality has positive effect on financial development at least in short term specially in countries with less income. The preliminary evidences of the research also showed that democratic transition increase the financial development. Singh et al., (2009) have studied the effect of institutional quality on development of financial department in African countries during 1992-2006. They showed that difference in institutional quality is the main factor of difference in financial development in these countries. Kim and Wu (2008) studied the effective variables (such as good indices of governance on financial development) by using panel data in 52 emerging countries during 1995 to 2003. Axis bank indices such as private credit with deposit money banks to GDP, share of domestic credit that are presented by banking sector from GDP, and bank system are used. Das et al (2004) studied the effect of regulation governance on making stability in financial system. Data of countries are extracted from FSAP. The results of regression showed that regulation governance index has positive significant effect on increasing of health of the financial system.

3. METHODOLOGY

In the conducted studies about financial department, the experimental method is based more on time-series techniques or sectional statistics. This kind of studies usually have face to statistical problems: among these problems we can point to heterogeneity of variance and autocorrelation. For this reason, combined data are noticed more recently. Among advantages of using this kind of data is to limit the accessibility to heterogeneity of variance, and it results in access to more information, more variability, less linearity of variables, more degrees of freedom, and more efficiency. In addition, by using extended torque (GMM), estimation of models conducted to solve or reduce the problem of endogenous of index of good governance and correlation between other explaining variables. This part pays to study of psychology of research and tests that are used in the research.

Combined data refers to a series of data, based on it, observations are often selected by using many sectional variables(N) randomly. During a determine time-series, T is studied. In this case, N*T of statistical data are called combined data of time-series and sectional data. Combined data contains both aspects of time-series data and sectional data, and using suitable statistical explaining models that describe the characteristics of that variables are more complex than models that are used in sectional data with time-series. Unit root test in combined data is established by Quah (1992, 1993). This study is completed by other researchers such as Levin et al., (2002), Breitung and Myer (1992), Im et al., (2003). We begin to study these tests by studying Lin and Levin's test (Baltagi et al., 2005). Levin et al., (2002), showed that using unit root test of data in combined data has power more than using unit root test in each sectional separately. Wu (1996), Oh (1996), McDonald (1996), and Francel and Rose (1996) showed that using common unit root tests in combined data such as Dickey-Fuller (1979), extension Dickey- Foller, and Phillips and Perron test (1988), have lower statistical power than unit root tests of combined data. Levin et al., (2002), showed unit root test as follow:

$$\Delta X_{i,t} = \rho_i X_{i,t-1} + \delta_t + \alpha_i + \varepsilon_{i,t} \qquad i=1, 2, \dots, N \qquad t=1, 2, \dots, T \qquad (1)$$

where N is the number of sections, T is time-series, P is auto parameter for each section of time, α_i is constant factor for each section and $\varepsilon_{i,t}$ is the sentence of disturbing model that has normal distribution with zero average and variance of δ^2.

In H1 hypothesis of this test, ρ_is have different values. In other word, hypotheses of this test are illustrated as follow:

$$H_0: \rho_i = 0 \qquad i = 1,2, \dots, N$$
$$H_1: \begin{cases} \rho_i < 0 & i = 1,2, \dots, N_1 \\ \rho_i = 0 & i = 1,2, \dots, N \end{cases} \qquad 0>N_1>N .$$

As based on these hypotheses, some sections can have unit root. Therefore, instead of doing test to combined data, unit root test is used for each section separately. After that average of these statistics are calculated as $\bar{t}_{NT}$. If $t_{iT}(\pi_i, B_i)$ shows the t statistics for unit root test of ith of section, with π_i pause and test coefficient of B_i. Baltagi et al., (2005).

Sargan (1958) in asymptote has χ^2distribution that is defined as follow:

$$S = \hat{\varepsilon} \acute{z} (\sum_{i=1}^{N} \acute{z}_i H_i z_i)^{-1} \acute{z} \hat{\varepsilon} \qquad (2)$$

In the test of $\hat{\varepsilon} = Y - X\hat{\delta}$, $\hat{\delta}$ is matrix of $k \times 1$ of estimated coefficient, z is matrix of instrumental variables, and H is square matrix with dimension of T-q-1, in which T is number of observations and q is the number of explaining variable of model. In this test, if zero hypothesis is not rejected, defined instrumental variables are valid in the model and this model does not needs to define instrumental variables more. But in rejection of zero hypothesis, defined instrumental variables are insufficient and unsuitable and it is necessary that more suitable instrumental variables are defined for model (Barro, 1996). Waste correlation test of first time and the second time is AR(1) and AR(2), respectively. This test also is used to study the valid and accuracy of instrumental variables. Arellano and Bond (1991) believe that in estimation of GMM, residuals statements have series correlation of the first time AR(1), and have no series correlation of the second time AR(2) (Mehrgan and Mohseni, 2012).

The economic model that is used in the research is illustrated as follow:

$$FD_t = \beta_0 + \rho FF + \sum \alpha_i G_{it} + \sum \gamma_i Z_{it} + FD_{t-1} + \sum \varepsilon_i \qquad (3)$$

$$G_{it} = VA + PSNV + GE + RQ + RL + CC + AVE \qquad (4)$$

$$Z_{it} = GDP + INF + TO + \cdots \qquad i=1,..,7 \qquad (5)$$

In order to prevent from bias in estimation, in term of income the countries are homogenized and estimation is conducted for developing countries with high income. The models of research are expanded as follow:

$$FD_t = \beta_0 + \rho FF + \alpha GE + \kappa GDP + \mu INF + \theta TO + \delta FD_{1,t-1} + \varepsilon_1 \qquad (6)$$
$$FD_t = \beta_0 + \rho FF + \alpha PSNV + \kappa GDP + \mu INF + \theta TO + \delta FD_{1,t-1} + \varepsilon_2 \quad (1)$$

$$FD_t = \beta_0 + \rho FF + \alpha VA + \kappa GDP + \mu INF + \theta TO + \delta FD_{1,t-1} + \varepsilon_3 \qquad (8)$$

$$FD_t = \beta_0 + \rho FF + \alpha RQ + \kappa GDP + \mu INF + \theta TO + \delta FD_{1,t-1} + \varepsilon_4 \qquad (9)$$

$$FD_t = \beta_0 + \rho FF + \alpha RL + \kappa GDP + \mu INF + \theta TO + \delta FD_{1,t-1} + \varepsilon_5 \qquad (10)$$

$$FD_t = \beta_0 + \rho FF + \alpha CC + \kappa GDP + \mu INF + \theta TO + \delta FD_{1,t-1} + \varepsilon_6 \qquad (11)$$

$$FD_t = \beta_0 + \rho FF + \alpha AVE + \kappa GDP + \mu INF + \theta TO + \delta FD_{1,t-1} + \varepsilon_7 \qquad (12)$$

Financial index (FD): This index obtained from direct demands of bank section of private section to GDP. If share of debt of private section to bank system is studied than GDP, it can illustrate the efficiency of bank system in using equipments of private section in relation to economic growth.

Gross Domestic Production (GDP): It contains total value of goods and services that is produced in a country during certain period usually one year.

Inflation rate: It equals to changes in an index of price that is the index of consumer price.

financial freedom (FF): Any action that is used to reduce the control on free trade and move to free economy is illustrated as financial freedom.

Trade Opening (TO): Trade opening in the simple language means reduction or deletion of trade obstacles in international trade.

Voice and Accountability (VA): This index illustrates political rights, freedom of expression, press freedom, representing the board of governors from social classes, political process in holding of election that is mentioned as democracy index.

Political stability (PSNV): It illustrates the concepts such as social unrest, terror and political executions, urban tumults, ethnic tensions, power transfer in higher levels.

Government effectiveness(GE): It illustrates the ability of government in legislation, arbitration of courts, management decisions about rule of law, management justice such as responsiveness and also quality of supplies and general services and competence of brokers.

Regulatory Quality(RQ): This is the index of ability of government to reinforcement the institutions in order to improve the abilities that needs institutionalize of rules and norms to motivate governmental officials to consider the total interests.

Rule of law (RL): It contains components such as people's trust in law, predictability of the judiciary, likelihood of success in lawsuit against the government.

Control of Corruption (CC): This index measures the concepts the concepts of corruption in authorities, effectiveness of corruption in authorities, effectiveness of anti-corruption policies, bon policies, bribery and other components.

AVE: It is the average of six indices of good governance that is illustrated as general index of good governance, except error of ε_i.

Table 1. Results of Unit Root Tests

variables	Levin Lin Cho test(LLC)		Im, Pesaran, Shin test (IPS)	
	Level	difference	Level	Difference
FD	-8/9948 (0/0000)*	-	-	-4/1310 (0/0000)*
GDP	-	-15/1117 (0/0000)*	-	-3/4292 (0/0000)*
GE	-3/9173 (0/0000)*	-	-	-4/0235 (0/0000)*
INF	-50/0505 (0/0000)*	-	-4/7084 (0/0000)*	-
KO	-4/4521 (0/0000)*	-	-5/2567 (0/0000)*	-
TO	-5/5488 (0/0000)*	-	-2/4500 (0/0427)*	-
PSNV	-4/6026 (0/0000)*	-	-	-7/4890 (0/0000)*
VA	-28/1971 (0/0000)*	-	-4/6829 (0/0000)*	-
RQ	-	-6/2595 (0/0000)*	-	-6/6949 (0/0000)*
RL	-2/2814 (0/0000)*	-	-	-5/9908 (0/0000)*
CC	-28/1971 (0/0000)*	-	-4/6829 (0/0000)*	-
AVE	-3/6200 (0/0001)*	-	-	-7/4410 (0/0000)*

4. RESULTS

Studying the stagnation of variables in the research is the first step of experimental estimation of the research. For this reason, two tests of Levin et al (2002) that is famous in LLC, and Im and et al (2003) that is famous in IPS are used. The results of these tests for developing countries with high income are illustrated in Table (1). Zero hypothesis of these tests implicate on unit root in studied variable implicate on unit root in studied variables. But the hypothesis against of them shows stagnation of variables. With regard to the below table, the results of Levin Lin cho, Im et al., (2003) show that studied variables are stable for developing countries with high income; that is, zero hypothesis with unit root is rejected. The results showed that some of the variables are stable at level and some of the variables are stable with one time of differencing. Based on these tests all variables are stable and unwary about problem of unit root we can estimate pattern parameters by using extended torques method.

Here the results of Sargan test for developing countries with high income shows the accept of zero hypothesis and reliability of instrumental variables. The results of Table (2) show that zero hypothesis that shows instrumental variable at level are accepted in %5 that implicates the suitability of instrumental variables in developing countries with low income.

Table 2. Results of Sargan Test

Model 1	Model 2	Model3	Model 4	Model 5	Model 6	Model 7
27/28 (0/39)***	27/89 (0/36) ***	26/39 (0/44) ***	27/27 (0/39) ***	27/59 (0/37) ***	26/39 (0/44) ***	26/38 (0/44) ***

With regard to the results in developing countries with high income in all models AR(1) is significant. for this reason, in all models, maybe AR(1) is smaller than 0/05 that shows AR(1) is significant at level of %95; that is, there is first time auto-correlation and in all models, AR(2) is more than 0/05 that shows it is not significant at level of %95; that is there is no second time auto-correlation.

Table 3. Results of Band Test

	Model 7	Model 6	Model 5	Model 4	Model3	Model 2	Model 1
AR(1)	(0/0416)*	(0/0416)*	(0/0305)*	(0/0069)*	(0/0058)*	(0/0279)*	(0/0073)*
AR(2)	(0/4035)***	(0/4035)***	(0/7986)***	(0/2277)***	(0/2484)***	(0/3504)***	(0/3523)***

After conducting of related tests, we try to estimate the parameters of selected model by using econometrics method. As illustrated in methodology section of the research, parameters of selected model are estimated based on extended torques.

First model (Equation 6): Index of government effectiveness (GE) is used as a component of good governance. With regard to the results of Table (4),in developing countries with high income, effective variables on financial development such as Gross domestic production, financial freedom and financial development of previous period in developing countries with high income has positive effect on financial development. With one unit increasing in financial development of previous period, gross domestic production, good governance, and financial freedom of dependent variables that are financial development are 0/81, 0/0006, 2/71, and 0/56 unit increasing, respectively. Government effectiveness has the most effectiveness as index of good governance and gross domestic production has the least effect.

Second model (Equation 7): Index of political stability (PSNV) is an index of good governance that is used in the model. With regard to Table (4) it is cleared that gross domestic production, index of political stability, financial freedom have positive effect on financial development in developing countries with high income. In developing countries with one increasing unit, financial development of previous period, , financial development of previous period, GDP and political stability are 0/81, 0/008, and 0/58 increasing units, respectively. financial development of previous period has the most effect and GDP has the least effect.

Third model (Equation 8): Voice and accountability (VA) index is the index of good governance that is used in the model. with regard to the results of estimation of Table (4) it is cleared that variables of the research in developing countries with high income have positive effect on financial development. In addition, with one unit increasing in financial development of previous period, GDP, and good governance are dependent variables of financial development that are 0/007, and 0/16 unit increasing, respectively. Voice and accountability index has the most effect and GDP has the least effect.

Fourth model (Equation 9): Regulatory Quality (RQ) index is the index of good governance that is used in the model. With regard to the results of estimation of Table (4), variables of the model, except variable of financial freedom and inflation have positive effect on financial development in developing countries with high income. In developing countries with high income with one unit increasing in financial development of previous period, GDP, RQ index and variable of trade freedom that are related to financial development are 0/74, 0/001, 2/75, 1/48 of unit increasing, respectively. RQ index has the most effect, and GDP has the least effect.

Fifth model (Equation 10): Rule of law (RL) index is used as good governance index in the model. With regard to the results of estimation of Table (4), it is cleared that in developing countries with high income, RL index and trade freedom have no effect on financial development, and they are significant at level of importance of %10. In developing countries with high income with one unit increasing in financial development of previous period, GDP and financial freedom are dependent variables that are financial development with 0/81, 0/0006, and 0/67 of unit increasing, respectively. Financial development of previous period has the most effect, and GDP has the least effect. Then with one unit increasing in inflation, financial development in developing countries with high income has -0/0007 unit reduction.

Table 4. Results of Estimation of Effectiveness in Good Governance and Financial Freedom

variable		Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
FD(-1)	Coefficient	0/81	0/81	0/21	0/74	0/81	0/71	0/79
	T-statistic	129/54	133/53	8/67	106/40	100/85	54/08	88/51
	Prob.	(0/0000) *	(0/0000) *	(0/0000) *	(0/0000) *	(0/0000) *	(0/0000) *	(0/0000) *
GDP	Coefficient	0/0006	0/0008	0/007	0/001	0/0006	0/001	0/0005
	T-statistic	4/96	6/47	4/61	5/69	4/80	7/34	4/90
	Prob.	(0/0000) *	(0/0000) *	(0/0000) *	(0/0000) *	(0/0000) *	(0/0000) *	(0/0000) *
Inflation	Coefficient	-0/004	-0/001	-0/0006	0/0006	-0/0007	-0/0007	-0/006
	T-statistic	-1/45	-0/44	-0/10	0/14	-4/76	-4/76	-2/35
	Prob.	(0/1456) ***	*** (0/6555)	(0/91) ***	0/8864) *** (	(0/0000) *	(0/0000) *	(0/0189) *
KO	Coefficient	0/56	0/64	0/28	-0/11	0/67	0/54	-0/24
	T-statistic	1/67	1/59	0/51	-0/14	1/76	1/15	-0/65
	Prob.	(0/0937) **	*** (0/1119)	(0/2500) ***	0/8836) *** (	(0/0779) **	/2500) *** (0	0/5102) *** (
TO	Coefficient	-0/09	0/09	0/77	1/48	-0/12	4/11	0/15
	T-statistic	-0/17	0/32	-0/74	2/72	-0/23	4/87	0/15
	Prob.	(0/8597) ***	*** (0/7487)	(0/45) ***	(0/0068) *	(0/8166) ***	(0/0000) *	0/8777) *** (
Institutional Variable		Government Effectiveness	No Political Stability	Voice and Accountability	Regulatory Quality	Rule of Law	Corruption	Average
	Coefficient	2/71	0/58	0/16	2/75	1/34	8/85	14/04
	T-statistic	3/80	1/90	0/11	3/87	1/08	8/06	12/75
	Prob.	0002) * (0/	0569) ** (0/	90) *** (0/	0001) * (0/	2804) *** (0/	2) *** /804 (0	0000) * (0/

In the studied countries, good governance has positive significant effect on financial development. Based on the results, in all models in developing countries with high income, index of good governance has positive significant effect on financial development that is corresponding with theory and experimental expectations. Voice and accountability index has positive significant effect on financial development in developing countries with high income. With regard to the results we can say that voice and accountability index that is the democracy index has positive effect on financial development. Because political competition that is one of the democracy characteristics, develop financial department. When countries have freedom of expression, press freedom, and political rights, efficiency and new ideas are shaped in financial markets and new and efficiency ideas provide the way of financial development, while in countries with authoritarian regimes, creativity in economic activities are not used and new ideas and policies are not applied in financial markets that provide the field of financial development, because their ideas remains off in their minds.

5. DISCUSSION AND CONCLUSION

The present research attempted to study the effect of good governance and financial liberalization on financial development during (1996-2013) for developing countries in revenue breakdown with dynamic panel data method in descriptive-analytical approach. According to the results of the research, political stability in developing countries with high income has positive and significant effect on financial development. It is clear that political stability is one of the characteristics of food governance.

Political instability such as rebellion, terror, and civil war and foreign war is the inhibiting factors of financial affairs such as pessimism of investors that results in weakening of financial markets. In other hand, supporting of investors is reduced and sponsors such as regulations, and courts cannot act in instability of political environment well. In addition, investors will face with risk in investments, and it results in reduction of investment and reduction of financial development. Also when there is political instability in the country, government officials pay attention to remove the political instability, then they are neglected of domestic policy and experts of the country. They are the infrastructure of a financial market that notice to each of them can make financial development. On the other hand, political instability results in reduction of economic activities, and reduction of economic activities result in reduction of demand of financial services and it follows with downswing. Then we can say that political stability has direct relationship with financial development that the results of the present research confirm this subject.

According to the results of estimation, government effectiveness has positive and significant effect on financial development in developing countries with high income. Government and its policies is one of the important factors that is effective on development of financial department. Government has important role in presentation of financial services. It can have important role in economic freedom and provide necessary conditions to improve political and economic institutions and efficient legislator institutions that this factor is effective in expansion of financial development. In addition, government monitoring on establishment of banks and it is clear that banks have important role in development of financial markets. Therefore, if the government is effective, we can expect that we have financial development. The results also confirm these speech and they confirm the positive relation of government effectiveness and financial development. Rule of law has positive and significant effect on financial development in developing countries with high income. We can say that rule of law index shows property rights and function of justice system. In fact it is the right that property owners can access to their return on investment. In the financial transactions this principle is irrefutable.

Because potential investors have less inclination to investing in affairs that have risk; therefore, the principle of property rights gives this motivation to investors that enter to financial market their asset types and on the other hand, they result in boom. Therefore, advantage of small capitals are provided to great projects. The result of the research also confirm this subject and they show that intensity of this index in developing countries with high income has higher intensity. For this reason, developing countries with high income are the suitable justice beds for development of financial markets that facilitate the way of financial development.

Control of corruption has positive and significant effect on financial development in developing countries with high income. High level of financial corruption makes ineffectively of government policies and it results in reduction of ret urn on investment. In addition, Financial corruption can move investment activities from productive form to bribery and underground activities. These factors can be the deterrent factors for financial development. Because if there is financial corruption in the country, we can say that motivation of small investment is reduced and collecting of small capitals and move them to great investment is reduced and process of financial development will reduce too. Therefore, control of financial corruption can prevent these affairs largely and it will provide the way to financial development. Regulatory quality has positive and significant effect on financial development in developing countries with high income. As we expected, insufficiency and complexity of regulations are the factors that prevent from financial development in the countries and whatever the regulation become more clear, investments increase.

Therefore, with increasing of investment, demand to financial development increases that results in development of financial resources. Through civil law, government can be effective on financial development. By legislation that support from private ownership, government can be effective on financial markets and it can encourage the investors. This affair has positive effect on financial development. Therefore, lucidity of regulations and its non-complexity has direct relationship with financial development that the results of the research confirm it too. Liberalization has positive and significant effect on financial development in developing countries with high income. About trade and financial liberalization with financial development we can say that whatever economic relation become more dynamic with other countries, in addition to increasing of economic exchanges, it results in technology transfer, obtaining of technologies of the world and creativity . By technology transfer, return on economic activities increases and it can be a stimulant to investment specially in technology that increasing of motivation and mobility of investing provide financial development. Financial liberalization can be the important factor of investment that is faced with political considerations that by financial liberalization it can increase investment and can provide the way to financial development of country. The results of the research confirm this note.

In countries in which there are efficiency bank systems, and inefficiency government systems, indiscriminate interventions of government can be obstacle for financial liberalization and finally obstacle of financial development. Factors such as lucidity of financial data can disturb the process of financial liberalization and financial development. Regulation of countries also can make limitation for financial liberalization and prevent from financial development. On the other hand, at first, trade liberalization also can make problem in process of financial development. Because trade liberalization in these countries increase the demand to financial services if foreign countries. If c increase the demand to financial services if foreign countries. If countries have no suitable domestic financial markets, not only needs of foreign markets are not provided, but domestic markets do not reach to their aims and many of the financial equipments that are useful to financial development will waste too. Therefore, the most important factors of economic infrastructure are financial markets that at first they must be reinforced, then liberalization conducts. In addition, the limited studied conducted about effective factors on good governance such as financial development and financial liberalization. In relation with financial liberalization, it is possible the results become different with regard to studied economic infrastructures. But on the whole, financial liberalization has positive effect on financial development in most cases. The result on the whole, financial liberalization has positive effect on financial development in most cases. The results of the research confirm the mentioned hypothesis.

Inflation has negative and significant effect on financial development in developing countries. Inflation makes disorders in process of making decision and existence of high inflation rate limits the asset and results in saving to real asset. It is a threat to financial markets. On the other hand, high inflation reduces the motivation of financial intermediation and causes investors become encourage to change savings to real assets. In the developing countries we can say that inflation rate is cost of keeping opportunity. In the developing countries, financial resources change more in money market than capital, therefore inflation rate that illustrates cost of money opportunity has effect on keeping the different combination of assets, as if inflation rate become high, investors prefer to add real asset in their asset basket. Because despite of high inflation rate, money value will decreases, but real assets such as gold keep their purchasing power. Therefore, this hypothesis accepted in developing countries with high income for models that good governance index that is used in it are voice and accountability, rule of law, control of corruption, government effectiveness, political stability, and overall index of good governance.

And a model in which regulation quality index is used is rejected. Also developing countries with low income except in the first model that governance index of it is government effectiveness, rejected the hypothesis. The reason of this rejection can be this that different countries have different reaction about inflation. In the model that is rejected by developing countries with high income, the reason is regulation quality is in the shape that government provide the field in which risk of inflation is covered and investors like to investment in inflation conditions. About models of developing countries with low income, a model in which government effectiveness index is used is confirmed so we can say that, for this reason, government can not make necessary conditions to use inflation and threads of inflation changes to an opportunity. GDP has positive and significant effect on financial development in countries that is confirmed too. GDP per capita is economic index and according to Patrik's view based on the demand side, changing in financial markets happens because of growth of real section of economy (because of development of technology or promotion of efficiency of work force). On the other hand, economic growth is because of growth of financial department. Demand to financial services depends on growth of real production in different parts of economy. Therefore, expansion of modern financial institutes and increasing of financial assets and their services are the reaction against demand of investors and savers for these services in the economy.

Recommendations

Before applying the different policies of liberalization such as reduction of limitation of international entry and exit of capital, reduction controlling the interest rate and bank credits and reduction of obstacles of entering to financial department to increase competition and increase the share of private department in bank ownership, it is necessary that countries pay to correct the institutional infrastructures. Otherwise, suggested policies are not effective as they must be. Without institutional corrections, it is possible that each action of financial liberalization results in exit of capital more than capital inflows and financial development. It is suggested that developing countries if they have necessary infrastructures, pay to financial liberalization to see financial development. In this framework, increasing of shares of private section from all credits and development of stock and using of financial development instruments are helpful. With regard to infrastructures, liberalization can transfer technology to the countries and transferring of technology itself can be a shock to the market and attract the attention of many investors and provide the way to financial development.

Making environment in which there are press freedom and freedom of expression, can increase creativity in markets such as financial markets. Therefore, the countries must provide the background to expressing the thoughts and creativity of individuals such as students to authorities be able to use new ideas in this way that study the ideas as experts and use the most optimum ideas to improve the economic process and financial development. Governments must use their ability to make security and political stability. It is better to prevent from internal tensions by using seminars, and deal with political opposites by tact and tolerance, and make stability and security. In addition, the countries can hold the meetings in which, the people can illustrate their ideas about different problems freely, and authorities also consider these ideas. Therefore, people have not to show their opposition to authorities by demonstration and terror. Then, internal security and political stability are not also unstable that have effect on financial markets and make slow the financial development process. We must act with neighboring countries with caution to not be in military threat. Because, this kind of threats leads to disturbance that it may make uncertainty in the society and this uncertainty transfer to financial markets and impress financial development.

Countries that have no suitable legal background, must try to improve their legal infrastructures, for example, they must increase their monitoring in courts and justice systems and institutionalize the meritocracy policies, and attract the trust of economic brokers. Then they must help the process of economic development and financial development. Codification of policies that support the private ownership can also be a motivation to investors that provide financial development by their activities in financial markets. Countries in which financial corruption is in the high level, it is better that policy makers must be caution more in government recommendations based on keeping of general investment. Because, keeping of general capitals can increase the motivation of embezzlement among government agencies. With correction of organizational structure and laws, there is a possibility to adjust the balance between interest and damages result from activities based on financial corruption. Structural correction in the fields of tax, regulations of private transactions, and development of infrastructural projects under the responsibility of the government is necessary. Institutional correction is necessary to increase the lucidity and accountability of government section and help to independent organizations.

As mentioned before in most cases, inflation decreases the financial development, therefore it is better that relationship between financial policies and monitory policies bring out from command and assignment mode and change to rational and expert mode. With regard to the necessity of improvement and development of financial department to have active role in this department in process of economic growth and also allocation of optimum financial resources, it is recommendate that government reinforce the bank system and leads the financial resources more to productive investment projects and facilitate the process of financial development. In addition, increasing of private investment can increase economic growth. As a results, due to economic growth, presented credits to this part will increase and financial development has improvement process. Therefore, it is suggested with reinforcement of fiscal discipline of government, private sector specially small agencies can access to bank resources with less cost to continue to their activities in order to help economic growth and financial development. Since policies of trade freedom by economic infrastructures can increase the level of financial development; therefore, it is suggested that developing countries go in this way, for example they can join to world trade organization.

In fact, not only policies of trade development for countries that have necessary infrastructures for trade freedom are not limit in financial sector, but they can develop this sector. Increasing of trade in developing countries can develop exports of departments that have saves of high scale, and it increases the needs of industries and agencies of these countries to financial resources out of agencies and industries and then it makes financial development. In the future some subjects can be suggested for researchers in which researchers can study financial development and liberalization by using other indices, or they can study the effect of good governance on types of economic liberalization.

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