

Financial and Capital Markets and Institutional Freedoms in Pakistan: A Time Series Analysis

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Abstract: Institutional freedom is considered one of the most important factor in the debate of economic growth of nations. The most prominent kinds of institutional freedom which actively take part in economic prosperity are democracy (political liberalization) and economic freedom (business liberalization). The nature of impact of democracy and economic freedom on nation's economic growth is not crystal clear. Effectiveness of institutional freedom on national well being directly indirectly depends on social, economic, political, geographical and cultural aspects of society. This study presents the overview of significance of democracy and economic freedom for Pakistan's financial and capital markets. For empirical investigation this study measured the indexes of level of economic freedom and democracy annually. "Alliance for Restoration of Democracy in Asia" (ARDA) and "The Fraser Institute Canada" methodologies are adopted for measurement of democracy and economic freedom respectively, while statistics of financial and capital markets growth proxies are taken from State Bank of Pakistan and Federal Bureau of Statistics government of Pakistan reports. For study period 1970 to 2007 this thesis has constructed data set of 38 annual observations. The most recent econometric technique ARDL approach is employed for examination of long run and short run relationships between targeted variables. Therefore in sum economic freedom did not contribute significantly toward financial and capital markets performance in Pakistan till 2007. On the other hand existence of fragmented democracy in past also did not support the financial and capital sector growth in Pakistan remarkably.

Key words: Economic Freedom • Democracy • Financial Market • Capital Market and ARDL

INTRODUCTION

Undoubtedly, existing sound financial system and better performance of capital markets in any economy closely related with economic performance of economy. In modern economic system efficient financial and capital markets are considered essential for economic growth and prosperity. Financial institutions work as intermediaries between institutions and investors and better financial system in any economy helps remarkably the economic prosperity. Financial intermediaries reduce transactions costs for saver and investors and also help to increase the productivity of investment. Stated differently, the well-organized the financial system, the stronger would be the economic comfort. In the same token developed capital markets is also considered as key element in modern investment mechanism, because capital markets works as the channel for flow of financial resources.

Capital markets are intermediate players between home and world economies. With the growing globalization of economies, the international capital markets are also become increasingly integrated. In other words one can say that financial and capital markets are considered high flying elements of a modern market based economic system. These markets play momentous role in process of economic development and in integration of home country with rest of world. A burly economy requires a progressive financial system that encourages the confidence and professionally provides a wide range of financial services to households and investors. A diversify financial system is conducive to both financial stability and to efficient resource allocation especially in support of medium term economic growth. Due to the vast consumer base Pakistan has massive and gorgeous investment opportunities. Akin to all other developing countries Pakistan also need both local and foreign

investment to support and sustain its economic growth. As stated above investment either by local or by foreigner investors is always based on sound and well organized financial services. In Pakistan major share of GDP is contributed by agricultural and industrial sector. Financial and capital markets play leading role in growth of economy through provision of credit to industry and agriculture sectors. From a handful of bank branches at the time of partition, the financial sector has expanded exponentially, now having branches in every corner and nook of the country. A growing securities market has also emerged in recent years as an agent for investment fund. According to requirement of economic growth Pakistan need an advanced and modern financial and capital mechanism. Pakistan has made noteworthy improvement to enhance the health and reliability of the banking and financial sector over the last two decades. During this period financial sector and capital markets of Pakistan have gone forward into a more progressive and dynamic module of the economy. In response to the growing demands of financial globalization, Pakistan's financial system is starting to integrate with international financial markets. The liberalization and deregulations in these sectors of the Pakistan's economy has taken place since November 1990, which in turn had meticulous connotation for the growth of financial sector. The basic aim of these reforms is removal of constraints within the financial and capital markets, to make financial capital more easily accessible. To assess that how much financial and capital markets performance in Pakistan is affected by democracy and economic freedom, this study is performed.

It is beyond doubt that economists and sociologists try to determine the nature of the impact of the above mentioned variables (democracy and economic freedom) on economic performance of economies jointly and separately [1-4]. Heckelman [5] explains that economic freedom causes the financial sector growth. Dawson [3], De Vanssay and Spindler [6] conclude that economic freedom accelerates the financial prosperity and then in return financial sector growth enhances the economic growth. Cole [7] concludes that economic freedom positively contribute toward inflation rates and state directed investment. Heckelman and Stroup [8]; Barro and Sala-i-Martin [9] indicate the existence of adverse connection between economic freedom and economic and financial sector growth.

Feng [10]; Bhagwati [11] found that stable political environment is considered key element for increase in private investment and financial sector growth. Study also found that movement of existing political system toward

democracy enhance the level of private investment in country while autocratic style political system deteriorate the level of private investment and business environment in economy. But opponents of this school of thought also argued that democracy is luxury and less developed countries cannot afford the lavish style of administration. Democratic administration hampers the growth game through reducing the pace of physical capital formation. The proponents of this thought also argued that in democratic period community consumes more at the cost of profitable investments; resources are lesser mobile and rent seekers maximize their interests. During democratic periods growing social, ethnic and sectarian struggles adversely affect the growth performance [12, 13].

The rest of this study is sorted out as follow: Section 2 explains the research design, section 3 based on empirical analyses and section 4 elaborates about the economic and statistical interpretation of. Section 5 presents the Short runs dynamic behavior and analysis and last section 6 summarizes the study with heading conclusion.

Research Design

Data: To analyze the significance of institutional freedom for financial and capital markets growth in Pakistan we use the annual statistics from 1970 to 2007. So the total number of observation is 38. The immaculate representatives of financial sector growth are Total Scheduled Bank Branches (TSBB), Scheduled Bank Assets Growth Rate (SBAGR) and Broader Money to GDP ratio (M2/GDP) as indicators of financial sector growth [14], while No. of Listed Companies at Karachi Stock Exchange (LCKSE) as a deputy of capital market liberalization [15]. The real deposit interest rate (RDR) is used in this study as control variable, because interest rate affects the financial sector and capital market performance. As the matter of the rating of Economic Freedom and level of Democracy in Pakistan, these are deputies of institutional freedoms in this study, we used methodology of The Fraser Institute Canada for measurement of economic freedom level in Pakistan, while the index of the level of democracy is gauged through the methodology which is adopted by "Alliance for Reforms and Democracy in Asia" (ARDA)¹. All the necessary statistics are taken from "Hand Book of Statistics on Pakistan Economy [16]" and annual reports published by State Bank of Pakistan. All the variables are taken in the natural log form to observe the relationships in form of Elasticities.

¹ Pakistan Democracy Index Foundation report, (2005), published by PAATAN house #5 Street #58 F-10/3, Islamabad an authorized institute of ARDA(Alliance for Reforms and Democracy in Asia) in Pakistan.

Methodology: 2.2.1 Unit Root Dilemma: It is also proved that the problem of non stationarity has its own implication in empirical analysis especially in time series investigation. The unit root process explains that either our given series are variant or invariant during a specific time period. If any series changed its attributes over time then in econometrics analysis one can say that the focused process is non stationary. It may be difficult for researchers to represent the future and past time lags with a simple model without considering the time lags and then as a result they may commit the model misspecification. But if the given series are invariant in given time process, then researcher can estimate the equation and coefficients are estimate able from the past statistics of given series.

This study used ADF (Augmented Dicky Fuller) and DF-GLS (Dicky Fuller Generalized Least Square) tests for unit root analysis. Because ADF investigate the order of integration that either our focused variables are stationary at level / at first difference or not. Due to less reliability of ADF for little range data [17, 18] the DF-GLS is the second test which is used here for scrutiny of unit root problem. This is considered more reliable test especially for small number of observations. Dejong *et al.* [17] and Harris [18] summarized that some time ADF committing type 1 and type 2 error when samples size are small. Then for more reliability we use DF-GLS as well as ADF test.

Co-Integration and Regression Analysis: As far as the matter of the co-integration analysis, conventional approach of co-integration investigation is condemned because it does not care that either there is unit root variable in focused series or not. It is obvious, that co-integration investigation is vital but unit root enquiry has its own unique importance in unbiased empirical analysis. Co-integration test probe that either our in-variant statistics of given variables are correlated in long run span of time or not. Furthermore, if given variables are correlated then whether these are according to theoretical framework and given restrictions or not. Thus in this respect one can say that co-integrations investigations demonstrate the true picture of long run relationships or equilibrium relations among focused economic variables. This study used the Pesaran *et al.* [19] Bounds Test Approach of co-integration for examination that either long run relationships between targeted vectors are exist or not. This work used the Autoregressive Distributed Lag Model which is one of most reliable method to examine the relationships between variables in long span of time.

ARDL investigation will employ the following unrestricted error correction model to investigation the integration between variables.

$$\Delta \ln(GI)_t = a_o + a_1 \ln(GI)_{t-1} + a_2 \ln(EFI)_{t-1} + a_3 \ln(DCI)_{t-1} + \sum_{i=0}^n \gamma_i \Delta \ln(GI)_{t-1} + \sum_{i=0}^n \phi_i \Delta \ln(EFI)_{t-j} + \sum_{i=0}^n \varphi_i \Delta \ln(DCI)_{t-j} + u_{1t} \quad (1)$$

Notation of summation in above said equation is demonstrating the error correction mechanism, while the remaining part of this equation is concerned with long run associations between variables. To test the long run relationships between targeted variables this study employed the following regression model.

$$\ln(GI)_t = a_o + a_1 \ln(EFI) + a_2 \ln(DCI) + \sum_{i=0}^n \phi_i \ln(Z)_t + u_{1t} \quad (2)$$

where “GI” is representative of all growth proxies of financial and capital sector growth, EFI is economic freedom index, DCI is democracy index, Z stands for control variables and u_i representative of stochastic error term. On the other hand to understand the short run variations of variables the ARDL specifies the following error correction model (ECM),

$$\ln(GI)_t = a_o + \sum_{i=1}^n \gamma_i \Delta \ln(GI)_{t-1} + \sum_{j=0}^n \phi_j \Delta \ln(EFI)_{t-j} + \sum_{j=0}^n \varphi_j \Delta \ln(DCI)_{t-j} + \beta (ECM)_{t-1} + u_t \quad (3)$$

Table 1: Times Series Data Unit Root Test Statistics

ADF Unit Root Test Statistics						
Variables	Intercept		Trend and Intercept.		None	
	Level	1 st diff.	Level	1 st diff.	Level	1 st diff.
ln(EFI)	-3.69*	-7.00*	-4.43*	-6.99*	-0.41	-7.09*
ln(DCI)	-2.75***	-1.87	-3.57**	-1.59	0.18	-1.94***
RDR	-2.92***	-5.85*	-2.99	-5.76*	-2.40**	-5.93*
ln(TSBB)	-2.31	-3.71*	-2.21	-3.82**	0.72	-3.48*
ln(SBAGR)	-5.74*	-10.86*	-5.68*	-10.71*	-0.57	-10.96*
ln(M2/GDP)	-2.15	-4.60*	-4.45*	-4.50*	-0.26	-4.66*
ln(LCKSE)	-0.02	-2.6	-3.85**	-2.52	1.94	-1.02
Critical Values	L.O.Sign.	Intercept	L.O.Sign.	Trend andInter.	L.O Sign.	None
	1%	-3.62	1%	-4.22	1%	-2.63
	5%	-2.94	5%	-3.54	5%	-1.95
	10%	-2.61	10%	-3.20	10%	-1.61

Table 2: Times Series Data Unit Root Test Statistics

DF-GLS(Dicky Filler Generalized Least Square) Unit Root Test Statistics				
Variables	Intercept		Trend and Intercept.	
	Level	1 st difference	Level	1 st difference
ln(DCI)	-2.49*	-1.39	-2.97***	-1.57
ln(EFI)	-2.40**	-7.09*	-3.28**	-7.20*
RDR	-2.95*	-5.91*	-3.01***	5.97*
ln(TSBB)	-0.77	-3.71*	-1.86	-3.93*
ln(SBAGR)	-5.84*	-10.49*	-5.53*	-10.35*
ln(M2/GDP)	-2.04**	-4.67*	-3.62**	-4.65*
ln(LCKSE)	0.10	-1.43	-3.42**	-2.80
Critical Values	Level of sign.	Intercept	Level of sign	Trend and Inter.
	1%	-2.63	1%	-3.77
	5%	-1.95	5%	-3.19
	10%	-1.61	10%	-2.89

Where *, **, *** indicate the ratio is significant at 1%, 5% and at 10% respectively.

Variety of diagnostic and stability tests are also enhance the credibility of the ARDL model. Through diagnostic tests researcher examine about the presence of autocorrelation, heteroscedasticity and appropriate functional form of the model. One can also asses the credibility of model through the prediction power of model. Through this technique model will consider the good fitted if the error or the difference between predicted value and real observation is minimum

Empirical Analysis

Unit Root Test: To ascertain the order of integration this study begins through applying the ADF (Augmented Dicky Filler) and the DF-GLS (Dicky Filler Generalized Least Square). Result about stationarity problems of financial and capital markets variables are presented in Table 1 and 2. ADF Process of unit root investigation reveals that ln (EFI), ln (SBAGR), ln (DCI),RDR and

ln(M2/GDP) are stationary at level even at 1% level of significance and ln(LCKSE) are stationary at level but at 5% level of significance while ln(TSBB) found stationary at first difference. On the other hand these results are also confirmed by DF-GLS unit root investigation.

Co-integration Analysis: Because focused variables are partially stationary at I (0) and I (1) (some at level but some at first difference), so ARDL technique is more appropriate for analysis. Co-integration test through bounds framework based on the comparison of the calculated F values and upper bound values. Vector considers co-integrated if calculated F ratio exceed the upper bound value and vice versa. Resulted are reported in Table 3.

According to ARDL approach explained variable of model # 1, 2 and 3exhibit the long run relationship with targeted explanatory variables because the calculated F

Table 3: ARDL Co-integration Bound Testing

Dependent Variable	Calculated F-statistics	
	Model #	F statistics
ln(TSBB)	1	25*
ln(SBAGR)	2	3.86***
ln(M2/GDP)	3	6.36*
ln(LCKSE)	4	0.20

Level of Significance	Critical Values	
	Lower Bound value I(0)	Upper Bound value I(1)
1%	4.31	5.54
5%	3.10	4.08
10%	2.95	3.45

Note: *, **, *** represent that F ratio is significant at the 1%, 5% and 10% level of significance respectively.

Table 4: Long Run Results

Independent Variable	ln(TSBB) Model #1	ln(SBAGR) Model #2	ln(M2/GDP) Model #3
Constant	1.27*	-3.22	1.10**
ln(EFI)	-0.93*	-0.34	-0.02
ln(DCI)	0.11	-5.51***	0.22
ln(RDR)	-0.01*	0.03	0.01**
ln[EFI(-1)]	-----	8.49***	0.36
ln[TSBB(-1)]	1.01*	-----	-----
ln[SBAGR(-1)]	-----	-0.03	-----
ln[M2/GDP(-1)]	-----	-----	0.91*
ln[M2/GDP(-2)]	-----	-----	-0.45*
ln[LCKSE(-1)]	-----	-----	-0.20
ln[LCKSE(-2)]	-----	-----	-----
R ²	0.96	0.13	0.79
Adj. R ²	0.95	0.10	0.74
DW	2.20	1.92	1.94
F Statistics	189*	0.95	17.83*
B.-Godfrey Serial Corr.	1.15	1.05	0.06
F-statistics			
ARCH Test: F-statistics	2.45	0.17	0.98

Note: *, **, *** represent that ratio is significant at the 1%, 5% and 10% level of significance respectively.

value of these models exceeds the upper bound value. Then the null hypothesis of no co-integration cannot be accepted and that there is indeed an existence of long run relationship among focused variables of these three models. But the calculated F ratio of model #4 is too bellow from the Paresh Kumar Narayan [20] upper bound value even at 10% level of significance. Hence the null hypothesis of no co-integration is accepted and there is not existence of long run relationship among variables of model #4.

Long Run Elasticities: Table 3 is demonstrating that variables of models # 1, 2 and 3 are co-integrated, so inquiries regarding the relationships between variables in

long span of time are not bogus. In these regressions this study probes that either democracy or economic freedom are worthy for financial market growth or not. Results are reported in Table no 4.

Economic and Statistical Interpretation

Model 1: ln (TSBB) is representative of financial sector growth, because increase in total scheduled bank branches directly correlated with the soundness of financial markets. Banks will increase their branches when the branch return is comparatively better due to business conducive economic environment. And in the era of competition and modernization growth of commercial banks directly correlated with their credibility and provision of better and easy financial services to citizens. In other words one can say that increase in commercial bank branches be a sign of financial sector growth. Due to such worthy connection between ln(TSBB) and financial sector growth, this study investigates the significance of economic freedom and democracy for focused dependent variable. Results reflect the positive but insignificant impact of level of democracy on Total Scheduled Bank Branches (TSBB). It mean democracy can promote the strength to scheduled bank branches, because inconsistent and less stable democratic governments could not perform remarkable for scheduled banks branches enhancement. On the other hand economic freedom which is the second prominent explanatory variable, contributes significantly but with negative connection toward total scheduled bank branches. One of the prominent factors of this outcome is nationalization of financial sector in 1972, which breed the momentous decline in the total scheduled bank branches. In 1972 government nationalized 14 banks and then 13 from these were merged into 5 commercial banks. Total bank branches which were 3415 in 1971 reduced down to 2600 in 1972,² while economic freedom level feel approximately minor change in volume³. Similarly from very beginning of the 21st century tight and restricted financial policy of General Musharuff’s authoritarian administration drastically affected the growth of commercial banks branches. In 1999 total number of scheduled bank branches was 8058, but this figure was 7026 in 2004⁴. While level of economic freedom was increased from 5.47 to 5.68 during this period. So these were the facts and figures which reflect here negative connection between economic freedom and total

²See Hand Book of Statistics on Pakistan Economy 2005.

³See Author made EFI

⁴See Hand Book of Statistics on Pakistan Economy 2005.

scheduled bank branches in Pakistan during study period. In this context inverse link is not unexpected. So nutshell is democracy and economic freedoms in Pakistan up till now did not prove beneficial for enlargement of commercial bank branches.

Model 2: Scheduled Banks Assets Growth Rate In (SBAGR) is second proxy which is used here to assess the growth performance of financial sector. Like previous investigation study also scrutinize the effects of economic freedom and democracy on In (SBAGR). Results reveal that democracy negatively and significantly affect the scheduled banks assets growth. Causes of such association are explained in discussion of interpretation of model #1. No democratic government contributed remarkably for financial sector growth due to short tenure of governments and inconsistent economic policies. Economic freedom which is the second considerable explanatory variable also showed negative insignificant impact on In (SBAGR). As far as the matter of analysis, it is obvious that in study period democratic phase is based on approximately half time, from 1971 to 1977 was ruled by Zulfikar Ali Bhutto and from 1988 to 1999 enjoyed by of seven different democratic governments (four elected and three caretakers). In 1972 Prime Minister Zulfikar Ali Bhutto nationalization policy and in 1992 Prime Minister Benazir Bhutto denationalization of financial institution policy considerably affected the financial sector growth. On the other hand sluggish or slight growth of schedule banks in presence of little bit improved economic freedom reflected insignificant inverse correlation between In (SBAGR) and In (EFI). So it is also not unexpected.

Model 3: In monetary analysis M2 is consider as a wider definition of money, because it contains M1 plus demand (savings) and time deposits. Here study employed In (M2/GDP) as an indicator of financial sector growth. Like previous investigation this section also scrutinizes the impact of level of democracy and rating of economic freedom on In (M2/GDP). Results of model number 3 are reflecting the nature of relationship between these variables. According to results, economic freedom has negative insignificant association while democracy has positive insignificant contribution toward In (M2/GDP).

Results are also not surprising because democracy definitely directly affect the growth of M2. The historical background of Pakistan's financial sector performance reflects that in early 90s of twentieth century democratic governments tried their best for improvement of financial

sector growth. Privatization of financial institution and other financial reforms by democratic governments in 90s caused the positive connection between broaden money. So called democratic government of Prime Minister Shoukat Aziz after election in 2005 did a lot in given circumstances for up gradation of financial sector. So insignificant positive impact of democracy on In(M2/GDP) is not astonishing, but. Other attention deserving fact is economic freedom at first lag positively and significantly affects the In (M2/GDP). It is obvious that economic freedom is a long term phenomenon and observation of impact of economic freedom on any sector growth in long span of time is comparatively more genuine. So the nominal increase in economic freedom significantly affected the financial sector growth.

As much as the credibility and integrity of above given regressions, study reported results after a comprehensive judgment of their fitness. The chronic problem of autocorrelations is examined by the more reliable tests LM and DW (Durbin Watson), heteroscedasticity by ARCH test. This study also relies on coefficient of determination for goodness of fit of model. Regression number 1, 3 and 4 have good coefficient of determination. But the coefficient of determination of regression no. 2 is indicating the lesser proportion of explained variation to total variation. Godfrey serial correlation LM tests indicating the absence of autocorrelation in all regression. In the same way ARCH test of heteroscedasticity also signal that all error term have equal variance or presence of homoscedasticity.

Short Run Dynamic Behavior and Analysis: Short run investigation also considers vital as well as long run examination in comprehensive analysis, because it indicates the feedback mechanism in case of shock or imbalances in focused variables of economy. In simple words one can say that short run examination tell us about how much error will be compensated during given lag of time. To provide the firmness to research results this study measured the error correction models (short run analysis) through the ARDL framework. Outcomes of short run analysis are given in Table 5.

According to results our all t ratios of error correction coefficients are statistically significant. This thing is providing support to study decision, that there is long run relationships exist between our targeted variables during study period. The results expose that the coefficients of error correction term (ECM) are negative in all 3 models.

Table 5: Short Run Results

Variables	Model #1 Δ[ln (TSBB)]	Model #2 Δ[ln (SBAGR)]	Model #3 Δ [ln(M2/GDP)]
Constant	4.53	-0.12	0.02
Δ[ln(EFI)]	-4.70	1.69	-0.88*
Δ [ln(DCI)]	-3.31***	-1.30	1.22
Δ [ln(RDR)]	-0.47*	1.12*	0.36*
Δ[lnEFI(-1)]	2.32	1.60*	0.35**
Δ [lnTSBB(-1)]	1.22-	-----	-----
Δ[lnSBAGR(-1)]	-----	-0.21	-----
Δ [lnSBAGR(-2)]	-----	2.13	-----
Δ [ln(M2/GDP)(-1)]	-----	-----	0.72*
Δ [ln(M2/GDP)(-2)]	-----	-----	0.64**
Δ[ln LCKSE(-1)]	-----	-----	-----
Δ[ln LCKSE(-2)]	-----	-----	-----
ECM	-1.04**	-0.84*	-0.86*
R ²	0.80	0.68	0.84
Adj. R ²	0.72	0.53	.78
DW	2.49	2.13	2.17
F Statistics	5.79*	6.25*	2.67*
ARCH Test: F-statistic		.922	0.20

Note: *, **, *** represent that ratio is significant at the 1%, 5% and 10% level of significance respectively.

It is indicating that the feedback mechanism very effectual. Actually it is correction of growth imbalances in financial market annually in Pakistan. In other words it is convergence of financial sector growth process to long run equilibrium in Pakistan during study period after a shock which is caused by economic freedom or by democracy simultaneously or separately. Correction of shock of all three models is very efficient. Model no.1 result is indicating that the recovery of shock is faster than its occurrence, it mean any shock in the TSBB growth will definitely recover within next year. Error correction coefficients value of model no. 2 and 3 are -0.84 and -0.86 respectively. So the recovery process in long run equilibrium of SBAGR and M2/GDP after any shock which is caused by economic freedom and/ or democracy is also not bad. According to results 84% deviation in long run equilibrium level of SBAGR will be recover within the next year. While 86% shock in M2/GDP will be recover within next year. It means that major portion of shocks in these sectors will be recovered within one year while remaining will be in 2nd coming year.

CONCLUSION

In general, to conclude that how much economic freedom and democracy have effects on the growth of financial and capital markets, one may conclude from above given regression results. According to outcomes economic freedom has negative but sole significant touch toward ln (TSBB). Apart from this economic freedom has

insignificant association with all other dependent variables. Overall economic freedom has negative association with financial market growth. The democracy which is other prominent explanatory variable only affected the ln(SBAGR) negatively and significantly, it has insignificant but positive association with all other dependent variables. The major reasons of such unconstructive contributions of democracy in Pakistan are as under:

Deterioration of small and medium enterprises, capital out flow and nationalization of financial institutions in Zulfiqar Ali Bhutto regime 1971-1977. b) Stoppage of foreign aid due to end of Afghan war, poor governance, macro imbalances and reduction in commercial banks branches due to the privatization of financial institutions during Benazir Bhutto and Nawaz Sharif 1st regimes during 1988 to 1993. c) 14% inflation as a whole, lower financial resources mobilization, unrest, frustration and violence of law and order in hub of financial and capital institutions Karachi during Benazir Bhutto 2nd democratic government 1993-96. d) Foreign reserve crises, discontinuity of macro policies, debt burden, increase in defense expenditure and economic sanctions due to atomic bomb blast in Nawaz's Sharif 2nd democratic regime during 1997-99. Hence in the presence of above given deficiencies of democratic governments the inconsequential touch of democracy on financial and capital growth is not unacceptable. So over all one can conclude that existence of democracy in past did not support the financial and capital sector growth in Pakistan remarkably. On the other hand results disclosed that economic freedom is not a matter for the growth of financial sector. Reason is that economic freedom is a luxury which is not affordable by less developed country like Pakistan, because illiterate community some time misuse the freedom for own interest at the cost of nation welfare. So, not only partially controlled economic freedoms (like in autocratic periods) did not contribute significantly toward financial and capital markets performance in Pakistan, but also hampered the financial market growth at some extent.

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