ABSTRACT

ESSAYS ON FINANCIAL DEVELOPMENT

By

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This study analyses financial sector development using an econometric model to understand various issues related to financial development through three essays. The first essay empirically investigates the non-linear effect of financial development on the shadow economy (SE) and how the development of the financial market and financial institution shape the size of the shadow economy. The estimation uses a two-stage least square method based on the data of 59 countries from 1991-2014 and uses the financial liberalization index as the instrumental variable. In general, the finding suggests that financial market development reduces the size of the shadow economy. Moreover, the influence is not monotonic, and it can be categorized by three stages. In the first stage, financial development might be insufficient; it has no clear influence on the shadow economy. When the development is higher than a certain level, it begins the second stage, in which the financial development starts to reduce the shadow economy. When financial development continues to rise, its influence diminishes in the third stage.

The second essay empirically explores how monetary policy (money growth) and fiscal policy (government expenditure) are related to financial development and how the economic environment influences these relationships. The estimation uses the fixed effects model constructed on the average 5-year period panel data of 59 countries from 1987 to 2011. The results show that both money growth rate and government expenditure are negatively related to financial development. Moreover, in a better economic environment (an index measured by six dimensions), a higher money growth rate comes with better financial development, while the relationship between government expenditure and financial development does not depend on the economic environment.

The third essay examines how the financial crisis influenced the speed of financial reform using the data of 91 countries from 1973 to 2005. The results indicate that the influences of the crisis on reform depend on the economic environment. After the financial crisis, small economies tended to speed up reform, while large economies tended to slow it down. The more connected an economy is to the world economy, the less likely it is to choose to reverse financial reform. These findings are basically in line with the 'crisis-begets-reform hypothesis', together with a condition.

Keywords: Financial development, Financial institutions, Financial markets, Shadow economy, Economic environment, Fiscal policy, Monetary policy, Financial reform, Financial crisis, Macroeconomic variables.