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Abstract

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Keywords: Financial Development, Private Investment, Gross Domestic Product, Liabilities

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Title

Financial Development and Private Investment

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Contents

Abstract

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Introduction

Money is taken as blood for the country's economy. Its smooth distribution within an economy is as critical as the distribution of blood in one's body. Its utmost presence in some specific departments of society is critical not only for that department but also for the entire society. That part will be devastated by the excessiveness of money and other departments lose briskness due to its deficiency. That is why struggles are continually made to certain its distribution within the country's economy so that is why all might benefit from this distribution.

So, this situation financial situation arose to achieve this objective and as time went on, this financial system went through various steps of evolution. The benefits of this financial system on economic movements or activities, economists stated studying its result on the overall country's economy. Due to this issue, the association

between the financial system and investment has always been a critical topic for discussion and debate. Different studies have managed or handled this association at theoretical and empirical stages. Many studies advise that there is a positive association among the financial sector evolution. Goldsmith (1999) has concentrated on the competency of investment due to the financial evolution. Goldsmith discussed that the steps of growth with the help of investment, generate further rewards for more development, and also investments have feedback results on the financial markets. In the same fashion Osei & Kim (2020), Mackinnon (1973), and Shaw (1973) impressed many times with accomplished tales of South East Asia, in which financial liberalization and overwhelming flow of portfolio investment, have created outstanding growth in rising equities market specifically in the Asian market.

It is very critical in developing nations to determine investment behavior, so development planning and demand management determine the investment behavior. Due to this factor, financial development has been the center of attraction for many decades in this interest. Now this study concentrates on the character of financial development in describing investment role in Pakistan. The chief goal of this study is to reveal and explain the result and conclusion of the financial sector evolution on private investment in Pakistan.

This work reveals how various factors measuring financial sector development, in various aspects are going to conclude the stages of private investment. This study discussed the different factors of financial development that have relatively powerful results on private investment.

This outcome supports the result that financial development increases the investment outcome within the country's economy.

All other studies have been arranged in the following manner. The next part consists of a summary of past work that is associated with the conjunction of financial development and investment. The third part consists of information about statistical data, the use of models, and methodology. In the fourth part regression analysis and empirical results have been discussed. The last part shows the overall analysis of the complete work and there is some suggestions regarding policy have been placed in the last part as well.

Literature Review

The financial sector is one of the critical departments in the country's economy. Investors who need funds can get from this sector. It changes the idle funds to some useful aspects and it guarantees that it will distribute the scarce resources in a competent manner. The financial sector is made up of different institutions and intermediaries and one of these departments, the bank is one important and critical financial institution. Now the question arises in regard to economists what is the character of the financial sector in a country's economy this is very debatable. There are a lot of studies on this debate and discussion on this issue. So it proves from the different studies that the financial sector has a very critical and important role in developing and strengthening any country's economy by increasing investment manifold in different ways. In the following part, there are concise but comprehensive reviews of different works and theories.

Keynes's theory of liquidity preferences (1936), the critical role of the financial market comes through money rather than credit. Securities and loans are ideal substitutes among several choices in the standardized IS-LM model. Money is the single sole element in the financial market that is accountable for the economic ups and downs when pursuing the Walras law in which the bond market is erased from the model. The prospect of monetarists' money is the sole factor in the financial market and thus the only factor that is responsible and affects the economy of a country. The economic activities of a country will develop in a big way if the monetary and financial system is well developed and well managed.

Much empirical research work explained that financial progress influences the economic movement in a real way. According to impressive studies by King and Levine (1993), many empirical works have been strongly in favor of the view that financial progress has a strongly positive influence on the economy of a country in various ways including investment. Just like there is the study of Wai and Wong (1982) in which there is clear evidence that there is a strongly positive

relationship between investment and fluctuations in banks' credit in actual way, and this is a critical factor of financial progress. Masih (1979) worked in his research in the context of Pakistan's economy and observed not only the association between private investment and financial affiliation but also studied affiliation among financial associations. He observed that there is a positive and straight influence on private investment if there is a continued flow of loans from influential credit institutions and this flow is also critical for long-term loans.

The study of Gurley and Shaw (1955) in which they stressed the critical role of financial medium in generating credit. The important and critical factors of the business cycle are the financial quantity and the overall development of financial institutions. They have the same idea as Fisher discussed before the balance sheets of borrowers are critical in affecting the business cycle. The study of Levine (1999) observed in his study that the financial sector improves economic development by evaluating the investment probabilities and managing a strong hold on corporations, helping management of risk, and minimizing the cost of recourse movement. So when as financial sector improves it becomes more competent in generating the services that improve economic capabilities.

In the studies of Goldsmith (1969), McKinnon and Shaw (1973) have stressed the critical role of the financial department in generating the actual economic activities due to which higher growth of the economy is witnessed. These studies tried to answer the different questions about whether financial sector progress is responsible for actual economic activities and or investment. According to Goldsmith's point of view, the improvement of the financial sector has a double effect on boosting of economy. On one point due to the improvement of the domestic financial market, it might increase the capital collection. (Thus boosting the growth rate of output) and on the 2nd point financial institutions can help in increasing saving rate and hence investment. In his studies, he also gets some positive correlation between financial sector growth and level of actual per capita GDP. He points out this correlation to the positive effect and it is due to the financial growth which encouraged the use of capital stock in a very competent way. In the study of Shaw (1973), most finance depends on external finance because bank's credits come from external finance. The more collection of funds in the bank's deposit, the more funds will be available for lending and forgiving loans ultimately due to which investment grows.

Jorgenson (1971) suggests in his study that determinants of investment can be divided into three categories (1) capacity utilization which is represented by the ratio of output to volume, the difference between output and volume, change in output, sales less previous peak of sales and so on; (2) flow of internal funds, accrued tax liability and stock of liquid assets, these factors represented internal finance; (3) the market value of the firm, rate of returns, stock prices and interest rates represented the external finance. In regard to this study which stated that for determinant of desired capital, the volume of utilization is very critical and important. In any model, the variables that are related to internal finance are not very critical as a determinant of desired capital and that also output includes as a critical determinant. From the empirical proof, it is clearly shown that the actual output arises as the most critical sole determinant of investment expenditures. The second critical variable is the feasibility of finance. Now here finance is separated into two types, internal and external finance. Internal finance is one way associated with the profits of a firm and thus it is clear that it is less critical for importance in boosting investment but external finance is done through financial agencies and other specialized credit institutions. External finance is comparatively than internally finance more important in financing investment.

In his studies, Shabbir (1997) has demonstrated a powerful relationship between financial markets with economic progress stressing financial progress, physical capital, and economic improvement. He stated that there is a positive association between the financial sector's progress and economic growth. In fact, a natural expansion of the association between the financial system and actual economic activity is to determine if there is a co-relation or casualty between financial agency and economic improvement. Levine et al (2000) supported in their studies that there is a positive influence on investment when there is an increasing degree of the financial system and

extending variation of financial instruments. Levine suggests in his studies that despite the uncertain reaction to saving rate, saving should be aided by the inception of a financial agency and this can be guided to higher economic improvement. With context to Pakistan, Masih (1979) suggests that private investment is affected by various financial variables. It is clear from the studies that various financial instruments used to increase financial growth have limited but positive influence on private investment, despite the country which has financially depressed economic condition just like Pakistan.

Many studies have considered the decision about the financial instruments that lead to higher chances of investment and better economic growth. In the model, Levine (1992), explained the factors that create a demand for financial intermediation in the establishment of technology are randomness, risk, and liquidity. The inception of financial intermediation supplies the liquidity benefit to clients and permitted the conception of funds without any barriers. The financial medium is excellent at checking corporations and would not only minimize the fixed expense but also the authentic chances of avoiding faulty investments. Greenwood and Jovanovich (1990) in their studies concentrate on which way this financial intermediation expertise in information pooling and analysis pools risk and it may lead to that area where the reward is the very best. According to this, there are two types of stocks one is aggregate and the second one is specific project stocks in insecure projects. Individuals would have rewards to differentiate between these two stocks so that's why they can minimize their loss in investment by taking relevant actions to end the risk. However, research on aggregate shock is so expensive that its research cannot be afforded by the individual investors so they join the information center which has information about aggregate shocks in order to pay a fee. So through financial intermediaries, more resources are supplied to risky but productive projects in order to make the return and safer too.

In his study, Masih (1997) says that the government financed the deficit from commercial banks and as a result, the banks acquired the government securities which are proven collateral from the central bank for borrowing. Commercial banks increase their capability to acquire borrowings from the central bank and this is due to the government's deficit financing from commercial financing so private investments are affected positively by these loanable funds. From institutions that are experts in credit financing similarly the stream of investment and loans and a critical factor of long-term loans, it has a positive and straight effect on private investment. In his study, Amjad (1976) described that firms that have bigger profits would invest more as an investment because it has great rewards for a firm and as well as more internal funds will be available to the firm in order to finance investment.

A study by McKinnon and Shaw (1973) is of the view that definite actual interest rates provoke financial intermediation and savings, because of this there is an increase in the allocation of loans to private departments, and in reaction, it provokes growth and investment. While the crucial pathway stressed is the influence of actual interest rate on the quantity of savings, it is acknowledged that a positive real interest rate from the distribution of money which can be invested more competent and in this way provides extra positive results on economic progress. In his study, Masih (1979) determined that the result of interest rate on time deposits is an association variable for investment development through financial intermediation, and in the result, it has an indirect positive effect on the accumulative fixed private investment.

In contradiction Gregorio and Pablo (1995) have contributed empirical proof that actual interest rates are probably to be comparatively poor signs of the caliber of financial intermediation and despite they can be better signs of the competency of investment. And that is why the result of actual interest rates on progress cannot be comfortably analyzed as calculating the influence of financial growth on progress.

Monetary aggregates suggest a substitute of variables set to calculate the magnitude of financial progress. The broad collection of monetary aggregates has been used by many empirical studies to examine the correlation between financial intermediation and the progress of a country's economy. Anyhow usage of monetary aggregates as an agent for the amount of financial intermediation generates conflicts. In the same fashion, King and Levine (1993) have observed that various interpretations of monetary aggregates can

act as agents for various characters of financial intermediation. Additionally, in most situations, the monetary aggregates may act as very poor signs of the magnitude of financial progress.

In principle, McKinnon and Shaw assume that a monetized economy shows a highly up-to-date market thus a greater level of monetization should be positively associated with growth performance. But Gregorio and Pablo (1995) suggest that the level of monetization is not a good measure of the degree of financial development more principally, the efficiency of financial division is to give credit competently and to arrange a channel of exchange is not certainly associated. Meanwhile, the feature of financial intermediation that is considered to be associated with investment and development is that which points out to the efficiency of financial markets to arrange credit, a liquid aggregate such as M1 and M2 is particularly associated with the competent financial system to supply liquidity or a channel of exchange.

Wai and Chorng-huey (1982) specified different variables to determine investment in developing countries. The study determined that the domestic credit of the banking system, and credit to the private sector by banks have a strong positive effect on private investment. In reality, private investment has counted increasingly on specialized non-bank and financial intermediaries along commercial banks. According to Gregorio and Pablo (1995), the usage of credit emerges to be the most relevant sign of the extent of financial intermediation that can take place with the help of the banking system. It can be a weaker sign of financial progress as vastly defined, to the extent that a meaningful size of financial progress happens outside the banking system. This stunner emerges to be more appropriate in industrial countries, which have witnessed wonderful nonbank financial modification. Although it is hopeful that the two forms of financial progress i.e. the bank and nonbank are positively associated. Thus the existence of financial modification outside the banking system will appear in the kind of a smaller co-efficient for credit. In comparison in developing countries, most of the financial progress has happened within the banking system. That way, in these countries, credit is probably to be a better alternative for financial progress as in a wider concept. According to Mash's (1979) study, loans and investment which are important components of long-term loan flow from specialized credit institutions especially in developing countries like Pakistan have a positive and direct influence on private investment. Masih has also recognized by explaining the behavior of various associated variables that the credit by these financial institutions is a powerful sign of financial progress because the complete stream of commercial loans will have a positive influence on the stream of long-term loans from the banks exhibiting increased competency on part of these intermediaries. In their study, Levin et al (2000) liked private credit as a sign of financial progress because this measure is more than simple measures of financial departments and wider measure of financial intermediaries which issued credits. It indirectly measures the improvement of information and also the transaction expense, a greater level of private credit indicates a greater level of financial services, and that is why higher financial intermediary progress.

In his study of cross country Shabbir (1997) analyzes, has used credit lengthened by private and Government banks as a sign of financial intermediation besides with the value of stock market trades and stocks outstanding. Finance aggregate is used by Thorsten and Levine (2002) and this equals the principle factor of two underlying measures of financial progress. The first portion of the principal component is the portion of the complete movement of financial markets and intermediaries. It levels the chunk of the product of private credit and quantity traded. Empirical studies express that private credit applies big pressure on economic progress by increasing the competency of financial intermediaries.

Banks are particularly critical for sponsoring the operations of small-scale firms and the generating of new small corporations. Additionally, a study from industrialized countries by Gentler and Gilchrist (1994) exhibits that blows to credit allocation by banks have an immensely big influence on investment for firms which totally dependent on banks specifically small firms. This shows a close association between aggregate investment and bank lending. In his study, Ndikumana (2005) preferred that credit is the most critical component in the progress of the financial sector, and as a result, higher investment was

witnessed. There are two other signs i.e. net domestic and banks' credit that do not differentiate among the public sector's credit. The public sector is mostly responsible for a bigger amount of domestic credit demand specifically in developing countries and a large amount of which is used for government expenditure rather than public investment. So clearly there will be no positive and increased influence on investment of domestic although banks increase total domestic credit and credit. To know the result of financial progress over the investment, perfectly the disaggregated signs should be used that differentiate between credit allocated for investment meaning and credit for consumption, as well as among the private sector and the public sector's credit.

In his study, Levine et al. in 2000 in judgment of the empirical predictions forward by many theoretical models in the context of association between finance and development have constructed many measures to explore and recognize profitable ventures. Liquid liabilities levels liquid liabilities of financial entity (currency added demand and interest posturing liabilities of bank and non-bank financial brokers) divided by GDP. It is an atypical calculation of financial intensity and in this manner complete size of the financial sector. This measure might not precisely measure the competency of the financial division in amending informational asymmetries and alleviating transaction expenses. Furthermore, it includes the doubt of 'double counting'. The commercial bank asset to the total assets ratio is another gauge used by Levine. This measures the degrees to which commercial banks vs. central banks assign the society's savings. Again this is not a direct measure in scrutinizing corporations of the competency of banks, applying corporate central, mobilizing savings, softening transactions, and supplying benefits of risk management to their customers. So this is used as an extra of financial broker progress. Masih (1979) has used excess liquid assets in this regard. Given the total liquid assets of the banks, the monetary authorities could pressurize the bank's extra liquid assets, holding by varying the liquid assets ratio which is under their direct control because extra liquid assets are similarly equal to the difference between total holdings of liquid assets and the required holdings of it. Similarly following Levine, Khan (2002) has also used the liquid liabilities and commercial banks' assets to total assets ratio as additional indicators of financial development.

In their studies, Thorsten, and Levine (2002) have used finance aggregate as an indicator of financial progress, which is equal to the fundamental reason for two underlying measures. It is a measure of the overall animation of financial intermediaries and financial markets. It levels the log of the amount of private credit (the quantity of credits by financial intermediaries to the private sector divided by GDP) and value traded (the amount of all shares traded on the stock exchange divided by GDP). The other one is a calculation of the complete structure of the financial department and equals the capitalization of the market log of total of private credit.

In their study, King and Levine (1993) have used four variables of financial sector progress. In addition to liquid liabilities, asset ratios of commercial and state banks, and the ratio of credit to the private sector to GDP, the extra variable used the non-financial private sector to total domestic credit ratio (not including credit to money banks ratio). This sign is made to calculate the domestic asset dispersion. It can show the complete structure of the public sector and the amount of borrowing of public departments, not showing completely correct the standard of financial service.

Regarding the measurement of financial progress, economists however different concepts about it, but from many studies it is evidenced that financial sector progress is the crucial factor and channel of increase in private investment. This is also a reality that investment is powerfully associated with the progress of the financial department irrespective of the size of the financial department in the country's economy.

Theoretical Framework

It is considerably helpful to generate the association between financial sector progress and investment by taking different economists' theories. In his study "Wealth of Nations," Smith (1776) recognizes the connection between facilitating the exchange of expertise, variation, and economic progress. In his debt deflation theory, Fisher (1933) emphasized the crucial aspect of credit. During the depression liquidation of debt more often owes deflation than in a boom. The elevated burdens on borrowers drop the payments

on consumption and investment and therefore assist the progress of output. Keynes (1936) in his theory of liquidity preference exhibits that the critical aspect of the financial market is money in place of credit. In very risky conditions when the financial market is not operating well and the interest rate drops to a low level so then people will prefer to save money rather than invest. Money is a single component for variation in the economy, following the Walras law bond market is omitted. And so there will be a clear association between investment and development. The more the financial organization is developed more competent will be in directing funds so investment will be higher. In his study, Solow (1956) said that financial organizations in physical capital have not much to do with the rate of investment. However, he established an association between the growth rate of capital and that of output per worker. Economists like Gold Smith (1969), McKinnon (1973), and Shaw (1973), etc, from a second school of thought, believe that the financial market pressures economic progress. In the model of Clark's accelerator desired capital is proportional to output. According to the Tinbergen (1938) model which is the second alternative to Clark's model is that investment depends on profits and it is mentioned in the study of Jorgenson (1971). According to this theory, investment is firstly associated with profit anticipation and secondly, the rate of investment is perhaps constrained by allocation of funds. In the powerful version of this theory the financial constraint functions at all times (the cost of funds becomes hugely inelastic where internal funds are drained). Within the context provided by the elastic accelerator model all three considerations – output, internal funds, and cost of external finance perhaps designated as a determinant of the desired level of capital.

Supply of funds is the basic constitute in the method of investment. Many funds are allocated with the help of financial department services because firms mostly depend on the external funds that they own. That is why its growth is determined as an important component for the increase in investment for firms and also for individual investors.

There are subsectors in the financial sector;

1. Financial markets
2. Financial intermediaries.

Financial markets are the cause of direct finance. But in developing countries, the financial markets are not much progressed and mostly in the financial system, the stream of funds takes place with the help of financial intermediaries. The banking sector is the most influential sector among the financial institutions in regard to channeling funds to different sectors of the economy. In the present period of time, it shows that stock markets are the most crucial cause of financing for investment. Although Mishkin (2000) in his study has shown that in different countries stocks performed a very small role in the financial sector. The financial sector is very critical in allocating a collection of services to the investor at small scale as well as at big scale.

Specification of Model

Many works in articles have analytically examined the association between financial sector progress and private investment. Like King and Levine (1993), Levine et al. (2000), Ndikumana (2005), and many others. This work gets the specification of the model from Ndikumana (2005) instead of panel data, with a difference using time series analysis. The model mentioned above is as follows;

$$I = \alpha + \beta GDP + \gamma FIN + \text{error term}$$

Where "I" is Gross domestic Private investment at constant prices of 2010 divided by real GDP. "GDP" is the growth rate of Gross domestic product at constant prices of 2010

"FIN" is the financial sector progress and it is proxy by three variables, these variables are defined as follows;

Liquid liabilities equals the progress of liquid liabilities of the financial system i.e. currency plus demand deposits of scheduled banks and interest-bearing liabilities (time deposits of scheduled banks) divided by GDP. Then its growth is taken. This is a conventional measure of financial intensity and thus of the complete structure of financial region progress. This measure has deficiencies as it does not precisely show the competitiveness of the financial sector in amending informational asymmetries and helping transaction expenses. It also includes the ambiguity of double counting. But this sign is beneficial in showing a complete picture of financial sector achievement

that's why we are using this as an important indicator for financial advancement.

The Bank Asset Ratio equals the progress of the ratio of commercial bank assets to the commercial bank assets plus central bank assets. Again this measure of financial progress indirectly measures the reexamining firm competency of banks, forcing corporate command, mobilizing savings, helping transactions, and giving risk management facilities to customers. In this manner, it is an indirect measure of the quality and quantity of work given by financial intermediaries. The insight after this measure is that banks most probably recognize beneficial investments, check managers, give risk management, and mobilize savings rather than central banks.

Credit to the Private Sector is a comparatively more trustworthy measure of financial progress. This is equal to the quantity of credit by banks to the private sector divided by GDP. Private credit indirectly calculates the improvement of knowledge and transaction costs, we define higher levels of private credit as greater levels of financial services and that is why, bigger financial intermediaries progress**.**

However different works have used different signs to measure the stages of financial progress. But most studies have shown consent on these variables for example Osei & Kim (2023), Ndikumana (2005), and Salifu, Peprah, Sebu, and Cantah (2024).

Sources of Data and Construction of Variables

Most of the data is taken from the Annual report of the State Bank of Pakistan. In addition, data is also taken from the World Development Index (WDI). The sample taken is from 1972 and 2023.

The development of the financial sector's variables is constructed according to their definitions. The Liquid liabilities are constructed by adding the currency in circulation, demand deposits, and time deposits of scheduled banks and then dividing by the GDP. Then its growth is taken so,

$$LL = \frac{C + DD + TD}{GDP}$$

Where LL is the growth of liquid liabilities, C is the currency in circulation, DD is the demand deposits of banks and TD is time deposits.

The second variable in this context is the bank asset ratio which is equal to the ratio of commercial bank assets to the total of commercial and central bank assets. i.e.

$$BR = \frac{CBA}{CBA + SBPA}$$

BR is the growth of bank ratio; CBA is the commercial bank assets, while SBPA is the assets of the State Bank of Pakistan.

The third variable credit to the private sector is taken as such to the ratio of GDP.

$$CDT = \frac{CD}{GDP}$$

Where CD is a credit to the private sector by banks and GDP is the real gross domestic product.

Empirical Analysis and Results

A simple and plain model has been given in the preceding portion to determine the critical role of financial sector development. The econometric model explained in Chapter Three gives a general kind of association between financial sector development and private investment. The complete analysis is given here. In this portion null hypothesis (Ho) that there is no association between financial progress and private investment is tested against the alternative hypothesis (H1) that there is some association between the two.

In this regard three equations are estimated, taking each time one indicator of financial development. So following are respective equations to be estimated;

$$I = \alpha_1 + \beta\ GDP + \gamma_1 BR + \text{error term} \quad \ldots 1$$

$$I = \alpha_{2^+} \beta_2 GDP + \gamma_2\ LL + \text{error term} \quad \ldots\ldots\ 2$$

$$I = \alpha_{3^+} \beta_3\ GDP + \gamma_3 CDT + \text{error term} \quad \ldots\ldots 3$$

This section examines the influence of financial sector progress on private investment in Pakistan empirically. Estimations are based on the data taken from 1972 to 2020, using OLS. The estimates of equations 1, 2, and 3 are given in tables 1, 2, and 3.

Table 1

Dependent Variable = I

Variables	Coefficients	t-Statistics
Intercept	0.17	6.93***
GDP	0.07	2.15**
Bank Ratio	0.04	0.86
R-squared	0.72	
F-stat (Prob)	0.01	
Durbin-Watson stat	1.72	

*"***" means significant at 1%, "**" means significant at 5%,*

Table 2

Dependent Variable = I

Variables	Coefficients	T-Statistics
Intercept	0.16	6.37***
GDP	0.05	0.81
Liquid liabilities	0.06	1.93**
R-squared	0.74	
F-statistic (Prob)	0.03	
Durbin-Watson	1.75	

*"***" means significant at 1%, "**" means significant at 5%,*

Table 3

Dependent Variable = I

Variables	Coefficients	t-Statistics
Intercept	0.16	6.37*
GDP	-0.01	2.28**
Credit to the private sector	0.20	2.64**
R-squared	0.95	
F-statistic	0.01	
Durbin-Watson	1.75	

*T-values are significant at 1% and 5% levels with * and ** respectively.*

Interpretation of the Results

Table 1 shows the regression results of Equation 1. Here except for intercept, both variables are insignificant, which means that they apply no meaningful effect on the investment. The more likely reason for the insignificance of BR might be that bank items consist of money items including government securities, physical assets, and loans, where only loans are such assets that might have shown significant meaningful association with investment. But in the total assets of the bank, it is not clear how much the ratio is composed of loans, and out of this loan how much is prolonged to the private sector. This might be the reason that the results of equation 3 given in Table 3 show of meaningful association between investment with credit to the private sector. All credit to the private sector is directly extended to the non-government sector, who mostly used for profitable purposes, as there is less chance for the private sector to use loans for current expenditure. Therefore it has a meaningful effect on private investment. Additionally, as individuals do not always have the competence to monitor the projects for which they enhance loans, therefore the probability of moral jeopardy is less in the case of loans taken from banks.

This result is also substantiated by the meaningfulness of the association between liquid liabilities and investment. As discussed earlier

liquid liabilities consist of currency in circulation, demand deposits, and time deposits. As task of the banks is to change completely liabilities into assets, so as soon as liabilities increase banks will have more caution to give loans to the private sector. That is why it also applies a positive association with investment. Despite its level of significance is less than the level of significance of credit to the private sector.

Dynamic analysis in all of the estimated equations also consists of the growth rate of GDP. In two of the equations, it showed insignificance. It means that growth itself does not contribute to an increase in investment. Its likely reason may be that along with investment GDP consists of consumption and government expenditure. And if development is due to consumption or government expenditure it means that investment has not increased. Additionally, it can be said that development reflects an increase in income, thus saving, which is completely changed to credit through banks. So growth might affect investment through other channels but it itself exerts no significant effect. Additionally, if growth is slow due to government expenditure and consumption, most of the reserves move in the direction of these sectors, and investment might decrease. This phenomenon is depicted in the table 3.

Conclusion

This work concludes that financial sector growth plays a critical role in improving private investment in Pakistan. It is learned that the growth of size, depth, and activity of financial intermediaries, specifically banks contribute generously to private investment. The mighty financial system minimizes risks involved in the decision-making process of investors and creditors. Thus a developed financial system contributes to reaching an appealing and better level of private investment through its accounting standards to facilitate decision making and managing the risk.

The critical role of this study in this discussion is that it shows theoretically and empirically in which way the financial sector development leads to an increase in the level of private investment. We take into consideration the direct channel by which the financial sector progresses yielding economic competency by increasing actual economic activity in the shape of investment in Pakistan. The sign of financial size (BR) makes clear in which way the size of the financial sector influences the level of private investment. It recommends that the more the ratio of commercial bank assets is, relative to total assets, the more the financial system is broad and well-progressed. And this has a very positive influence on the level of private investment. Similarly, the financial deepening (liquid liabilities) is playing a very critical role in increasing private investment in Pakistan. So the banking system should be progressed to improve the liquid liabilities position by lowering the transaction costs, ameliorating risk management, and minimizing the asymmetries from the system. Credit to the private sector is a critical variable of financial sector development. The more the loans are allocated to the private sector, the more the investment level will rise. In the case of Pakistan, this determinant is satisfactory in improving the real economic situation, additionally need is to make the credit system in line with the investment requirements with a look at Pakistan's economy. It is likely possible by applying corporate control, reducing the risk, and making the approach to these loans easy and at a lower cost. The study recommends that the financial system of Pakistan should be made better in the fields that really suit the economic needs of the country. Being a developing country the financial markets are not much updated. So guiding of funds mostly happens with the help of financial intermediaries. So these financial intermediaries should become more powerful by enforcing contracts, minimizing the risks, and thereby encouraging the development of the financial sector.

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