



Government Effectiveness, Regulatory Quality and Stock Market Performance: A Quantile Regression Approach¹

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INTRODUCTION

One of the most important parts of the financial markets is the capital market, and along with the banking system, it plays a vital role in financing production and economic activities. Therefore, understanding the characteristics of the capital market and the stock exchange, as the main component of the capital market, and determining the factors influencing its performance, is of particular importance. According to most of the studies conducted in the field of identifying the factors affecting the performance of stock markets, institutions and the quality of governance have a significant impact on stock market performance. The governance index is often used to examine the impact of institutional factors and the legal environment. The World Bank (2022) has defined good governance based on six indicators, which include the right to comment

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and respond, the rule of law, legislative quality, government effectiveness, political stability and absence of violence, and control of corruption. Based on the research results, most governance sub-indices, especially the rule of law, quality of legislation, and government effectiveness, can directly impact stock market performance. For instance, the rule of law can influence the capital market's performance through multiple channels. The first channel is the protection of property rights and the proper execution of contracts. Advanced property rights motivate people to invest because owners have confidence in future returns from their investments. Additionally, sound laws and institutions strengthen all markets, including the capital market, as every exchange in the market requires a legal structure that recognizes the property rights of buyers and sellers. Nevertheless, the effects of governance components such as government effectiveness, rule of law, and quality of legislation on the performance of the stock market in Iran have not been studied, making it necessary to investigate their impact on the capital market's performance in Iran.

MATERIALS AND METHODS

The statistical population of this research includes all the countries for which data and information are available in the World Bank. Among these countries, samples are selected from Iran, as well as developing and less developed countries. Data and information from these countries are extracted for the period of 2000-2021. In this research, the quantile regression method is used to estimate the research model. Quantile regression methods outperform normal regression and are particularly effective when dealing with non-normally distributed regression variables or outlier data.

RESULTS AND DISCUSSION

Based on the estimated model, the results indicate that at a significance level of 5%, government effectiveness, quality of legislation, and the rule of law have a positive and significant impact on stock market efficiency. High government effectiveness implies efficient government institutions, favorable government policies for businesses, and the government's ability to implement economic and social programs. This fosters economic development, increases GDP per capita, and positively influences stock market efficiency and performance. A high quality of legislation enhances public trust

in the government and the regulatory system, creating a climate of confidence for investors and reducing capital costs. This, in turn, boosts investor willingness to participate in the stock market and positively affects its performance. The rule of law indicates that both the government and citizens adhere to the law. It ensures that the law applies universally, regardless of one's position, and that laws are easily comprehensible, accessible, and enforceable. Establishing the rule of law in the economic environment enhances predictability for citizens and economic actors. Commitment to the rule of law reduces transaction costs and provides predictability and fairness, particularly for economic actors and investors. This has a positive impact on stock market performance. Additionally, the research findings reveal that inflation, per capita income, exchange rate, and industrial production growth have a positive and significant effect on stock market performance. Conversely, crude oil prices and interest rates have a negative and significant impact on stock market performance.

CONCLUSION

Based on the estimation results of the model, the effectiveness of the government, the quality of the law, and the rule of law have a positive and significant effect on the efficiency of the stock market. Additionally, the effects of inflation, per capita income, exchange rate, and growth of industrial production have been positive and significant on stock market performance. On the other hand, the effect of crude oil prices and interest rates on stock market performance has been negative and significant.

Considering the positive effect of the variable of government effectiveness on stock market efficiency, it is suggested that the government increase the effectiveness index of the government by improving the quality of public services, facilitating doing business, and being decisive in the implementation of economic and social programs. This will have a positive effect on the performance of the stock market. It is also suggested that the legislative systems of countries consider two important issues: law transparency and public trust. When approving laws and regulations, it is crucial to avoid creating instability in the field of financial and investment laws. By doing so, the quality of laws in the country will increase, resulting in a positive effect on the efficiency of the stock market.

Keywords: Rule of Law, Regulatory Quality, Stock Market Performance, Iran,
Quantile Regression.

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