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**EFFECTS OF FINANCIAL LIBERALIZATION ON
STOCK MARKET DEVELOPMENT, FDI INFLOWS
AND TFP IN SELECTED AFRICAN COUNTRIES**



**DOCTOR OF PHILOSOPHY
UNIVERSITI UTARA MALAYSIA
August 2016**

**FFECTS OF FINANCIAL LIBERALIZATION ON STOCK MARKET
DEVELOPMENT, FDI INFLOWS AND TFP IN SELECTED AFRICAN
COUNTRIES**

BY

BALOGUN WAKILAT OLABISI



**Thesis Submitted to
School of Economics Finance and Banking,
Universiti Utara Malaysia,
in Fulfilment of the Requirement for the Degree of Doctor of Philosophy**

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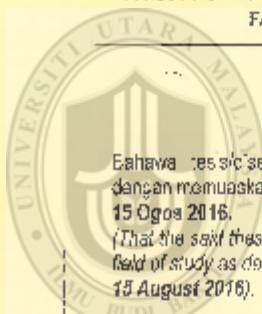
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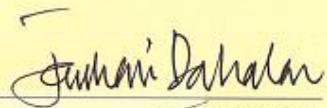
Effects of Financial Liberalization on Stock Market Development, FDI
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Doctor of Philosophy

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ABSTRACT

Under the International Monetary Fund and World Bank structural adjustment reform programs, liberalization was introduced to the developing countries as a means of growing these economies. However, two decades after liberalization, empirical findings of some of the liberalized countries in Sub-Saharan African (SSA) countries show mix results. The study sets out to investigate the long run influence of financial liberalization on stock market development, foreign direct investment (FDI), and total factor productivity (TFP) for seven selected SSA countries for the period 1990-2013. The study employs dynamic panel data analysis to investigate for the influence of liberalization on stock market development, FDI and productivity in the seven selected SSA countries. The techniques of Pooled Mean Group (PMG) and the Mean Group (MG) are employed to determine possible long run relationships among the variables. The direction and effects of liberalization on stock market and FDI, and the effects of these FDI inflows on productivity change is crucial for the development of the nascent economies of the SSA. Findings validate the positive significant impact of stock market liberalization on the development of stock market. Liberalized interest rate however has a long run negative influence on development of stock market although it has a positive effect on FDI. The study thus recommends that the individual SSA economies should set up market-friendly financial policy that would further boost the contribution of liberalization to their economies. More efforts should be made to improve the state of poor institutions in order to enhance FDI in the selected SSA nations in order for foreign investment to have sustained impact on productivity. Steps should be taken to encourage the local citizens to invest in stock market so as to reduce the overbearing influences of foreigners in the stock market.

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Keywords: foreign direct investment, liberalization, stock market development, total factor productivity, Sub-Saharan African countries.

ABSTRAK

Liberalisasi diperkenalkan kepada negara-negara membangun untuk memacu kemajuan ekonomi di negara tersebut di bawah program pembaharuan pengubahsuaian struktur Dana Kewangan Antarabangsa dan Bank Dunia. Namun begitu, dua dekad selepas liberalisasi dikenakan, dapatkan empirik dalam kajian yang dijalankan di beberapa negara Sub-Sahara Afrika (SSA) memperlihatkan hasil dapatkan yang berbeza. Kajian ini dikendalikan untuk menyelidik kesan jangka panjang liberalisasi kewangan terhadap pembangunan pasaran saham, pelaburan asing langsung (FDI) dan produktiviti faktor keseluruhan (TFP) di tujuh buah negara SSA terpilih bagi tempoh 1990-2013. Kajian ini menggunakan analisis data panel dinamik untuk mengkaji kesan liberalisasi ke atas pembangunan pasaran saham, FDI dan TFP di tujuh buah negara SSA. Teknik Kumpulan Min Terkumpul (PMG) dan Min Terkumpul (MG) digunakan untuk menentukan hubungan jangka panjang dalam kalangan boleh ubah. Hala tuju dan kesan liberalisasi pasaran saham dan FDI serta kesan aliran masuk FDI terhadap perubahan produktiviti adalah penting kepada pertumbuhan ekonomi SSA yang baru berkembang. Dapatkan kajian mengesahkan impak positif yang signifikan liberalisasi pasaran saham terhadap pembangunan pasaran saham. Walau bagaimanapun, kadar faedah liberalisasi mempunyai kesan negatif jangka panjang terhadap pembangunan pasaran saham meskipun ia memberi kesan positif terhadap FDI. Kajian ini menyarankan agar ekonomi setiap negara SSA menggubal dasar kewangan yang lebih mesra pasaran yang boleh merangsang lebih banyak sumbangan liberalisasi kepada pertumbuhan ekonomi di negara-negara SSA. Lebih banyak usaha perlu dilaksanakan untuk memperbaiki kelemahan institusi bagi merangsang FDI di negara SSA terpilih dan seterusnya memastikan FDI memberikan impak yang mampan terhadap pertumbuhan ekonomi. Usaha-usaha yang perlu diambil adalah dengan menggalakkan warga tempatan melibatkan diri dalam pasaran saham supaya dapat mengurangkan kebergantungan kepada warga asing dalam pasaran saham.

Kata kunci: pembangunan pasaran saham, pelaburan asing langsung, produktiviti faktor keseluruhan, liberalisasi, negara-negara Sub-Sahara Afrika.

ACKNOWLEDGEMENT

I am immensely grateful to Allah who has lessened the burden on this tortoise journey. The efforts of my late mother Alhaja Fatimah Lawal in satisfying my quest for knowledge through, financial, spiritual and moral support throughout her lifetime is highly appreciated. May Allah admit her in Al-Jannah firdaus. The sacrifice of my husband Abdwaheed Balogun and my son Abdwahab for managing to cope with my absence during the entire period is greatly appreciated. The effort of my late father Alhaji Abdullahi Lawal towards a rightful upbringing is also acknowledged. The great push by my first supervisor Professor Dr. Jauhari Dahalan is one of the challenges that facilitate the achievement of the task. This is not to downplay the selfless contribution of my second supervisor Associate Professor Dr. Sallahudin Hassan. The immense support of my Rector Dr. Abdul-Aziz A. Lawal and his wife Alhaja Madinat Lawal who are part of the genesis of the program is truly appreciated. Appreciations also go to the external examiner Professor Dr. Naziruddin Abdullah and the internal reviewer Professor Dr. Zaini Abd Karim both of who painstakingly went through the scripts and make useful comments.

The entire programme might not have come to fruitful completion without the support of my senior sister Alhaja Ganiat O. Awonaike and all her children Mariam and the rest who have all been keeping forte while i am away. The support of my elder brother Mr. Tajudeen Sule and his wife Mrs. Sule is hereby acknowledged. Also of note is the support of my junior sister and her husband in Canada Mr. and Mrs. Wesley Ogude. I cannot forget the efforts of my lecturer/brother Dr. Wakeel Ishola and my sister/ friend Dr. Mrs Jameelah Yaqub. The efforts of the following people are: greatly acknowledged. Alhaji & Alhaja H.T. Fajimite, Murtala Ajose,

Gbade Gbede, Abd. Ganiy Sodamade, Saheed Adeyemo, Drs. Taofeek Kasali, Abu Nurudeen, Abdrauf Tosho, Raji Olajide, and Rhianat Abdkadir. My other colleagues, brothers and friends: Luqman Afolabi, Umar Muhammed, Basit, Olayemi, Adenuga Adekoya Saheed Adeyemo, AbdulAziz Abdrahim and Toye Oyetade. The encouragement of my sisters-in-law and brother-in-law is really appreciated. Finally the contributions of other numerous friends and relations through words of encouragement and prayers are all appreciated.



TABLE OF CONTENTS

	Pages
TITLE	i
CERTIFICATION	II
CERTIFICATION	III
PERMISSION TO USE	IV
ABSTRACT	V
ABSTRAK	VI
ACKNOWLEDGEMENT	VII
TABLE OF CONTENTS	IX
LISTS OF TABLES	XV
LISTS OF FIGURES	XVII
LISTS OF ABBREVIATIONS	XVIII
CHAPTER ONE INTRODUCTION	1
1.1 Introduction	1
1.2 Background of Study	1
1.2.1 Overview of Financial Liberalization in selected sub-Saharan African Countries	3
1.2.2 Interest Rate Liberalization	9
1.2.3 Stock Market Development in the Sub-Saharan African Countries	14
1.2.4 Mechanism of Transmission between Stock market Liberalization and Stock market Development	19
1.2.5 Foreign Direct Investment Inflows	21
1.2.6 Institutional Quality	23

1.2.7	Mechanism of transmission between Financial Liberalization and FDI Inflows	26
1.2.8	Effects of FDI Inflows on Total Factor Productivity	29
1.3	Statement of the Problem	32
1.4	Research Questions	37
1.5	Research Objectives	38
1.6	Hypotheses	38
1.7	Significance of Study	39
1.8	Scope of Research	40
1.9	Summary of Chapter	41
CHAPTER TWO LITERATURE REVIEW		42
2.1	Introduction	42
2.2	Theoretical Review	42
2.2.1	Financial Liberalization Theory	43
2.2.2	The Concept of Stock Market Development	45
2.2.3	Theory of Foreign Direct Investment Inflow	48
2.2.4	The Concept of Total Factor Productivity	52
2.3	Empirical Literature	58
2.3.1	Studies on Relationship between Financial Liberalization, Financial Development and Growth	58
2.3.2	Studies on Relationship between Financial Liberalization and Institutional Qualities	63
2.3.3	Studies on Financial Liberalization, Financial Development and Interest Rates	65
2.3.4	Studies on Stock Market Development and Stock Market Liberalization	69

2.3.5 Studies on Foreign Direct Investment	73
2.3.6 Studies on Determinants of Capital inflow and its Links with Liberalization	77
2.3.7 Studies on Total Factor Productivity	80
2.4 Relationship between the Dependent Variables and the proposed Explanatory Variables	87
2.4.1 Relationship between Stock Market Development and Stock Market liberalization	87
2.4.2 The Linkage between Interest Rates, Stock Market Development and Financial Development	89
2.4.3 The Link between Liberalization and FDI Inflow	90
2.4.4 Link between Institutional Qualities, liberalization and Stock Market	92
2.4.5 Link between FDI Inflow and TFP	93
2.4.6 Summary of Gap in the Literature	94
CHAPTER THREE METHODOLOGY	95
3.1 Introduction	95
3.2 Theoretical Framework	95
3.2.1 Theoretical Framework for Stock Market Development	95
3.2.2 Theoretical Framework for Foreign Direct Investment	97
3.2.3 Theoretical Framework of the Total Factor Productivity	98
3.3 Estimable Models	101
3.3.1 Stock Market Development Model 1	101
3.3.2 Foreign Direct Investment Model	103
3.3.3 Stock Market Development Model 2	105
3.3.4 The Production Function	106

3.3.5 Total Factor Productivity Model	108
3.4 Justification of Variables	111
3.4.1 Definitions and Measurements of Variables	111
3.4.2 Market Capitalization	112
3.4.3 Interest Rate Liberalization Index	112
3.4.4 Stock Market Liberalization Index	113
3.4.5 Stock Turnover Ratio	114
3.4.6 Real Gross Domestic Product	114
3.4.7 Institutional Quality	115
3.4.8 Domestic Credit to the Private sector	115
3.4.9 Foreign Direct Investment	116
3.4.10 Foreign Interest Rates	116
3.4.11 Total Factor Productivity	117
3.4.12 Human Capital	117
3.4.13 Gross Fixed Capital	118
3.4.14 Labour Force Total	118
3.5 Justification of Variables by Model	118
3.6 Hypothesis on Relationships between the Dependent and Explanatory Variables	119
3.7 Data	121
3.8 Method of Analysis	121
3.8.1 Panel Unit Root Test	123
3.8.2 Panel Cointegration Test	126
3.8.3 Pedroni Cointegration Test	127
3.8.4 Fisher Cointegration Test	130

3.9 Macro Dynamic Panel Data Analysis	132
3.9.1 Derivation of the TFP Model	132
3.9.2 Mean Group Estimator	133
3.9.3 Dynamic Fixed-Effects	134
3.9.4 Pooled Mean Group (PMG)	135
3.9.5 Specification of Stock Market Model 1	139
3.9.6 Specification of Stock Market Model 2	140
3.9.7 Specification of Model 3 (FDI Inflow Model)	141
3.9.8 Specification of Model 4 (Total Factor Productivity Model)	142
3.10 Conclusion	143
CHAPTER FOUR DISCUSSION OF RESULTS	144
4.1 Introduction	144
4.2 Descriptive Statistics	144
4.3 Correlation Analysis	145
4.3.1 Correlation Analysis of Stock Market Models	146
4.3.2 Correlation Analysis of FDI Inflows Model	147
4.4 Panel Cointegration	149
4.4.1 Cointegration Results of Stock Market Model 1	149
4.4.2 Cointegration Results for Model 3 (FDI Inflow Model)	150
4.4.3 Cointegration Results for Stock Market Model 2	151
4.4.4 Cointegrating Results for TFP Model	152
4.5 Estimates Result of PMG for Stock Market Model 1	152
4.6 Robustness of Stock Market Model 1	155
4.7 Individual Countries Results for the Stock Market Model 1	157
4.8 Estimates Results of FDI Inflows model	158

4.9	Robustness of PMG Estimates for FDI Model	160
4.10	Estimates of Individual Countries PMG Results for FDI Inflows Model	162
4.11	Estimates Results of Stock Market Model 2	163
4.12	Robustness of the PMG Estimation of Stock Market Model 2	165
4.13	Individual Countries Estimates of Stock Market Model 2	167
4.14	Deriving the Total Factor Productivity Model	168
4.15	Results of TFP Model with FDI	169
4.16	Conclusion	171
SUMMARY, POLICY RECOMMENDATION AND CONCLUSION		173
5.1	Introduction	173
5.2	Summary of Findings	173
5.3	Policy Recommendations	176
5.4	Limitation of Study	178
5.5	Suggestion for Future Research	179
5.6	Conclusion	179
REFERENCES		181
APPENDIX		205

LISTS OF TABLES

Table		Page
Table 1.1	Interest Rate Spread	11
Table 1.2	Financial Crisis	12
Table 1.3	Dates of Interest Rates Liberalization in selected Sub-Saharan African Countries	14
Table 1.4	Average Values of Stock Market Indices in Selected SSA Countries	18
Table 1.5	Dates of Stock Market Liberalization of selected SSA Countries	19
Table 4.1	Descriptive Statistics for Variables among Countries	144
Table 4.2	Correlations of Variables in the Stock Market Development Models	145
Table 4.3	Correlations of Variables in the FDI inflows Model	146
Table 4.4	Correlations of Variables in the TFP Model	147
Table 4.5	Estimates Results of Panel Unit Root Tests	148
Table 4.6	Fisher Cointegration Results for Stock Market Development Model 1	149
Table 4.7	Pedroni Cointegration results for Model 3 (FDI Inflows Model)	150
Table 4.8	Fisher Cointegration Results for Stock Market	151

Development Model 2	
Table 4.9 Fisher Cointegration Results for TFP Model	151
Table 4.10 Results of PMG Estimator for 1 st Stock Market	153
Development Model	
Table 4.11 Robustness of PMG Estimator for Stock 1st Market	155
Development Model	
Table 4.12 Individual Countries Results of the 1st Stock Market	157
Development Model using PMG Estimator	
Table 4.13 Estimates Results of PMG for FDI Inflows Model	159
Table 4.14 Robustness of PMG Estimator for FDI Inflows	160
Model	
Table 4.15 Results of Individual Countries of FDI Inflows	162
Model using PMG Estimator	
Table 4.16 Estimates Results of Stock Market	164
Development Model 2	
Table 4.17 Robustness of PMG Estimation for Stock Market	165
Development Model 2	
Table 4.18 Individual Countries Results of Stock Market	166
Development Model 2	
Table 4.19 Estimates Results of Production Function Model	168
Table 4.20 Estimates Results of TFP Model with FDI	170
Table 6.0 Lists and Sources of data for Variables	204

LISTS OF FIGURES

Figures	Page
Figure 1.1 Real Interest Rates	9
Figure 1.2 Number of Listed Companies	16
Figure 1.3 Foreign Direct Investment Inflows	23
Figure 1.4 Real Domestic Savings	28



LISTS OF ABBREVIATIONS

ADF	Augmented Dickey Fuller
ARDL	Autoregressive Distributed Lag
AREAR	Annual Report on Exchange Arrangements and Exchange Restrictions
BCEAO	Central Bank of the West African States.
BTSW	Botswana
CIV	Cote d'Ivoire
DCPS	Domestic Credit to the private sector as a percentage of GDP
DF	Dickey Fuller
DFE	Dynamic Fixed Effects
ECM	Error Correction Mechanism
ECOWAS	Economic Community of West African States
ECT	Error Correction Terms
EP	Export Promotion
FEVD	Forecast Error Variance Decomposition
FDI	Foreign Direct Investment
GDP	Gross domestic product
GDPP	GDP per capita
GFK	Gross fixed Capital formation
GHA	Ghana
GIVE	Generalized Instrumental Variable Estimation
GMM	Generalized Methods of Moments

HCAP	Human Capital
ICRG	International Country Risk Guide
ILO	International Labour Organisation
IMF	International Monetary Fund
INSTI	Institutional Quality
IPS	Im Pesaran & Smith
IS	Import Substitution
K& S	Kaminsky & Schmukler
KEN	Kenya
LFT	Labour Force Total
LL	Levin and Lin
LLC	Levin Lin & Chu
M -S	McKinnon (1973) Shaw (1973)
MALS	Malaysia
MART	Mauritius
MCAP	Market capitalization
MG	Mean Group
MNCs	Multinational Corporations
MNE	Multinational Enterprises
OECD	Organization for Economic Cooperation and Development
OLI	Organizational Location and Internationalization
OLS	Ordinary Least Square

P & S	Pesaran & Smith
PILP	Philippine
PMG	Pooled Mean Group
PRS	Political Risk Service
R & D	Research and Development
RGDP	Real GDP
RLIB	Interest Rate liberalization index
SAF	South Africa
SAP	Structural Adjustment Program
SEM	Stock Exchange of Mauritius
SLIB	Stock market liberalization index
SSA	Sub-Saharan Africa
TFP	Total Factor Productivity
THAI	Thailand
TRNV	Turnover ratio
UK	United Kingdom
UNDP	United Nations Development Program
US	United States
US\$	United States Dollar
USTB	United States Treasury bill
VAR	Vector Autoregressive
VECM	Vector Error Correction Model

WAMU West African Monetary Union

WDI World Development Indicator.



CHAPTER ONE

INTRODUCTION

1.1 Introduction

Developing countries are beset with the problems of generating capital flows to shore up investment in order to promote growth. McKinnon (1973) and Shaw (1973) recommend liberalization of the financial sector so as to attract the desired savings for development. However, attempts at liberalization yield little or no fruitful results among the sub-Saharan African (SSA) countries (Ahmed, 2013; Reinhart & Tokatlidis, 2000). Buttressing this point, the United Nations Development Program (UNDP) 2014 human development Report published not too recent indicates the level of human development of the SSA countries. In this report, South Africa and Ghana are the only countries among the 45 SSA countries that are within the medium human development countries. The remaining SSA countries are in the low human development category. Hence, the present study investigates the effectiveness of liberalization on stock market development and productivity in selected SSA countries. This is done by looking at the influence of liberalization on stock market, Foreign Direct Investment Inflows and the effect of these FDI inflows on Total Factor Productivity for selected SSA.

1.2 Background of Study

Financial liberalization was rejuvenated in the 70s through the seminal works of McKinnon (1973) and Shaw (1973). It is recommended as a better alternative to the financial repression of the economies of the developing countries. Financial repression is a situation where the governments are controlling the costs and the

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