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

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

**BY**

**BALOGUN WAKILAT OLABISI**



**UUM**  
**Universiti Utara Malaysia**

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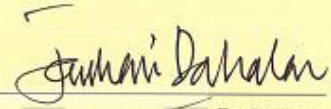
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## ABSTRACT

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 diketengahkan, dapatan empirik dalam kajian yang dijalankan di beberapa negara Sub-Sahara Afrika (SSA) memperlihatkan hasil dapatan 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 Berkumpul (PMG) dan Min Berkumpul (MG) digunakan untuk menentukan hubungan jangka panjang dalam kalangan pemboleh 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. Dapatan 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.



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## 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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