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Impact of Financial Liberalization on Private Investment

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Abstract* – *Financial liberalization would enhance economic growth by stimulating saving and investment. The relationship between financial system development and saving, investment and economic growth is tricky to analyze. In this paper we analyze the impact of financial liberalization on private investment.

Keywords: Financial Liberalization, Investment, Economic Growth

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INTRODUCTION

The term financial liberalization is used to cover a whole set of actions, such as the whole freedom of economics to move into and out of the economy, which implies the full convertibility of the currency; the rejection of all "priority sector" lending targets; an end to government-imposed differential interest rate schemes; a freeing of interest rates; the complete freedom of banks to follow profits unimpeded by government directives; the elimination of restrictions on the possession of banks, which means de-nationalization, full freedom for foreign ownership, and an end to "voting caps"; and so on.

REVIEW OF LITERATURE:

The experiential relationship flanked by financial system development and saving, investment and economic growth has been difficult to test. Two streams of research may be illustrious. The first examines more generally the relationships between financial development indicators and economic recital Levine and Zervos (1998), Rajan and Zingales (1998). The second focuses more specially on the impact of financial liberalization on economic recital Henry (2000), Kim and Singal (2000), Bekaert and Harvey (2000)).

In the empirical literature on the impact of liberalization on investment and growth, we see two distinct empirical approaches to measuring financial liberalization. One approach is to substitute financial liberalization by unambiguous policy measures, such as the use of year dummies or indices of reform implementations. By construction, these measures do not distinguish between de facto and de jure implications of liberalization. The second approach focuses on outcome variables and uses macroeconomic events of financial sector or financial honesty to proxy for liberalization.

Wurgler (2000), using industry level data provides confirmation that the rate of growth in speculation is more closely connected with contemporary growth in value added, in countries with more developed financial systems. Country level financial growth is measured by the standard size of credit and equity markets comparative to GDP. More specifically, countries which have a more developed financial system, both increase investment more in their growing industries and reduce speculation more in their declining industries.

Financial liberalization in general engrosses replacing one deeply flawed system characterized by heavy government intervention with another with different flaws. Whether these changes will improve the allocation of savings and investment is fundamentally an empirical question. Various researchers analyses cross-country aggregate data and find confirmation of positive effects of various measures of financial development on growth (Arturo Galindo, 2003).

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Oshikoya (1994) observed the determinants of private investment in eight African countries for the period 1970-1988. The results show that the growth rate of real GDP, the public investment ratio, and the accessibility of credit all have a positive impact on private investment. The debt service ratio has a negative effect on private investment. Matsheka (1998) predictable an investment purpose for Botswana for the period 1976-1995. The dependent variable is the real level of domestic investment. Descriptive variables are real private sector credit, the real deposit interest rate, the lagged accelerator (past level of demand), a dummy variable for 1987/88 that captures the effect of the decline in investment. The results showed a positive and significant coefficient for private sector credit and the lagged accelerator, while other variables are insignificant.

CONCLUSION:

In this paper we found that financial sector reforms from the mid-1980s into the 1990s. These reforms focused on eliminate of directed credit allocation, bank restructuring, interest rate liberalization and privatization, and strengthening of prudential regulation and supervision. It is predictable that with the reforms, liberalized interest rates will encourage savings, and increased bank deposits will make more credit available for investment.

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