Financial Liberalisation and Economic Growth in the SADC

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The major priorities of the SADC include trade, economic liberalisation, poverty eradication and infrastructure development to support regional integration. SADC have set a number of policies or targets to foster regional and economic integration amongst member countries. These targets include having a SADC free trade area, customs union, common market and the establishment of a monetary union. In order to achieve these targets SADC have proposed greater co-ordination between its member countries with regards to macroeconomic variables such as inflation rates, current account deficits as percentage of GDP, fiscal deficits as a percentage of GDP and public debt as a percentage of GDP.

The accomplishment of these goals requires higher levels of economic growth and development. Financial liberalisation is defined literature as a process which involves the removal of controls by the government in the financial sector namely, credit controls and interest rate controls and the removal of barriers for foreign financial institutions and eradicating restrictions on foreign financial transactions. It can exert a positive influence on savings, investments, financial sector development and hence economic growth.

Pierre Le Roux and Clement Moyo examine the relationship between financial liberalisation and economic growth in the SADC region in the ERSA working paper No. 516 using the Generalised Methods of Moments (GMM) estimation and the Fully-Modified Ordinary Least Squares (FMOLS) estimation technique. The Chinn-Ito-Index is used as a proxy for the level of financial liberalisation and GDP is used as a proxy for economic growth. The model is estimated as a dynamic panel data model which includes a one period lag of the dependent variable. The model includes control variables such as investment, credit, trade openness, government spending and public debt.

The authors conclude that financial liberalisation and economic growth are positively related in SADC countries, indicating that increasing the level of financial liberalisation could lead to higher economic growth. The authors also conclude that there is no long-run relationship between financial liberalisation and economic growth based on the results of the FMOLS. This suggests that the relationship could be short-term. Trade and investment are positively related to economic growth while credit, government spending and public debt are negatively related to economic growth.

On the other hand, financial liberalisation has to be undertaken with caution especially in developing countries because it increases the risk of financial crises. The success of financial liberalisation is
dependent on well-established and secure property rights as well as sound regulatory framework to monitor the financial system. A sound regulatory framework reduces the likelihood of financial crises by preventing financial institutions from embarking on imprudent practices such as borrowing to individuals who are not credit worthy. The security of property rights makes long-term investments attractive by legally enforcing contracts.

The authors recommend that SADC countries should enact policies that are conducive to the progress of the financial liberalisation process. Increasing the level of financial liberalisation would be beneficial but without a sound regulatory framework to monitor the financial system, financial crises would prevail. As such, the establishment of a sound regulatory framework should precede any attempts to increase the level of financial openness. SADC countries should also establish well-defined and secure property rights in order to attract long-term investments.

Furthermore, the removal of trade barriers would be beneficial to SADC countries in terms of increased economic growth. Investment is a key driver of economic growth and hence measures have to be taken to ensure that the conditions are conducive for savings and capital inflows which can supplement low levels of savings. Removal of controls on interest rates and restrictions on capital flows could have a positive effect on savings and investments. Government spending and public borrowing for consumption purposes should be kept to a minimum. Government expenditure should be directed at productive areas in the economy such as infrastructure development including transport facilities, telecommunications and electricity generation which can positively impact on economic growth. Public borrowing should be used to fund profitable investment projects.