

# FINANCIAL LIBERALISATION POLICIES IN SUB-SAHARAN AFRICA

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## Abstract

The dawn of the 1980s saw most Sub-Saharan African (SSA) countries undertaking policy reform to abolish controls in their countries' financial sectors. These reforms were largely drawn from the framework of Structural Adjustment Programmes (SAPs) supported by the International Monetary Fund (IMF) and the World Bank. The main objective of the SAPs was to replace former protectionist economic policies blamed for economic and financial instability, with more market-oriented policies. Financial liberalisation adopted by many SSA countries entailed reform along several dimensions.

While different research bodies have produced several liberalisation indices, most financial liberalisation measures examined in the available literature focus on a limited number of African countries, are limited both in terms of time coverage as well as in scope. Thus, the truncated nature of such data limits its usefulness in analyzing the effects of liberalisation on long-run performance of financial sectors in cross-country and panel studies. This paper fills this gap in the literature by constructing a new set of liberalisation indicators using country by country information on the timing of seven liberalisation policies using the framework developed by Detragiache, Abiad, and Tresselt (2008).

We make use of the questions and the coding rules from this framework to construct indices for the different facets of liberalisation. Each liberalisation dimension has various sub-dimensions. A score is

given for each of the questions that are set for a specific dimension. This raw score is then normalised on a scale of 0 to 3 where three corresponds to full liberalisation, 2 refers to largely liberalised, 1 means partially repressed, while zero indicates a highly repressed financial system. After assigning scores to the seven financial liberalisation policies, we derive a matrix of liberalisation, with scores for each dimension forming the columns of the matrix.

Using this methodology, the paper collects data that tracks efforts made in 26 SSA countries, over the 1986 to 2016 period, to abolish controls in the financial sector for the following dimensions: 1) credit controls and reserve requirement, 2) interest rate controls, 3) entry and activity barriers, 4) state ownership in the banking sector, 5) capital account restrictions, 6) prudential regulation and supervision of the banking sector, and 7) securities market policy. Thus, the indicators we construct provide liberalisation measures that capture the magnitude, pace, and timing of reform aspects, on a wide spectrum of SSA countries.

The financial liberalisation indicators constructed in this paper confirm that total financial liberalisation has been on an upward trend over the years, signifying concerted efforts by the government to allow market forces to determine market equilibrium in the financial sector. Our index for financial reform indicates that financial liberalisation was less gradual between 1986 and about 1992, accelerated sharply between 1993 and 2004 and slowed down between 2004 and 2016. This is likely because most countries had by then liberalised a greater part of their financial sectors. Furthermore, the data collected in this study indicate that although individual liberalisation components are correlated, interest rate liberalisation is the most advanced dimension for each year, in all the 26 countries. This is followed by the abolition of bank entry and activity restrictions, as well as bank privatization respectively. On the contrary, the least advanced dimensions are security market policies, international capital controls, as well as bank supervision and prudential regulation, respectively. The study recommends that SSA countries should put more effort towards the removal of capital account controls as well as implementing further reforms in order to update and modernize prudential regulation and supervision of banks in SSA as they remain highly constrained.

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