

Financial Liberalisation, Stockmarkets and Economic Development

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Extract

During the 1980s and 1990s, many developing countries (DCs) have been engaged in far-reaching reforms of their financial systems, liberalising them and making them more market-oriented. This liberalisation, involving *inter alia* ‘financial de-repression’ has been inspired partly by the work of the McKinnon (1973) and Shaw (1973) (M–S) school.

This paper suggests that, in addition to financial de-repression, there has been a major new element in the development of DC financial systems in recent years – the establishment and fast expansion of stockmarkets. These markets have played a key role in the internal as well as external financial liberalisation processes in leading DCs. Further, the paper finds that the actual behaviour of these markets in many countries has led to outcomes which undermine the effects of the higher real interest rates arising from ‘financial de-repression’. These important empirical phenomena have received scant attention from M–S economists, who need to incorporate them into their analysis of financial liberalisation. However, for DCs, the essential question is: what will be the impact of these developments on industrialisation and long-term economic growth? This paper argues that in general financial liberalisation and the associated expansion of stockmarkets in DCs is likely to hinder rather than assist their development.

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