The Journal of International Trade & Economic Development ›
An International and Comparative Review
Volume 13, 2004 - Issue 4

Original Articles

Financial liberalization, openness and convergence

Theo Eicher & Leslie Hull

Pages 443-459 | Published online: 12 Dec 2010

Cite this article https://doi.org/10.1080/0963819042000300609

Abstract

All industrialized nations relied on capital account controls for significant periods of their economic development and relaxations of capital account restrictions thought to be an integral aspect of economic development. Economists long advocated the removal of capital controls as a stabilizing factor of the development process to improve efficiency and return economies from distorted factor prices to production frontiers. Empirically, however, financial liberalizations have become associated with capital flow reversals, where initial capital inflows at the onset are subsequently offset by capital outflows resulting in higher levels of accumulated indebtedness. We investigate how capital flow reversals caused by financial liberalizations affect the speed of convergence of an economy. We show that financial liberalizations reduce short run convergence speeds, implying that open economies should experience significantly less output volatility but also longer transitions. The increased smoothness in response to initial shocks comes at a cost: as foreign borrowing rises to smooth

domestic income fluctuations causing an increase in the domestic interest rate OECD data confirms our findings.

Keywords:

Financial liberalization

openness

convergence

Related research

People also read

Recommended articles

Cited by
2