

Determinants of Financial Liberalization in SAARC Region

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ABSTRACT

Financial liberalization is the face of financial reforms around the world. This study examines the determinants of financial liberalization in SAARC (South Asian Association for Regional Cooperation) countries. The study considers both political and economic factors as possible determinants of financial liberalization. Data from five countries of the South Asian region (Bangladesh, India, Nepal, Pakistan, and Sri Lanka) over a time span of 48 years i.e. 1970 to 2018 had been analyzed. We selected 1970 as a start point of data as liberalization policies were theoretically advocated for and practically started implementing in the '70s. The result of panel data estimation shows that among economic factors trade openness, foreign reserves, economic development (GDP growth), and recession predict financial liberalization in the SAARC region. Further, political stability and level of democracy are important political factors in predicting financial liberalization in the region. The country-specific analysis shows some variation from the overall region and is reported in the results section. We also tested for the likelihood of dynamic modeling. However, the result of Arellano and Bond estimation shows that static modeling is appropriate in our context and validates the robustness of our initial estimates. Our study gives useful insights to the policymakers who aim to liberalize the financial markets.

Keywords: Economic factors, financial liberalization, political factors, SAARC

ARTICLE INFO

Article history:

Received: 18 March 2020

Accepted: 07 September 2020

Published: 26 March 2021

DOI: <https://doi.org/10.47836/pjssh.29.1.33>

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INTRODUCTION

In about the last 50 years, countries around the globe have started implementing financial reforms (Hermes & Meesters, 2015). The ultimate objective of these reforms is to minimize the involvement of the state in institutions to maximize competition and efficient resource allocation. The proponents of this school of thought believe that these

reforms bring financial and economic development and are a source of economic growth (e.g. see, Beck et al., 2000; Bumann et al., 2013; Elkhuzen et al., 2018). One of these important reforms is financial liberalization. Financial liberalization allows the interest rate to reach market equilibrium which will enhance savings and investments and ultimately results in economic growth (McKinnon, 1973).

The liberalization of financial markets that started around the globe in the 1970s reached its peak after the “Washington Consensus” proposed by Williamson (1990). In a post-Washington-consensus world, both developed and developing countries started implementing liberalization policies. The developing countries, in order to revamp their economy, implemented the economy recovery program famously called “Structural Adjustment Program” introduced by the Bretton Woods Institutions (World Bank & International Monetary Fund) aimed at liberalizing prices in distress and melt-down economies (Kalu, 2007). The adoption of this program signals the phasing out of financial repressive policies in the economy. Financial liberalization thus became the process of eliminating financial repression.

Without any doubt, financial liberalization has changed the outlook of many countries and has remained a focal point for researchers and practitioners around the world since the seminal work of McKinnon (1973) and Shaw (1973) on this area. However, much of the research till now has remained focused on either examination of the consequences of financial

liberalization and its relation with economic growth (e.g. Bandiera et al., 2000; Hossain, 2020; Naveed & Mahmood, 2019; Reinhart & Tokatlidis, 2003) or the links between financial liberalization and financial crisis (e.g. Demirguc-Kunt & Detragiache, 2001; Kaminsky & Reinhart, 1999; Yalta, 2011). There is still a dearth of research that examines the factors influencing the adoption of financial liberalization policies. Among the studies conducted on determinants of financial liberalization, the focus of researchers has remained on Africa, Latin America, and some parts of Europe. To the best of our knowledge, there has been only one study that examines determinants of equity market liberalization in emerging economies (i.e. Kaya et al., 2012). However, the emphasis of the mentioned study was only restricted to equity market liberalization which is a subpart of the complete financial liberalization process.

This study aims to explore factors leading towards liberalization policies of countries in the South Asian region and are members of the South Asian Association for Regional Cooperation (SAARC) i.e. Bangladesh, India, Nepal, Pakistan, and Sri Lanka (Due to unavailability of data on liberalization, Bhutan and Maldives are excluded from the study). The region faces different political and economic challenges including terrorism, political instability, and economic and political pragmatism which make it important to study the factors that can possibly influence the economic growth in the region (Awan et al., 2018; Bhattacharjee, 2017) and can affect the financial liberalization process.

The region has also become an important economic hub because of China Pakistan's economic corridor, Indo-Iran-Afghan cooperation, the emergence of Bangladesh as an Asian tiger, and the emergence of India as the fifth-biggest economy in the world. Further, the economic and financial growth of the region is ever-increasing (Awan et al., 2018) and the region is attracting foreign investment more than ever before (Ahmad et al., 2019). The countries in the region also have healthy bi-lateral trade with agreements like SAFTA (South Asian Free Trade Area) in place that ensures mutual cooperation for economic development and growth (Sun et al., 2019).

It is thus prudent to look for different political and economic factors that can influence the level of financial liberalization within the region. Further, almost all of these countries are going through the process of financial restructuring and the biggest problem they are facing is structural reforms for economic development and growth including agriculture, ICT, industry (Babu & Joshi, 2019), and political reforms. Thus, it is important to look at the factors that can help in achieving the liberalization goals of these countries.

Previous research shows that there are different factors that can predict financial liberalization. These factors can be both economic and political. Among economic factors, GDP Growth, foreign reserves, trade openness, and recession while among political factors, level of democracy and political stability are considered as important predictors of financial liberalization. We

thus examine that whether these different economic and political factors predict the liberalization in the SAARC region or not.

Our contribution to the body of knowledge is two-fold: Firstly, we add to the scarce body of knowledge that examines the determinants of financial liberalization. As it is well established that financial liberalization is a source of economic development, it is important to understand the factors that can possibly lead to liberalization. We thus fill this gap in the existing literature by examining different economic and political factors as possible antecedents of financial liberalization. Secondly, the study is exclusively focused on the SAARC region. SAARC is the only intergovernmental geopolitical body in the South Asian region. All members of SAARC are participants of the SAFTA agreement that ensures similarity in the enforcement of economic policies. The region has been ignored in the previous research on the liberalization issue. Our study also serves as a guide for policymakers in the region. The results of the study show that policymakers who are trying to liberalize financial sectors and are trying to bring reforms shall look for trade openness, GDP growth, increase in reserves, political stability, and democracy in their respective countries.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Financial liberalization is an important way to achieve economic growth. The initial studies on liberalization and reforms by McKinnon (1973) and Shaw (1973)

promoted financial reforms as a way forward to achieve efficiency in the allocation of capital and economic development.

Since then, researchers have studied the importance of financial restructuring and financial liberalization in different countries and regions. A lot of work has been conducted on the liberalization-growth nexus (Naveed & Mahmood, 2019). However, despite its importance, the research on the explanatory factors of liberalization is scarce to date specifically in the context of emerging economies (Kaya et al., 2012). It is vital to study these factors even today as emerging economies around the world are struggling to have a sound financial system. The different economic and political factors that can explain financial liberalization are discussed below.

The first factor that can influence financial liberalization policy in the region is economic development. Economic development can have a crucial role in financial reforms and liberalization (Henisz & Mansfield, 2019; Kaya et al., 2012). Previous research had shown that poor countries (i.e. those having less GDP) might not have developed institutions and thus would continue to go with financial repression (Abiad & Mody, 2005). Alternatively, countries with high GDP have better institutions and thus liberalize more (Henisz & Mansfield, 2019).

Financial liberalization allows foreign investors to invest in a country. Economically developed countries want foreign investors to invest more. This will lead economically developed countries to liberalize their

financial sectors and economic policies (Kaya et al., 2012). Previous research has also shown that economic development leads to current account liberalization (Henisz & Mansfield, 2019) and equity market liberalization (Kaya et al., 2012). We use GDP growth rate to measure economic development and thus expect that

H1: Economic development (GDP growth) is positively related to financial liberalization

A country's level of trade openness is another macro-economic factor that may affect the likelihood of financial liberalization. Trade openness may induce financial liberalization as foreign firms with operations in the local market search for ways to facilitate the repatriation of profits to their home countries. To measure the extent of trade openness, we use the sum of imports and exports as a percentage of GDP. A high level of openness indicates that foreign businesses and capital have a significant influence on the domestic economy. Such external influence would strengthen the position of domestic actors pushing for financial liberalization. Previous research also shows that trade openness is positively associated with the likelihood of financial liberalization (e.g. Abiad & Mody, 2005; Maxfield, 1998; Shortland & Girma, 2005). Thus, we hypothesize that

H2: Trade openness is positively related to financial liberalization

Another important factor that we believe may play a role in liberalization

is a recession. A recession is a situation when the economy is contracting and the economy needs some structural adjustments. Financial liberalization policies are a way through which the economy can be restructured. Generally, interest rates rise in a recession. So, closed economies have to deregulate interest rates in order to combat the recession. Similarly, more investment is required in the economy. Liberalization provides the mechanisms through which the economy can be boosted. This is the reason that during the recession period, countries would opt to liberalize their economic and financial markets.

H3: Recession is positively related to financial liberalization.

Another important economic factor that may affect the likelihood of financial liberalization is a country's balance of foreign reserves (Kalu, 2007). Where a country is able to maintain a high GDP growth rate and a healthy balance of foreign reserves, policymakers do decide to leave economic repression and adopt liberalization policies to attract foreign investors. In their study, Rajan and Zingales (2003) argued that small firms would also not oppose the policy of liberalization as it enhanced capital flow. Similarly, a high level of foreign reserves makes a country more favorable to trade and attracts more investors. Thus, in order to avail of these opportunities, countries with a high level of foreign reserves would decide to liberalize the economic and financial policies. Thus, we expect that

H4: Foreign reserves are positively related to financial liberalization

Besides economic factors, political factors can also be important determinants of the financial liberalization process. The process of democratization and financial liberalization both were accelerated at the world level in the early 1990s. Giuliano et al. (2013) suggested that democracy significantly and monotonically affected economic reforms and financial reforms and further with the passage of time democratization across the world proposed little room for the policy reversals. Susemihl and Hicks (1894) pointed that in the 4th century BC, Aristotle suggested that democratization, oligarchic and tyrannical polities were idiosyncratic in all types of adopted policies (Ch. 11). The studies conducted by Helliwell (1994), Keefer and Knack (2000), Mansfield et al. (2000, 2002), and Rodrick (1999) propose many advanced theories of the politics-economic liberalization relationship. Liberalization policy is dependent on the government and the political system. Research suggests that financial liberalization is good for the development of the economy only if the government is strong (Blackburn & Forgues-Puccio, 2008). Researchers have argued that political stability brings economic development and countries leave the repressive regime once they attain stability in political regimes. Similarly, recent studies have shown that political systems and democratic governments are key players in the liberalization of economic and financial policies (Hashmi et al., 2020;

Henisz & Mansfield, 2019; Steinberg et al., 2018). Thus we hypothesize that,

H5: The existence of democratic governments is positively related to financial liberalization

H6: Political stability is positively related to financial liberalization

METHOD

Data

Data for economic factors were extracted from IMF statistics and World Bank open data (WDI) whereas the political factors are dummy variables. The observational data of political variables were extracted from reports of the center for systemic peace. The specific data source for each study variable is mentioned in Table 1. Data of 48 years i.e. from a period of 1970-2017 was used for analysis purposes. The year 1970 was purposively selected because of certain important events within the South Asian region including: (i) Bangladesh's independence in 1971, (ii) Current account liberalization in South Asian countries, and most importantly (iii) emergence of financial liberalization as a policy reform in the 70s.

Measures

Dependent Variable (Financial Liberalization). The financial liberalization index was constructed using eight factors: i) Interest Rate Deregulation (IRD), ii) Removal of Entry Barriers (REB), iii) Reduction in Reserve Requirement (RRR), iv) Easing in Credit Control (ECC), v)

Implementation of Prudential Rule (IPR), vi) Stock Market Reforms (SMR) vii) Privatization of State-Owned Banks (PSB), and viii) External Account Liberalization (EAL). This same approach has previously been used by Bandiera et al. (2000), Demetriades and Luintel (1997), Hermes and Meesters (2015), Laurenceson and Chai (2003), and Shrestha and Chowdhary (2006). For each policy variable, a value between 0 and 1 is assigned depending on how the policy has been implemented. If a particular sector is fully liberalized that policy variable will be assigned value 1 and if any particular sector remains regulated it takes a value 0. In the case of partial and phase-wise ongoing liberalizations of a particular sector, different values have been assigned like 0.33, 0.5, and 0.66. In the case of the two-phased deregulation process, the value of 0.5 is assigned in the first phase, whereas 1 at the end of the second phase. For the three-phased deregulation process, 0.33 in the first phase, 0.66 in the second phase, and 1 at the end of the third phase have been assigned.

Mathematically, the index is shown as:

$$FLI = w_1 IRD + w_2 REB + w_3 RRR + w_4 IRP + w_5 PSB + w_6 EAL + w_7 SMR + w_8 ECC \quad (i)$$

Here, w_i is the weight of the component. IRD takes the value of 1 if the interest rate is deregulated, 0 otherwise. REB takes the value of 1 if licensing of new businesses is easy, foreign investments are encouraged, specialized banking

services and universal banks exist, 0 otherwise. RRR takes the value of 1 if reserve requirements are decreased, 0 otherwise. IRP takes the value of 1 if BASEL accord has been adopted, banking supervisory agency is independent and supervisory oversight is maintained, 0 otherwise. PSB takes the value of 1 if all state-owned banks have been privatized, 0 otherwise. EAL takes the value of 1 if the external account has been fully liberalized, 0 otherwise. SMR takes the value of 1 if the policies with respect to auctioning of government securities exist, markets are open to foreign investors, and tax regulations regarding the securities market exist, 0 otherwise. ECC takes the value of 1 if credit control requirements are easy, 0 otherwise.

Independent Variables. Both economic factors and political factors were measured using standard proxies/ measures.

Table 1 below summarizes the measures of economic and political factors.

Table 1
Summary of measures/proxies and data sources of independent variables

Variable	Measures	Data Source
Trade Openness	Sum of imports and exports as a percentage of GDP	World bank open data
Reserves	\$ value of net reserves	IMF Statistics
GDP growth	%age change in GDP of the country with respect to last year	IMF Statistics and World bank open data
Recession	Dummy variable. 1 if GDPg is negative, 0 otherwise.	IMF Statistics
Political stability	Dummy variable. 1 if no regime change occurs in 20 years, 0 otherwise. Regular transfer of power from one political party to another does not constitute a regime change.	Center for systemic peace
Level of democracy	Democracy scores from 0-10 based on the openness of the political process, as well as the level of check and balances on the power of the executive	Center for systemic peace

Mathematical Equation. The mathematical equation of the study is shown below:

$$\begin{aligned}
 FL_{i,t} = & \beta_0 + \beta_1(TO)_{i,t} + \beta_2(RES)_{i,t} + \beta_3(GDPg)_{i,t} \\
 & + \beta_4D_1(REC)_{i,t} + \beta_5D_2(PS)_{i,t} + \beta_6(LOD)_{i,t} \\
 & + \mu_{i,t} \qquad \qquad \qquad (ii)
 \end{aligned}$$

Here,

FL= Financial liberalization, TO= trade openness, RES= Reserves, GDPg= GDP growth, REC= Recession, PS= Political stability, LOD=level of democracy.

RESULTS

Descriptive Statistics and Correlation Analysis

Table 2 provides the results of descriptive statistics and correlation analysis for SAARC countries. The mean and standard deviation value of foreign reserves are not of raw form, rather it is the logarithmic value used in the analysis.

It can be seen in the table that economic factors are significantly and positively related to financial liberalization: GDP

Table 2
Descriptive statistics and correlation analysis for SAARC region

	Mean	S.D.	1	2	3	4	5	6	7
1. GDP growth	10.25	11.68	1.00						
2. Trade openness	26.02	19.32	-.51*	1.00					
3. Recession	0.042	0.22	-.25*	-0.12	1.00				
4. Reserves	17.43	7.28	.89*	.43*	.04	1.00			
5. Level of Democracy	1.58	1.98	.80*	-.48*	-.10*	-.72*	1.00		
6. Political Stability	7.92	4.15	.17*	-.01	-0.02	.23*	.22*	1.00	
7. Financial Liberalization	4.81	3.30	.37*	.43*	.29*	.17*	.13*	.14*	1.00

Note. *p<.05, S.D.= Standard deviation

Table 3
Results for unit-root test

Variable	Statistic	p-value
Financial Liberalization	-2.00	.02
GDP Growth	-6.19	.00
Recession	-6.13	.00
Reserves	-3.31	.03
Trade Openness	-2.71	.01
Level of democracy	-0.70	.00
Political Stability	-5.43	.00

Note. H₀ for Levin-Lin-Chu= Panels contain unit-root, H_a= Panels are stationary

growth and financial liberalization (r=.37, p<.05), trade openness and financial liberalization (r=.43, p<.05), recession and financial liberalization (r=.29, p<.05) and foreign reserves and financial liberalization (r=.17, p<.05). Similarly, results show that level of democracy (r=.13, p<.05) and political stability (r=.14, p<.05) are also positively linked with financial liberalization. These results provide initial support for all formulated hypotheses.

Diagnostic Testing for Possibility of Two-Way Relationship

Before proceeding with regression analysis, diagnostic testing was done to check whether OLS estimation can be performed

on our data or not? The big question that arises regarding our study is the existence of theoretical rationale for two way relationship of variables under study. We performed the unit-root test (Levin-Lin-Chu test) to confirm the stationary of data. Our results of the unit root test are summarized in Table 3 which shows that all variables were stationary at level. So, we rejected H₀ and pursued OLS estimation instead of the co-integration technique.

Results of Panel Data Regression Analysis

Once the stationary of data was confirmed, the panel data regression technique was applied to the data. Table 4 reports results

for both pooled OLS regression and fixed effect regression along with the results of the Hausman test to determine fixed or random effect regression model. The results for the overall SAARC region and country-wise variations are reported in the table. It can be seen that for our model, fixed effect regression was more appropriate for the overall SAARC region and individual countries.

It can be seen in the table that for the overall SAARC region among economic factors trade openness is significantly positively related to financial liberalization ($\beta=.10, p<.01$). Similarly, reserves ($\beta=.09, p<.01$), GDP growth ($\beta=.18, p<.01$), and recession ($\beta=.16, p<.05$) are all significantly positively related to financial liberalization. Among political factors, the level of democracy is significantly and positively related to financial liberalization ($\beta=.15, p<.05$). Similarly, political stability is also significantly and positively related to financial liberation ($\beta=.42, p<.01$).

A fixed-effect regression model was applied after the results of the Hausman test. The results for fixed effect regression also show a positive relationship between all economic and political factors under consideration and financial liberalization with slight variations in the value of coefficient. It can be seen that trade openness ($\beta=.16, p<.01$), reserves ($\beta=.05, p<.01$), GDP growth ($\beta=.17, p<.01$), recession ($\beta=.75, p<.05$) level of democracy ($\beta=.42, p<.01$) and political stability ($\beta=.19, p<.05$) are all significantly and positively associated with financial liberalization in SAARC

region. The results of both pooled OLS and panel data regression analyses for the overall SAARC region support our formulated hypotheses from H1 through H6.

The country-wise analysis shows some variations in results of countries from the overall region. These variations can also be seen in Table 4. Among economic factors, the strongest predictor of financial liberalization is GDP growth in the overall SAARC region whereas among political factors it is the level of democracy. Country-wise analysis shows that although the relationship between all economic and political factors is positive with financial liberalization. However, there are slight variations in the effect size that are evident in the table. Country-wise analysis shows that, for all countries, among economic factors, either GDP growth or trade liberalization appears to be the most important factor. For instance, GDP growth is the strongest predictor of liberalization in Bangladesh, Nepal, Pakistan, and Sri Lanka whereas, for India, trade openness is the strongest predictor.

Robustness Check

In order to test for the robustness of our results, we tested for possible endogeneity in our data and considered dynamic estimation too. We used Arellano and Bond's (1991) estimation to test for dynamic panel data modeling. After applying Allerano and Bond test, we also tested for the unidentified restrictions in the model. Our results for both the tests for the overall region are summarized in Table 5.

Table 4
Results of panel data regression analysis

	Overall SAARC		Bangladesh		India		Nepal		Pakistan		Sri Lanka	
	(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)
C	2.28** (0.522)	0.75* (0.823)	1.40** (0.534)	0.76** (0.834)	2.12** (0.573)	0.83** (0.421)	3.22** (0.638)	0.64** (0.461)	2.23** (0.556)	0.81** (0.569)	0.93** (0.625)	0.86** (0.632)
Trade	.101** (0.010)	.16** (0.015)	.113** (0.010)	.11** (0.017)	.354** (0.528)	.17** (0.632)	0.100** (0.010)	.14** (0.021)	0.101** (0.010)	.18** (0.012)	.145** (0.015)	.14** (0.011)
Reserves	.092** (0.021)	.058* (0.022)	.102** (0.020)	0.012** (0.020)	.085** (0.023)	0.06** (0.021)	0.087** (0.028)	.08** (0.164)	0.091** (0.216)	0.07** (0.064)	0.065** (0.021)	.09** (0.017)
GDP growth	.18** (0.026)	.17** (0.061)	.198** (0.026)	.15** (0.021)	.167** (0.027)	0.19** (0.069)	.163** (0.026)	.19** (0.037)	0.181** (0.066)	0.14** (0.054)	.158** (0.025)	.13** (0.036)
Recession	.16* (0.900)	.75* (0.094)	.119* (0.867)	.10* (0.761)	.152* (0.915)	.64* (0.752)	.145* (0.893)	.61** (0.729)	0.148* (0.102)	.71* (0.345)	.117* (0.887)	.52* (0.762)
Political stability	.159** (0.041)	.19** (0.048)	.19** (0.040)	.18** (0.023)	.167** (0.043)	.17** (0.036)	.231** (0.050)	.21** (0.041)	0.162** (0.042)	.17** (0.036)	.089* (0.044)	.11** (0.041)
Level of democracy	.428* (0.141)	.42* (0.142)	.452** (0.138)	.45* (0.138)	.421* (0.144)	.43** (0.132)	.496** (0.145)	.46** (0.139)	0.413** (0.152)	.43** (0.135)	.325* (0.142)	.36** (0.126)
R ²	0.42	0.38	0.46	0.48	0.42	0.36	0.44	0.38	0.42	0.35	0.47	0.39
f- stat	11.04		29.62		24.29		25.73		24.20		29.65	
Significance	0.000		0.000		0.000		0.000		0.000		0.000	
Hausman-test	42.47		22.78		82.10		32.39		40.89		13.78	
	0.000		0.000		0.000		0.000		0.000		0.01	

Note: **p<.01, *p<.05, standard error in (), (1) shows Pooled OLS regression, (2) shows results for Fixed effect regression (FE)

Table 5
Results of Arellano and Bond test and Sargan test of over identified restrictions

	Co-efficient/ Chi-square value	p-value
Arellano Bond test (L1)	0.12	.71
Sargan test of overid. Restrictions	198.5	.09

Note. H_0 for Arellano Bond= no autocorrelation, H_0 for Sargan test=overidentified restrictions exists

The results for dynamic modeling as shown in Table 5 indicate that in the case of both Arellano and Bond estimation and Sargan test for over-identified restrictions, we can't reject H_0 . This leads to the conclusion that dynamic modeling is inappropriate for the study and thus the initial results of the study are robust. So, our original estimates of OLS are robust.

DISCUSSION

Considering the importance of financial reforms for emerging and developing economies, this study was conducted to examine the determinants of financial liberalization in the SAARC region. We identified both economic and political factors from literature as determinants of liberalization in the region. Among economic factors, it was hypothesized that trade openness, foreign reserves, GDP growth, and recession are determinants of financial liberalization. Similarly, it was hypothesized that the level of democracy and political stability are political determinants of financial liberalization in the SAARC region. Overall, our results support the formulated hypothesis with minor variations for individual countries.

The first hypothesis of the study was that GDP growth has a positive relationship with financial liberalization. The results of

the study support this hypothesis. When the economy grows, GDP grows and the dream for the achievement of economic growth realizes for countries. They would liberalize thus their economies so that foreign investors can also invest in the economy. This will help in the achievement of economic growth. Previous research has also shown that economically developed countries (countries with high GDP) liberalize their markets (Kaya et al., 2012).

The second hypothesis of the study was that trade openness has a positive relationship with financial liberalization. Our results support this hypothesis. Trade openness represents the openness of the country to trade with other countries and is measured with respect to imports and exports. Trade openness can be seen as the first step towards the liberalization of financial markets. Trade openness opens the door for foreign investors and is a way towards economic development. Previous research has shown that trade openness is related to economic growth and sustainable development (Alam & Sumon, 2020; Klasra, 2011; Murshed, 2020). Thus, countries with open policies for trade are more likely to go for financial liberalization. Previously, Kaya et al. (2012) also found support for the relationship between trade openness and equity market liberalization.

The third hypothesis of the study is that recession is positively associated with financial liberalization. Results of the study support this hypothesis too. A recession is a situation when the economy is contracting and needs some structural adjustments. Financial liberalization policies are a way through which the economy can be restructured. Generally, interest rates rise in a recession. So, closed economies have to deregulate interest rates in order to combat the recession. Similarly, more investment is required in the economy. Liberalization provides the mechanisms through which the economy can be boosted. This is the reason that during the recession period, countries would opt to liberalize their economic and financial markets.

Our fourth hypothesis was related to the last economic factor i.e. foreign reserves. We hypothesized that a high level of foreign reserves is positively associated with financial liberalization. The results of the study support this hypothesis too. Foreign reserves represent the amount of foreign currency in a country. The more foreign reserves a country has, the more it aims to liberalize as it will help in making itself more competitive. Liberalization will allow foreign banks to start operations and in the local country and the presence of foreign banks enhances competitiveness in the local market (Wang & Bayraktar, 2004).

The fifth and sixth hypotheses of the study were related to the relationship of political factors i.e. political stability and level of democracy with financial liberalization respectively. Both hypotheses

have also been supported by the results. The government of any country is the most important policymaker regarding liberalization. The most important thing that leads to economic development is the consistency of economic policies. The consistency of economic policies is dependent on the political stability within a country. Political stability helps in gaining the trust of investors both local and foreign. Previous research has shown that political parties, systems, and bureaucracy are important in determining the liberalization policies of a country (e.g. Zhang, 2003). Research has also shown that democratic governments encourage financial liberalization (Quinn, 2000). Our results are in line with the school of thought which says that democratic institutions and political structure are important in liberalization and reported a positive relationship between the two (e.g. Giuliano et al., 2013; Henisz & Mansfield, 2019; Steinberg et al., 2018).

IMPLICATIONS, LIMITATIONS & FUTURE DIRECTIONS

Our study provides empirical evidence towards determinants of financial liberalization. We report that GDP growth, trade openness, recession, and foreign reserves are important economic factors that predict financial liberalization and signals financial reforms. Similarly, we found that political factors i.e. political stability and democratic governments were also important in predicting financial liberalization. These results carry serious implications for policymakers of local,

regional, and global forums. Policymakers who intend to liberalize economies to boost financial development must try to enhance GDP growth, reserves and must open borders for trade. Similarly, democratic governments should be promoted and stability in the political system should be maintained in order to achieve liberalization and structural reform goals.

Our results must be interpreted with caution as they are related to a specific region i.e. South Asian region. Future studies may investigate the determinants of financial liberalization in other regions and see the pattern of liberalization across countries and regions.

ACKNOWLEDGEMENT

The authors acknowledge the support of Dr. Zeeshan Ghafoor at Riphah International University who helped us in accessing the database and Mr. Irfan Ahmed who helped us in proof-reading the document.

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