Available online at www.sciencedirect.com
ScienceDirect

Int. Fin. Markets, Inst. and Money 17 (2007) 387–402

Journal of INTERNATIONAL FINANCIAL MARKETS, INSTITUTIONS & MONEY

www.elsevier.com/locate/intfin

Explaining when developing countries liberalize their financial equity markets

Bonghoon Kim, Lawrence W. Kenny *

Department of Economics, Box 117140, University of Florida, Gainesville, FL 32611-7140, USA

Received 22 May 2005; accepted 9 February 2006
Available online 22 March 2006

Abstract

This paper is the first to explain when countries opened their financial equity markets and is the first to explain financial liberalization using a large sample of developing countries. We test several novel hypotheses. We find that equity markets are opened earlier in countries that trade more with developed countries and that have more developed financial markets. Equity markets are opened earlier in democracies, especially if the country's leader is a civilian. Our other findings are consistent with the literature, which has found greater financial market openness in countries receiving more FDI, in richer countries, and in democracies.
© 2006 Elsevier B.V. All rights reserved.

JEL classification: D78; F2; G1

Keywords: Financial liberalization; Equity markets; Developing countries

1. Introduction

The liberalization of financial markets has been found to have important consequences for countries. For example, financial liberalization is widely believed to lead to more rapid economic growth,[1] and there is some evidence (Wyplosz, 2002) that countries, particularly developing countries, face more exchange rate instability after financial liberalization. But these economic policies of course are endogenous. Recognizing this, several studies have explained why some *equity markets* are more open to foreign investors than others. The data sets used in these studies are, with one exception, completely dominated by developed countries, containing no more than

* Corresponding author. Tel.: +1 352 392 0117; fax: +1 352 392 7860.
E-mail addresses: gators@posri.re.kr (B. Kim), larry.Kenny@cba.ufl.edu (L.W. Kenny).

[1] See the excellent review in Bekaert et al. (2001) and Prasad et al. (2003).

1042-4431/$ – see front matter © 2006 Elsevier B.V. All rights reserved.
doi:10.1016/j.intfin.2006.02.003

a handful of developing countries. That exception (Abiad and Mody, 2005) explains the extent of *general financial liberalization* in two-dozen developing countries and nearly a dozen developed countries.[2] To summarize, little is known of the determinants of when developing countries liberalize their equity markets. Our study is the first to examine the causes of equity market liberalization in a sizeable sample of developing countries.

This literature has explained the extent to which a country's financial markets are open de jure to outside investors.[3] Measuring the extent of financial openness requires a lot of information about many aspects of the financial market, and the methodology used to create these measures of financial openness has been subject to some debate. The data requirements of this methodology are particularly hard to satisfy in developing countries. It may be easier to determine when an equity market is generally liberalized than to measure how liberalized the market is. Ours is the first paper to explain the timing of financial liberalization. Two different types of hazard models are employed to judge the robustness of results to functional form.

Studying financial liberalization among developing countries leads us to develop and test several interesting new hypotheses. A developing country's benefit from opening its equity market is greater if it attracts more foreign direct investment (FDI) or engages in more trade with developed countries. Trade with advanced countries attracts more potential investors from these countries, which increases the benefit from opening the equity market to foreign investors. Accordingly, we predict that trade with developed countries should lead developing countries to liberalize their equity markets at an earlier date. Trading with less developed countries, on the other hand, offers fewer benefits from financial liberalization. Thus, trade with advanced countries should be a more appropriate determinant of the timing of financial liberalization than the trade with all countries that the literature has studied. A similar logic suggests that more FDI should lead countries to open their equity markets sooner to attract more investors from developed countries; this effect has been studied in the literature.

There is little point in opening the equity market if it is not sufficiently developed. This is not an issue in most developed countries, but it is an important consideration in developing countries. We test whether financial liberalization occurs earlier in countries with a more developed equity market.

We also test whether leaders with a military background are less likely to open their equity markets, perhaps because they are more resistant to change, and whether this effect interacts with the level of democracy.

The remainder of the paper is organized as follows. In the next section, we briefly summarize the previous literature and develop our hypotheses. We describe data sources and measurement in Section 3. Section 4 summarizes the econometric duration methods that will be employed to study how long it takes to open equity markets. Section 5 reports the estimation results of the Weibull and Cox duration models. Concluding remarks are found in Section 6.

[2] They aggregate financial liberalization measures for six policy dimensions: credit controls, interest rate controls, entry barriers in the banking sector, operational restrictions, privatization in the financial sector, and restrictions on international financial transactions.

[3] That is, the literature has studied the determinants of the regulations governing various financial transactions. Prasad et al. (2003) and others argue, however, that de jure financial liberalization (measured by regulations) may not accurately measure the extent of actual (de facto) financial integration. This may be due to lags in the reaction to changes in regulations, lax enforcement of regulations, or other factors that affect financial integration. But, as noted above, there is a literature that has estimated the effects of de jure changes in these regulations on economic growth, exchange rate volatility, etc. Our study explaining when equity markets are opened should be of value to a literature that studies the effects of this policy change using the same de jure measures.

دریافت فوری ← متن کامل مقاله

ISIArticles
مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات