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Financial globalisation uncertainty/instability is good for financial development



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ABSTRACT

This study assesses the effect of time-dynamic financial globalisation uncertainty on financial development in 53 African countries for the period 2000–2011. The empirical evidence is based on the Generalised Method of Moments with forward orthogonal deviations. The following findings are established. First, financial globalisation uncertainty does not significantly affect money supply, financial system deposits and financial size. Second, the uncertainty increases banking system efficiency, banking system activity and financial system activity. Moreover, the positive effects are consistently driven by above-median uncertainty levels. It follows that uncertainty in foreign capital flows may be a disguised advantage for domestic financial development, especially in dealing with the substantially documented issue of surplus liquidity in African financial institutions. Additionally, the sceptical view in the financial globalisation literature that ‘allocation efficiency’ is only plausible in the absence of uncertainty/instability is not substantiated by the findings. Justifications for the nexuses and policy implications are discussed.

1. Introduction

Developing countries that had been experiencing surges in foreign capital inflows have had to also experience a decline in the same capital inflows during the recent global financial crisis¹ (Kose et al., 2011). Uncertainty in financial flows has resurfaced the longstanding debate about whether the advantages of recent financial engineering far outweigh their development inconveniences (Rodrik and Subramanian, 2009). In essence, the rewards of financial globalisation to developing countries remain an open debate. While moderate consensus has been established on the rewards of trade globalisation (Asongu, 2014a), benefits from financial globalisation remain very conflicting, with a post 2007–2008 financial crisis strand of the literature substantially documenting the downsides of complete capital account openness, inter alia: Kose et al. (2011) on the risk of financial globalisation without solid domestic initial conditions; Prasad and Rajan (2008) on the imperative of incorporating country-specific features and Asongu and De Moor (2016) on the relevance of financial globalisation thresholds for positive domestic development outcomes.

Consistent with the theoretical underpinnings motivating recommendations for complete financial globalisation: (i) less

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¹ For simplicity, the terms ‘financial crisis’ ‘financial crises’, crisis and crises are used interchangeably throughout the study.

developed countries which are labour-rich and capital-poor are rewarded with more access to foreign capital needed for investment and growth whereas (ii) developed countries benefit from less volatile output (Asongu and De Moor, 2016). The theoretical basis argues that financial globalisation is a mechanism for risk sharing and capital allocation efficiency (Kose et al., 2006, 2011). Fischer (1998) and Summers (2000) are in accordance with the position that enhanced financial integration has benefited both developing nations and developed countries, notably, by consolidating economic stability in the latter and enabling the former to make transitions from low- to middle-income.

Conversely, a stream of the literature has also documented the questionable economics of financial globalisation by arguing that the phenomenon fuels global financial instability which has substantial negative externalities on development outcomes (Stiglitz, 2000; Rodrik, 1998; Bhagwati, 1998). According to Asongu (2014a), some narratives are supportive of the view that the concept of financial globalisation is a hidden agenda to extend the benefits of international trade in commodities to trade in assets.

The above debate is relevant to Africa within the framework of financial globalisation in financial development outcomes for at least a fourfold reason: recent global poverty trends; surplus liquidity issues in African financial institutions; the need for foreign investment to finance Africa's growing needs/projects and gaps in the literature assessing the impacts of globalisation on the continent's development.

First, an April 2015 World Bank report on attainment of Millennium Development Goals (MDGs) has revealed that extreme poverty has been declining in all regions of the world with the exception of Africa (World Bank, 2015). Given that financial development is poverty-inhibiting (Efobi et al., 2015), the role of finance remains crucial for the post-2015 development agenda (Asongu and De Moor, 2015). Second, a major concern in African financial development literature is the issue of surplus liquidity in financial institutions that is limiting financial access to households and corporations (see Saxegaard, 2006; Fouda, 2009; Asongu, 2014b). Third, African business literature is also consistent on the position that Africa's growing ambitions and projects require considerable external financial sources like foreign direct investment (see Bartels et al., 2009; Tuomi, 2011; Darley, 2012). Fourth, as far as we know, 2007–2008 financial crisis literature focusing on financial globalisation on the continent has failed to address the incidence of financial globalisation uncertainty on financial development.

To the best of our knowledge, the post-crisis literature on the nexus between financial globalisation and development outcomes has failed to address the highlighted concern of financial globalisation uncertainty. Accordingly, the extant literature has focused on, *inter alia*: financial flows in terms of aid, remittances and foreign direct investment (FDI) and other macroeconomic outcomes (see Massa and te Velde, 2008; Allen and Giovannetti, 2010; Arieff et al., 2010); growth effects (see Brambila-Macias and Massa, 2010; Chauvin and Geis, 2011; Price and Elu, 2014) and financial development (Massa and te Velde, 2008; Asongu, 2014a; Motelle and Biekpe, 2015; Asongu and De Moor, 2015). In essence, some inquiries have been positioned on: (i) examining the effects on remittances and foreign aid (e.g. Arieff et al., 2010); (ii) employing trade (Allen and Giovannetti, 2010) and finance (Price and Elu, 2014) as mechanisms to growth externalities from the crisis; (iii) providing evidence from selected countries with globally-integrated financial markets (Massa and te Velde, 2008); (iv) articulating the importance of FDI as a channel through which financial globalisation has influenced growth (Brambila-Macias and Massa, 2010) and (v) investigating financial globalisation conditions/thresholds for rewards in domestic financial development (Asongu, 2014a; Asongu and De Moor, 2016).

Noticeably, the above literature leaves room for improvement in three main areas. First, there is rare focus on financial development effects from financial globalisation. Moreover, studies on stock market development have limited policy implications because they are focused on a selected number of African countries with globally-integrated and well-functioning financial markets (see Massa and te Velde, 2008). In essence, policy implications provided by studies focused on financial markets have limited relevance because most African countries do not have well-functioning and globally-integrated financial markets (Alagidede et al., 2011, p. 1333). The selective positioning of inquiries is not exclusively limited to 'stock market'-oriented investigations, but well extends to the financial intermediary sector (Price and Elu, 2014; Motelle and Biekpe, 2015). Moreover, Price and Elu (2014) have only engaged the financial intermediary sector as a channel between global financial instability and economic growth.

Second, as far as we have reviewed, with the exception of a study by Massa and te Velde (2008), which has appreciated financial globalisation in terms of FDI (on selected countries though), there has been limited scholarly emphasis on FDI externalities to financial development in the post-crisis literature. Accordingly, in the light of the discourse above, for the most part, remittances and foreign aid have been used to appreciate external flows. To put this point into perspective, an inquiry by Arieff et al. (2010), which has presented a comprehensive account of financial globalisation effects, does not engage FDI in spite of the plethora of engaged institutional and macroeconomic outcomes, namely: fiscal and trade balances, foreign aid, remittances, political stability, poverty reduction and fiscal balances. Third, to the best of our knowledge, extant literature has failed to engage uncertainty in financial globalisation. In essence, Asongu (2014a) and Asongu and De Moor (2016) which are closest to the current inquiry have focused on investigating, respectively, financial development and financial globalisation thresholds for the materialization of domestic financial development benefits from financial globalisation.

This study contributes to the literature by filling underlined gaps. It assesses the effect of financial instability/uncertainty² on financial development in 53 African countries for the period 2000–2011. For this purpose, it employs all the dimensions identified by the Financial Development and Structure Database (FDSD) of the World Bank.³ Financial globalisation uncertainty is computed as

² Consistent with Lensink and Morrissey (2000) and Kangoye (2013), the terms instability and uncertainty are used interchangeably throughout the study.

³ Employed financial dimensions include: financial depth (overall money supply and financial system deposits); financial efficiency (at banking and financial system levels); financial activity (from banking and financial system perspectives) and financial size.

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