Financial Liberalization:

Theories and Experience from Developing Countries

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Topics

- The origin and definition of financial liberalization (FL)
- The experience of FL in developing countries
- The effect of FL
- Some lessons from FL

Topic One

The origin and definition of FL

The Origin of FL

- McKinnon (1973) & Shaw (1973), Kapur (1976), Mathieson (1980): Financial Deepening Theory (FD)
- Positive links between FD, savings, employment and economic growth
- Financial repression existed in most developing countries was the one of the major obstacle which encumbered the economic growth of these countries
- Developing countries needed FD in order to stimulate the economic growth
- The best way of FD: FL

Financial Repression (FR)

- Insufficient functioning of the market mechanism or even market failure in financial sector in developing counties
- Direct intervention and over regulation by government in financial sector
- Direct price control in financial market by government, i.e.., interest rates, foreign exchange rates, etc.
- Credit rationing by government: quantity control by government in credit allocation
- Limited choices of financial product and service in an immature market

Definition of FL

- **Narrow definition: liberalization of interest rates**
- **Broad definition:**
  - **Liberalization of pricing (interest rates and FX rate)**
  - **Liberalization of business innovation**
  - **Liberalization of market entering**
  - **Liberalization of capital flow**

Policy Implications of FL

- **To eliminate the over regulation by government on financial industry in order to ease the entering of the market, to breakdown the market monopoly and to encourage the market competition**
- **To abolish direct intervention in financial market and release the government control on interest rates and foreign exchange rates in order to improve the market mechanism in determining the demand and supply**
- **To abolish the Credit rationing system and FX control in order to let the capital flow more freely and efficiently**
- **To adopt a more flexible interest rate and FX rate system**
- **To adopt a more flexible taxation system**

Topic Two

The experiences of FL in developing countries

The experiences of FL in developing countries

- General features of FL
- Asia countries
- Latin American countries
- China

General features of FL

- Liberalization Dates
- Criteria to Define Liberalization Periods
  - Capital Account
  - Domestic Financial Sector
  - Stock Market
- Institutional Reforms
- Strategies of Liberalization
- Duration of the Liberalization
- Index of Financial Liberalization

Liberalization Dates

Country	Capital Account	Domestic Financial Sector	Stock Market	Partial Liberalization	Full Liberalization
Asia					
Hong Kong	Jan 73 -	Aug 94p/May 00 -	Pre 73 -	Jan 73 -	Aug 94 -
Indonesia	Jan 78p/Jan 88 - Feb 91	Jan 78p/Jan 83 -	Dec 88p/Aug 89-	Jan 83 -	Dec 88 - Feb 91
Korea	Jan 93p/Jan 96 -	Jan 88p/Jan 95 -	Jan 91p/May 98 -	Jan 93 -	Jan 96 -
Malaysia	Jun 79p - Dec 93 Sep 94 - Aug 98	Oct 78p - Sep 85 Feb 91 -	July 73/Jan 75p/84 - Dec 97	Jun 79 - Aug 98	Feb 91 - Dec 93 Sep 94 - Dec 97
Philippines	Jan 76p - Dec82 Jan94p -	Jul 81p/Dec 82 -	Mar 86p/Jan 94 -	Mar 86 -	Jan 94 -
Taiwan	Jan 87p/Jan 97 -	Sep 84p/Jul 89 -	Jan 87p/Apr 98 -	Jan 87 -	Jan 97 -
Thailand	Jan 79p - Dec 81 Jan 92/Aug 95p - Apr 97 Jan 98 -	Jun 89p/Jun 92 -	Jan 88p/Jan 90 -	Jan 90 -	Jan 92 - Apr 97 Jan 98 -
Europe					
Denmark	Oct 88 -	Jan 73p - Jan 75 Mar 79p/Jan 81 -	Pre 73 -	Jan 73 - Dec 75 Mar 79 -	Oct 88 -
Finland	Jan 87p/Jun 89 -	Jan 86p/ Jan 90 -	Pre 73p/Jan 90 -	Jan 87 -	Jan 90 -
Ireland	Jan 79p/Jan 92 -	May 85p/Feb 86 -	Pre 73p/Jan 92 -	May 85 -	Jan 92 -
Norway	Jan 80p - Dec 81 Jan 85p/Jan 88 -	Jan 79 - Dec 79 Sep 85p/Jan 88 -	Jan 84p/Jan 89 -	Sep 85 -	Jan 88 -
Portugal	Sep 89p /Aug 92 -	Jan 84p/Mar 90 -	Pre 73 - Dec 75 Jan 86 -	Jan 86 -	Mar 90 -
Spain	Jan 75p/Jan 80/Jun 88p/Dec 92 -	Jan 74p/Jan 81 -	Pre 73 -	Jan 74 -	Jan 80 -
Sweden	Jan 84p/Jan 89 -	Jan 78p/Jan 85 -	Pre 73p/ Jan 80 -	Jan 80 -	Jan 85 -

Liberalization Dates (cont')

Country	Capital Account	Domestic Financial Sector	Stock Market	Partial Liberalization	Full Liberalization
G-7					
Canada	Pre 73p/Mar 75 -	Pre 73 -	Pre 73 -	Jan 73 -	Jan 73 -
France	Jun 85p/Jan 90 -	Jan 85 -	Pre 73 -	Jan 85 -	Jun 85 -
Germany	Pre 73p/Mar 81 -	Pre 73 -	Pre 73 -	Jan 73 -	Jan 73 -
Italy	May 87p/Jan 92 -	Jan 74 - Dec 74 Jan 81-	Pre 73 -	Jan 74 - Dec 74 Jan 81 -	May 87 -
Japan	Jan 79p/Jul 80 -	Jan 79p/Dec 91 -	Jan 85 -	Jul 80 -	Jan 85 -
United Kingdom	Oct 73p/Oct 79 -	Jan 81-	Pre 73 -	Oct 73 -	Jan 81 -
United States	Jul 73 -	Pre 73p/Jan 82 -	Pre 73 -	Jan 73 -	Jul 73 -
Latin America					
Argentina	Apr 76p/Dec 78 - Mar 82 Dec 89 -	Jan 77 - Jun 82 Oct 87 -	Jan 77p - Mar 82 Jan 89 -	Jan 77 - Mar 82 Jan 89 -	Dec 78 - Mar 82 Dec 89 -
Brazil	Jan 90p - Dec 93 Mar 95p -	Jan 76 - Dec 78 Jan 88p/Jan 89 -	Pre 73 p/Jun 91 -	Jan 76 - Jan 79 Jan 89 -	Jun 91 - Dec 93 Mar 95 -
Chile	Jun 79p - Dec 82 Apr 90/Jun 91p/Sep 98 -	Jan 74p/May 75 - Nov 82 Jan 84p/Jan 85 -	Jan 87p/Jan 92 -	Jun 79 - Nov 82 Jan 87 -	Apr 90 - May 91 Jan 92 -
Colombia	Jan 91p/Sep 98 -	Aug 74p/Sep 1980 - Dec 85 Jul 86 -	Jan 91p -	Jan 91 -	Sep 98 -
Mexico	Pre 73 - Jul 82 Nov 91 -	Jan 74p - Aug 82 Oct 88p/Apr 89 -	Jan 89p/Jan 91 -	Jan 74 - Jul 82 Apr 89 -	Nov 91 -
Peru	Pre 73p - Dec 86 Jan 91 -	Pre 73p - Dec 81 Jan 91 -	Jan 92 -	Jan 91 -	Jan 92 -
Venezuela	Pre 73 - Jan 83 Mar 89 - Dec 93 Apr 96 -	Aug 81 - Jan 84 Jan 89 - Aug 94 Apr 96 -	Jan 77 - Dec 87 Jan 90 - Jun 93 Jun 95 -	Jan 77 - Jan 84 Mar 89 - Dec 93 Apr 96 -	Aug 81 - Jan 83 Jan 90 - Jun 93 Apr 96 -

Criteria to Define Liberalization Periods

Capital Account

Criteria for Full Liberalization	
Borrowing abroad by banks and corporations	Banks and corporations are allowed to borrow abroad mostly freely. They may need to inform the authorities, but the authorization is granted almost automatically. Reserve requirements might be in place but are lower than 10 percent. The required minimum maturity is not longer than two years.
	And
Multiple exchange rates and other restrictions	There are no special exchange rates for either current account or capital account transactions. There are no restrictions to capital outflows.
Criteria for Partial Liberalization	
Borrowing abroad by banks and corporations	Banks and corporations are allowed to borrow abroad but subject to certain restrictions. Reserve requirements might be between 10 and 50 percent. The required minimum maturity might be between two and five years. There might be some caps in borrowing and certain restrictions to specific sectors.
	Or
Multiple exchange rates and other restrictions	There are special exchange rates for current account and capital account transactions. There might be some restrictions to capital outflows.
Criteria for No Liberalization	
Borrowing abroad by banks and corporations	Banks and corporations are mostly not allowed to borrow abroad. Reserve requirements might be higher than 50 percent. The required minimum maturity might be longer than five years. There might be caps in borrowing and heavy restrictions to certain sectors.
	Or
Multiple exchange rates and other restrictions	There are special exchange rates for current account and capital account transactions. There might be restrictions to capital outflows.

Criteria to Define Liberalization Periods

Domestic Financial Sector

Criteria for Full Liberalization	
Lending and borrowing interest rates	There are no controls (ceilings and floors) on interest rates.
	And
Other indicators	There are likely no credit controls (subsidies to certain sectors or certain credit allocations). Deposits in foreign currencies are likely permitted.
Criteria for Partial Liberalization	
Lending and borrowing interest rates	There are controls in either lending or borrowing rates (ceilings or floors).
	And
Other indicators	There might be controls in the allocation of credit controls (subsidies to certain sectors or certain credit allocations). Deposits in foreign currencies might not be permitted.
Criteria for No Liberalization	
Lending and borrowing interest rates	There are controls in lending rates and borrowing rates (ceilings and floors).
	And
Other indicators	There are likely controls in the allocation of credit controls (subsidies to certain sectors or certain credit allocations). Deposits in foreign currencies are likely not permitted.

Criteria to Define Liberalization Periods

Stock Market

Criteria for Full Liberalization	
Acquisition by foreign investors	Foreign investors are allowed to hold domestic equity without restrictions.
	And
Repatriation of capital, dividends, and interest	Capital, dividends, and interest can be repatriated freely within two years of the initial investment.
Criteria for Partial Liberalization	
Acquisition by foreign investors	Foreign investors are allowed to hold up to 49 percent of each company's outstanding equity. There might be restrictions to participate in certain sectors. There might be indirect ways to invest in the stock market, like through country funds.
	Or
Repatriation of capital, dividends, and interest	Capital, dividends, and interest can be repatriated, but typically not before two and not after five years of the initial investment.
Criteria for No Liberalization	
Acquisition by foreign investors	Foreign investors are not allowed to hold domestic equity.
	Or
Repatriation of capital, dividends, and interest	Capital, dividends, and interest can be repatriated, but not before five years of the initial investment.

Institutional Reforms

Countries	Index of Law and Order (1)	Insider Trading Laws Existence (2)	Insider Trading Laws Enforcement (3)
Asia			
Hong Kong	Sep-93	1991	1994
Indonesia	Jun-91	1991	1996
Korea	Oct-91	n/a	n/a
Malaysia	Apr-93	1973	1996
Philippines	Jul-92	1982	No
Taiwan	No Change	1988	1989
Thailand	Apr-88, Aug-92	1984	1993
Europe			
Denmark	Highest Level (whole sample)	1991	1996
Finland	Highest Level (whole sample)	1989	1993
Ireland	Sep-89, Apr-96	1990	No
Norway	Highest Level (whole sample)	1985	1990
Portugal	Oct-94	1986	No
Spain	Dec-91	1994	1998
Sweden	Highest Level (whole sample)	1971	1990

Institutional Reforms (cont')

G-7			
Canada	Highest Level (whole sample)	1966	1976
France	Jan-92	1967	1975
Germany	Highest Level (whole sample)	1994	1995
Italy	Aug-95	1991	1996
Japan	Jul-92	1988	1990
United Kingdom	Sept-89, Jan-92	1980	1981
United States	Highest Level (whole sample)	1934	1961
Latin America			
Argentina	Dec-92	1991	1995
Brazil	No Change	1976	1978
Chile	Apr-94	1981	1996
Colombia	Mar-94	1990	No
Mexico	No Change	1975	No
Peru	Sep-92	1991	1994
Venezuela	No Change	1998	No

Column (1) reports the dates in which there is a "permanent" improvement in the International Country Risk Guide's index of law and order. In this index, law and order are assessed separately, with each sub-component comprising zero to three points. The law sub-component is an assessment of the strength and impartiality of the legal system, while the order sub-component is an assessment of popular observance of the law. The improvement periods in this index are characterized by at least one point increase in the index from its two-year period average, and the maintenance of the index above this average for at least another two years. This column also shows those countries for which the index of law and order was at its highest level during all the sample. "No change" corresponds to no permanent changes in the index. Columns (2) and (3) come from Bhattacharya and Daouk (2000). The columns report, respectively, the dates when insider trading laws are approved and when the first prosecution under these laws occurs. The authors surveyed stock market participants and national regulators to obtain the answers. "n/a" means not available. "No" means that there is no enforcement of insider trading laws.

Strategies of Liberalization

Regions	Proportion of Episodes in Which a Particular Sector Partially Liberalized First (in percent)		
	Capital Account	Domestic Financial Sector	Stock Market
Asia	33	33	33
Europe	0	25	75
G-7	0	0	100
Latin America	25	58	17

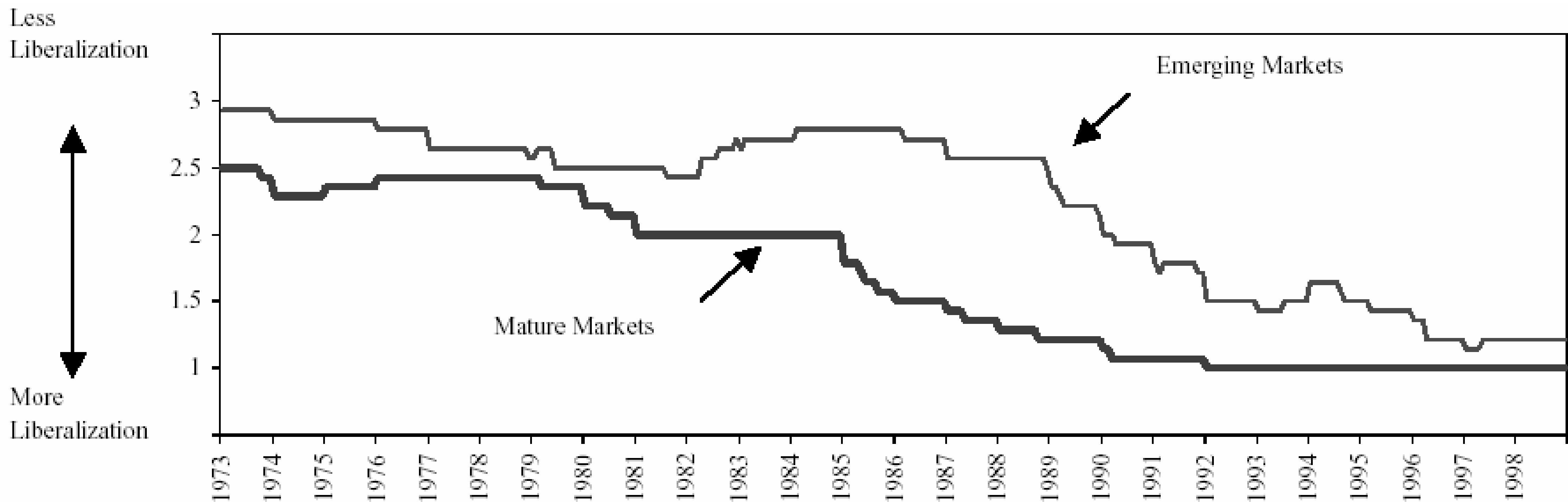
Regions	Proportion of Episodes in Which a Particular Sector Fully Liberalized First (in percent)		
	Capital Account	Domestic Financial Sector	Stock Market
Asia	0	55	43
Europe	13	25	63
G-7	20	0	80
Latin America	15	77	8

Duration of the Liberalization Reform

Regions	Number of Months between the Opening of the First Sector and the Third Sector
Asia	108
Europe	55
G-7	61
Latin America	38
All Regions	66

First Sector to Open	Number of Months between the Opening of the First Sector and the Third Sector
Capital Account	107
Domestic Financial Sector	58
Stock Market	47

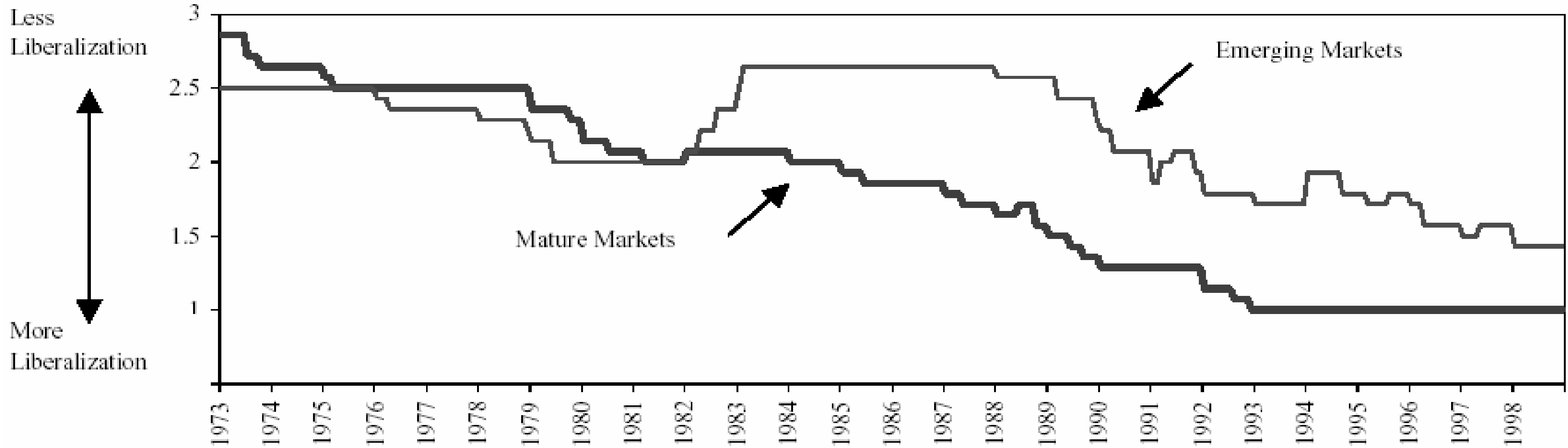
Index of Financial Liberalization



The index of financial liberalization jointly evaluates the liberalization of the capital account, the domestic financial sector, and the stock market. The index is a cross-country average. The value three means repression, two means partial liberalization, and one means full liberalization. Mature markets include: Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Norway, Portugal, Spain, Sweden, United Kingdom, and United States. Emerging markets include: Argentina, Brazil, Chile, Colombia, Hong Kong, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Taiwan, Thailand, and Venezuela.

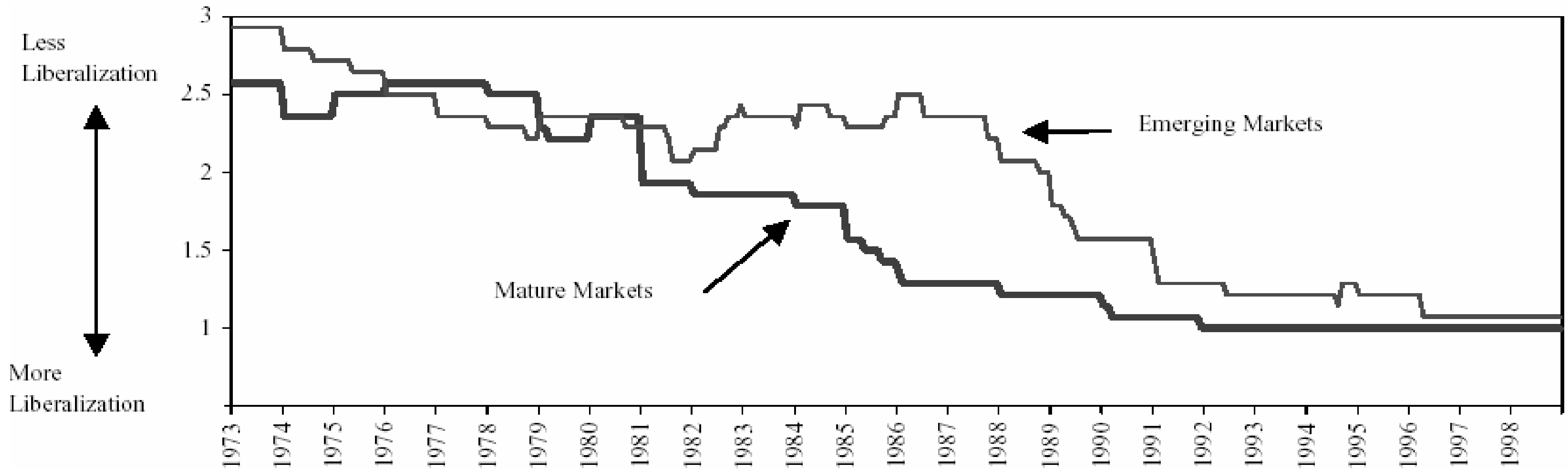
Indexes of Financial Liberalization by Sector:

Capital Account



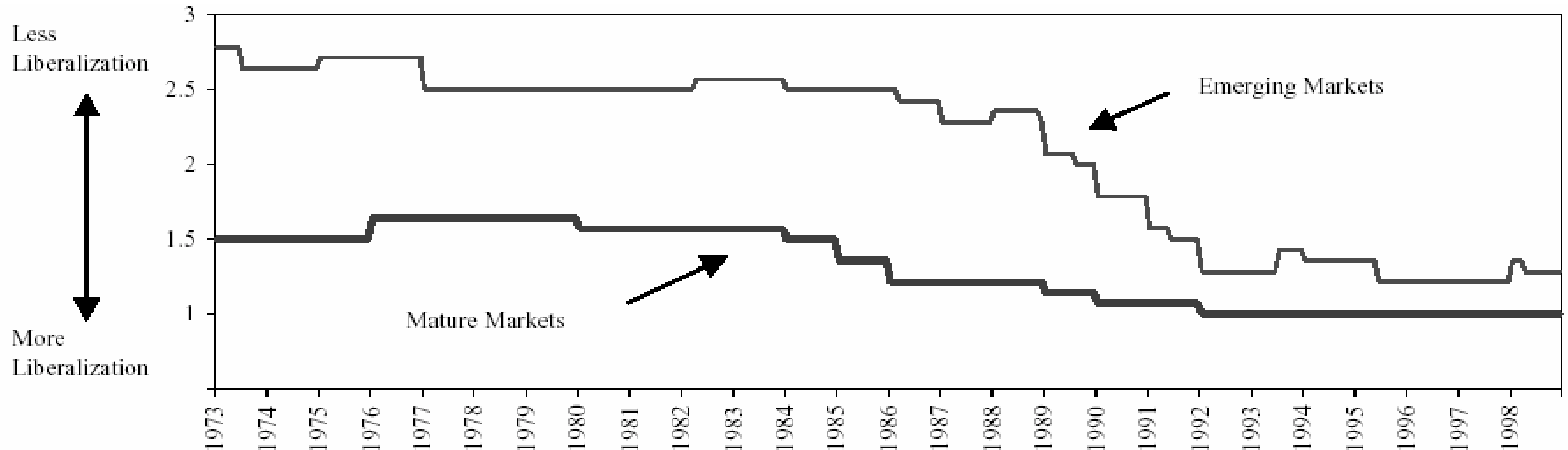
Indexes of Financial Liberalization by Sector:

Domestic Financial Sector



Indexes of Financial Liberalization by Sector:

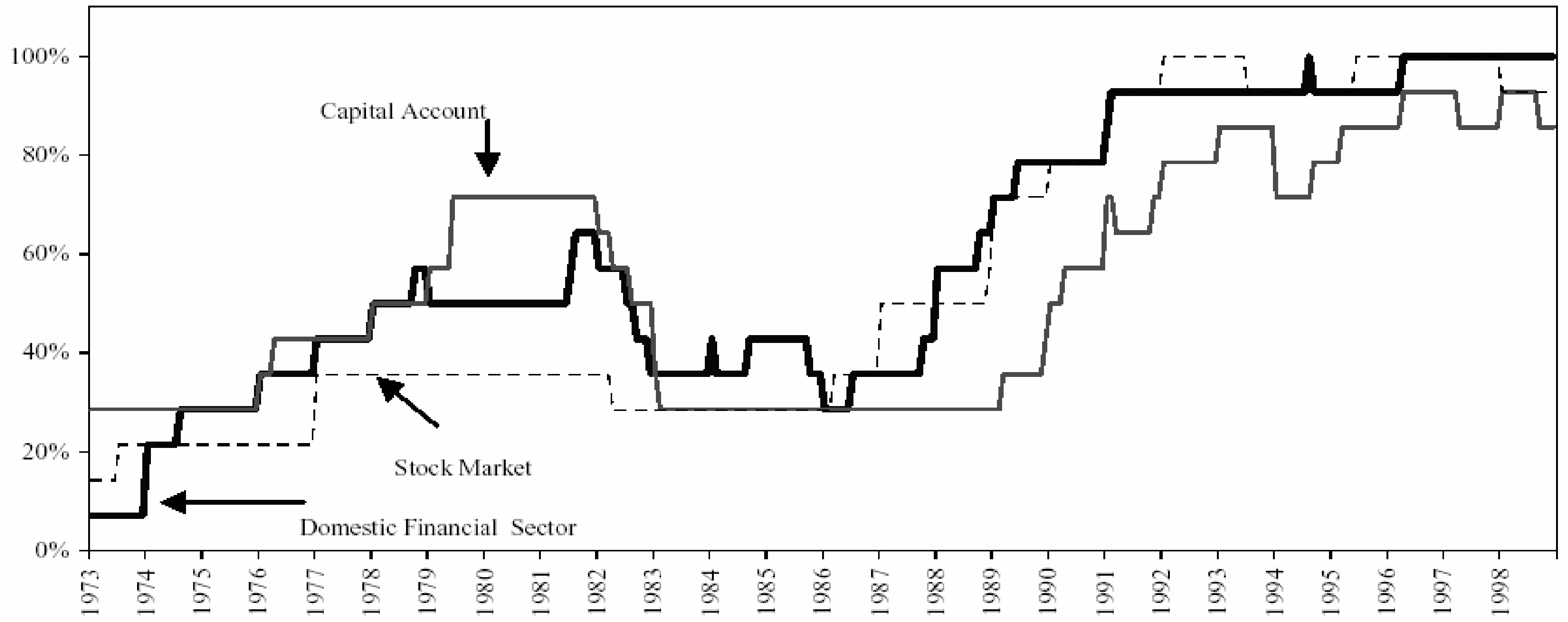
Stock Market



The three indexes evaluate separately the liberalization of the capital account, the domestic financial sector, and the stock market. The indexes are a cross-country average. The value three means repression, two means partial liberalization, and one means full liberalization. Mature markets include: Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Norway, Portugal, Spain, Sweden, United Kingdom, and United States. Emerging markets include: Argentina, Brazil, Chile, Colombia, Hong Kong, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Taiwan, Thailand, and Venezuela.

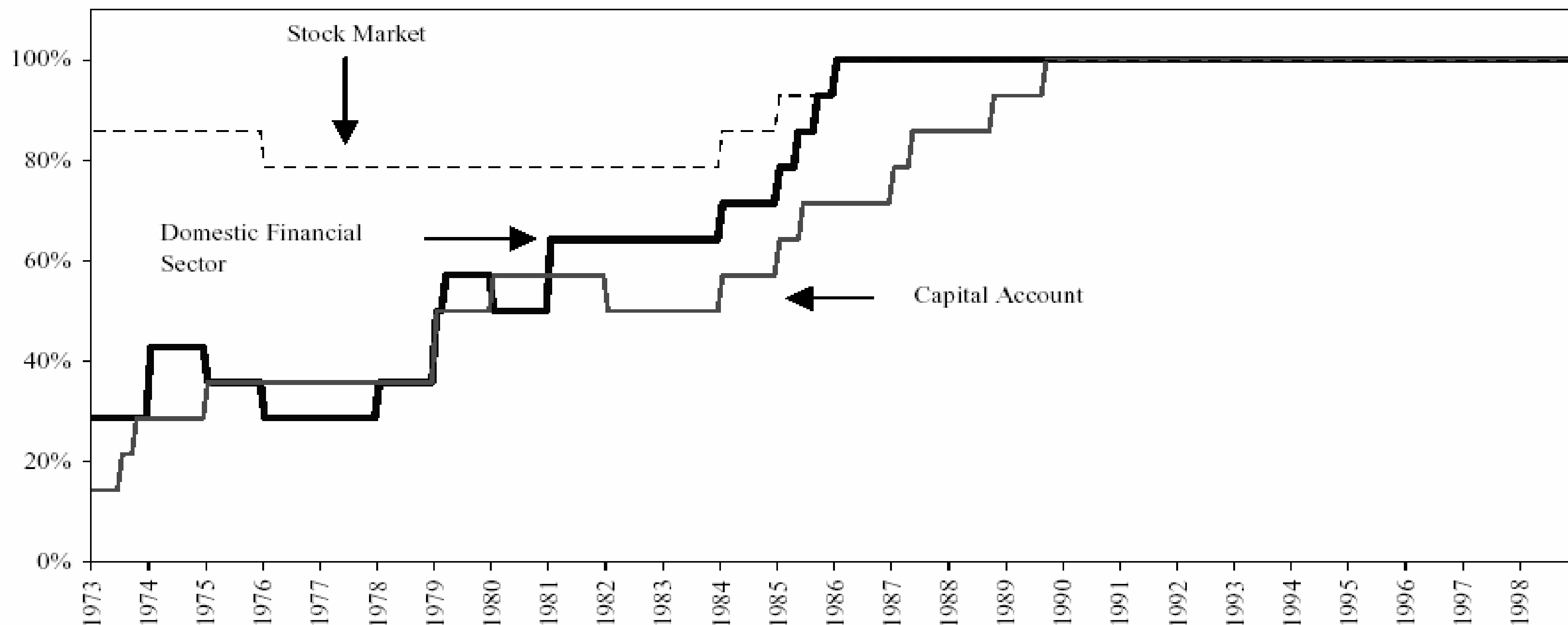
Proportion of Emerging Markets with Partial Liberalization

(in percent)



Proportion of Mature Markets with Partial Liberalization

(in percent)



The panels show the proportion of countries with (at least partially) liberalized capital account, domestic financial sector, and stock market. Mature markets include: Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Norway, Portugal, Spain, Sweden, United Kingdom, and United States. Emerging markets include: Argentina, Brazil, Chile, Colombia, Hong Kong, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Taiwan, Thailand, and Venezuela.

Case of Asia countries

- Indonesia
- Korea
- Malaysia
- Philippines
- Thailand
- Taiwan region

Indonesia: Capital Account

•In 1978, a special exchange rate regime for current account transactions was introduced. The deposit requirements for foreign currency liabilities by corporations were abolished. A 15% reserve requirement was applicable to foreign currency liabilities of foreign exchange banks.

•In 1979, the special exchange rate regime for current account transactions was abolished.

•In 1988, almost all (except for open position limits) restrictions on borrowing abroad were lifted.

• In 1991, a reduction on bank's net open position was implemented to reduce banks' access to foreign borrowing. In March, the central bank adopted measures to discourage foreign borrowing. The Bank of Indonesia began to scale down its swap operations, reducing individual bank's limits from 25% to 20% of capital. The three-month swap premium was raised by 5%. In November, bank's short-term foreign exchange liabilities could not exceed 30% of their own capital. A reserve requirement of 2% was applicable to foreign currency liabilities of foreign exchange banks. Firms could also obtain foreign credit subject to a 30% reserve requirement for a year.

•In 1992, the central bank limited banks' short-term foreign liabilities to 30% of capital. Borrowing abroad required a prior approval of the central bank.

•In 1996, foreign exchange banks were subject to central bank directives with respect to borrowing abroad. A prior approval of the team set in 1991 was required before the acceptance of a loan from abroad. An annual borrowing ceiling was imposed by the central bank on foreign commercial borrowing of more than two years of maturity.

•In 1998, a special exchange rate regime for capital transactions was introduced.

Indonesia: Domestic Financial Sector

- In 1978, private banks were allowed to set their own deposit rates, but state banks could set rates only for rupiah deposits of three months or less and for foreign currency deposits.
- In 1983, most loan rates were liberalized, credit ceilings were abolished, and centrally oriented credit was greatly reduced. In June, state banks were free to set their own deposit rates on all classes of time deposits.
- In 1990, banks were required to allocate 20% of loans to small businesses.

Indonesia: Stock Markets

- In December 1988, the government introduced deregulation measures to allow foreigners to purchase shares in eight non-joint venture companies.
- In 1989, investors were granted the right to repatriate capital and profits. The law provided that no transfer permit would be issued for capital repatriation as long as investment benefits from tax relief were being received. However, foreign payments did not require a transfer permit. In August 1989, foreigners were allowed to purchase up to 49% of all companies listed shares, including foreign joint ventures, but excluding bank shares. No person could purchase more than 1% of any collective investment security.
- In 1992, the exclusion of bank shares was eased and foreigners were allowed to buy listed shares (up to 49%) in three categories of banks: private national, state owned, and foreign joint venture.
- In December 1997, foreign companies were authorized to purchase, without limit, shares issued by Indonesian nonbank companies in the Indonesian capital market.

Korea : Capital Account

•In January 1979, the Korean authorities revised their exchange control regulations to permit domestic banks to lend to nonresidents, but not to borrow abroad.
•In 1993, a capital act liberalization plan was announced, giving greater freedom for residents concerning capital outflows. Despite the capital act liberalization plan, considerable restrictions remained on capital inflows: bond-holding by nonresidents was allowed indirectly through the Korea Trust and Country Fund; direct holding was allowed only for convertible bonds issued by small and medium enterprises; domestic companies could use foreign commercial loans within certain limits only for the import of capital goods and for foreign direct investment (FDI).
•In 1996, long-term borrowing was forbidden in practice, but short-term foreign borrowing was permitted under the regulations governing open exchange positions.
•In 1998, borrowing abroad by high-tech foreign-financed manufacturing companies was allowed up to 100% of the foreign invested capital. However, maturity was limited to three years or less and limitations were imposed on the use of funds. In April, authorities abolished regulations on usage of long-term loans with maturity of over five years that were brought into the country by foreign manufacturers.

Korea : Domestic Financial Sector

- In 1988, loan rates from banks and nonbank financial intermediaries, other than interest rates on loans subsidized by government funds, were liberalized. Interest rates on time deposits with maturities of more than two years at banks, postal savings, and credit unions, and on time and savings deposits with maturities of over one year at mutual savings and finance companies were liberalized. Short-term deposit rates were still under the authorities' control. Bank of Korea also controlled the total volume of credit and the minimum credit guidelines to small and medium firms and conglomerates.
- In 1991, the government announced a four-stage plan for interest rates deregulation (deposit and lending rates). In November, short-term lending rates (bank overdrafts, discounts of commercial paper, and trade bills) were liberalized.
- In 1995, all lending rates and most deposit rates were deregulated, except government supported lending and demand deposits.
- In 1997, all lending rates were freed. In July, remaining restrictions on deposit interest rates were eliminated.
- In January 1998, all direct restrictions on lending to prohibited sectors were completely abolished.

Korea : Stock Markets

- In 1984, the repatriation of dividends was fully permitted.
- In 1991, repatriation of capital became freely permitted. Market opened to foreign investors. A notification system made authorization of foreign investment subject to approval or notification. Foreign participation became easier under the regulations.
- In 1992, foreign investors were permitted to invest in the domestic stock market, subject to the restriction that foreign ownership of listed firms could not exceed 10% of total equity, and they could not hold more than 3% of total equity. Investments in stocks by resident foreign financial institutions were subject to the same limits as those by institutions owned by nationals.
- In 1995, the ceiling on stock investment by nonresidents was raised twice. The ceiling on aggregate purchases was raised to 12% in January, and to 15% in July.
- In 1996, the ceiling on aggregate purchases was increased to 18% in April, and to 20% in October. The ceiling on individual purchases was raised to 5%.
- In 1997, ceilings on foreign ownership of Korean equities were raised four times (May, November, and twice in December). In December, these ceilings were increased to 50% and to 55%.
- In May 1998, the aggregate ceiling on foreign direct investment in Korean equities was eliminated, and equity investment in non-listed companies was permitted.

Malaysia: Capital Account

•In 1973, no special exchange rate regime for capital account transactions existed. In May, the new exchange control regulations opened up opportunities for banks and corporations to expand considerably their foreign exchange operations. Borrowing by Malaysian residents from nonresidents required the approval of the Controller of the Foreign Exchange, which was freely given on all loans raised on reasonable terms and used to productive purposes in Malaysia.
•In June 1979, borrowing from nonresidents by banks and corporations was freely permitted, but only up to a certain limit.
•In January 1987, resident borrowers could borrow up to US$400,000 from nonresidents without obtaining any permission. Larger amounts required permission from the Controller of Foreign Exchange, which was freely given to finance productive activity in Malaysia.
•From January to August 1994, all residents were prohibited from selling short-term monetary instruments to nonresidents.
•In September 1998, exchange controls were introduced.

Malaysia: Domestic Financial Sector

- In October 1978, the liberalization of (deposit and lending) interest rates started.
- In October 1985, controls on deposit and lending rates were reimposed by restricting the competitive bidding up of interest rates among banks.
- In February 1991, those controls were completely eliminated.

Malaysia: Stock Markets

- In 1973, repatriation of capital and income was free. Since May, all payments for capital repatriation up to US$400,000 were freely approved by any commercial bank. Payments in excess of that amount required the approval of the Controller of Foreign Exchange, which was freely given under normal circumstances. In July 1973, the Malaysian stock exchange was established. In conformity with the liberalization of the Malaysian exchange control regulations, all nonresidents were permitted to trade freely in all shares listed, without any need for exchange control permission.
- In 1975, the general aim was that foreign investment would be allowed in the proportion of 30% of foreign equity and 70% of Malaysian equity. New import substitution projects had to have 100% Malaysian ownership. Industries exporting more than 80% of their production and using mainly imported materials could be considered for majority foreign ownership, ranging from 51% to 70%, but in exceptional cases, 100% foreign ownership could have been considered.
- In 1984, a relaxation of these regulations on foreign ownership was announced. Majority equity shares could be held by foreign firms engaged in capital-intensive and resource-oriented enterprises. In addition, the possibility of 100% foreign ownership, previously limited to export industries, was extended to other sectors.
- In 1988, foreign stock brokerage firms were allowed to increase their equity share in local brokerage firms from 30% to 49%.
- In 1992, the guidelines on foreign equity capital ownership were liberalized. Companies exporting at least 80% of their production were no longer subject to any equity requirements. Companies exporting between 50% and 79% of their production were permitted to hold 100% equity, provided that they had invested US$50 million or more in fixed assets or completed projects with at least 50% local value added, and that the company's products did not compete with those produced by domestic firms. These guidelines did not apply to sectors in which limits on foreign equity participation had been established.
- In August 1993, the minimum amount of equity that had to be held by an indigenous Malay group, company, or institution was lowered from 51% to 35%.
- In 1998, investors could not directly convert their short-term investment into foreign exchange. Proceeds from investments held for less than one year could be transferred only to Malaysian ringgit-denominated accounts, which could be used only to acquire other ringgit assets.
- In February 1999, the minimum holding period was eliminated and a graduated system of exit taxes was introduced: for investments made prior to February 1999, capital was taxed at 50% if repatriated less than seven months after entry, 20% if repatriated after seven months, and 10% if repatriated nine to twelve months after entry; capital repatriated after a year and the original capital of investments made after February were not taxed. However, repatriated gains for those investments were taxable as follows: capital gains repatriated within twelve months after the gain was realized were taxable at 30%, and those repatriated after more than twelve months were taxable at 10%.

Philippines: Capital Account

- In 1976, the central bank exempted Offshore Banking Units (OBUs, introduced in 1972) from reserve requirements, local taxes, and fees and permitted them to extend foreign currency loans to any enterprise from deposits raised outside the country.
- In 1979, regulations were introduced to gain control over short-term borrowing from OBUs.
- In 1983, foreign borrowing required prior approval from the central bank.
- In 1994, commercial banks were allowed to maintain open exchange positions, but subject to the limitation that long and short positions could not exceed 25% and 5%, respectively, of unimpaired capital.

Philippines: Domestic Financial Sector

- In 1981, the central bank deregulated all lending and deposit rates, except short-term lending rates. In July, ceilings on all deposit rates were lifted and in October, the ceilings on medium and long-term lending rates were also lifted.
- In December 1982, the ceiling on short term lending rates was eliminated.

Philippines: Stock Markets

- In May 1986, a country fund ("The Thornton Philippines Redevelopment Fund Limited") was introduced.

- In 1991, a new foreign investment law was promulgated. It expanded the number of sectors opened to full foreign ownership, simplified the approval process, and defined more clearly restrictions on foreign investment. However, the law required that Philippines nationals owned a minimum of 60% of the shares issued by domestic firms. To ensure compliance, Philippine companies typically issued two classes of stock (A-shares, to be held by Philippine nationals, and B-shares, which both foreign and national investors could buy). Foreign investors were allowed to invest in all sectors, except for those specified in a negative list. Also, full and immediate repatriation privileges for all types of investments were allowed to be serviced directly, without the approval of the central bank. Foreign investment regulations were removed over the following three years and most sectors of the economy became open to 100% foreign ownership.

Thailand: Capital Account

•In 1982, authorities set the maximum rate that foreign lenders could charge to Thai costumers in conformity to the domestic interest rate ceiling, which enabled borrowers to legally borrow from abroad at rates higher than the ceiling rate stipulated in the Civil and Commercial Code. A special exchange rate regime for current account transactions was introduced in 1983 and abolished in 1984.

•In 1992, loans from abroad could be contracted without restrictions, but if the loan was used domestically, resident borrowers were required to convert foreign currency obtained into bahts.

•In August 1995, asymmetric open position limits for short and long positions were introduced in order to discourage foreign borrowing. In December, a variety of measures aimed at reducing foreign-financed lending was introduced.

•In 1996, the remaining restrictions on credit to residents from nonresidents were eliminated.

•In May and June 1997, the central bank adopted some measures to limit capital flows.

•A two-tier exchange rate regime was introduced in July 1997 and abandoned in January 1998.

Thailand: Domestic Financial Sector

- In June 1989, the Bank of Thailand decided to eliminate the ceiling for time deposits with maturity of more than one year.
- In March 1990, interest rate ceilings on all types of deposits were eliminated.
- In June 1992, lending interest rates were liberalized.

Thailand: Stock Markets

- In 1988, repatriation of income and capital could be made freely. In January, a country fund ("The Siam Fund Limited") was introduced.
- In 1990, equity capital investments by nonresidents could be made freely. Foreign equity participation or joint ventures were freely permitted. Foreign investors could hold up to 100% of the equity of a firm, but provided that the firm exported all of its output. Certain economic activities were still reserved to Thai nationals. The Banking Law restricted foreign ownership in banks to 25%. The Alien Business Law restricted foreign ownership in specified sectors to 49%. In addition, other laws provided similar restrictions that ranged from 15% to 65%.

Taiwan: Capital Account

•In July 1987, foreign exchange controls were liberalized and foreign exchange market was opened. Exchange controls on current account transactions were completely abolished, and controls on capital account transactions were limited to transactions over US$5 million per year per person.

•Ceilings of banks' foreign liabilities were gradually raised during the late 1980s and 1990s.

•In October 1996, domestic corporations were allowed to freely borrow from overseas financial institutions and convert the foreign currency funds to New Taiwan dollars. In December, remaining restrictions on forward foreign exchange trade were removed.

•In 1997, capital account transactions for investment or trade purposes were completely free, but controls remained on capital transactions of a short-term nature. The amount that companies could freely inwardly or outwardly remit each year was raised from US$20 million to US$50 million. In May, restrictions on foreign liability limits of authorized foreign exchange banks were abolished.

Taiwan: Domestic Financial Sector

- In September 1984, the central bank allowed banks to set their prime rate based on their cost of funds.
- In 1986, the central bank approved a proposal from the Banker's association to enlarge the range between the maximum and minimum lending rates, allowing banks to enjoy a greater latitude in setting their own lending rates according to loan maturity and customer's credit worthiness.
- In July 1989, interest rate ceilings and floors were completely abolished.
- In November 1994, in order to further liberalize the deposit-taking business, banks were allowed to post interest rates specified for deposits in excess of 3 millions of New Taiwan dollars, and these rates could differ from those on deposits of less than 3 millions of New Taiwan dollars, even though the length of maturity could be the same.

Taiwan: Stock markets

- In May 1983, portfolio investment by foreign investors was permitted through the purchase of beneficiary certificates issued by a securities investment trust fund enterprise within the country and sold by agents outside the country. A preapproval procedure was required for issuing beneficiary certificates. Also in May 1983, the first country fund was established.
- In December 1986, regulations were relaxed, and foreigners were permitted to invest in stock markets via contracts with mutual funds.
- In 1987, outward remittances of capital were allowed freely up to US$5 million per year.
- In February 1995, the ceilings on the total amount of foreign investment in the local stock market were abolished. The new regulation required that each foreign investor held no more that 6% of the market capitalization of a listed company, and foreign investors as a group could not hold more than 12% of the market capitalization of a listed company. In August, the ratios were increased to 7.5% and 15%, respectively. Foreign direct investment by all foreign natural persons was permitted.
- In March 1996, the domestic securities market was further opened to nonresidents. Each offshore natural person and offshore juridical person could invest up to US$5 million and US$20 million in the market, respectively. The ceiling on total foreign direct investment in any listed corporation was raised in March and November to 15% of the outstanding shares. In December 1996, the ceilings on investments in the stock market by qualified foreign institutional investors was raised from US$400 millions to US$600 millions.
- In February 1997, domestic companies were allowed to issue stocks overseas, and foreign companies were allowed to list their stocks in the domestic market.
- In January 1998, ceilings on the proportions of a local companies' listed shares that could be held by an individual foreign investor and by foreign investors as a group were raised to 25%, and 30%, respectively. In April, the ratio was increased to 50%.

Latin American countries

- Chile
- Colombia
- Brazil
- Argentina
- Mexico
- Peru
- Venezuela

Chile: Capital Account

•In 1973, all new foreign borrowing or refinancing of existing credits by commercial banks, except for short-term lines of credit, were subject to prior approval of the central bank. Corporations were allowed to borrow abroad, but were subject to some exchange rate regulations.
•In 1977, the special exchange rate regime for capital account transactions was abolished.
•In January 1978, a limit on external indebtedness of commercial banks to relend in local currency (25% of capital and reserves of each bank) was imposed.
•In 1979, non-interest bearing deposit requirements on foreign borrowing were introduced: 25% for maturities less than three years, 15% for maturities between three and four years, and 10% for maturities between four and five years. In June, the pre-existing limit on external indebtedness of commercial banks was eliminated.
•In 1982, most capital outflows were restricted, and a special exchange rate regime for capital account transactions was introduced. In May, authorities imposed a 20% reserve requirement on foreign borrowing with maturity of less than 24 months. In July, authorities reduced to 5% the reserve requirement on foreign borrowing with maturity of less than six years.
•In September 1985, commercial banks were allowed to borrow abroad without any restrictions or prior authorization.
•In April 1990, new regulations liberalizing foreign exchange market operations were introduced. Previously, those operations were prohibited unless under central bank's specific authorization. By then, all transactions were permitted unless specifically restricted by the central bank.
•In June 1991, a non-remunerated reserve requirement of 20% was imposed on direct foreign borrowing for the first twelve months.
•In May 1992, reserve requirements were raised to 30%.
•In September 1998, reserve requirements on capital inflows were eliminated.

Chile: Domestic Financial Sector

- Liberalization of lending and deposit rates started in 1974 and was completed by May 1975. Also in 1974, selective credits to priority sectors were mostly eliminated.
- In 1976, quantitative credit controls were abolished.
- In December 1982, commercial banks' interest rates controls were re-imposed (deposit and lending rates).
- In 1984, deposit rates were mainly liberalized, but the indicative interest rate for 30-day deposits was still in place. In 1985, loan rates were liberalized.
- In 1987, the central bank eliminated its practice of announcing indicative interest rate for 30-day bank deposits.

Chile: Stock Market

- In 1987, Law 18,657 permitted foreign capital investment funds to purchase shares issued by Chilean corporations and other securities approved by the securities commission, provided that such funds met certain portfolio diversification requirements and had certain minimum paid-up capital levels. Aggregate foreign ownership was limited to 25% of shares of a listed company.
- In May 1987, a country mutual fund was introduced.
- In 1992, Chilean enterprises were authorized to issue ADRs. In January, regulation DL600 eased restrictions on foreign investment and repatriation of capital to a minimum holding period of one year.
- In August 1995, authorities allowed capital to be repatriated after one year.

Colombia: Capital Account

•In January 1991, under the "Apertura" program, authorities unified the exchange rate and controls on borrowing abroad were relaxed. Authorities maintained some controls on the capital account to reduce the volatility of capital flows, in particular those of short-run nature.
•In February 1992, residents were allowed to hold foreign stocks and other foreign portfolio investments abroad up to US$500,000.
•In September 1993, authorities imposed a non-remunerated 47% deposit requirement on most foreign borrowing.
•In 1994, foreign loans with maturity ranging from thirty days to five years were subject to a non-remunerated deposit requirement ranging from 43% to 140% of the loan.
•In 1996, reserve requirements of 50% were imposed on all foreign credits with a maturity of less than five years.
•Since May 1997, foreign loans (all maturities) were subject to non-remunerated deposits requirements of 30% of the loan in pesos to be held for eighteen months.
•In January 1998, foreign loan non-remunerated deposit requirements were reduced to 25% of the loan in domestic currency, and the period was shortened to twelve months. In September, foreign loan non-remunerated deposit requirements were further reduced to 10% of the loan in domestic currency, and the period was shortened to six months.

Colombia: Domestic Financial Sector

- A gradual liberalization was implemented between 1967-1972, but some controls remained, like ceilings on deposit rates.
- In August 1974, interest rates on loans were liberalized and ceilings on deposit rates were substantially raised. Policies attempting to control the amounts and types of loans were abandoned. Also, the financing of preferential sectors from the central bank was reduced.
- After September 1980, most deposit interest rates were freely determined.
- In 1982, credit controls were greatly, but not completely, eliminated.
- In May 1984, the central bank increased from 8% to 15% the interest rate paid on the agricultural bonds, which were held by banks as a forced investment equivalent to 16.5% of their loan portfolio.
- From January to June 1986, authorities introduced a temporary (deposit and lending) interest rate control.
- In 1990, all deposits rates at commercial banks were market determined.
- In 1994, directed and forced lending to agricultural sector was reduced.

Colombia: Stock Markets

- In January 1991, a new foreign investment code, Resolution 49, came into effect, which gave foreigners the same rights as domestic investors. Foreign investors could not repatriate their capital within one year of registration, but were free to do so thereafter. In October, limitations on annual transfers of profits were abolished. Capital had to be registered with the central bank before profits could be repatriated.
- In December, Resolution 52, which allowed foreigners to purchase up to 100% of locally listed companies, came into effect. Special regimes remained in effect in the financial, petroleum, and mining sectors. The purchase of a 10% or more of the shares of a Colombian financial institution required prior approval by the Superintendence of Banks.

Brazil: Capital Account

•In 1990, certain financial institutions were authorized to obtain resources from abroad through the issuance of commercial papers. Brazilian banks located abroad were authorized to issue medium- and long-term certificates of deposits. Borrowing abroad by corporations had a minimum maturity term of one year. In March, the government introduced a foreign exchange interbank market for transactions related to capital repatriation and profit and dividend remittances.

•In May 1992, authorities banned the issuance of international bonds with maturity less than three years. In June, foreign investors represented by funds and institutional investors were authorized to operate in options and futures markets.

•In January 1994, the automatic authorization of foreign loans was suspended. Renewal or extensions of previous loans were also subject to a minimum term of 36 or 96 months, which prevailed for new loans. In March, automatic authorization for issuing bonds, commercial paper, and other fixed-income instruments abroad was terminated. Also in March, the government introduced new restrictions on the constitution and operation of foreign institutional investors. In October, the financial transaction tax on foreign borrowing was increased from 3% to 7%.

•In March 1995, financial and non-financial institutions were authorized to obtain resources from abroad by issuing commercial papers, notes, and bonds, including securities. Also in March, the minimum period for new foreign loans was lowered from 36 to 24 months.

•In February 1996, another package of measures aimed at restricting short-term capital inflows was enacted. The minimum average term for contracting, renewing, or extending foreign loans was increased from 24 to 36 months. Banks were permitted to buy and sell foreign exchange in the forward market without restrictions.

•In 1997, the minimum average term for borrowing abroad was decreased from three to one year for new loans, and to six months for renewals or extensions. In April, the "entrance" tax was reduced to 2%.

•In 1998, the special exchange rate regime for capital account transactions was abolished.

Brazil: Domestic Financial Sector

- In 1976, ceilings on deposit and lending rates were removed.
- In 1979, those ceilings were re-imposed.
- In 1988, some loan rates were liberalized.
- In 1989, deposits rates were liberalized.

Brazil: Stock Market

- In 1973, persons domiciled or residents abroad could purchase Brazilian commercial and industrial securities, provided that transactions were channeled through a Brazilian investment company and were effected in Brazilian stock exchanges. Capital was subject to registration in the central bank and had to remain in the country for at least three years. Remittances of profits and dividends were subject to certain limitations.
- In 1979, the minimum holding period for capital repatriation was reduced from three to two years.
- In 1983, it was reduced again, from two years to three months.
- In 1987, foreign portfolio investment could not exceed 5% of the voting capital and 20% of the total capital of a company. New legislation gave foreign investors exemption from domestic income tax on capital gains.
- In July 1989, remittances abroad of profits and dividends were allowed after sixty days.
- In June 1990, the government announced a gradual liberalization of capital repatriation that was completed in the following year (1991).
- In June 1991, the Foreign Investment Law was changed. Until that month, foreign portfolio investors could invest in Brazil only through country funds. By then, foreign investors were allowed to set up omnibus accounts which were essentially portfolios of one or more shares held in local custody. Besides, foreign ownership levels were increased. Foreign institutions could own up to 49% of voting common stock and 100% of non-voting participating preferred stock. Some corporate limitations applied (e.g. Petrobras common stocks was off limits), and the voting class (ON) of banks were not available.

Argentina: Capital Account

•In July 1980, the authorities eliminated the 1-year minimum maturity requirement for foreign loans.
•In June 1981, a dual foreign exchange market was introduced. In December, the administration that came into power returned to a more liberal exchange system, unifying the exchange markets, eliminating the exchange insurance and swap facilities, liberalizing sales of foreign currency, and announcing that the peso would be allowed to float.
•In April 1982, all amortization payments on loans other than import-related loans were made subject to prior approval of the central bank.
•In November 1989, a free exchange rate was introduced. In December, proceeds from all loans had to be transacted in the free exchange market. There were no conditions on maturity, dates, or interest rates.
•In 1990, the special exchange rate regime for capital account transactions was abolished.

Argentina: Domestic Financial Sector

- In January 1977, credit controls were abolished. Also in 1977, ceilings on domestic (lending and deposit) interest rates were eliminated.
- In July 1982, new economic authorities introduced a financial reform, setting interest rates at sharply negative real terms. Credit controls were reimposed in a large scale basis.
- In October 1987, most domestic interest rate regulations were eliminated.
- Domestic interest rate deregulation was completed by the end of 1989.
- In 1990, the process of reform of the banking sector continued.
- Remaining controls on credit at the national level were progressively eliminated until 1994.

Argentina: Stock Markets

- In January 1977, a new Foreign Investment Law eased previous restrictions on foreign direct investment, provided the right of foreign investors to repatriate capital after three years and repatriate their profits and dividends without any central bank prior approval.
- Foreign investment regulations were further liberalized in 1980. Prior approval was no longer required for investment in any of the country's stock markets, provided that the amount did not exceed 20% of the capital of the company involved.
- In April 1982, the right to freely transfer profits and dividends abroad was "temporarily" suspended.
- In 1989, the Economic Emergency Law further liberalized foreign investment in the stock exchange. Repatriation of capital, profits, and dividends was fully liberalized in that year.

Mexico: Capital Account

•In 1973, private corporations and private banks were allowed to borrow abroad, but subject to the approval of the central bank. There was no special exchange rate regime for capital account transactions.
•In August 1982, commercial banks were required to surrender to the Bank of Mexico their net foreign exchange holdings, including gold and silver. In September, an exchange control was introduced with a preferential exchange rate to be used to make interest payments on foreign credit.
•In November 1991, the special exchange rate regime for capital account transactions was abolished, and the central bank abolished the restriction on bank loans obtained from foreign financial institutions to be channeled through the controlled exchange market.

Mexico: Domestic Financial Sector

- In 1974, authorities allowed banks to issue certificate of deposits at free interest rates.
- In August 1979, a new system to increase flexibility on deposit interest rates was introduced. By then, the maximum rates were frequently adjusted by the central bank.
- In September 1982, the Mexican president nationalized the banking system.
- In October 1988, some interest rate controls were lifted, and liberalization of deposit interest rates started.
- In April 1989, interest rate ceilings were abolished. Banks were authorized to pay interest on checking accounts.

Mexico: Stock Markets

- In 1989, restrictions on foreign capital participation were substantially liberalized. Foreign investments were permitted in the Mexican Stock Market through specially designed trust funds and "B" shares of Mexican corporations. However, participation was not allowed in the administration of the companies involved. Foreign investors could hold majority of shares in new firms, as long as the new investment met a list of conditions.

- In 1991, restrictions on repatriation of capital and income were abolished, and restrictions on portfolio investment were lifted. However, there were sectors that remained reserved to Mexicans or to Mexican corporations with a foreign exclusion clause. There were also caps to foreign participation in some sectors, and foreign investment in others required prior authorization.

Peru: Capital Account

•In 1973, a special exchange rate regime for capital account transactions existed. Borrowing abroad by corporations was permitted, but under some restrictions.
•In 1974, the central bank eliminated the regulation restricting the net foreign exchange position of commercial banks.
•In 1987, controls were imposed, commercial banks were nationalized, and borrowing abroad by banks was substantially limited. A cash deposit requirement was re-imposed.
•In December 1990, restrictions were relaxed, capital controls were removed, and the special exchange rate regime for capital account transactions was abolished.
•In 1991, borrowing abroad was substantially deregulated, and
•in 1992, restrictions on borrowing abroad were lifted.

Peru: Domestic Financial Sector

- In 1973, there were no interest rate ceilings for deposit and lending rates, but some preferential lending rates existed.
- In 1982, binding interest rate ceilings were put in place.
- In 1991, controls on lending interest rates were abolished.
- In March 1992, interest rates for foreign exchange deposits were freed.

Peru: Stock Markets

- In 1991, repatriation of capital, income, and dividends were liberalized.
- In 1992, under the Private Sector Guarantee Regime, foreign investors were guaranteed non-discriminatory treatment. The stock market was 100% opened except for banks, which had a foreign portfolio investment limit of 15% of total shares outstanding.
- In 1993, shares of banks, insurance companies, and pension fund management companies became freely available.

Venezuela: Capital Account

- In 1973, all capital transfers were permitted freely. Banks and corporations were allowed to borrow abroad without any restrictions.
- In February 1983, authorities announced that authorized private debt could be paid at the preferential rate and a dual exchange rate regime was introduced. All foreign credit had to be registered.
- In March 1989, the system of multiple exchange rate was abolished, and virtually all forms of exchange controls were eliminated.
- In 1994, the foreign exchange market was closed, and a comprehensive system of exchange controls covering all current and capital account transactions was introduced.
- In April 1996, exchange controls were abolished.

Venezuela: Domestic Financial Sector

- In August 1981, the government largely freed interest rates. The discretional control of interest rates by the central bank was replaced by a system of freely floating interest rates.
- In February 1984, interest rate controls were re-established. A mixed regime was introduced: the central bank imposed a maximum for lending rates, but banks were allowed to freely determine deposits rates. In June, the central bank decided to introduce a minimum for deposit rates.
- In 1989, legal restrictions on deposit and lending rates were mostly eliminated.
- In 1991, interest rate ceilings were completely removed.
- In September 1994, the central bank established a 25% financial margin with respect to the interest rate of its short term liabilities (plus 15% for the maximum lending rate, and minus 10% for the minimum deposit rate).
- In June 1995, a new measure for fixing money market interest rates was established as a band, where maximum asset rate was established at 46% and a minimum liability rate at 24%.
- In April 1996, the maximum lending rate and minimum deposit rate were removed.

Venezuela: Stock Markets

- In 1973, capital transfers were permitted freely.
- In 1977, ceilings on transfers of profits and dividends were increased to 20%. National enterprises were permitted to increase foreign participation from 20% to 49%. Sectoral limits remained in place.
- In 1987, no capital repatriation was allowed for a period of five years, and in the following eight years, repatriation was limited to a maximum annual rate of 12.5%.
- In 1989, capital repatriation became freely permitted.
- In 1990, profits could be freely repatriated, and controls on foreign participation in non-financial companies were completely abolished.
- In 1994, the government fixed the exchange rate and effectively prohibited the repatriation of capital and income.
- In 1995, the government approved the trading of Venezuelan Brady bonds at the stock market, creating a de facto currency convertibility for the repatriation of capital and income.

Note: The country data and document are from Graciela L. Kaminsky and Sergio L. Schmukler June 2003

China

- **The reform and opening policy in financial sector started from the end of 1978**
- **From 1978 to 1984, to set up a two tier banking system:**
  - **In 1978, PBOC was separated from MOF and become the central bank**
  - **From 1978 to 1984, four state owned banks (with their own business field) were established by the government**
  - **In 1979, the first Trust and Investment company was set up and banks began to develop trust and investment business**
  - **In 1980, urban and rural credit union were introduced**
  - **In 1983, the first insurance company was separated from PBOC**

China (cont')

- **From 1985 to 1988, competition was introduced into financial sector:**
  - **In 1985, business barriers between four big banks were broken**
  - **From 1986, new banks with investment other than the government were set up**
  - **In 1986, an interbank borrowing and lending market was introduced, also from that year, some big cities started to setup trade centers for the trade of treasury bills and other securities**
  - **In 1986, the duel FX rate system was abolished, a new FX retention system was introduced, a FX swap center was setup**

China (cont')

- **From 1988 to 1991, development of the stock market:**
  - **In December 1990, the first nation wide stock exchange was setup in Shanghai**
  - **In January 1991, Shenzhen setup the second stock exchange**

- **From 1992 to present, the rapid development in financial sector:**
  - **From 1992, more and more new banks were setup and foreign banks began to enter into Chinese market, different types of non bank financial institutions were introduced into market also in that year**
  - **In 1992, CSRC was separated from PBOC**
  - **In 1994, three policy banks were established, the FX control system and the FX rate system was reformed also in that year**
  - **In 1995, both central bank law and commercial bank law were promulgated by government**
  - **In 1998, CIRC was setup**
  - **In 2003, CBRC was setup**
  - **From 2004, the four state owned banks started their restructuring**
  - **In 2006, the financial service industry will full open to foreign investors**

Topic Three

The effect of FL

The effect of FL

- According to Carmen M. Reinhart and Ioannis Tokatlidis (2001), from the data of 50 countries (including 14 developed and 36 developing countries) of 1970-1998 period, there are two types of effect:
  - The effect of domestic financial liberalization (DFL) and
  - The effect of external financial liberalization (EFL, mainly the opening of capital and financial account)

The Effect of DFL

- Gross Savings (GS): a decrease in GS for most of mature market and Latin American market, but a significant increase for most of Asia and middle east countries, non change for African countries
- Domestic GS: a significant decrease in DGS for most of mature, Latin American and African countries, but an increase for most of Asia and middle east countries
- Domestic Gross Investment (DGI): a significant decrease in DGI for most of mature, Latin American and African countries, also a decrease for most of middle east countries, but an increase for most of Asia countries
- Current Account (CA): almost every country saw the improvement of its CA except for the Latin American countries
- Private Capital Flow (PCF): a significant increase in size of PCF for most of mature, Asia, and Latin American countries, but a significant decrease for most of African countries, non change for the middle east countries; most of the high and medium income country can see a significant increase in size of PCF, but most of most of low income countries saw a significant decrease

The Effect of DFL (cont')

- FDI: a significant increase in size of FDI for most of mature, Asia, and Latin American countries
- GDP Growth Rate: most of mature and Asia countries can see a significant decrease in GDP growth rate, as well as the African and middle east countries, only Latin American countries can see an increase in GDP growth; almost every medium and low income country can see a decrease in GDP growth
- Consumption/GDP: an increase in mature, African and Latin American, but a decrease for Asia and Middle East
- Real Interest Rate (RIR): a significant increase in RIR for mature, African and Latin American countries, but a slightly decrease for Asia and Middle East
- M1/M2: a decrease for every county
- M2/GDP: almost every country saw a significant increase except for the African countries who had few change
- Private Credit/GDP: almost every county saw a significant increase

The Effect of EFL

- Gross Savings (GS): a decrease in GS for most of mature market and Latin American market, but a significant increase for most of Asia, African and middle east countries
- Domestic GS: a significant decrease in DGS for most of mature and Latin American countries, but an increase for most of Asia counties, African and middle east countries saw no changes
- Domestic Gross Investment (DGI): a significant decrease in DGI for most of mature and Latin American countries, also a decrease for most of African and middle east countries, only Asia countries saw an increase
- Current Account (CA): African and middle east countries saw the significant improvement of its CA, but Latin American and most of medium income countries saw a deterioration of its CA
- Private Capital Flow (PCF): a significant increase in size of PCF for most of mature and Asia countries, but a significant decrease for most of African countries, only a slightly decrease for Latin American, non change for the middle east countries; most of the high and medium income country can see a significant increase in size of PCF, but most of low income countries saw a significant decrease

The Effect of EFL (cont')

- FDI: a significant increase in size of FDI for most of mature and emerging countries
- GDP Growth Rate: most of mature countries can see a significant decrease in GDP growth rate, non change for other countries
- Consumption/GDP: similar to savings, an increase in mature and Latin American, but a decrease for Asia, non change for African and Middle East
- Real Interest Rate (RIR): a significant increase in RIR for mature, Latin American and African countries, only a slightly decrease for Asia, few change for Middle East
- M1/M2: a decrease for every county
- M2/GDP: almost every country saw a significant increase except for the African countries who had few change; in terms of income, almost every country saw a significant increase except for low income countries who had few change
- Private Credit/GDP: almost every county saw a significant increase except for low income countries who had few change

Conclusion

- FL may cause:
  - high interest rate
  - high level of FDI
  - more capital flow
  - credit supply and
  - A possible increase in economic growth

Conclusion (cont')

- But FL may also cause:
  - More fragility in economy
  - More risk accumulation
  - More chance for an outside shock/attack and
  - A possible crisis

Topic Four

Some lessons from FL

- There is no guarantee for the success of FL, but some key issues should be considered, they are:
- A stable macro-economy as base for FL
- Pricing mechanism reform/flexible pricing
- Enhanced law and enforcement
- Good governance in financial sector
- Gradually withdrawal of government regulation and intervention