

## FINANCIAL LIBERALIZATION IN OECD COUNTRIES – THE IMF FINANCIAL REFORM INDEX

Most industrialized countries have embarked on measures to liberalize finance over the last decades, and a growing number of developing countries are currently moving along that course. Reforming financial markets and making them more accessible for investors has become apparent as numerous studies have found evidence that greater financial sector development has a positive impact on key macro-economic variables such as growth, productivity and poverty (Bekaert et al. 2001). However, in the wake of the current financial crisis, financial reform also means regulatory reform. Therefore designing new rules and institutions to reduce systemic risks without stifling economic growth is a top priority.

In a new database Abiad et al. (2008) collected data on financial reforms, covering 91 economies over the period 1973–2005, with a main focus on financial liberalization. Although the database is based on precise regulatory settings, analyzing liberalization indexes can provide useful insights in the context of ongoing financial regulatory reform. The database provides a multifaceted measure of financial liberalization that covers seven financial reform dimensions:

- credit controls and excessively high reserve requirements,
- interest rate controls,
- entry barriers,
- state ownership in the banking sector,
- capital account restrictions,
- prudential regulations and supervision of the banking sector, and
- securities market reforms.

Along each dimension, a country is given a final score on a graded scale from 0 to 3, with 0 corresponding to the highest degree of repression and 3 indicating full liberalization.

In their paper Abiad et al. (2008) mention that liberalization tends to occur simultaneously in all seven categories, but that some are much more highly correlated than others. Among the highest correlations are those between interest rate and credit control, between securities markets reforms and capital account restrictions, and between interest rate controls and capital account restrictions.

Going from single categories to the overall IMF index of financial liberalization for each economy, all seven dimensions are aggregated. Thereby the authors use the sum of the individual components, whereas, as each of the seven indicators can take on values between 0 and 3, the totals range within 0 for full repression and 21 for full liberalization. The following Table shows the outcomes of the financial liberalization index normalized to range between 0 and 1.

First of all, the Table shows that all OECD economies included managed to increase their financial liberalization since 1973. Average outcomes during the period 1995–2000 range from 0.67 for Turkey to 1.00 for Ireland and Canada. During 2001–2005 all selected OECD countries in the Table increased their financial liberalization up to an average outcome score of above 0.80. Interestingly, looking at past outcome averages, most of the reform efforts were undertaken between 1973–1989 and 1990–1994. During this period the liberalization index indicates the strongest changes for the majority of countries shown here. Regarding the subsequent periods 1990–1994 and 1995–2000, a significantly smaller number of the here selected OECD countries made strong reform efforts.

**Table**

**The IMF Financial Reform Index, 1973–2005**

	1973–1989	1990–1994	1995–2000	2001–2005
Austria	0.31	0.59	0.81	0.91
Belgium	0.52	0.84	0.94	0.97
Czech Republic	n.a.	0.45	0.74	0.92
Denmark	0.48	0.92	0.96	1.00
Finland	0.46	0.76	0.81	0.81
France	0.42	0.87	0.98	1.00
Germany	0.73	0.85	0.90	0.90
Greece	0.21	0.55	0.80	0.84
Hungary	n.a.	0.44	0.83	0.96
Ireland	0.61	0.92	1.00	1.00
Italy	0.34	0.64	0.88	0.91
Netherlands	0.76	0.93	0.95	0.99
Poland	n.a.	0.43	0.75	0.85
Portugal	0.19	0.67	0.79	0.83
Spain	0.50	0.83	0.98	1.00
Sweden	0.49	0.93	0.95	0.95
United Kingdom	0.70	0.95	0.98	1.00
Norway	0.46	0.77	0.85	0.87
Switzerland	0.84	0.87	0.92	0.95
Turkey	0.19	0.59	0.67	0.74
Australia	0.31	0.80	0.98	1.00
Canada	0.71	0.92	1.00	1.00
Japan	0.44	0.72	0.83	0.86
New Zealand	0.46	0.93	0.95	0.95
United States	0.75	0.90	0.96	1.00

Notes: n.a. = not available. The numbers are period averages. Financial liberalization outcomes range from 0 and 1, with 1 resembling full liberalization.

Source: Abiad et al. (2008).

The exceptions were Hungary and Poland. Fewer, but still considerable, liberalization efforts were undertaken by Austria, the Czech Republic, Greece and Italy during the same periods. Post 2000, significant increases in financial liberalization were observed only for Austria, the Czech Republic, Greece and Poland, and also to some extent for Turkey. Most of the other countries remained at their relatively high post-1994 liberalization level.

T. S.

### **References**

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Bekaert, G., C. R. Harvey and C. Lundblad (2001), "Does Financial Liberalization Spur Growth?", *NBER Working Paper* no. 8245.