Capital Account Liberalization, Capital Flows and Exchange Rates in Sub-Saharan Africa

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Abstract

Capital account liberalization (CAL) is the removal of restrictions on capital accounts to allow for the free movement of capital across countries. It has been suggested that CAL can lead to exchange rate appreciation by promoting an influx of capital flows. Evidence of this remains wanting, however, as few studies have been conducted with little consensus obtained. This paper, therefore, aimed at investigating this conjecture in sub-Saharan Africa (SSA) for the period between 1996 and 2013. System-GMM estimation techniques are employed from which we find that CAL leads to an exchange rate appreciation in SSA. However, higher levels of financial sector development (FSD) help to attenuate the appreciation effects. Individual country analyses for South Africa and Nigeria are also performed using Autoregressive Distributed Lag models. From this, we find that CAL causes an appreciation of exchange rates, only in the short run. The study makes contributions to the body of knowledge by including interactive terms for CAL and FSD thus unearthing the non-linear dynamics in the CAL-exchange rate nexus in SSA. In doing so, this also controls some heterogeneous characteristics in the sample. Lastly, the study employs a new measure of CAL which, not only builds upon past measures and improves on them, but also disaggregates CAL based on several criteria such as asset type, the direction of liberalization, and whether liberalization is on residents or non-residents.

Keywords: capital account liberalization, exchange rates, sub-Saharan Africa

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