Finance repression and liberalization.

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Question number 3: Financial repression and financial liberalization.

Financial repression:

Financial repression is a concept that refers to the nation that a federal government regulation, laws prevents the various financial intermediaries of an economy to function at their full capacity (Ban, and Bohle, 2021). In fact, it is a revolving series of polices in which the federal government takes the wealth from the private sector insidiously and make it easier for them to finance its debts. However, this term is not new; it uses dates back in the year 1973 when economist from Stanford University Edward Shaw and Ronald McKinnon used this word in their publications. Initially, the term ‘financially repression’ was used to criticize various policies made by government to reduce economic growth in underdeveloped countries. In modern financial repression concept, it includes:

1. Zero policy rate, where the central bank of country keep their lending rate to almost zero. This results a lower interest rate on government.
2. Quantitative easing is a policy framed by central bank to buy government debts from banks. This increased demand can certainly increase the government bond’s prices and declines the interest rate on that bond.

Financial repression has three main components, firstly, the banking system of certain country forces to hold the bonds of government by imposing high reserve as well as the liquidity ratio parameters (Jafarov, Maino, and Pani, 2019). This opens a gate for government to finance budget deficits at almost zero cost. Secondly, the government revenue cannot be obtained easily from private sectors, so the development of private bond as well as equity markets has been discouraged. Thirdly, the banking system is known for its interest rate in order to prevent the competition with public funds rising from the private sector and to evolve low cost investment. Various economist claims that financial repression works opposite to efficiency capital allocation and stops economic growth.

Financial liberalization:

The concept of financial liberalization comes from the McKinnon and Shaw in 1973, who contributed to the economic developments to financial liberalization in developing countries. According to them, financial liberalization is utmost important for generating high savings rate and investment (Yang, *et al.,* 2019). Shaw further states that gradual growth in financial institution offers the investors with a key incentives to borrow and eventually save, this enable them to collect more equity whilst lowering the borrowing cost. Gibson also opined in this context that financial liberalization is essential ingredient for financial markets so that they can operate efficiently and it also offers new opportunities to finance in the existing economy.

In other words, financial liberalization is the deregulation of the national financial market and capital accounts are being liberalized that implies eradicating the interest rates ceilings. For instance, the growth process in financial markets increases the activities that make the development and introduction of various financial institutions. It has been argued in literature that the financial institution, by accumulating and analyzing the information from borrowers ensures the funds allocation for investment plans in order to become more efficient and henceforth encouraging growth and investment.

According to Roy and Kemme, (2020) there are three types of financial liberalization, firstly, liberalization term can be used to express the various financial sector reforms such as privatization, etc. secondly, the financial liberalization can be used to indicate the stock market liberalization. In this regard, stock market liberalization prevails when the nation open up their stock markets to the foreign investors whilst allowing the national company to access to international financial markets. Lastly, financial liberalization also refers to the capital account liberalization. This is a circumstance where the exchange rates for the transactions like capital account are relaxed and the domestic companies are allowed to borrow funds from foreign countries.

Difference between financial repression and financial liberalization:

Financial liberalization refers to a key strategy adopted that directly impacts the economic growth and development mainly during a financial crisis and capital market development. On the other hand, financial repression hinders the economic growth because the government indirectly forces private firms to pay off their debts. In fact, through financial repression government steals the economic growth with vague tools such as zero interest rate and also the inflationary policies etc to knock down their own debts. So, it can be considered that financial repression has negative impact upon the economic growth of nation, while financial liberalization leads to a faster economic growth. For example, UK has witnessed a positive growth rates by 5.5% since the inception of financial liberalization. According to De, Pleninger, and Sturm, (2018) the increased regulation of the financial sector in the UK has brought financial stability on the economy. The financial crisis have compelled the UK government to review a fiscal policy and monetary policies, such as rate of interest of Bank of England was cut among others, is a best example how the UK has took advantage of liberalization. Feijo, Lamônica, and Lima, (2019) sets out a different effect of liberalization in the UK, such it has affected the economic levels indicating a positive of the GDP in the short run.

Another major difference between financial liberalization and financial repression is its policies to enter the domestic markets. The liberalization process allows the foreign banks to enter the domestic markets of a developing countries by developing branches, subsidiaries and acquiring banks of host country, but financial repression restricts the financial institution to enter into a potential markets so that the government can form a monopoly for the domestic banks. Furthermore, financial repression leads to the inefficient capital allocation, higher cost for financial intermediation and a lower rate of returns (Davis, Stewart, and Knaack, 2021). For example, financial repression in India has been negative and substantial. From the 1970s, the government of India has imposed the financial repression by imposing conditions for banking system known as Statutory Liquidity Ratio (ANGADI, 2020). As per the condition, the banks of India have to ensure a given percentage of its Net Demand and Time Liabilities. The government intends that private firms to invest their money in government's bonds.

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