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THE IMPACT OF FINANCIAL SECTOR LIBERALIZATION ON FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH IN KENYA

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ABSTRACT

Financial sector liberalization is the removal of controls to allow market determined interest rates and/or to allow competition (Jorge and Zhaohuri - 2000). This study analyzed the impact of financial liberalization on the finance – growth nexus in Kenya by comparing a list of selected indicators of financial development using data covering pre - reform and post - reform periods. The study employed a time series analysis to evaluate the impact of financial liberalization in the finance – growth nexus. An Interactive econometric analysis on the data collected was done using Microfit 4.0.

The empirical results suggest that there is a significant relationship between the size of financial services sector and economic growth. There is a significant relationship between the ratio of Liquid Liabilities to GDP, ratio of Investment to GDP, ratio of Private Credit to GDP and Government consumption as a ratio of GDP with economic growth. This implies that the comprehensive measure of the size of the financial sector exerts a positive and statistically significant effect on economic growth. However, financial liberalization has been found to have insignificant impact on financial development. These results shed light to policy makers with regard to suitable policy directions; that is, if the lending sub-sector is to play a role as a measure of financial development thus be relied upon for economic growth, policy makers need to pay greater attention on the functioning of the financial system and target the enabling financial intermediaries to deliver their services in the most effective and cost minimizing manner.