

Globalisation and Financial Development in Sub-Saharan Africa (SSA) 1980-2005

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ABSTRACT

This paper empirically investigates the impact of globalization on financial development in SSA for the period of 1980-2005 in a dynamic panel data framework that uses Arellano and Bond GMM estimation. The study finds minimal empirical evidence for the impact of globalization on the financial development in the region. To confirm the robustness of our study, we conduct panel cointegration test to confirm whether globalization has any long-run impact on financial development in particular and economic growth in general in these countries. We equally conduct a sensitivity analysis, by analysing financial development in the presence of human capital accumulation, political stability and institutional quality in the region. In, all we find limited empirical support for the impact of globalization on the financial development in SSA, the study concludes that minimum threshold of institutional quality, infrastructure and human capital development are necessary in order to reap the benefit of globalization.

JEL CLASSIFICATION: G21, G15, 016 and 055

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Introduction:

Globalisation as popular as it is, has no universally acceptable definition; however it is a phenomenon that is not only changing the world economy but its polity as well.

The last two decades have witnessed unprecedented changes in the world economy, with increases in the direction and volumes of trade and commercial transaction.

This change has been caused by “globalization”. Kobrin, (2005), argues that globalization implies deep integration and interconnectedness, networks of relationships between a large number of heterogeneous social, cultural, political, and economic organizations. Globalization refers to “ the growing economic interdependence of countries worldwide through the increasing volume and variety of cross-border transactions in goods and services and of international capital flows and also through the more rapid and widespread diffusion of technology” (IMF 1997)

Globalization offers numerous benefits, poses potent risks and throws daunting challenges. Globalisation is conceptually defined in this paper as the degree of openness of an economy to the rest of the world and measured as trade and financial openness.

The waves of globalisation through technological advances and ease in transportation and communication have transformed the financial sectors in many economies by quickening financial innovation, transmission of information and reduction of transaction cost. This trend is further strengthened by a gradual shift of policy paradigm from Keynesian government –led system to a classical laissez faire or market-led system with strong emphasis on liberalisation and openness.

UNDP (1997) in its reports observes that globalization encompasses both a description and a prescription. Description in terms of widening of the global market and prescription in terms of policy shift to market based or liberalization.

Most Sub-Saharan Africa (SSA) economies embraced this new trend with the theoretical expectation that globalisation would enhance the growth of their respective

economies. However the empirical evidence has been mixed. Sachs and Warner (1997) observe that openness increases growth rate and leads to convergence, while Balamoune (2002) argues that openness has only led to divergence in African countries and UNDP (1999) concludes that globalization is an uneven process with unequal distribution of benefits.

Globalization affects domestic financial markets and enhances financial development by increasing access to capital and lowering cost of capital for productive investments. Mishikin (2007) also highlights the indirect effect of globalization on financial development, which includes promotion of reforms and healthy competition, evolution of best practises in the industry, and enhancement of manpower development (See also Kose et al 2006).

The role of financial development as a catalyst for economic growth has been well-documented in the literature and other empirical works, notably among them include, Schumpeter (1911), Gurley and Shaw (1955), Goldsmith (1969), Mckinnon(1973), Shaw (1973) Levine (2003), Demetriades and Andrianova (2004), among many others. However, one of the causes of uneven financial development among countries in the literature is the differences in level and degree of openness of economies.

Rajan and Zingales (RZ) (2003) argue that the more opened an economy is, the more financially developed it would be, and more growth in the overall economy.

Financial incumbents stand to lose from financial development in an open economy, because openness breeds competition which erodes their rents (Baltagi et al 2007).

Empirical works that analysed the effect of financial openness on economies started with the works of Grilli and Milesi-Ferretti (1995), hereinafter used as G-M(1995)

Quinn (1997) and Rodrik (1998). G-M using overlapping generations' model and panel data estimation for 61 countries during the period (1966-1989), find no evidence of positive and robust correlation between financial openness and economic growth. However, Quinn (1997) examines the effects of international financial liberalization on economic growth and income distribution by using cross-section regression frame work for 64 countries. His results show that financial openness is strongly and robustly correlated with long-run economic growth for the period 1960-1989.

Edison et al (2002) examines the impact of international financial integration on economic growth for the period 1980-2000 using a sample of 57 countries in a dynamic panel data framework, they could not establish any robust link between openness and economic growth.

Kose et al (2006) examines the effects of financial openness on growth, they conclude that financial globalization indeed has potentials of indirect effects of promoting long-run economic growth in Less Developed Countries through an array of "collateral benefits" which include financial market development, institutional development, good governance and macroeconomic discipline. However, they believe that these collateral benefits can only be realised when countries meet certain threshold conditions. Others studies on the issue include Klein (2003); Fratzscher and Bussiere (2004), all find no robustly correlated relationship between financial openness and economic growth.

Empirical studies on trade openness and economic growth just like financial openness are inconclusive. While Dollar (1992), David (1993), Sachs and Warner (1995) and Edward (1998) conclude that trade openness has positive and significant impact on economic growth. Rodriguez and Rodrik (2001) argue that the aforementioned works

are confronted with methodological problems and in many cases; the indicators of openness are poorly measured and often correlated with other sources of bad economic performance. Their results show no significant evidence between trade openness and economic growth.

Bolaky and Freund (2006) examine cross-country regression for 98 countries to test whether trade effects on growth is dependent on a country's regulation. Their results suggest that in heavily regulated economies, trade does not promote growth. This means that trade openness can only have positive effect on economic growth through regulatory reforms.

Thus, from the foregoing, it is obvious that the effect of globalisation as measured by the financial and trade openness on the economy in general is inconclusive. Our search further analyses the effect of globalisation on the financial development. This is a relatively new area as there are few empirical works on the issue.

Huang (2006) in a sample of 35 emerging markets presents the effects of financial openness on the development of financial system for the period (1976-2003). The results suggest that the effect of financial openness on stock market development appears to be strong and robust under both static and dynamic model specification. There is no robust correlation between financial openness and banking sector development. However, the overall effects of financial openness on both banking and stock market appears to be significant this is due to indicators of stock market development

Baltagi et al (2007) test the Rajan and Zingales's hypothesis that simultaneous openness to trade and capital flows have positive influence on financial development

They use dynamic panel data estimation for 43 developing countries for the period 1980-2000. Their findings suggest that simultaneous openness of trade and capital flows do have positive influence on financial development. In addition, capital flows are found to have separate positive influence on financial development independent of their interaction term. Trade openness on the other hand does not have separate independent influence on financial development.

Ajayi (2003), Balamoune-Lutz and Ndikumana (2007) observe that economic marginalisation in the region is due to isolationist policies and closed economies, thus they advocate more openness of the economies. A number of studies also document the benefit of financial repression policy on financial development in particular and the economy in general to some countries and at some stages of economic development¹ (Diaz-Alejandro 1985, World Bank 1993, Ang and Mckibbin 2007, Ang 2007). Stiglits (2006), observes the negative impact of globalisation on some developing economies. Thus, Mckinnon (1991), Edwards, (1989) then suggest sequencing of financial reform efforts. From the foregoing, it becomes clear that the issue is still inconclusive in the literature.

This study aims at empirically testing the impact of globalisation on the financial development in SSA . Thus, the study tests three hypotheses, (a) Do trade and financial openness have any impact on financial development in the region, (b) Is simultaneous opening of both trade and financial sectors necessary for financial development in the region? (c) Does continuous opening of trade and financial sectors have any impact on financial development.

For the first hypothesis, (a) it suffices to say globalisation has an impact on the financial sector, if either the coefficient of trade or financial openness is statistically

¹ China, Japan and South Korea

significant, but a stronger condition would require joint significance of the two indicators of globalization.

The second hypothesis is a test of simultaneity, the Rajan- Zingales (RZ) hypothesis, this states that trade openness without financial openness (and vice versa) may impact negatively on financial development and that only simultaneous opening of both the trade and financial sector is necessary for economic growth and financial development (See Baltagi et al 2007). Hence if the coefficient of the interaction element is statistically significant, we cannot reject the hypothesis, but if not, then RZ hypothesis does not hold for the countries in the sample..

The third hypothesis tries to evaluate the impact of continuous opening of the economy and its impact on the financial development of the country, more importantly that Ajayi 2003 observes continuous closing of the SSA economies is the cause of economic marginalisation of the region, Baltagi et al 2007 also observes that for some poor countries continuous opening of their economies do not impact positively on the financial development nor the overall economies. Yet Mckinnon (1991) suggests sequencing of reforms. Thus we investigate: does openness exhibit increasing or decreasing returns to these economies. This is done by introducing a quadratic specification into the model. If the coefficient of the quadratic function is significant, and positive it implies that openness has increasing effect on the financial sector of the country over time, but if significant but negative it shows that continuous openness only exhibits decreasing returns to the economy.

The paper is divided into five sections. Section two explains the empirical model. Section three explains the data employed in the study and econometric methodology., section four reports and discusses the econometric results. Finally, section five gives the policy recommendations and conclusion.

2 THE EMPIRICAL MODEL

Consider a panel of i countries, observed over t periods of time as to their financial development FD_{it} ($i=1,2,\dots,I$; $t=1,2,\dots,T$). This study adopts Baltagi et al (2007) model for the empirical model while adding a quadratic specification in model 3. Thus we specify the following dynamic equation for financial development

$$\ln FD_{it} = \beta_0 + \gamma \ln FD_{it-1} + \beta_1 \ln Y_{it} + \beta_2 \ln TO_{it} + \beta_3 \ln FO_{it} + \varepsilon_{it} \dots \dots \dots (1)$$

Where FD is an indicator of financial development, Y is income, which acts as a control variable for the demand for financial services, TO is the trade openness, FO is the financial openness, and FD_{it-1} the lagged dependent variable is included to allow for the partial adjustment of FD to its long run equilibrium value.

The above specification is a test of the first hypothesis (a). A necessary condition to conclude that globalisation has an impact on the financial development in the region requires either β_2 or β_3 to be significant, while a sufficient and stronger condition requires joint significance of both β_2 and β_3 .

To test the simultaneity hypothesis, which is the second hypothesis (b) of this paper, trade and financial openness are interacted, and the interaction term enters as a separate independent variable as follows:

$$\ln FD_{it} = \beta_0 + \gamma \ln FD_{it} + \beta_1 \ln Y_{it} + \beta_2 \ln TO_{it} + \beta_3 \ln FO_{it} + \beta_4 (\ln FO_{it} * \ln TO_{it}) + \varepsilon_{it} \dots \dots \dots (2)$$

We introduced the partial derivatives of financial development with respect to each of the openness variables to assess the short-run effects of (Trade) or financial openness dependent on the extent of (financial) or trade openness respectively. This is

simply to test the marginal effect of each openness variable on the financial development.

$$\frac{\partial \ln FD_{it}}{\partial \ln TO_{it}} = \beta_2 + \beta_4 \ln FO_{it}$$

$$\frac{\partial \ln FD_{it}}{\partial \ln FO_{it}} = \beta_3 + \beta_4 \ln TO_{it}$$

The simultaneity hypothesis requires that both derivatives are positive. This implies that the marginal effect of trade openness is larger on the financial sector, the more open the financial sector and vice versa, that the marginal effect of financial openness is larger on the financial sector, the more open the trade sector

The third hypothesis (c) is captured by introducing a quadratic specification of both openness variables and each entering the model as a separate independent variable as follows

$$\ln FD_{it} = \beta_0 + \gamma \ln FD_{it} + \beta_1 \ln Y_{it} + \beta_2 \ln TO_{it} + \beta_3 \ln FO_{it} + \beta_4 \ln TO_{it}^2 + \beta_5 \ln FO_{it}^2 + \varepsilon_{it} \dots \dots \dots (3)$$

Baltagi et al (2007) and Demetriades and Law 2006, find that continuous opening of economies may have little or no impact on financial sectors in poor developing countries. They suggest that an alternative channel of banking sector development may be particularly useful to low income countries that are already open, which stand to benefit little in terms of additional openness, and interestingly all the countries mentioned in their study are SSA². Thus we try to test this hypothesis rather than imposing it. The intuition is, does openness exhibit any economies of scale?

² The countries mentioned are Cameroon, Ethiopia, Gabon, Ghana, Kenya, Malawi, Nigeria, Senegal, Togo, and Zambia (Baltagi et al 2007, pg23). All the countries are in our sample data set.

The partial derivative of financial development with respect to each of the openness variables is:

$$\frac{\partial \ln FD_{it}}{\partial \ln TO_{it}} = \beta_2 + 2\beta_4 \ln TO_{it}$$

$$\frac{\partial \ln FD_{it}}{\partial \ln FO_{it}} = \beta_3 + 2\beta_4 \ln FO_{it}$$

3.0 DATA

There is a growing debate in the literature as to the efficacy of either bank based or market based systems, while some rationalise the potency of the bank based system others prefer the market-based, and some argue that the distinction is less important(See Levine 2004). One of the key features of the financial system in SSA is the underdevelopment of the capital market³. There are large number of small firms that are privately owned and (families have significant control), but they are usually not listed in the capital market, hence the major source of finance is through the banks and not the capital market. Thus the financial system in the region can be described as a bank-based system rather than market-based system, hence the use of bank-based financial proxies as appropriate financial development indicators in the region.

The study uses four indicators of banking sector development that have been used in the literature. These indicators include liquid liabilities, broad money, private credit, and domestic credit, each taken as a ratio of the GDP (gross domestic product) See Levine (2003), and King and Levine (1993). The first two indicators examine the

³ As at 2006, it is only South Africa that has highly developed capital market in the region, though there are some efforts in some other countries like Nigeria, Cameroon etc (World Bank 2007)

depth of financial intermediaries in the countries, while the last two measures the relative degree to which the financial system allocates credit for productive ventures.

Ang and Mckibbin (2007) argue that the financial deepening measures ($M2/Y$, $M3/Y$) only reflect the extent of transaction services provided by financial system rather than the ability of the financial system to channel funds from depositors to investment opportunities. They opine that bank credit to the private sector is the most relevant measure of financial development, since the private sector is able to utilise funds in the most efficient and productive manner.

The trade openness is measured by the ratio of total trade to GDP. The financial openness is measured by the ratio of foreign direct investment to the GDP, though we recognise this is a flow variable, and that Lane and Milesi-Feretti (2006) suggested using the volume of a country's financial assets and liabilities as a ratio of GDP, However, we are constrained by inadequate data for the relevant period for this measure. Also, Abiad and Mody (2005) measure of financial liberalisation could not be used, this data set is available for 35 countries out of which only three countries are from the SSA (Ghana, South Africa and Zimbabwe) and only available for 1980-1993. The data for this study are sourced from World development Indicators, (see Table1 for Data definitions and sources.

For the sensitivity analysis, three factors were considered, namely human capital accumulation, political stability and level of corruption. We use the human capital index compiled by Bosworth and Collins (2003), for the political stability factor we use the polity 2 variable from the polity IV project, this variable is measured on the scale of -10 to 10, higher level indicates better political stability, for SSA countries in the sample, the values range from - 9 to +9 thus we add,10 to all to get a positive integer and then apply the log transformation. For the institutional quality we use the

corruption index compiled by the International Country Risk Guide (ICRG). The values range from 1.6 to 5.33.

3.1 METHODOLOGY

We estimate the financial development equation with panel data from 29 SSA countries over a 26-year period from 1980-2005. To address the issue of endogeneity and orthogonality between the error term and the regressors, we use Arellano and Bond (1991) dynamic panel data estimator (DPD) based on General Method of Moments (GMM). This estimator technique optimally exploits the linear restrictions implied by the dynamic panel model proposed in this study. In estimating the model, all explanatory variables are lagged by one period to ensure that FD_{t-1} can be treated as predetermined in period t and that error terms are not serially correlated.

The consistency of the estimates is premised on the assumption of lack of first order autocorrelation of the error terms, thus the study tests for the existence of the first and second order serial correlation. A sargan test which is a joint test of model specification and the appropriateness of the instrument was also conducted.

We restrict the moment conditions to a maximum of two lags on the dependent variable to reduce the potential bias resulting from too many moment conditions while increasing the efficiency of the estimates (See Baltagi, 2005).

4.0 DISCUSSIONS ON THE ECONOMETRIC RESULTS

The data sets are summarised in Table 1 which provides the definition and source of each variable, its measurement, summary statistics, sample period and countries for which these variables are available. The correlation matrix between the variables is also provided in Table 2

All variables display considerable variation between countries justifying the use of panel estimation techniques. Moreover correlations between various financial development indicators are positive and significant as expected from the literature. The correlation coefficient between trade openness and financial openness is positive. The correlation between trade openness and financial development indicators are also positive, small in case of credit indicators and high in case of monetary indicators. However, the correlation between our measure of financial openness and financial development indicators are negative for the credit indicators and positive with the monetary indicators, these trends tend to suggest that private enterprises are yet to be fully developed in the region and that the financial sector is still being driven by the public sector.

The estimation results are presented in Tables 3 and 4. Most of the diagnostics tests in both tables are satisfactory. Specifically, the Sargan test does not reject the over-identification restrictions in all cases. The absence of first order serial correlation is rejected in all cases, while the absence of second order serial correlation is not rejected in most cases except in Models where the broad Money are used (i.e 4a and 4b). Moreover, the lagged dependent variables in all cases are positive and significant. This further lends credence to the appropriateness of dynamic GMM as the preferred panel estimator as this is confirmed by the data, suggesting that our estimates have some good statistical properties.

The empirical results are presented in Tables 3a-b. The two log linear panel model specifications are estimated with four different measures of financial developments, Columns a and b test objective 1, and 2 respectively while Table 4 gives the estimation results of the quadratic model.

Using Private Credit as financial development indicator

Focusing on the credit to the private sector, the two globalisation measures are positive and statistically significant. Trade openness is statistically significant at 10%, but the financial openness is statistically significant at 5%. This satisfies the necessary condition that globalisation may have positive impact on financial development in the region. The lagged dependent variable has an estimated coefficient of 0.49, with a standard error of 0.08; this indicates a strong evidence of considerable persistence in the variable. It however indicates slow speed of adjustment to shock. This is in consonance with the findings of Baltagi et al (2007). The estimate of the interaction term is positive and statistically significant at 1% this indicates that simultaneous opening of the trade and financial sector has a positive impact on financial development, precisely it indicates that simultaneous opening of the trade and financial sectors could lead 1.4% improvement in financial development. This further provides a limited empirical evidence for the Rajan-Zingales hypothesis in the region. The quadratic specification indicates that financial openness is statistically significant at 1%, though negatively signed. This suggests that continuous opening of financial sector may impact positively on the financial development in the region; also it may suggest that openness exhibits economies of scale to financial development. The trade openness is positive but insignificant. This may only signify a relatively long time lag for the region to reap the benefit of globalisation. However, strangely we observe that the coefficient of real income is statistically insignificant; this is similar to the findings of Chinn and Ito (2006).

Domestic Credit

The lagged dependent variable is positive and statistically significant at 1% exhibiting evidence of considerable persistence, the real GDP surprisingly enters with a negative coefficient and it is statistically significant at 1% level. This is similar to the findings of Baltagi et al (2007) where they rationalised this trend as suggesting counter-cyclical trend of monetary policy.

The coefficient of the trade openness is statistically significant at 1%, but negatively signed, this may be lending empirical evidence to Ajayi 2003 that weak low openness might have negative impact not only on the overall economy but also the financial sector in particular. Surprisingly, the coefficient of the financial openness is statistically insignificant. The interaction element is also insignificant; however the financial openness in the quadratic specification is positive and statistically significant. Again, suggesting that financial openness may exhibit increasing returns to scale, suggesting more openness of the financial sector may be enhance financial development in the region. While we do not have strong evidence to suggest that simultaneous opening of both trade and financial openness has any impact on financial development in the region, we have evidence that continuous opening of the financial sector could enhance financial development in the region.

Liquid Liabilities and Broad Money

Similar results are obtained when using the two indicators; there is evidence for considerable persistence of financial development variable. The lagged dependent variable has an estimated coefficient of 0.49-0.55. It suggests high persistence of shock and low speed of adjustment. The real GDP is significant but negative for

broad money but insignificant for liquid liabilities. The trade openness seems to have impact on financial development when using liquid liability but financial openness seems more important for broad money. The interaction term in either case is insignificant, thus no evidence for the simultaneous opening hypothesis.

The quadratic specifications for the two indicators are more impressive, the two globalisation measures are positive and statistically significant even at 1%. This may suggest that continuous opening of the economy may impact positively on the financial development in the region. It may also indicate that benefits from globalisation can only be reaped with continuous or consistent policy.

In summary, there are mixed empirical evidence to support the impact of globalisation on the financial development in the region. There are more evidence of positive impact of trade openness on the financial development than we have for financial openness, when using model 1 and 2, hence there are some weak evidence in support of the argument that globalization has positive impact on the financial sectors in the region. These satisfy the first two objectives, of the importance of globalization and simultaneous opening of the trade and financial sectors to financial sector development in the region.

This weak evidence of the simultaneous opening hypothesis may be due to structural and institutional weakness and this may also suggest a more empirical evidence for the Mckinnon (1991) sequencing of reforms hypothesis. These findings are consistent with the findings from earlier works especially Baltagi et al (2007) and Chin and Ito (2006).

There is more robust evidence to suggest that continuous opening of the economies might have beneficial impact on the financial development in the region. Continuous financial openness has positive impact on financial development regardless of the indicator used.

4.1 Marginal Effects of Openness

To further analyse the quantitative importance of trade and financial openness for financial development in the region. We calculate the marginal effects of both types of openness for the interaction and quadratic terms, the results are presented in Table 5a and 5b respectively. For the short run effect, we use the value of the coefficient if the parameter is statistically significant. Where the estimated parameter is not significant at the 10% level, zero value is assigned to the parameter. In addition to the short-run effects, we also calculate the long run effects by dividing the short-run values by one minus the estimated coefficient of the lagged dependent variable. The mean value is used for each of the variables in the computation of the marginal effect.

The results suggest that there is minimal positive impact of trade openness on the financial development in the region in both short run and long run, the best channel is through the private sector development, via credit to the private sector. This finding is consistent with the Rajan-Zingales hypothesis, that openness brings competition and reduces corruption and enhances private sector and financial development. It further lends supports to the view that private credit may be the most potent financial development indicator in the region (see Ang and Mckibbin 2007). We also observe that there is greater effect of the simultaneous openness on the financial development through financial sector liberalization.

However, a different conclusion emerges when examining the effects of continuous openness on financial development. There is no evidence for short run or long run effect of continuous trade openness on the two credit indicators (DCp and DC), but there is substantial evidence for the monetary indicators (M2, and M3). There is a positive impact of continuous financial openness on the financial development for all the indicators. This result suggests increasing returns to openness and supports RZ hypothesis of the beneficial effect of simultaneous openness of both trade and financial sectors.

The effects of openness on domestic credit is surprisingly negative or zero, both in the short run and long run, this is however similar to the findings of Baltagi et al (2007). Thus, the elasticity of domestic credit with respect to trade openness is negative, while there is no significant impact of financial openness on domestic credit in the region for the period under review. This result is not very surprising, given the fact that substantial portion of the credit goes to the government; this ultimately crowds out private investment, again an evidence for the government-led keynessian approach.

On, the balance, there is a mixed effect, of the effects of simultaneous opening of the trade and financial sectors in the region for the period under review, and limited evidence to support the RZ hypothesis. The results with the quadratic specification again suggest that more financial openness may have more positive impacts on the financial development.

4:2 SENSITIVITY ANALYSES

Mishkin (2007) observes that the poor institutional quality is the major factor for the low positive returns of globalization to the developing countries. Thus we interact institutional factor (corruption index) with our measures of globalization. We also

assess the impact of globalization on the financial development in the presence of human capital and political stability, by interacting the human capital index and political stability index respectively with the measures of globalization. The results are presented in Table 6.

Our result shows that it is the interaction term with the human capital alone that has significant impact. It indicates that financial openness can have more significant effect on financial development in the region in the presence of highly developed human capital. It also suggests that countries with high manpower development would likely attract foreign banks. (Ajayi 2003, Mishikin 2007 all suggest human capital accumulation as a pre-condition for reaping the benefits of globalisation)

De Soto(2000) Ajayi(2003), Demetriades and Law (2006) Baliaoune-Lutz and Ndikumuma(2007) and Mishikin (2007) all suggest the importance of institutions, strong property rights, effective legal system as necessary conditions. While these conditions are important, we do not have empirical evidence for this in the region for the period under review.

4:3 Panel Cointegration Analysis

The preliminary stage commences with the confirmation of the degree of integration of each variable. Thus the study conducts a panel unit root exercise using LLC and IPS unit root tests. The results indicate that the variables are I(1) series, the result is shown in Table 7. This makes it econometrically reasonable to conduct the panel cointegration test. We then conduct the panel cointegration test for the relevant variables(measures of globalization, financial development indicators and real GDP) using Kao, Pedroni, and Fisher tests for these countries as a panel. We report only the latter two due to space. More importantly, both Pedroni and Kao tests are residual based cointegration tests based on the Engle-Granger (1987) two-step approach, while

the Fisher test is a combined Johansen test proposed by Maddala and Wu (1999). Both Pedroni and Kao fail to detect any cointegration relationship, however Johansen does. This is not strange, as many researchers have found the Johansen test more powerful to detect cointegration relationship (See Demetriades and Hussein 1996), however caution might be exercised in the interpretation of this result. Thus we concentrate on the Johansen test, where we detect cointegration relationship, we impose restriction on the coefficient of the β and the α to test the longrun impact and speed of adjustment to disequilibrium (the weak exogeneity restriction). The result is presented in Table 8 and 9.

In all the cases, we reject the null hypothesis of the insignificance of the variables in the vector. However, for the weak exogeneity restriction, none of the globalization measure is weakly exogenous. Thus, again suggesting these measures may not have strong impact on financial development and economic growth in the region. We only find real GDP and financial development as weakly exogenous variables.

4:4 Why Globalization has not delivered the good in the Region

A number of factors may account for the weak impact of globalization on the financial development in the region; these factors include weak property right (De soto 2000), which is a serious impediment to financial development. Also, inefficient legal system, that cannot guarantee loan contract enforcement, often hinders credit creation ability of the financial system and constrains financial intermediation by preventing lending to the deficit units. Endemic corruption weakens enforcement of legal contracts and inhibits smooth functioning of the financial system by increasing transaction cost. Incessant bank crisis, poor prudential regulation and supervision of the banking system may elicit poor response from global markets. As most SSA

economies are bank-based, poor lending policies, favouritism, insider lending are some factors that may inhibit financial development in the region from reaping the benefit of globalization.

SECTION FIVE: POLICY RECOMMENDATION AND CONCLUSION

The results suggest that globalisation has had a minimal impact on financial sector in SSA. This may largely be due to long history of financial repression and heavy regulatory policy regimes in the region in line with Bolaky and Freund (2004).

Other policy implication of this study is that the region has to meet some necessary preconditions such as improvement in institutional quality, development of infrastructures, stable polity and highly skilled manpower before it could optimally reap the benefits from globalisation.

This may also suggest need for gradual sequencing of the liberalisation effort in SSA in line with Mckinnon 1991, and World Bank 1993 especially in the early stage of development characterised by dominance of the keynessian government-led development approach that allocates minimal role for private participation in economic activities.

This study further suggests that globalisation appears to have more impact on financial development through credit to the private sector channel; this confirms that the policy regime in the region is gradually shifting to market- led approach, and an empirical evidence for the Rajan –Zingales hypothesis. This may equally suggest the potency of this indicator in the region.

Finally, necessary caution must be exercised in interpreting the findings of this study, as they may only reflect the quality of data used or the appropriateness of the measure of openness. The weak empirical evidence could also be due to misspecification error

in the models, perhaps globalisation may not have a contemporaneous but delayed effect on the financial sector, indicating that its effects may only be evident after some periods as suggested by the sequencing of reforms hypothesis. Also, due to the underdevelopment of the stock market in the region, this study could not assess the impact of globalisation on the stock market development in the region, an area that can be explored in the future.

In conclusion, though globalisation offers numerous benefits, these benefits are not automatically conferred on any country, there is a minimum threshold of development of necessary institutions, infrastructures and enabling environment before an economy can optimally reap these benefits. Also, as Ajayi (2003) suggests globalization may not be panacea to all economic problems in the region.

APPENDIX:**Globalisation and Financial Development in SSA****Table1 : SUMMARY OF DATA SET USED (ANNUAL DATA 1980-2005)**

Variables	Definition of variables	Sources	Unit of Measurement	Mean	Standard Deviation	Minimum	Maximum
DCp	Private Credit	WDI	% of GDP	18.38	19.14	1.54	142.59
M3	Liquid Liabilities	WDI	% of GDP	27.89	16.64	6.54	145.63
M2	Broad Money	WDI	% of GDP	24.92	15.10	6.95	122.08
DC	Domestic Credit	WDI	% of GDP	32.83	29.34	-19.37	213.33
Y	Real GDP Per Capita	WDI	US Dollars at 2000 constant prices	869.47	1424.10	92.07	7578.85
TO	Trade Openness	WDI	% of GDP	64.87	35.65	4.11	224.89
FO	Financial Openness	WDI	% of GDP	1.81	4.13	-28.62	46.62

Countries: Benin ,Burkina faso, Burundi, Cameroon, CAR, Chad, Congo Republic, Cote d'ivoire, Ethiopia, Gabon, Gambia, Ghana, Kenya, Lesotho, Madagascar, Malawi, Mali, Mauritius, Nigeria, Niger, Rwanda, Senegal, Seychelles, Sierra-Leone, South Africa, Sudan, Togo, Zambia and Zimbabwe

Table2: Correlation Matrix of the Variables

Definition of variables	Domestic Credit	Private Credit	Liquid Liabilities	Broad Money	Real GDP Per Capita	Financial Openness	Trade Openness
Domestic Credit	1.000						
Private Credit	0.80	1.00					
Liquid Liabilities	0.67	0.56	1.00				
Broad Money	0.68	0.59	0.96	1.00			
Real GDP Per Capita	0.49	0.38	0.55	0.61	1.00		
Financial Openness	-0.07	-0.07	0.09	0.12	0.11	1.00	
Trade Openness	0.15	0.10	0.46	0.49	0.49	0.41	1.00

Table 3: Financial Development and Globalisation in SSA (1980-2005)

FD Proxied by	Model 1		Model 2		Model 3		Model4	
	Private Credit (% of GDP)		Liquid Liabilities (% of GDP)		Domestic Credit (% of GDP)		Broad Money (% of GDP)	
Specification	1(a)	1(b)	2(a)	2(b)	3(a)	3(b)	4(a)	4(b)
Ln FD _{it-1}	0.49*** (0.08)	0.52*** (0.08)	0.52*** (0.05)	0.49*** (0.07)	0.44*** (0.04)	0.46*** (0.05)	0.55*** (0.05)	0.58*** (0.074)
Ln Y _{it}	-0.14 (0.09)	-0.04 (0.16)	-0.36 (0.09)	-0.38 (0.09)	-0.71*** (0.21)	-0.52** (0.24)	-0.44*** (0.10)	-0.54*** (0.064)
Ln TO _{it}	0.012* (0.006)	0.045*** (0.007)	0.014 (0.01)	0.02** (0.009)	-0.02*** (0.007)	-0.02 (0.015)	0.004 (0.002)	-0.002 (0.005)
Ln FO _{it}	0.003** (0.002)	-0.05*** (0.007)	0.004 (0.004)	-0.012 (0.15)	0.002 (0.003)	0.002 (0.011)	0.003** (0.001)	0.015 (0.011)
Ln FO _{it} *Ln TO _{it}		0.014*** (0.002)		0.005 (0.003)		-0.002 (0.003)		-0.003 (0.009)
Sargan Test (p-Value)	26.76 (0.99)	26.89 (0.989)	24.65 (0.99)	24.35 (0.996)	26.48 (0.99)	27.20 (0.987)	27.02 (0.99)	27.61 (0.985)
Autocovariance of Order 1	0.002	0.0009	0.0001	0.0002	0.003	0.0022	0.004	0.005
Autocovariance of Order 2	0.17	0.137	0.65	0.59	0.53	0.502	0.014	0.011

- 1 GMM estimations using a maximum of two lags of the dependent variable as instruments N=29, T=26
- 2 The variables are defined as follows FD_{it} = financial development; Y_{it}= real GDP per capita, TO_{it}= Trade openness defined as total exports plus imports/GDP, FO_{it}=Financial openness defined as the ratio of foreign direct investment to GDP,
- 3 Figures in the parentheses are the standard errors.
- 4 ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels respectively

Table 4: Globalisation and Financial Development in SSA

$$\ln FD_{it} = \beta_0 + \beta_1 \ln FD_{it-1} + \beta_2 \ln Y_{it} + \beta_3 \ln TO_{it} + \beta_4 \ln FO_{it} + \beta_5 \ln TO_{it}^2 + \beta_6 \ln FO_{it}^2 + \varepsilon_{it} \dots \dots \dots$$

FD Proxied by	Model 1 Private Credit (% of GDP)	Model 2 Liquid Liabilities (% of GDP)	Model 3 Domestic Credit (% of GDP)	Model4 Broad Money (% of GDP)
Ln FD_{it-1}	0.53*** (0.08)	0.51*** (0.07)	0.48*** (0.39)	0.54*** (0.08)
Ln Y_{it}	-0.02 (0.19)	-0.40*** (0.08)	-0.34 (0.24)	-0.48*** (0.039)
Ln TO_{it}	-0.24 (0.21)	-0.25*** (0.09)	-0.08 (0.11)	-0.30*** (0.07)
Ln FO_{it}	0.013** (0.005)	0.01*** (0.003)	0.008** (0.004)	0.008*** (0.003)
Ln TO_{it}^2	0.038 (0.032)	0.042*** (0.014)	0.008 (0.017)	0.048*** (0.009)
Ln FO_{it}^2	0.003*** (0.0007)	0.002*** (0.0004)	0.002*** (0.0004)	0.001*** (0.0003)
Sargan Test (p-Value)	25.92 (0.992)	23.87 (0.997)	23.69 (0.997)	26.04 (0.992)
Autocovariance of Order 1	0.0007	0.0002	0.001	0.009
Autocovariance of Order 2	0.163	0.420	0.369	0.004

- 5 GMM estimations using a maximum of two lags of the dependent variable as instruments N=29, T=26
- 6 The variables are defined as follows FD_{it} = financial development; Y_{it} = real GDP per capita, TO_{it} = Trade openness defined as total exports plus imports/GDP, FO_{it} =Financial openness defined as the ratio of foreign direct investment to GDP,
- 7 Figures in the parentheses are the standard errors.
- 8 ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels respectively

Table 5a: Marginal Effects of openness on Financial Development in SSA
(Simultaneous Openness)

Openness Indicator	Financial Development indicators			
	Domestic Credit	Private Credit	Liquid Liability	Broad Money
	Mean	Mean	Mean	Mean
TO Short-run	-0.02	0.07	0.02	-.002
TO Long-run	-0.05	0.15	0.04	-0.0003
FO Short-run	0	0.86	0	0
FO Long-run	0	1.79	0	0

**Table 5b: Marginal Effects of continuous openness on Financial Development in
SSA (Continuous Openness)**

Openness Indicator	Financial Development indicators			
	Domestic Credit	Private Credit	Liquid Liability	Broad Money
	Mean	Mean	Mean	Mean
TO Short-run	0	0	2.47	2.81
TO Long-run	0	0	5.04	6.11
FO Short-run	0.01	0.02	0.01	0.001
FO Long-run	0.02	0.04	0.02	0.002

6: SENSITIVITY ANALYSIS

FD Proxied by	Model 1					
	Private Credit (% of GDP)					
Specification	FO	TO	FO	TO	FO	TO
Ln FD _{it-1}	0.59*** (0.12)	0.21 (0.15)	0.39** (0.19)	0.51** (0.19)	0.47*** (0.11)	0.39*** (0.14)
Ln Y _{it}	0.74 (0.81)	1.13 (0.78)	0.91 (1.08)	2.26* (1.23)	-0.63 (0.89)	0.46 (0.80)
Ln TO _{it}	0.22 (0.25)	0.27 (0.28)	0.21 (0.25)	0.09 (0.24)	-0.21 (0.25)	0.22 (0.22)
Ln FO _{it}	-0.05** (0.02)	-0.03* (0.02)	0.013 (0.02)	-0.02** (0.02)	-0.25*** (0.02)	-0.02 (0.014)
LnFO _{it} *lnPOL _{it}	0.013 (0.01)					
LnTO _{it} *lnPOL _{it}		-0.17 (0.02)				
lnFO _{it} *lnCOR _{it}			-0.03 (0.02)			
LnTO _{it} *lnCOR _{it}				-0.04 (0.03)		
LnFO _{it} *lnHC _{it}					2.18*** (0.65)	
LnTO _{it} *ln HC _{it}						-0.32 (1.44)
Sargan Test (p-Value)	8.66 (1.00)	5.77 (1.00)	4.51 (1.00)	6.41 (1.00)	5.88 (1.00)	8.18 (1.00)
Autocovariance of Order 1	0.02	0.32	0.20	0.11	0.04	0.09
Autocovariance of Order 2	0.53	0.15	0.64	0.63	0.79	0.42

Table 7: Panel Unit Root Test

Variables	At Level		First Difference		Order of Integration
	LLC	IPS	LLC	IPS	
LDC/Y	0.03	1.57	-8.16**	-10.63**	I(1)
LDCp/Y	-1.19	1.06	-8.52**	-11.4**	I(1)
LM3/Y	1.01	1.19	-8.36**	-11.10**	I(1)
LM2/Y	0.37	1.16	-9.81**	-10.86**	I(1)
LY	-1.66**	0.65	-9.03**	-11.01**	I(1) ⁴
LFO	2.45	3.22	-11.0**	-12.97**	I(1)
LTO	1.85	3.51	-13.1**	-15.4**	I(1)

*Note: * ** *** indicates rejection of the null hypothesis of unit root at 1%, 5% and 10% respectively. All variables are stationary at first difference.*

⁴ All other unit root tests indicate the variable is I(1) when both specifications (using either the intercept alone or intercept and trend) except LLC that indicates the variable is I(0). Thus we consider it as an I(1) in line with IPS and Breitung tests.

Table 8a: Johansen Panel Cointegration Test

Variables in cointegration vector	Trace Statistic			Maximal Eigenvalue		
	(Fisher stat)			(Fisher Stat)		
	r=0	r=1	r=2	r=0	r=1	r=2
LDC, LY, LTO	167.5***	73.77	92.40	142.9***	58.06	92.40
LDCp,, LY, LTO	174.1***	80.94**	106.4***	144.8***	57.14	106.4
LM2, LY ,LTO	187.1***	93.79***	89.67***	144.1***	77.20***	89.57***
LM3, LY LTO	187.3***	94.34**	92.48	145.18***	76.93**	92.46

Note: * ** *** indicate that we reject the null hypothesis at 1%, 5% and 10% respectively

The critical values are provided by McKinnon 1996.

Table 8b: PEDRONI COINTEGRATION TEST					
Variables in cointegration vector	Test	LDCY	LDCP	LM3	LM2
Financial Globalization	$panel - v$	-0.83	-0.16	-2.25	-2.15
	$panel - \rho$	-3.83	1.55	3.89	3.98
	$panel - pp$	1.75	-0.33	0.67	1.48
	$panel - Adf$	2.73	0.41	3.21	1.75
	$Group - \rho$	5.70	2.91	6.35	6.11
	$Group - pp$	1.04	-0.27	1.52	1.21
	$Group - Adf$	3.88	0.09	3.79	2.06

Table 9: Test of the significance of the variables in the vector and its LR impact

Variables	Null Hypothesis: $\beta_i = 0$			Null Hypothesis: $\alpha_i = 0$		
	$H_o : \beta_{fd} = 0$	$H_o : \beta_{TO} = 0$	$H_o : \beta_y = 0$	$H_o : \alpha_{fd} = 0$	$H_o : \alpha_{TO} = 0$	$H_o : \alpha_y = 0$
LDC, LY, LTO	20.96***	28.98***	21.46***	0.25	17.93***	3.63
LDCp, LTO,,LY	20.53***	24.63***	9.59***	4.17**	18.52***	1.23
Lm2,LTO,LY	15.06***	21.10***	7.33***	0.05	15.65***	3.06
Lm3,LTO,LY	14.83***	9.73***	21.58***	0.02	16.80***	2.47

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