Economic liberalization, financial development and economic growth in Tanzania

Asimwe Bashagi

Master of Arts (Economic)

University of Dar es Salaam, college of social Science, 2003

This study analyses the impact of economic liberalization on the finance-growth nexus in Tanzania by comparing a list of selected indicators of financial development using data covering pre and post reform economic liberalization. The study employs a time series analysis to evaluate the impact of the economic and financial liberalization in the finance-growth nexus. The empirical results suggest that there have been a positive significant relationship among the size of financial sector and economic growth. Contrary to the hypothesis, the analysis established a negative significant relationship between the ratio of private sector credit to Gross Domestic Product (GDP)-to total domestic credit and economic growth. In addition, causality tests were performed between various measures of financial development and economic growth. The results of the Grangercausality indicate that uni-directional causality exist between financial depth and economic growth and runs from financial depth to economic growth, and for the lending sub-sector measures of financial development, causality exist between the ratio of private sector credit to GDP and economic growth and it runs from economic growth to financial development. These results shed more light on policy makers; that is, if the lending sub-sector is to play a role as 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 most effective and cost minimizing manner. In particular financial institutions should widen their network to reach the potential investors and preferably in rural areas.