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DOES CAPITAL ACCOUNT LIBERALIZATION PROMOTE ECONOMIC GROWTH IN DEVELOPING COUNTRIES: INVESTIGATING THE NIGERIAN AND SOUTH AFRICAN EXPERIENCE

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Abstract

This study examines whether capital account liberalization (CAL) promotes economic growth in developing countries, with a specific focus on the experiences of Nigeria and South Africa. The motivation stems from mixed empirical evidence on CAL's growth effects and the need to understand why some developing countries gain while others face instability, particularly in the context of external financial shocks like the 2008 global financial crisis. The study employs a critical review of empirical literature and a descriptive comparative analysis of macroeconomic outcomes (FDI, portfolio investment, exchange rates, GDP growth, and market capitalization) in Nigeria and South Africa before, during, and after the 2008 crisis, using data from World Bank WDI (2022) and CBN statistical bulletins. CAL's impact on growth is neither automatic nor uniform; it is contingent on complementary factors such as institutional quality, macroeconomic policy soundness, and regulatory oversight. While Nigeria experienced severe macroeconomic disruptions during the 2008 crisis, evidenced by a sharp drop in market capitalization (over 100%), portfolio reversal, and sustained GDP slowdown, South Africa showed greater resilience due to more developed financial markets and a gradual, sequenced approach to liberalization. The study therefore recommends that developing countries should adopt a gradual and well sequenced CAL strategy, underpinned by strong institutional frameworks, prudent macroeconomic management, and effective financial regulation to mitigate risks from capital flow volatility and external shocks.

Keywords: Capital Account Liberalization; Economic Growth; Macroeconomic Stability; Developing Countries.
JEL Classification Codes: F21; F32; O16; E44.

1.0 Introduction

He pursuit of economic growth has prompted countries to adopt diverse economic systems, policy prescriptions, and national and international interventions (World Bank, 2026). Some nations have pursued growth through restrictive policies that limit trade and capital flows, while others have embraced greater openness to facilitate the free movement of resources, which they believe will stimulate economic expansion (Kose & Prasad, 2024).

International financial institutions such as the International Monetary Fund (IMF), World Bank, and Organisation for Economic Co-operation and Development (OECD) have consistently endorsed the latter approach, promoting capital account liberalization (CAL) as a pathway to growth in less developed economies (IMF, 2024; World Bank, 2026).

Capital account liberalization refers to the process by which a government removes or relaxes restrictions on cross-border capital movements. This allows individuals, organizations, and financial institutions to freely invest in foreign assets, borrow from international markets, and participate in global financial activities (Henry, 2006). In essence, it represents a sovereign decision to shift from a restrictive capital account regime to one that permits unrestricted capital flows (Henry, 2006).

Theoretically, free capital mobility offers substantial benefits. Inflows of foreign direct investment (FDI) enable resource-scarce countries to bridge savings-investment gaps and accelerate growth (Ekpo, 1997; Fabiyi, 2026). FDI also facilitates technology transfer, human capital development, and managerial expertise (Ekpo, 1997). Additionally, unrestricted capital flows support consumption smoothing during crises by enabling international borrowing and promote efficient global resource allocation through asset diversification (Kose & Prasad, 2024; Wang, 2007). Recent empirical work further highlights that CAL can enhance export margins and reduce financing frictions for firms in developing economies (Fabiyi, 2026).

However, despite these potential advantages, capital account liberalization carries significant costs and risks. Liberalizing countries often become exposed to transitional vulnerabilities that can undermine growth, including heightened susceptibility to external financial shocks and macroeconomic instability (Mughogho & Alagidede, 2021; Guo, 2023). Historical episodes in Latin America during the 1970s–1980s and the 1997 Asian financial crisis illustrate how premature or poorly managed CAL can lead to severe economic disruptions in developing nations (Mathieson & Rojas-Suarez, 1993; Liu et al., 2026). Moreover, CAL has been linked to rising income inequality, reduced labor income shares, and exchange-rate appreciation that worsens current-account balances (Furceri & Loungani, 2015; Mughogho & Alagidede, 2021).

Empirical studies also identify several conditioning factors that can weaken CAL's growth-enhancing effects. These include capital-market imperfections, weak institutions, inadequate infrastructure, and inconsistent macroeconomic policies

(McLean & Shrestha, 2002; Henry, 2006; Rehman et al., 2021). Asymmetric information and excessive government intervention further distort capital allocation and limit returns (Wang, 2007). Recent panel evidence from emerging markets confirms an inverted U-shaped relationship: moderate capital openness supports growth, but excessive openness can impede it when institutions are weak (Liu et al., 2026). These findings have renewed debate about the extent to which CAL reliably promotes growth in developing countries (Guo, 2023; Adeboje, 2025).

The literature increasingly emphasizes the importance of appropriate sequencing of CAL. Gradual, phased removal of capital controls—rather than abrupt liberalization—is argued to mitigate adverse effects, particularly when domestic financial systems are underdeveloped (Omoruyi, 2006; Mughogho & Alagidede, 2021). This sequenced approach allows time for complementary reforms in institutions and regulation, thereby maximizing benefits while minimizing volatility risks (Fabiyi, 2026).

2.0 Literature Review

2.1 Theoretical Framework.

The theoretical foundation of CAL and economic growth draws primarily from the neoclassical growth model, which posits that capital-poor developing countries experience a permanent decline in the cost of capital upon liberalization, leading to a temporary surge in investment and growth rates that converge toward steady-state levels (Henry, 2006; Solow, 1956). In this framework, free capital flows equalize marginal returns to capital across borders, accelerating capital accumulation and output growth in recipient economies (Henry, 2006).

Extensions of neoclassical theory incorporate financial globalization channels, including risk-sharing, technology spillovers via FDI, and consumption smoothing (Kose et al., 2003; Obstfeld, 1994). However, endogenous growth models and information asymmetry theories highlight limitations: capital market imperfections, weak institutions, and moral hazard can distort resource allocation, potentially reduced growth or exacerbating volatility (Wang, 2007; Stiglitz, 2000). Recent theoretical advancements emphasize institutional complementarities; CAL yields growth dividends only when paired with strong governance, financial development, and macroprudential policies, otherwise amplifying systemic risks (Guo, 2023; Rehman et al., 2021).

Threshold models further suggest non-linear effects: benefits emerge beyond minimum levels of institutional quality and financial depth, with excessive

liberalization increasing vulnerability to sudden stops (Mughogho & Alagidede, 2019; Hao, 2025). These theories underscore that CAL's growth-promoting potential is contingent rather than unconditional, aligning with empirical observations of heterogeneous outcomes across developing countries.

2.2. Empirical Review

Capital Account Liberalization and Economic Growth in Developing Countries: What does the evidence say?

The results of recent empirical research on the relationship between capital account liberalization (CAL) and economic growth in emerging markets and developing nations are inconsistent, frequently highlighting the fact that results are highly context-specific and dependent on complementary elements like macroeconomic stability, institutional quality, and financial development. Increased inequality, financial instability, and limited or negative growth effects in the absence of strong supporting conditions are just a few of the risks that are highlighted in numerous analyses.

Differentiated effects by type of capital flow and country characteristics are often indicated by cross-country evidence. Using a sample of 105 countries during the 2008 global financial crisis, Verberi, Yasar, and Sugozu (2023) discovered that while portfolio debt flows had a negative impact, portfolio equity flows significantly increased economic growth. They attributed some of the crisis dynamics to moral hazard and excessive risk-taking associated with liberalization. Similar to this, Alley (2017) looked at capital flow surges in 25 Sub-Saharan African (SSA) economies between 2003 and 2013 and found that while bond (debt) flows decreased growth through decreased capital formation and real exchange rate appreciation, risk-sharing flows (FDI and equity) supported growth via credit supply and capital formation channels; surges generally had negative effects.

In contrast, other studies underscore limited or adverse growth effects. Angelico and de Oliveira (2020) analysed emerging economies and concluded that CAL did not deliver the promised benefits for economic growth or financial stability, contrary to neoclassical predictions; instead, it heightened exposure to risks within the contemporary international monetary and financial system. Furceri and Loungani (2015), employing data from 149 countries (1970–2010), showed that CAL reforms increased income inequality (measured by the Gini coefficient) and reduced the labour share of income in the short and medium term, with amplified effects in settings of weak financial institutions or subsequent financial crises.

The growth effects of CAL are dependent on complementary factors, especially institutions and developmental thresholds, according to an increasing amount of evidence. In a panel of 45 SSA nations, Njikam (2017) showed that financial liberalization (including CAL components) only increased growth in conjunction with advancements in human capital, macroeconomic and external stability, and governance quality. Using a panel threshold approach to SSA data, Mughogho and Alagidede (2019) discovered that while CAL generally encouraged capital inflows, benefits only became apparent above thresholds of institutional quality and financial sector development; effects were either negligible or non-existent below these levels. Atiq-Ur-Rehman, Bashir, Shah, and Bhatti (2021), using panel data on 17 emerging market economies (1995–2019), confirmed that institutional quality is a critical moderator: countries with stronger institutions derived greater growth benefits from CAL, while weaker institutional environments limited or negated gains.

Evidence specific to components of capital flows further refines these insights. Ur-Rehman and Hayat (2017), focusing on 17 emerging economies (1991–2015), reported that only foreign direct investment (FDI) exerted a positive and significant impact on growth; other measures of capital account openness showed statistically insignificant effects. Recent SSA-focused work, such as Aliyara, Bello, and Agness (2022) on five countries (including Nigeria and South Africa) from 1984–2019, found that capital account deregulation accelerated growth when interacted with bureaucratic quality, underscoring the role of sound public administration.

Overall, post-2015 empirical studies indicate that the effectiveness and risks of full CAL in developing countries are highly context-dependent. Benefits are more pronounced (or realized at all) in environments with strong institutions, adequate financial depth, human capital, and macroeconomic stability; otherwise, liberalization can exacerbate inequality, instability, and uneven growth outcomes without delivering robust long-term gains.

Analysis of the experience of Nigeria and South Africa with respect to the 2008 financial crisis

Nigeria and South Africa, both SSA economies that had pursued capital account liberalization to varying degrees by the mid-2000s, illustrate the conditional and sometimes destabilizing effects of openness during the 2008 global financial crisis. Nigeria, which had implemented structural adjustment and financial reforms since the 1980s (including partial capital account opening), experienced amplified banking sector vulnerabilities and capital flow

volatility; global linkages transmitted shocks that contributed to a sharp contraction in growth and stock market performance, with post-crisis analyses highlighting how liberalization without sufficient regulatory safeguards heightened exposure to external reversals. South Africa, more deeply integrated into global capital markets following post-apartheid liberalization, recorded significant portfolio investment outflows (peaking negatively as a share of GDP in 2008), which exacerbated the current account deficit and contributed to a recession; however, its relatively stronger institutional framework and policy responses (including macroprudential measures) facilitated a quicker recovery compared with some peers.

These experiences are placed within larger SSA patterns by recent empirical research. According to studies like Mughogho and Alagidede (2019) and Aliyara et al. (2022), both nations benefited from inflows during times of global liquidity but faced threshold constraints related to institutions and financial depth; South Africa's deeper markets provided some buffering but were still vulnerable to abrupt stops, while Nigeria's problems were exacerbated by gaps in infrastructure and governance. Improvements in macroeconomic stability and governance could have reduced the spread of crises and increased the growth benefits of openness, according to Njikam (2017) and related conditional analyses. In both situations, the 2008 episode highlights how CAL amplified external shocks in the institutional and policy environments that were in place at the time, even though it may have improved growth under favourable circumstances. According to post-crisis literature, sustained sound macroeconomic policies are still necessary to mitigate volatility and maximize potential gains.

3.0. Methodology

The methodology of the present study is grounded in a mixed qualitative approach that integrates a critical review of existing empirical literature with a descriptive comparative analysis of macroeconomic indicators across two Sub-Saharan African economies. This design allows for a nuanced examination of capital account liberalization (CAL) outcomes without relying on econometric modelling, focusing instead on contextual patterns and policy implications in developing country settings Literature synthesis involved a systematic critical review of peer-reviewed studies published between 2004 and 2023, prioritizing panel and case-study evidence on CAL-growth linkages while identifying gaps in African contexts. Sources were selected for relevance to developing economies, with emphasis on complementary factors such as institutional quality and macroeconomic stability. This

step mirrors contemporary systematic reviews that advocate narrative synthesis over meta-analysis when data heterogeneity across emerging markets is high (Rehman et al., 2021; Liu, 2026).

Data for the descriptive component were sourced exclusively from secondary macroeconomic time series covering the pre-crisis (pre-2008), crisis (2008–2009), and post-crisis (2010 onward) periods. Key variables included foreign direct investment (FDI) inflows, net portfolio investment, exchange rates, real GDP growth rates, and stock market capitalization. These indicators were extracted from the World Bank World Development Indicators database (World Bank, 2022) and the Central Bank of Nigeria Statistical Bulletin (Central Bank of Nigeria, 2022), ensuring consistency and reliability in cross-country comparisons. Contemporary studies examining CAL shocks in Nigeria and South Africa similarly rely on these authoritative secondary sources to benchmark volatility and resilience during global financial episodes (Verberi et al., 2023; Diop, 2025).

4.0 Results and Discussion of Findings

Capital Account Liberalization: The Nigerian Experience

Like many developing countries, Nigeria has over the decades carried out series of economic reforms at the behest of the IMF and World Bank. Using secondary time-series data from the World Bank WDI (2022) and CBN Statistical Bulletin (2022), in this paper a descriptive comparative analysis was used to monitor important macroeconomic metrics prior to, during, and following the global financial crisis of 2008. Contrasted pre-crisis patterns (liberalization period) with disruptions during the crisis (2008–2009) and results after the crisis (2010 onward). Figures 1–10, interpreted changes in each indicator's direction and magnitude as proof of the conditional effects of CAL

The main contention is that CAL's effects are contingent upon institutional quality, sequencing, and the growth of the financial market. Due to these conditioning factors, Nigeria and South Africa experienced the same external shock (the 2008 crisis) in different ways. For Nigeria, the benefits of increased capital inflow resulting from liberalization policies are enormous. For instance, opening up the capital account may attract foreign investment which could be used to bridge the domestic resource gap and engender growth (Ekpo, 1997). Also, Increased competition from foreign firms can enhance efficiency and stimulate productivity (Ojo, 2006). Furthermore, gains from portfolio diversification could improve income growth and improve living standard.

Driven by investment in the oil and gas sector, FDI improved significantly

following SAP. Data from the World Bank World Development Indicator (WDI) (2022) indicate that FDI rose from 190 million dollars in 1984 to about 1.88 billion dollars 1n 1989 representing a 1000 percent increase in FDI inflow. Following further liberalization in 1995 FDI inflow rose to 8.1 billion dollars in 2008 before declining to since then, FDI inflow has remained positive even though the trend has remained nonlinear (see figure1.).

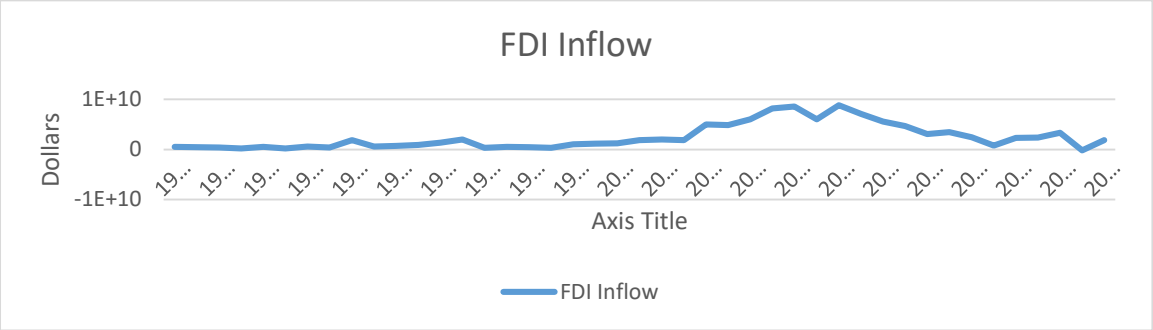


Figure1: FDI Inflows into Nigeria
Source: Authors computation using data from World Bank WDI 2022

On the other hand, portfolio investment showed marginal increases in the initial stages of the post SAP era, a phenomenon that was attributed to the underdeveloped capital market of the mid 80's and early 90's. Nonetheless, it grew significantly following the liberalization policies of the 80's and 90's. Net Portfolio investment rose from -401 million dollars in 1986 to 488 million dollars in 1990 (WDI, 2022)

The Capital market witnessed gains as free flow of capital allowed foreign investors to purchase equities of traded companies in Nigeria, significantly improving the market capitalization of the stock market as seen in figure 2. Market capitalization rose from 16.4 billion naira in 1990 to about 472 billion naira in the year 2000 (Central Bank of Nigeria (CBN) Statistical Bulletin, 2022).

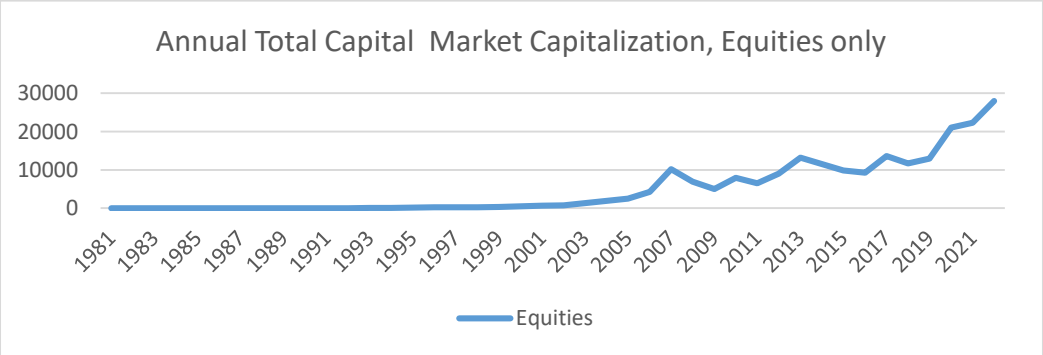


Figure 2: Annual Total Capital Market Capitalization for Nigeria
Source: Central Bank of Nigeria statistical bulletin, 2022.

External debt trends from 2008 showed an upward trend in the trajectory of external debt reflecting the enhanced ability to borrow foreign funds by economic agents as a result of the capital account liberalization policy. External debt rose from 8.3 billion dollars to over 33 billion dollars in the 2000 (WDI, 2022)

The 2008 Global Financial Crisis

Capital account liberalization is not without its own costs. The risks of capital fight in the event of a financial crises can impose great costs on the overall economy. Following the Financial crises of 2008, net portfolio investment dropped from 3.4 billion dollars in 2008 to -2.58 billion dollars in 2010 as the impact of the shock began to spread.

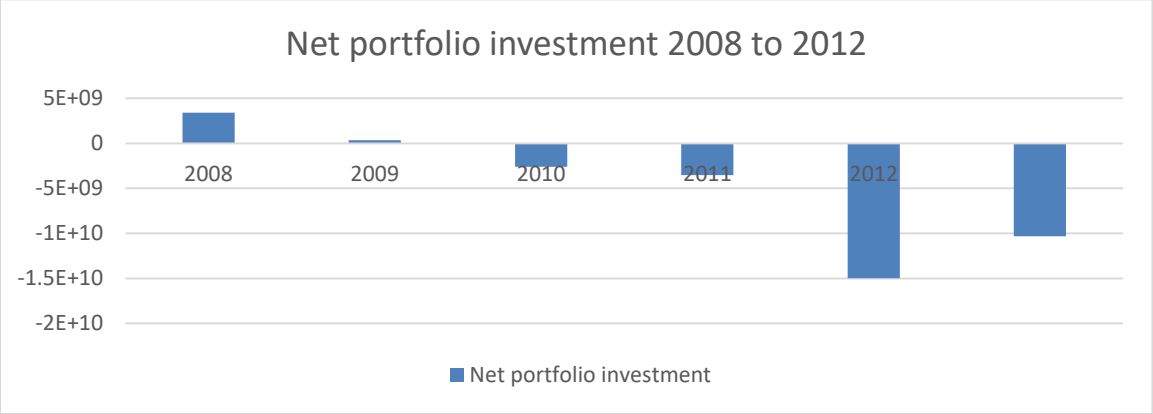


Figure 3: Nigeria's Net Portfolio Investment
Source: Authors computation using data from WDI

The Nigeria capital market felt the impact the most. Data from CBN statistical bulletin 2022 indicate that the capital Market Capitalization of the Nigerian Capital market dropped from 9. 5 trillion naira in 2008 to about 7.03 trillion naira in 2009 as investors uncertainty in the market began increased, exposing the market vulnerabilities of the capital market to external financial shocks. The market capitalization of the stock market also dropped from over 10 trillion naira in January 2008 to about 4.9 trillion in January 2009 representing a more than 100 drop in the market capitalization.

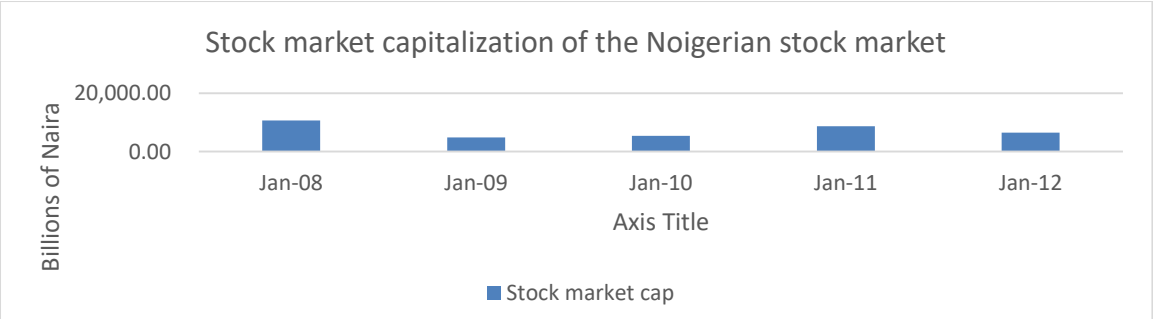


Figure 4: Nigeria Stock Market Capitalization
Authors computation using data from CBN Statistical bulletin 2022

Exchange rate depreciated from 118 Naira per dollar in 2008 to 148, 150.3 and 153. 4 naira per dollar in 2009. 2010 and 2011 respectively as demand for naira decreased relative to supply.

Growth rate of Real gross domestic product dropped from 8 percent in 2008 to 5 and 4 percent in 2010 and 2011 respectively, signalling a slowdown in economic activity within the period of the financial crises.

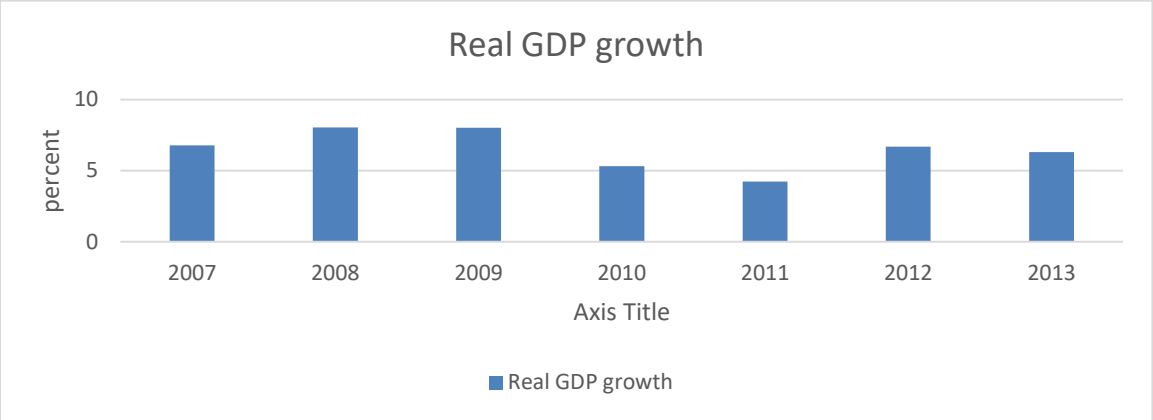


Figure 5: Nigeria's Real GDP Growth
Source: Authors computation using data from World Bank WDI 2022

Empirically, Lukman (2015) found that the financial crisis significantly affected the capital market in Nigeria. Njiforti (2015) used Vector error correction model to evaluate the impact of the crisis on the Nigerian stock market. He found that the financial crisis had a significantly negative impact on the Nigeria stock exchange both in the short run and the long run. Alege et al. (2012) extended the research by investigating the impact of the financial crisis on the Nigerian Economy. He found that the crisis had significant impact on output growth in Nigeria with the expected transmission mechanism passing through the stock exchange, the

Capital Account Liberalization: The South African Experience

Following the end of apartheid rule in South Africa, series of economic reforms aimed at reintegrating the economy into the global financial system were carried out by successive government starting from 1995. Molemoeng (2012) observed that capital market liberalization in South Africa followed a gradual phased approach after the return to democratic rule in the early 90's. Khumalo and Kapingura (2014) highlighted series of reforms carried out between 1995 and 2009 that significantly opened up the capital account. Some of the capital account control relaxations includes

the removal of all restriction to investing and sourcing funds abroad by South African firms, legalizing assets swaps by foreign firms. By 1996 the percentage of assets swaps allowed by any foreign firm increased from 5 to 10 percent. Others include the legalization of purchase of foreign investment, allowing individuals above 18 to invest abroad and listing of registered fund managers involved in private assets management as institutional investors. In the same period, regulations were passed to increase foreign capital for residents and companies and scraping of restrictive borrowing policies on non-residents investors in South Africa.

According to de Beer (2015), the series of economic reforms and the fact that prior economic sanctions had negatively affected capital stock in the country, led to significant capital inflow into the country. Evidence from data showed that capital account liberalization policies yielded significant effects in terms of inflow of foreign direct investment, portfolio investment and external debt.

FDI inflow grew after the liberalization policies of the mid 1990's. FDI inflow rose from 254 million dollars in 1990 to about 970 million dollars in 2000 representing a 261percent in less than 10 years. By 2010 FDI Inflow had grown to 3.7 billion. It eventually peaked at 9.2 billion in 2022 before declining to 3.44 billion in 2023 as seen in Figure 6.

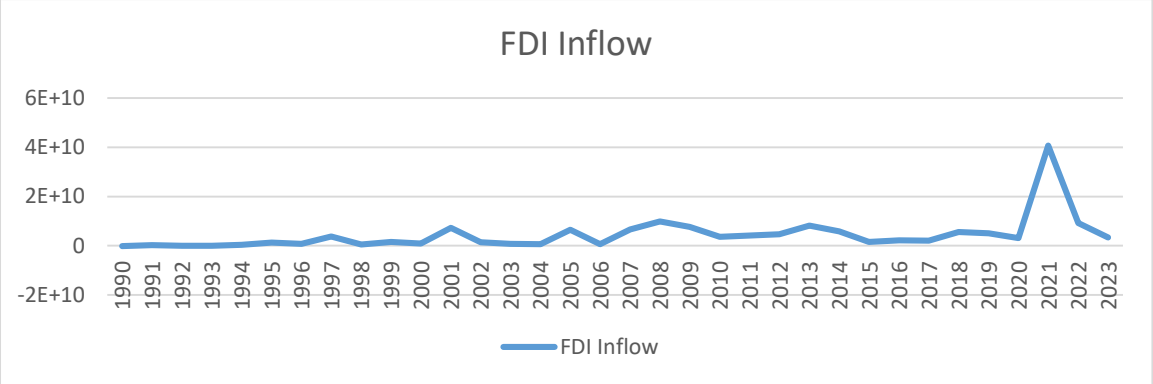


Figure 6: FDI Inflows to South Africa
Source: Authors computation using data from World Bank WDI 2022

Data from WDI (2022) showed that net Portfolio investment was negative between 1990 to 1999. Portfolio investment stood at -6.4 million dollars in 1990, declined further to about -2.4 billion dollars in 1995. Net portfolio investment declined further to -8.7 billion dollars in 1999 before moving into positive territories in 2000. For the most part net Portfolio Investment in south Africa remained negative hitting the lowest

point in 2009 as the effect of 2008 global financial crisis began to bite. Negative net portfolio investment indicates outflows of portfolio investment from south Africa to other countries. In recent times, however, positive net portfolio investment has been recorded.

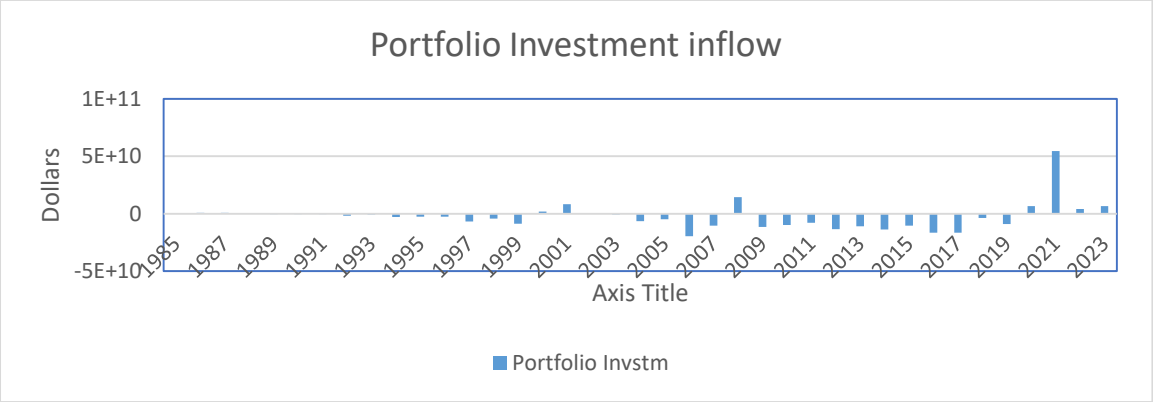


Figure 7: South Africa's Portfolio Investment Inflows
Source: Authors computation using data from World Bank WDI 2022

Effect of 2008 Global financial crisis

Following the 2008 financial crisis, net portfolio investment dropped from 14.3 billion dollars in 2008 to −11. 4 billion and −9.8 billion dollars in 2009 and 2010 respectively.

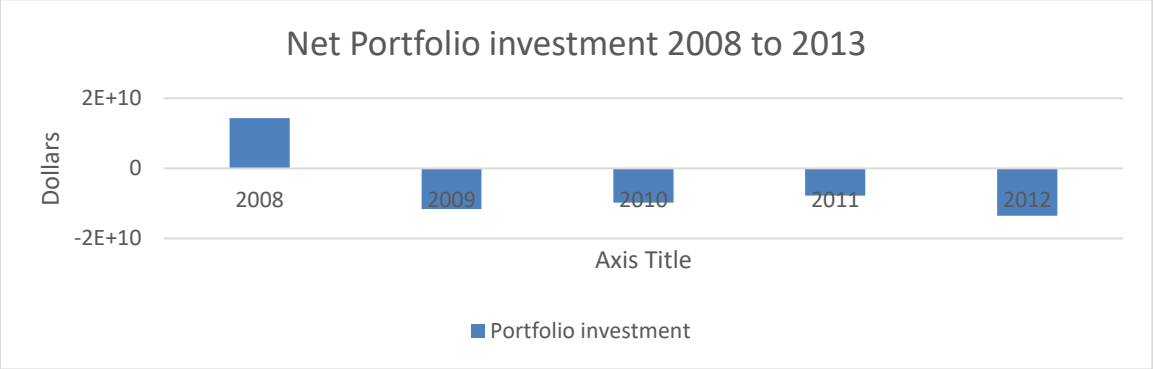


Figure 8: Net Portfolio Investment for South Africa
Source: Authors computation using data from World Bank WDI 2022

FDI inflow also dropped from 9.8 billion dollars in 2008 to 7. 6 and 3. 6 billion dollars in 2008 and 2009 respectively representing a more than 200 percent fall in FDI inflow between 2008 and 2010. The Rand however recorded only a marginal drop in value from 8.2 Rand per dollar in 2008 to 8.5 per dollar in 2009. By 2010 it had appreciated to about 7.3 per dollar.

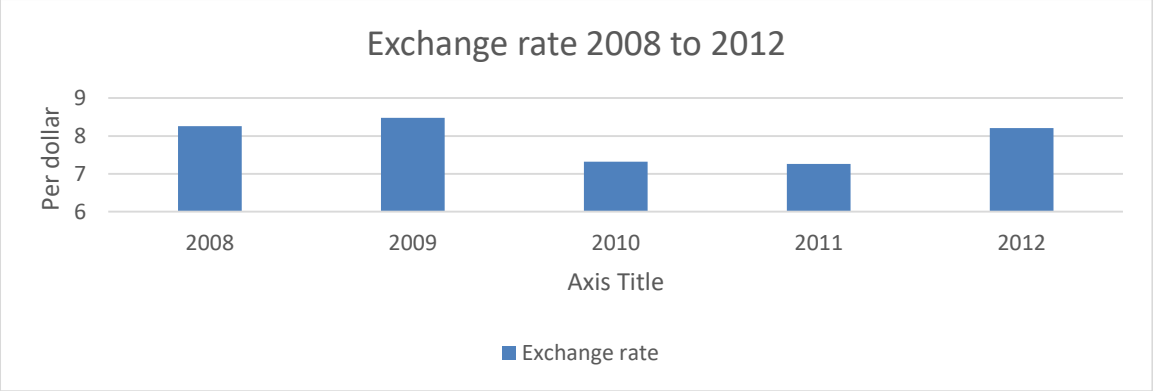


Figure 9: South Africa's Exchange Rate
Source: Authors computation using data from World Bank WDI 2022

Unemployment increased marginally from 22.3 percent in 2007 to 24 and 25 percent in 2009 and 2010 respectively caused by layoffs in the mining and banking sectors as prices of commodities began to fall. Economic growth rate fell sharply from 3.2 percent in 2007 to −1.54 percent in 2008. However economic growth soon recovered the following year indicating that the effect of the financial crisis on output growth in South Africa was short lived.

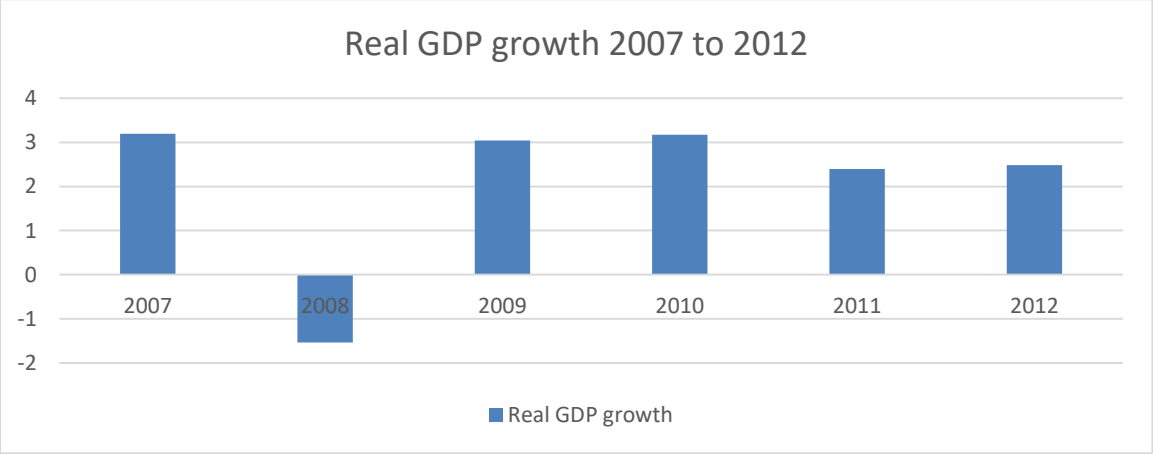


Figure 10. South Africa's Real GDP Growth
Source: Authors computation using data from World Bank WDI 2022

The analysis suggests that south Africa were able to manage the financial crises better than Nigeria did. Otchere, Senbet & Simbanegavi, (2016) attributed the muted effect on economic growth in south Africa to good supervisory and regulatory system put in place. A study by Makrelov, Davies, and Harris (2019), found that capital reversals impose costs on the domestic economy through its negative effects on portfolio investment and risk taking behaviour of firms in the capital market. A critical analysis by Rena and Msoni (2014), showed that the crisis affected the south African economy through fall in the price of commodities in the international market,

rising unemployment and reduction in credit supply by banks

5.0 Conclusion and Recommendation

Capital account liberalization, theoretically a silver bullet that is supposed to eliminate inefficiency in capital allocation and accelerate economic growth for developing countries, have over time produced mixed results. The study analysed the effect of CAL on the economic trajectory of developing countries while highlighting the experience of developing countries that have pursued CAL. We find that the evidence in terms of its impact on economic growth of developing countries is still subject to debate, with its impact found to be dependent on complimentary factors such as the strength of institutions, soundness of macroeconomic policies and regulatory oversight. Evidence from the experience of Nigeria and South Africa indicate that the experience of any two countries might differ despite experiencing similar shocks. While Nigeria experienced substantial macroeconomic problems as a result of the 2008 financial crisis, the experience of South Africa was slightly different. This could be attributed to a more developed financial markets or as a result of the nature of capital account sequencing it adopted while liberalizing it capital account. In sum, while the benefits from capital account liberalization are undeniable structural and institutional deficiencies in developing countries could expose it to undue impact from external shocks. This can have significant effect on macroeconomic conditions. The study recommends that developing countries should adopt a gradual and well sequenced CAL strategy, underpinned by strong institutional frameworks and effective financial regulation to mitigate risks from capital flow volatility and external shocks.

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