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# The impact of financial integration in Botswana

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**Abstract**

This study examines the impact of financial integration in Botswana. Direct and indirect transmission channels to growth are investigated. Financial integration commonly influences growth through encouraging cross border capital flows, transferring technologies and managerial expertise and promoting risk sharing. These market developments that are realized translate into enhanced access to finance as intermediation channels improve. Our empirical results are in line with previous literature in that financial depth does occur in the wake of the financial integration era and positively influences growth in Botswana. Not withholding, our results reveal that market depth has not promoted access to private sector's credit in Botswana so far. To a larger extent, a negative impact of financial integration on growth is observed as there could be short-term risks associated with increased financial openness. Nonetheless, an indirect, significant and positive influence from financial integration through financial access to growth is also observed. This indirect transmission demonstrates that financial integration increases financial innovation which in turn fosters growth in the country. Financial innovation enhances service delivery and improves access to financial services. We observe a positive influence from macroeconomic and institutional variables implying prevalence of sound and prudent supervisory structure and the rule of law in Botswana. Policy wise, there is still need and scope for greater financial integration, financial development and financial access which can contribute to national development goals of sustainable economic growth, diversification, employment creation and poverty reduction in Botswana.

**Keywords:** Financial integration; financial access; economic growth; Botswana
**JEL classification:** E22; G21; G28; O16; O43

## 1. Introduction

Capital inflows in the form of foreign direct investments (FDIs) and portfolio flows resulting from financial integration may imply better access to finance by the local firms and individual households. Financial integration is also commonly known to accelerate domestic financial market depth and is therefore reasonable to assume that financial integration enhances access to finance. Contrary to popular believe, Zaman et al. (2012) argue that it is not guaranteed that capital inflows will trickle down to the poor. Whilst it is taken for granted and implied by vast literature that well developed financial markets in industrialised economies make access to finance much easier, an investigation on the impacts of financial integration in the European market by Volz (2004) gives evidence that even though financial developments occurred, they did not necessarily improve financing conditions for the local private sector. Nonetheless, Bekaert et al. (2005) conclude that financial integration results in shared risks across markets leading to lower cost of equity capital and more investments, implying improved access to finance. A well-financed private sector enhances growth through

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