Comments to Ajit Singh on Stock markets in low-income countries

It is an honour to comment on this paper: another excellent piece by Ajit Singh. It is also a bit of an embarrassment, as I can hardly call myself a specialist on stock market development. Hence, I will focus my comments on some broader issues related to the role of stock markets in financing development in the low-income countries (LICs) and Africa in particular.

Let me start from a quote from within the UN of a couple of years ago. In 2003, Mark Malloch Brown, then UNDP administrator, told investment managers and heads of African stock exchanges that: “The future of Africa’s stock markets is the future of the poor in Africa.” And further that: “The jobs, the businesses, the prosperity and the future of the region lies in its stock markets.” At that same meeting, in Wall Street of all places, the head of the Nigerian stock exchange echoed these remarks indicating that “African stock exchanges help create wealth and the long-term capital needed for development and through that will contribute to poverty reduction.”

Well that was then and Mr. Brown is no longer heading UNDP. Prof. Singh’s paper concludes to just about the opposite when he concludes that for capitalism works better when stock markets do not have a major role in the economy. Since growth is mainly driven by market forces in Africa and most other LICs, one could translate that as to saying that development is better served with a minor role for stock markets. I am inclined to agree with Prof. Singh, but with some caveats.

The paper gives a clear view of opposing view

Potentially stock markets could attract more equity financing from abroad, but until other important constraints are lifted they unlikely will become major sources of finance. Stock markets in Sub-Saharan Africa loose out because of their small size and very low liquidity (as matter of speaking: the NYSE trades more before tea time than all of Africa in one year). According to experts a stock exchange must have $50 billion in market capitalization and $10 billion in value traded to attract any interest from global emerging market funds. Only South Africa's market is large enough and hence absorbs just about all of equity financing going into Africa. The barriers to improve are huge. Few companies are in the formal sector and when they are moving into the formal sector they will face structural development bottlenecks, such as the lack of infrastructure, human capital, and diversity in economic structure, which tend to keep them small and non-dynamic. Developing a stock market will not change this by anything much and because of their small size foreign investments into that market should also be expected to be quite volatile. One should also expect that a much bigger role must be given to the development of domestic bond markets and improve mechanisms for those countries to issue bonds on international capital markets in order to provide for the finance needed for long-term development.

Stock markets and financial market efficiency

Table 1

Financial Depth W[illegible]ldwide, 2003

As shares of	[illegible]	Stock	[illegible]	Debt Secto[illegible]	[illegible]
[illegible]	[illegible]	0.63	0.30	0.27	0.67

[illegible]ncial Stability Report 2005

Source: IMF Fi[illegible]

Table 2

Financial structure worldwide

As shares of total assets	Stock Market	Debt Sector		Bank	Total
World	0.23	0.16	[illegible]	0.42	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
of which					
Germany	0.13	0.15	0.36	0.50	0.36
France	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]