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Africa's Emerging Stock Markets

by Todd J. Moss and Charles J. Kenny

A new trend has recently emerged in the financing of sub-Saharan Africa's economic development: the national stock exchange. Not long ago, few observers would have believed that Africa could establish, sustain, and develop a significant equity market sector, much less attract foreign investors. Yet today there are 12 operating stock markets in sub-Saharan Africa with a total capitalization of over $291 billion. Although this dollar amount is small compared to the $6.9 trillion U.S. market and less than Hong Kong's $304 billion, the emergence and expansion of stock markets in sub-Saharan Africa will help attract private investment and represents a significant step toward integration into the global financial marketplace. Many of these markets are offering dramatic returns for investors. Côte d'Ivoire's stock price index shot up more than 140 percent in 1995, making it the world's best performer that year. Although sub-Saharan stock markets are relatively new (nearly half have opened in the past seven years), there are still some trends that can be discerned and implications examined for both Africa and foreign investors.

Present Limits, Future Promise

As of 1996, stock exchanges are operating in Botswana, Côte d'Ivoire, Ghana, Kenya, Malawi, Mauritius, Namibia, Nigeria, South Africa, Swaziland, Zambia, and Zimbabwe. Tanzania and Uganda are on the cusp of opening their exchanges and plans are in the works for bourses in Ethiopia, Lesotho, Madagascar, and Mozambique. In addition, a project is under way to transform Côte d'Ivoire's exchange in Abidjan into a West African regional stock exchange by 1998.

Market Size. South Africa's Johannesburg Stock Exchange (JSE) has been in operation since 1887 and boasts a capitalization of over $280 billion. As the world's tenth largest stock market, it dwarfs by far the other sub-Saharan exchanges, which are distinguished by their small size, in both relative and absolute terms. As of January 1996, the total capital invested in sub-Saharan stocks outside South Africa was $10.8 billion—only 0.6 percent of all emerging-market capitalization, or less than 1/600 the size of the U.S. market. Sub-Saharan exchanges other than the JSE range from the $189 million Namibian market with 10 listed companies to the $2 billion Zimbabwe Stock Exchange with 64 companies (see Table 1).

The exchanges are also small relative to their own economies. Market capitalization in Nigeria is only 8 percent of GNP; it is between 25 and 35 percent in Kenya, Ghana, and Zimbabwe. In contrast, most stock market capitalizations in Asia and Latin America total more than 100 percent of their countries' GNP, with many above 200 percent.

Key factors restricting market size include the prevalence of limits on foreign ownership and weak local demand. Zimbabwe and Ghana have set 35 percent and 74 percent respectively as the upper limit on foreign ownership of any single stock. Analysts suggest that foreign investment comes close to the 35 percent ceiling in Zimbabwe, and reaches as high as 60 percent of capitalization in Ghana. In Kenya, a sizable middle class and a relatively well-developed financial intermediary sector have enabled active local involvement in the market. During the April 1996 Kenya Airways privatization, for example, the government received 112,000 domestic applications to buy stock. Even in Kenya, however, the weakness of the domestic capital market is a barrier to further market growth.

Liquidity. These small bourses are highly illiquid—that is, shares are rarely traded. Indeed, 8 of the world's 12 least liquid exchanges are in sub-Saharan Africa (see

Table 2). None of the stock markets south of the Sahara had turnover above 10 percent of capitalization in 1995, compared to 226 percent in Turkey, 115 percent in China, and 86 percent in the United States.

The markets also tend to be dominated by a few large companies. Five companies account for 75 percent of transactions in Abidjan, while one stock—Ashanti Goldfields—accounts for over 90 percent of Ghana's market capitalization.

Sub-Saharan bourses are often open for only a few hours per week. For example, the Ghana Stock Exchange is open for three hours, three days a week, and trading is frequently marked by long silences.

Illiquidity, combined with poor regulatory procedures and slow clearance processes, can lead to spectacular delays (up to six months in Kenya, for example) in the purchase, delivery, and sale of shares. Once money is advanced to a broker, investors may be vulnerable to high inflation until the shares are actually purchased. A six-month delay with current Kenyan inflation of 10 percent can translate into an up-front loss (in terms of purchasing power) of nearly 5 percent. Another delay may ensue before the investor actually receives custody of the shares, during which time he or she is unable to sell and therefore exposed to further risk by a weak brokerage system.

Volatility. As a result of their small size, illiquidity, and often unstable political and economic environments, these infant markets have been extremely volatile (see Table 2). The Zimbabwe Stock Exchange Industrial Index, for example, reported spectacular gains (in U.S. dollars) of 133 percent in 1990 and 110 percent in 1993, but losses of 55 percent in 1991 and 59 percent in 1992. The country's mining index has displayed similar peaks and troughs, surging from 198 points to 987 in just nine months after June 1993.

P/E Ratios. On the whole, sub-Saharan stocks remain cheap. The average price-to-earnings (P/E) ratio is 2.7 for Ghana, 6 for Kenya, and 7.8 for Zimbabwe, whereas U.S. markets currently trade at an average P/E ratio of more than 17. Low P/E ratios reflect, among other factors, high political risk and the heavy concentration of these markets in sectors with slow productivity growth. In 1994, 6 of the sub-Saharan region's 10 largest listed companies were involved in the production of primary commodities; the remaining four were in the banking and brewery sectors.

Hopeful Trends. Yet the foregoing statistics do not tell the story of the whirlwind changes now under way in sub-Saharan stock markets. Despite their small sizes and low turnover, these exchanges are rapidly picking up steam. The subcontinent's exchanges (outside South Africa) doubled their capitalization between 1993 and 1995. Over the 18 months ending in August 1994, Kenya's market capitalization tripled to nearly $2 billion. Liquidity is also rapidly improving. Trading figures for 1995 reached $376 million, four times the level of 1990. During the period from 1991 to 1994, the number of trades on the Ghana Stock Exchange soared from less than 2 million to over 87 million shares annually. Regulations on ownership and income repatriation continue to be liberalized (most notably in Ghana, Kenya, and Zimbabwe) and information is becoming more easily available. In addition, some African companies have begun cross-listing on exchanges in London, New York, and Toronto. In early 1996, Ashanti Goldfields became the first indigenous sub-Saharan company to be fully listed on the New York Stock Exchange (symbol ASL). As a result, foreign involvement is growing and the range of shares bought by investors is expanding.

Why Stock Markets Are Expanding

New Private-Sector Emphasis. One reason why new stock markets have sprung up and older ones have blossomed is a major ideological shift among Africa's economic policymakers. Many of the African nations that became independent in the 1950s and 1960s initially followed a course of tight state control of the economy and antagonism toward capitalism, which was perceived as being linked to colonialism and exploitation. But with the collapse of the socialist model and the increasing influence of international financial institutions (especially the International Monetary Fund and the World Bank), Africa has seen a revolutionary shift away from state controls and toward liberalized economies, including open investment environments. Although most African governments have continued to intervene heavily in their economies, financial controls are being loosened. Exchange rates have been floated and regulations eased on capital flows, including repatriation. Although it is reasonable to ask whether the continent's current embrace of international capital markets is a permanent change or merely the economic flavor-of-the-month, Africa seems to have little choice for the foreseeable future but to follow liberalizing adjustment policies.

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Markets as a Tool of Reform. Stock markets can be viewed as a tool as well as a symptom of African economic reform. Operational financial markets can help build credibility with investors and serve as a sign of a country's increased emphasis on the private sector. For example, in 1989 Ghana initiated a Financial Sector Adjustment Program (FINSAP) aimed at reforming and improving the banking sector and developing capital markets. Although FINSAP has had only limited success, it remains a key part of Ghana's strategic economic plan.

A few countries have used public floatations of privatized state industries with shares reserved for citizens as a means of dampening political backlash and avoiding accusations that the "family silver" is being sold off to foreigners. This approach has met with varying degrees of success. Kenya, for example, generated so much domestic interest in the privatization of Kenya Airways that the initial local stock offering was massively oversubscribed. Ghana's 1994 sale of portions of Ashanti Goldfields in Accra and London was blocked in court for months by angered nationalists, however. When it finally took place, the stock was offered in such large blocks that few Ghanaians could afford to invest.

Using the stock market as a vehicle to smooth the privatization process can also assist the development of the market itself by making attractive new issues available for trading. Many analysts argue that African nations should create interest in their stock markets by offering major industries as "flagship" issues, Ashanti Goldfields and Kenya Airways being prominent examples. It remains to be seen whether Africa will follow the Latin American example and offer the biggest prize of them all—telecommunications.

Markets as a Capital Magnet. Stock markets can bring enormous amounts of money into capital-starved economies. Equity investors may be more willing than others to take the plunge into Africa, because it is easier to dispose of equities than direct investment or sovereign loans. According to the World Bank, $22 billion in portfolio equity flowed into developing countries in 1995, with sub-Saharan Africa (excluding South Africa) receiving $465 million or about 2 percent. In 1993, before the Mexican peso crisis, the total was $45 billion, with only $144 million (0.3 percent) going to sub-Saharan Africa. These emerging-market flows are heavily concentrated in Asia and Latin America, but Africa's share is growing. It is worth remembering that 10 years ago Indonesia received almost no foreign equity investment and even South Korea was once considered an economic basket case.

In addition to attracting new foreign investment, stock markets can be used to allocate capital more effectively and to tap into underutilized domestic funds. Many African countries have notoriously low savings rates and inefficiently distributed capital resources. Although this is partly due to the prevalence of poverty, major causes include economic mismanagement, large government budget deficits, and a lack of efficient or reliable financial institutions. Domestic savers choose to hold their assets in less risky (and less productive) forms, thereby reducing the amount of capital available for economic expansion. In Ghana, for example, there is anecdotal evidence that an artificial construction boom is occurring because small businessmen have so little confidence in the financial system that excess capital is often used to build unneeded buildings or additional rooms.

The Prestige Factor. Emerging stock markets are trendy. For governments, stock exchanges are the latest prize that every country must have—a symbol of legitimacy akin to national airlines a generation ago. Meanwhile, foreign investors have caught emerging-markets fever. Improved communications and information technology have made global trading easier, while increased use of financial innovations, such as Global Depository Receipts (GDRs) and American Depository Receipts (ADRs), allow foreign investors to purchase shares of foreign companies on their home exchanges.

Favorable Global Trends. The two most significant reasons for the timing, size, and direction of the emerging-market phenomenon are the decline in interest rates in the West and the new strength of developing countries' economies. U.S. investment in these markets has greatly increased, but only enough to keep up with the remarkable expansion of emerging markets as a proportion of the global market. Between 1983 and 1993 the value of developing-market stock markets increased 20-fold from $100 billion to $2 trillion.

Low interest rates and overpriced markets in the West, combined with the incessant flood of money into mutual funds and retirement plans, forced a search for new investment destinations. While fantastic returns in Asia and Latin America spurred interest in developing economies as a whole, the optimism over postapartheid South Africa and the opening of markets there drew attention south of the Sahara. Indeed, there has been global interest in the region, with flows originating not only from North America and Europe, but also from Asia.

Funds specializing in African equities have sprung up in some of the most prominent British and U.S. investment houses, including Baring Asset Management, Morgan Stanley, Mercury, Alliance Capital, and the Calvert Group. Demand has been high (the Morgan Stanley Africa Investment Fund hoped for a $60 million capitalization but raised $300 million), but these funds have made only limited sub-Saharan investments beyond South Africa. Only about 15 percent of the Morgan Stanley fund, 6.5 percent of Alliance's, and 3.9 percent of the Mercury fund are invested north of the Limpopo River. Indeed, such funds appear to possess more capital than there are attractive and accessible African equities in which to invest it. Whether African equity markets will grow and develop enough to meet this demand is an open question.

The Economic Impact of Stock Markets

Although the evidence is preliminary, the findings of World Bank researchers Ross Levine and Sara Zervos suggest that

Table 1
Sub-Saharan African Stock Exchanges

Country	Listings	Capitalization ($ millions)	
	1995	1990	1995
Botswana (opened 1989)	12	n.a.	397
Côte d'Ivoire (1976)	31	549	867
Ghana (1985)	19	n.a.	1,680
Kenya (1954)	56	453	1,889
Malawi (1996)	n.a.	n.a.	n.a.
Mauritius (1989)	28	268	1,381
Namibia (1992)	10	n.a.	189
Nigeria (1961)	181	1,372	2,033
South Africa (1887)	640	137,540	280,526
Swaziland (1990)	4	17	339
Zambia (1994)	n.a.	n.a.	n.a.
Zimbabwe (1946)	64	2,395	2,038
Malaysia	529	48,611	222,729
Brazil	543	16,354	147,636
Great Britain	2,078	848,866	1,407,737
United States	7,671	3,059,434	6,857,622

SOURCE: International Finance Corporation, World Bank Group, Washington, D.C., 1996.

developed stock markets are correlated with improved economic performance. Specifically, an aggregate index of stock market development based on size, liquidity, and openness was found to be correlated with increased growth.

There are many possible explanations for this relationship. Stock exchanges encourage saving by providing more liquid investments, offering investment choices, and allowing risk diversification. They are also a key source of capital for corporate expansion, particularly in developing regions such as Africa. For example, approximately 43 percent of large-company growth in Zimbabwe is financed through equities, with the fastest-growing companies relying on equities the most.

Another virtuous cycle links stock market development with the maturation of banking and other financial intermediaries. The improved transaction and settlement techniques offered by a sophisticated banking sector can promote stock market efficiency and international credibility. Indeed, transactions clearance and account settlement are among the most important prerequisites for international investment. Fund managers repeatedly point to the crucial role of financial intermediaries, such as banks and brokerages, in the development of a functioning stock exchange. At the same time, the increased information flows that stock markets encourage appear to stimulate loan markets in the banking sector, leading to greater overall access to capital.

The demands of international investors—transparent activities, standardized reporting structures, timely reports—may also help to institutionalize improved flows of information. In an effort to bridge the current information gaps (and ease red tape), many African governments have set up trade and investment promotion centers both at home and abroad. Although information about African stock exchanges and companies remains difficult to find and is often out of date, guides to stock exchanges are available from many African embassies; a number of Internet World Wide Web sites provide instant information for potential investors. (See "The Information Revolution Comes to Africa" by Ernest J. Wilson III, CSIS *Africa Notes* no. 185, June 1996.)

Foreign investors are likely to insist on a stable macroeconomic environment as a condition of their continued participation, thereby encouraging sound economic policy. Because equities trade in local currency, high inflation and unpredictable currency depreciation can be a prohibitive barrier to foreign investment in domestically oriented companies, even if the environment is otherwise favorable. Many analysts point to continuing fears about the prospects of Ghana's cedi as today's major deterrent to foreign investment in that country's market.

Although currency devaluations have been an important

Table 2
Turnover and Price Change

Country	Turnover % 1995	Price Index Change % ($) 1994	Price Index Change % ($) 1995
Botswana	10.0	6.0	2.6
Côte d'Ivoire	2.2	-19.7	140.8[a]
Ghana	1.3	68.8	-22.2
Kenya	2.8	179.0	-38.9
Malawi	n.a.	n.a.	n.a.
Mauritius	4.6	56.5	-26.5
Namibia	1.6	-2.7	40.3
Nigeria	0.8	168.8	-26.9
South Africa	6.5	28.5	14.8
Swaziland	0.1[b]	25.7	-0.2
Zambia	n.a.	n.a.	n.a.
Zimbabwe	7.6	22.5	10.6
Malaysia	35.9	-22.8	1.8
Brazil	47.8	67.6	-22.1
Great Britain	77.1	-5.2[c]	19.4[c]
United States	85.7	-2.0[d]	34.1[d]

a. World's best.
b. World's worst.
c. Financial Times 100.
d. Standard & Poor's 500.

SOURCE: International Finance Corporation, World Bank Group, Washington, D.C., 1996.

part of the adjustment process (because they can lower labor costs and improve export-sector competitiveness), further major devaluations will be unnecessary if there is a stable fiscal and monetary environment. This requires an end to deficit finance and printing money to pay for bloated government budgets. Civil service rolls must be culled of dead or fictitious staff members. Subsidies to inefficient industries must be slowly phased out. These conditions also help state enterprises to become more efficient, thus preparing them for eventual sale to the private sector. Further privatizations will provide both a new (albeit onetime) source of revenue for state coffers and new listings for the domestic stock market.

The liquidity of equity markets (in comparison to the relatively fixed assets of direct investment) may enable international stock investors to impose a strict discipline on African decision makers and thereby inhibit the extreme policy swings to which the continent has been so prone in the past. Drastic changes in economic policy, let alone expropriations or nationalizations, would almost certainly cause a massive pullout by international investors.

The Political Dimension

To a greater degree than in other regions, business in Africa has relied on the state for both protection and patronage. With notable exceptions, these traditional business interests have not supported much of the liberalization agenda, which often threatens their favored positions. An emerging business class comprised of both managers and investors in companies that do not rely on state intervention for survival could become a significant new player in favor of economic reform, perhaps altering the political power balance in the process. Stock markets, as a component of economic liberalization, may help consolidate the freedom of these autonomous business groups from government domination and serve as a check on further state intervention.

As the preceding paragraph suggests, stock markets have the potential to play a destabilizing role (at least in the short term) by ushering in new flows of capital and new sources of power. The increased foreign economic ownership that open stock markets facilitate will certainly have political ramifications—in particular, accusations of neo-imperialism, a historically sensitive issue in Africa. Ghana's suspension of international trading in Accra Brewery stock once it had breached the 74 percent foreign ownership ceiling and the legal challenge to foreign ownership of Ashanti Goldfields indicate the degree of this sensitivity even in one of Africa's most open economies. Recent attacks by Zimbabwe's President Robert Mugabe on white farmers and foreign companies provide another example of the political

scapegoating that economic uncertainty can ignite. High dividends paid in Nigeria and Zimbabwe, and often repatriated rather than reinvested locally, are criticized as a drain on foreign currency reserves.

It should be kept in mind that equity investors do not typically seek any managerial control. In this sense, it would be logical to regard equity investment as less politically sensitive than direct investment. Realistically, however, foreign ownership will remain a potent African political issue—one that investors should watch closely.

Could Things Go Wrong?

From the African standpoint, technology and globalized capital markets are mixed blessings. Although the interconnectedness of financial markets and the ability to move capital instantaneously across borders can bring funds in, these factors also exacerbate the risk of volatility. The 1994 Mexican peso crisis exemplifies this danger. Dubbed the "tequila effect," the resulting investor stampede out of Mexico led to steep drops in nearly all emerging markets, from Argentina to the Philippines. Something similar could happen again. It is even possible that Africa could experience its own tequila effect through an event such as the sudden death of South Africa's President Nelson Mandela or the collapse of Nigeria's federal government.

Although the problem of volatility will lessen as African markets increase in breadth and depth, these markets will clearly remain extremely unstable for the short to medium term. African economies are highly vulnerable to shocks due to their small size and fragility, weak domestic savings rates, and reliance on primary commodities and external inputs. Under these circumstances, a bad shock can both stunt growth and possibly scare away investors. Some World Bank studies suggest that markets with the most liberal investment regimes and greatest liquidity are actually best protected from such shocks. A major danger, however, is that African governments might react to economic instability with a reflexive reimposition or tightening of price and capital controls, a step that could start a downward spiral into a full-blown financial crisis and break the hard-won confidence of both policymakers and foreign investors.

An equity flow reversal could also be caused by economic shifts in the developed world. Part of the dramatic increase in U.S. capital outflows can be explained by low domestic interest rates. Although most Africa-related funds advise their clients to invest for the long term, an increase in U.S. interest rates could have negative consequences for emerging markets. The same holds true for a prolonged period of market nervousness in the West. Because African stock exchanges are among the world's riskiest markets, foreign capital placed there will tend to be cautiously invested but could be pulled out quickly.

Even a seemingly successful evolution of African stock markets could have an unexpected and undesirable consequence—the premature withdrawal of aid. Rising private capital flows could be used to justify the cessation of both bilateral and multilateral assistance. Recent debates in the U.S. Congress suggest that this may already be happening.

Although private capital will certainly play an increasingly important role in Africa, public-sector investment with support from the international financial institutions and donors remains essential. Portfolio inflows into sub-Saharan Africa (excluding South Africa) between 1990 and 1995 were under $2 billion, whereas official flows to the region were $20 billion in 1995 alone. Aid simply cannot be replaced by private capital flows for many investments in health, education, and infrastructure. It will be well into the next century before private capital flows entirely replace official transfers, particularly in African countries where economic recovery has not begun.

Implications for Foreign Investors

A number of factors make Africa an attractive destination for investment capital. In 1995, African real GDP grew at a rate of 3.2 percent—with Côte d'Ivoire at 6.5 percent, Kenya at 5.0 percent, and Ghana at 4.5 percent. The International Monetary Fund estimates that growth in sub-Saharan Africa will amount to 5.4 percent in 1996. Many analysts speculate that rising Asian demand for primary commodities will push up prices for African exports. Continued policy reform and the potential size of Africa's consumer market are also positive considerations.

For the international investor, Africa's new markets are a means of diversifying portfolios—something particularly desirable when equities in the investor's home market are overpriced. The Zimbabwe Stock Exchange, for example, has near-perfect independence from the Dow Jones Industrial Average, with a correlation of 0.03. As long as returns remain acceptable and prospects for economic and political stability seem reasonable, Africa will develop as an appealing vehicle for reducing portfolio risk.

Of course, political risk remains a primary concern. One problem for many international investors will be developing ways of adequately analyzing such risk in sub-Saharan Africa. The combination of a lack of experience in the region (less of a problem for the British and French than for Americans or Asians), media stereotypes of African crises, and real problems of instability and violence create special barriers to investment. Accurate calculations of political risk are difficult with regard to countries with complex and poorly understood social and political arrangements. In addition, information is often expensive, inaccessible, or nonexistent. Combined with the small size of the region's markets, this makes equity research a challenging and costly process.

Because they are in the early stages of development, sub-Saharan markets may exhibit peculiar distortions and responses. Problems of distribution, efficiency, and illiquidity contribute to significantly imperfect markets, rendering even general economic predictions problematic. The dearth of stock market listings and the small number of investors can create bizarre conditions. One fund manager

with extensive experience in exotics described how he and another institution were the primary private holders of a particular Zambian stock. When one wanted to buy or sell shares, they would have to call the other in order to make the deal. This anecdote highlights the scale of the liquidity problem in Africa.

Finally, investors must be mindful of the fits, starts, delays, and deceptions that characterize African economic reform programs. Many of the reforms undertaken, including liberalizing investment, were carried out against the wishes of powerful political interests, sometimes after considerable pressure from international donors. Given this context, it is not surprising that many changes are often poorly implemented, ignored, or abandoned at the eleventh hour. (See "Can Ghana's Economic Reform Survive the 1996 Elections?" by Todd J. Moss and David G. Williams, CSIS *Africa Notes* no. 175, August 1995.) Although massive reforms have taken place, particularly in Ghana and Uganda, most African countries still have a long way to go.

Strengthening the Market

Although remarkable progress has been made in overcoming logistical, political, and ideological barriers to the creation and growth of stock markets, serious challenges must be met if sub-Saharan Africa is to join other emerging-market regions as a destination for large sums of private capital. Weaknesses remain in three fundamental market attributes—liquidity, efficiency, and volatility. These limitations are partly due to the small, poor economies that host these markets, but appropriate institutional and policy changes could improve the operation of the markets.

African governments can assist the development of stock markets by creating an adequate but not overly restrictive regulatory structure. Legal issues of contractual enforcement, prevention of fraud, and "insider trading" are also significant. Fund managers continually point to the need for efficient and reliable clearance and settlement procedures. Planners of new exchanges can visit existing exchanges to see how they operate (the Singapore and Toronto markets are often cited as excellent models). The cost of running a technologically efficient bourse has plummeted (e.g., Morocco's stock exchange already uses the same computerized trading system as the Toronto market).

Improved reliability and availability of information can go a long way toward easing fears and encouraging new foreign investment. Exchanges must insist that companies provide regular audited reports and announce major changes or market activities. The exchanges themselves could provide timely price and volume data.

More broadly, a healthy banking sector can help to build a stronger financial market and increase domestic liquidity. At present, banking systems and other financial institutions across the continent are woefully inadequate. Kenya, with one of Africa's most developed banking sectors, has only 15 bank branches per million people. In Uganda, domestic credit extended by banks amounts to just 4.8 percent of GNP compared to 47.6 percent in China. (See "Increasing Investment in Africa: Lessons To Be Learned From Ghana" by Tamara J. Duggleby, CSIS *Africa Notes* no. 150, July 1993.)

No stock market can survive without solid domestic participation. Moreover, the best way to minimize the potential negative impact of any sudden outflow of foreign capital is to develop a substantial domestic investment base. Governments can help by creating incentives, or at least minimizing disincentives, to save and invest. The tax system should encourage rather than discourage investment (by both foreigners and domestic investors), and incentives to reinvest dividends can be crafted. Governments can follow Chile's successful example and encourage the establishment of private savings and pension plans that could invest in the local stock market. State pensions and insurance schemes could be allowed to invest in equities rather than being required to purchase government debt. Governments must also refrain from monopolizing savings pools. (In recent years, the Ghanaian public sector has swallowed up almost three-quarters of total available credit, squeezing out private-sector demand.) Even a perfect regulatory structure will be meaningless, however, if there is no confidence in the economy. Overall, therefore, the best way that governments can help to create an investor-friendly climate is to maintain macroeconomic stability.

The small size of sub-Saharan stock markets is a serious problem—one that has led some African companies to float stock abroad in larger developed markets. More than 90 percent of trades in Ashanti Goldfields occur in London and New York. Without further development—through privatizations, new listings, and improved financial infrastructure—many African stock markets will remain too small to be viable. Companies operating in Africa will continue to turn to overseas markets to raise equity capital, rather than waiting in the hope that foreign capital will risk entering tiny and stagnant local markets.

One answer to the problem of small markets may be to establish regional exchanges and cross-list shares from smaller bourses. This is particularly attractive in the West African portion of the Franc Zone, where such a project has already begun with the support of the International Finance Corporation, the World Bank affiliate tasked with encouraging private-enterprise development. Such an arrangement might also make sense in other regions as a means of consolidating start-up and operations costs and increasing the number of listings and market liquidity. This is especially true for the poorer or smaller countries, such as Mozambique or Lesotho, where a national stock market makes little sense.

Finally, stock exchanges are no panacea for Africa's financial problems, but merely one instrument that must be integrated into a larger economic strategy. By themselves, financial intermediaries such as stock markets can do little. But combined with other elements—privatization, trade liberalization, banking reform, sound fiscal and monetary policies, effective use of foreign aid—stock exchanges can be

very useful. In fact, many of these elements reinforce each other and can create a self-perpetuating cycle. Only when kept in perspective and seen as one small (albeit important) piece in the puzzle of Africa's economic recovery will stock markets live up to current expectations.

In Sum

Creating and investing in African stock markets is a leap into the unknown. One can be sure that they will remain a small consideration for foreign investors, but if they continue to grow they could have a huge impact on African economies and lives. For now, Africa seems to have embraced stock exchanges, and enticing investment opportunities are clearly available for the thick-skinned and patient investor.

Integration into international financial markets could provide a window of opportunity for Africa to pull itself out of its current malaise, enter the global economy, and move toward sustained growth. Stock markets can help this process not only through their role in attracting foreign capital and providing a vehicle for privatization, but also because their presence in an economy improves the overall business and investment climate and reinforces other elements of economic reform. Africa's ability to integrate and modernize its economies, including the successful development of financial institutions such as stock exchanges, will be the key to turning the continent's white elephants into emerging lions.

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