Carving a Place for Africa’s Emerging Capital Markets in a Globalized World

Opening Address

By Patrick Asea
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at the second sub-Regional Workshop of the African Capital Markets Development Program

Cairo, Egypt
March 30, 2004

Mr. Sameh El-Torgoman, Chairman of Cairo and Alexandria Stock Exchanges
Distinguished participants,

It is a great honor for me to open this sub-regional workshop of the Economic Commission for Africa's Capital Market Development Program. I am very pleased to welcome such a distinguished group of policymakers, renowned academics, senior government officials, security market regulators, CEOs of stock exchanges and other top private sector executives from North Africa and elsewhere.

We, at the Economic Commission for Africa, feel privileged to be co-sponsoring this event with the Cairo and Alexandria stock exchange and JP Morgan---the world famous investment bank. We look forward to continuing this unique "public" private collaboration as we work together to build strong and vibrant capital markets in North Africa.

Ladies and Gentlemen,

You have a busy schedule ahead of you over the next three days in which you will cover several important themes related to emerging capital markets. Let me just offer some observations on why we need to work hard to improve the attractiveness of our capital markets and what the key policy measures that need to be in place to achieve this objective.

The reality today is that an increasing proportion of private flows to developing countries comes in the form of portfolio equity capital. Used wisely, capital markets have the potential to accelerate economic growth by raising capital for financing domestic investment, making risk diversification easier for investors, and strengthening corporate governance.

The emerging capital markets of North Africa are well poised to benefit from the increased flows of capital from globalization Nonetheless, they face a special set of challenges as they compete with other emerging markets in Asia and Latin America for new issues and investors. The competition is tough.

It is well known that the risk-adjusted rate of return is higher in Northern African capital markets than many other places. However, there are certain attributes of the markets that reduce investor attraction. To begin with, markets are shallow and illiquid; transaction costs are high; and regulatory frameworks are not very strong. Underlying economic structures do not help much, either. For instance, the prevalence of frequent and deep macroeconomic shocks means that risks remain high for investors.

These are issues that bother investors and policy makers alike. On the investors’ side, there is a concern about the robustness of our emerging markets. This concern is largely to do with poor market infrastructure that results in delays in trade and settlement; lack of transparency as a result of weak regulation; and illiquid markets that prevent investors from liquidating their interests quickly.

Policy makers on the other hand are worried that deeper financial integration will increase volatility in capital markets and make economies more vulnerable to external shocks. They are also concerned that the increasing importance of foreign investors in capital markets may not bode well because these investors are driven by herd like behaviour that may threaten the stability of the capital markets. In short, policy makers fear greater susceptibility to financial meltdowns as a result of deeper integration. They only have to look to the emerging market meltdowns in South East Asia and Latin America to find examples of market volatility playing havoc on otherwise strong economies.

What is clear, however, is that benefits brought by capital markets are enormous and cannot be ignored. What we need to do then is to put in place safeguards that would minimize the risks and maximize the benefits. These measures must also address the concerns of investors that I mentioned earlier.

What are these safeguard measures?

A key safeguard is reforms to improve market infrastructure—these include clearance, settlement, and depository system. Another key safeguard is reforms to strengthen regulatory and legal frameworks. Let me focus the next few minutes on the key role played by regulatory frameworks in our capital markets.

Regulatory authorities are responsible for making markets fair, efficient and safe. Fair markets are those in which the investor is protected from fraud and abuse, while efficient markets improve competitiveness and provide adequate infrastructure and information for the market to function. Safe markets are those that provide protection against systemic risks. This is a tall order for regulators in emerging markets. In the next few days, practitioners themselves will share their experiences and challenges with us.

What needs to be done to strengthen the regulatory framework? Over the years, a consensus has emerged on key elements of a regulatory model. Underlying this model is the recognition that better public disclosure is necessary and self-regulation by the market and industry is crucial.

What are the key elements of this model?

First, the regulatory framework should ensure that timely and accurate information is made available to investors so that they can make their investment decisions in a fraud free environment.

Second, the self-regulation of markets should be encouraged. This means that market participants--and not the government--should be responsible for initiating and enforcing market rules and regulations. This function can be largely undertaken by exchanges, broker-dealer associations, and accounting and auditing associations.

Third, prudential rules and oversight of investment firms need to be put in place to protect investors from the insolvency of firms.

These key regulatory functions are essential to foster market confidence and expansion. In turn, a regulatory model based on these elements will essentially address the concerns of both the investors and policy makers that I outlined above.

Putting in place a sound regulatory framework is necessary but not sufficient. The other essential component is enforcement. Without enforcement investors would not have confidence in the capital markets and consequently, these markets may never reach their potential. For the enforcement to be effective, roles of various components of regulatory framework should be clearly defined. And the regulatory body should be independent from all interest groups. It is our belief that one independent regulator should be in charge of the capital market.

Getting the regulatory and legal framework right is crucial to promote investor confidence and reduce systemic risks and volatility that the policy makers are concerned about. Paying attention to this aspect is crucial if North African markets are to successfully compete with other emerging markets.

With these few observations let me hope that I have put on the table a few key issues that need to be seriously discussed in the coming couple of days. Let me assure you that ECA is committed to work with you in strengthening capital markets in North Africa. It is my hope that the recommendations coming out of this meeting will outline a framework of long-term collaboration between ECA and North African capital markets that would ultimately strengthen market competitiveness.

I THANK YOU.