CHAPTER 2

Capital Market and Financial Sector Development in Sub-Saharan Africa

Paul V. Applegarth

Executive Summary

Capital market and financial sector development can be an important facilitator of economic growth in sub-Saharan Africa. It also supports U.S. strategic interests and is a prerequisite for the success of other U.S. bilateral and multilateral initiatives, including counterterrorism efforts, increased transparency, and improved governance. The U.S. government should recognize this by

- Establishing capital market and financial sector development as an explicit objective of U.S. development assistance efforts in sub-Saharan Africa;
- Institutionalizing assistance to capital market and financial sector development within the government; and
- Providing comprehensive U.S. government support for the essential components of capital markets through increased funding, technical assistance, and coordination with other donors.

Establish an explicit objective. Establishing capital market and financial sector development as an objective does not mean that it should be given the highest priority to the exclusion of other development objectives and programs. However, it should not be deliberately excluded either, as it may have been at times in the past. Promoting capital market development in a country should complement other efforts to promote that country's development. It should be recognized as an important and legitimate component of a country's development program

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and should receive the support of U.S. government departments and agencies through allocations of their staff and financial resources. Fortunately, an attractive aspect of including capital market development in a country's development program is that financial sector improvements should be less expensive than, for example, infrastructure or traditional poverty alleviation efforts. Much of the effort will likely take the form of technical assistance and training. The development benefit relative to dollar of expenditure should be high.

INSTITUTIONALIZE ASSISTANCE WITHIN THE U.S. GOVERNMENT. Several steps can be taken to institutionalize financial sector development assistance within the U.S. government, including

- Bringing more people with capital market skills and experience into the government by, for example, establishing a separate salary scale within the government for financial markets experts;
- Establishing an interagency working group devoted to capital market and financial sector development issues;
- Encouraging the Millennium Challenge Corporation (MCC) to take a leadership role by including financial sector and capital market development programs within its activities; and
- Using U.S. influence with the G-8 and with international financial institutions such as the World Bank and the International Monetary Fund (IMF) to increase their efforts in support of capital market and financial sector development.

PROVIDE COMPREHENSIVE ASSISTANCE FOR CAPITAL MARKET DEVELOPMENT. Because formal savings channels do not capture a large amount of local wealth—held, for example, in cattle, houses, and land—there is a particular need for initiatives to boost domestic savings and investment in sub-Saharan African markets.

Successfully mobilizing these local funds can yield amounts that are multiples of the amounts provided from traditional Official Development Assistance (ODA) and from foreign direct and portfolio investment. It can also improve resource allocation by placing capital in the hands of local stakeholders who are better positioned to make informed decisions than foreign investors operating at a distance.

Important actions that the U.S. government can take to mobilize local capital and to build key components of sub-Saharan countries' financial sectors are

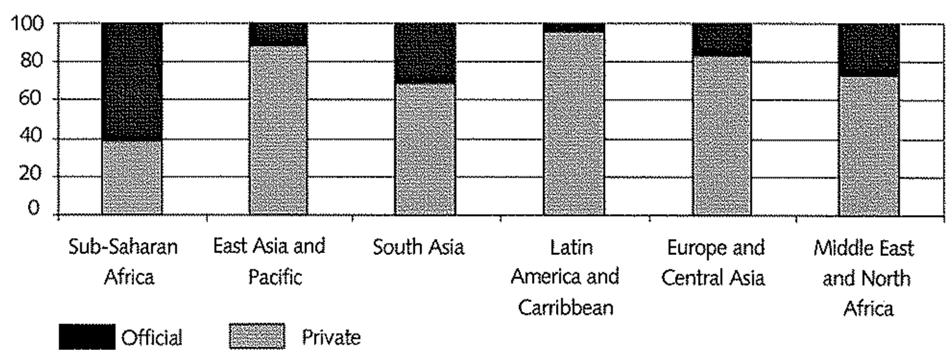
- Significantly increasing technical assistance, particularly from the U.S. Treasury and other government organizations with financial expertise;
- Strengthening domestic banking institutions, payment systems, credit bureaus, and private pension funds;
- Consolidating the excessive number of sub-Saharan stock exchanges;
- Expanding current State Department initiatives to promote sovereign credit ratings and to establish benchmark yield curves;

- Establishing dedicated Overseas Private Investment Corporation (OPIC) funds, and
- Working with U.S. universities and the private sector to strengthen university and vocational financial, legal, and regulatory training.

Introduction

Since the early 1990s, aggregate private capital flows to developing nations have rapidly outpaced levels of Official Development Assistance (ODA). This is an important and positive trend given the limited amounts of, and competing demands for, ODA. However, sub-Saharan Africa, aside from South Africa, remains the only region of the developing world where this trend has not been realized: annual levels of development assistance inflows continue to be higher than private capital flows, and private capital flows in aggregate remain small.

Figure 1. Distribution of Official vs. Private Long-Term Net Resource Flows (Year 2000) (in percent)



Source: World Bank, *Global Economic Prospects 2003,* figure A.3.10a.
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Simultaneously, only low levels of domestic savings can be mobilized because of a high level of capital flight out of the continent[1] and because a large amount of local wealth—real (cattle, houses, land, small businesses, etc.) and cash—is not captured by the formal sector.[2] Constrained levels of ODA, small amounts of private foreign investment, and low levels of available domestic capital combined with high investment needs create a large financing gap that is impeding development.

1. Capital flight captures 39 percent of private wealth generated in Africa, according to most recent available data (World Bank, "Can Africa Claim the 21st Century?" March 2000). Approximately $187 billion in African capital was invested outside the region between 1976 and 2003 (Abraham Mclaughlin, "Stock in Africa Going Up," *Christian Science Monitor,* December 11, 2003).

2. Hernando DeSoto in *The Mystery of Capital* (New York: Basic Books, 2000), p. 5, estimates that "the value of savings among the poor is, in fact, immense—forty times all the foreign aid received throughout the world since 1945."

Capital markets—encompassing markets for stocks, bonds, and other financial instruments—traditionally are thought of as exchanges or other centralized institutions for transactions between willing investors and those companies and borrowers in need of funding. This initiative to examine steps the U.S. government can take to promote capital market development arises from a recognition that generating appropriate systems, mechanisms, and incentives will encourage international and African investors to mobilize funds to help fill this gap, and thus boost sub-Saharan Africa's economic growth and promote long-term poverty reduction. There is a particular need for initiatives to boost domestic savings and investment.

Given the limited state of development of markets in many sub-Saharan countries, targeting capital market development in the region demands a broader commitment—i.e., a commitment to overall *financial sector development,* including, but not limited to, the banking system, pension and insurance mechanisms, social security schemes, small and medium-sized enterprise (SME) finance, and access to private nontraded sources of finance. This in turn requires a strong emphasis on developing concrete mechanisms for building a country's financial architecture, which can serve as the base for effective management of existing financial resources and the mobilization of additional ones.

Assessment of Current U.S. Efforts in Capital Market and Financial Sector Development

To date, the U.S. government has placed little concerted focus on building the financial sector in sub-Saharan Africa, and it is currently ill-equipped to handle the subject in a substantial way. Though congressional hearings concerning "Africa's Emerging Capital Markets" have been held in the past decade, a tangible mobilization of resources and programmatic effort has failed to emerge. This is in part due to confusion and a lack of consensus about what constitutes "capital market development."[3] It can also be attributed to the lack of an appropriate government home for capital market efforts. Although the U.S. Agency for International Development (USAID) is the nation's designated international development agency, it has devoted very few resources to financial sector and capital market development in recent years. For instance, USAID has two people to staff its global financial sector development efforts, and the leader of these efforts is now spending half of his time on Iraq.[4] Moreover, some aspects of capital market development and economic growth programs fall more within the realm of technical expertise held by the

3. In interviews with various governmental agencies (including the U.S. Treasury, USAID, the Overseas Private Investment Corporation [OPIC], United Nations Development Program [UNDP], the International Finance Corporation [IFC], World Bank, and the International Monetary Fund [IMF], private sector companies, and foreign-based participants in African development about their programs, responses to questions about capital market development covered the spectrum from trade and private sector development to foreign direct investment to commercial bank flows.

4. Recognizing the importance of financial sector development, USAID's financial sector team is currently developing a new strategy. However, with its current resources and staff, its ability to implement a meaningful strategy will remain limited.

Department of Treasury, the Overseas Private Investment Corporation (OPIC), and others, than they do within USAID.

As a result, capital market development has been overlooked in the face of other economic development initiatives, and the few efforts that have taken place have been, for the most part, uncoordinated. Therefore, going forward, it is critical to delineate and address "capital market development" as a category of its own, distinct from other economic development efforts. In addition, an appropriate "home" and a new framework for providing assistance for financial sector development may be called for.

Finally, increased U.S. attention to capital market development does not imply only unilateral action. There are a number of ongoing capital market initiatives by European bilateral donors to which the United States has yet to contribute, or to which existing U.S. allocations are quite minimal. Partnering some U.S. efforts with such initiatives, as well as with some of the multilateral and African initiatives discussed further below, is an effective way of streamlining the cost and manpower needed to implement an effective capital market development strategy.

Why capital market and financial sector development is important. Capital market and financial sector development is important for three key reasons: it promotes economic growth; it supports U.S. strategic interests; and it complements and reinforces existing U.S. bilateral and multilateral development initiatives.

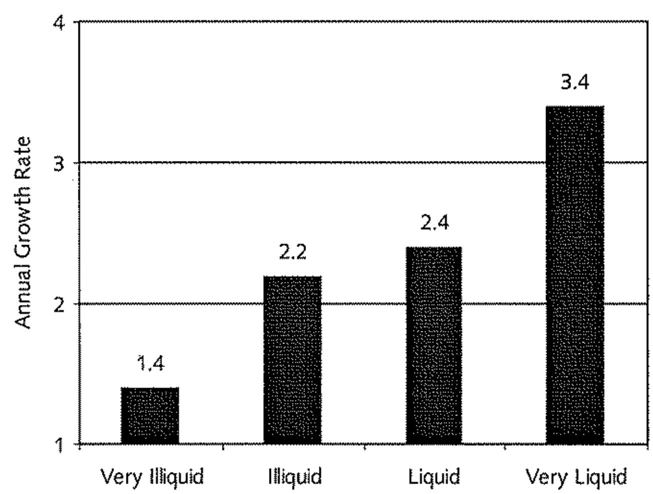
- Capital market and financial sector development promotes economic growth. In its recent publication, *Finance for Growth,* the World Bank concluded, "Getting the financial systems of developing countries to function more effectively in providing the full range of financial services . . . is a task that will be well rewarded with economic growth."[5] More specifically, capital market and financial sector development promotes growth in the following ways:
- It promotes private sector development. Access to and ease in movement of financial resources fundamentally influence the prospects for private sector growth in developing country economies. The extent that existing firms can borrow and grow, the ability of emerging firms to act entrepreneurially, their willingness to invest in assets, and the ability to allocate their assets freely—all factor into economic growth. An examination of the levels of capital market development and economic growth in Asia with those in sub-Saharan Africa shows that India and China continue to add several hundred companies to their stock exchanges annually. The immediate benefit of the flourishing capital market activity in Asia is reflected in the sizeable increase in the momentum of private sector development. In contrast, the number of companies added by each of the major sub-Saharan African exchanges other than South Africa was generally fewer than 10.
- It increases liquidity, which is linked to economic growth. An increase in the number of firms and investors participating in exchanges generates

5. Gerard Caprio and Patrick Honohan, *Finance for Growth: Policy Choices in a Volatile World* (New York: Oxford University Press, 2001), p. 2.

liquidity, or the volume of active *trading* that occurs. Liquidity has a proven relationship with economic growth; recent studies have found that countries with liquid markets experience faster rates of capital accumulation and greater productivity gains. Figure 2, adapted from a study by Ross Levine,[6] depicts this positive relationship.

As liquidity increases, firms gain increased assurance that they will be able to exit from longer-term investments. They therefore become more willing to make the permanent investments critical to development. Simultaneously, local consumers are more willing to mobilize domestic savings. This process allows for a market-based system of allocating financial resources, whereby more resources are more efficiently distributed to the more productive and innovative firms.

Figure 2. Economic Growth of Countries by Stock Market Liquidity between 1976 and 1993 (in percent)



Source: Adapted from Ross Levine, "Stock Markets: A Spur to Economic Growth," *Finance and Development* 33, no. 1 (March 1996): 8, http://www.imf.org/external/pubs/ft/fandd/1996/03/pdf/levine.pdf.

- IT HELPS MOBILIZE LOCAL SAVINGS AND MAKES RESOURCES AVAILABLE FOR LOCAL DECISIONMAKING. Capital market development encompasses more than just foreign inflows to emerging markets. Equally important is the cultivation of local investor interest as a means of increasing the available investment sources within an economy. An increase in domestic investor interest originates from the availability of profitable options for saving within the local economy; in other words, the existence of incentives to keep money in float domestically. Formal and credible savings options, which include such instruments as pension plans, insurance policies, and mortgage markets, are key to generating necessary sources of financing within an economy and to allow more resources

6. Ross Levine, "Stock Markets: A Spur to Economic Growth," *Finance and Development* 33, no. 1 (March 1996): 8, http://www.imf.org/external/pubs/ft/fandd/1996/03/pdf/levine.pdf.

to be mobilized and allocated to various investment needs—thereby serving to drive the growth process. A central benefit of this activity is the increase in local decisionmaking and the increase in input from local stakeholders. If one accepts the principle that local decisions close to investment opportunities and by those with an economic stake in the outcome are better than less-informed decisions made at a distance, these informed local decisions in turn lead to improved resource allocation.

- It enhances bank competition and develops a greater diversity of financial institutions. At the heart of local capital market development is the mobilization of domestic savings for a broader array of institutions with varied investment objectives. In comparison to other developing regions, sub-Saharan Africa does not mobilize its domestic capital effectively.[7] The lack of long-term local currency savings instruments is a barrier to local investment of local capital. For example, in South Africa, only half of the adult population has a bank account, and the United Kingdom's Department for International Development (DFID) estimates that the unbanked population Africa-wide is between 80 percent and 90 percent.[8] Sub-Saharan African financial activity can be characterized by the oligopolistic behavior of a few commercial banks (in several cases, government-owned). The absence of adequate competition is reflected in the large gap between deposit rates for savers, which tend to be very low, and interest rates for borrowers, which tend to be very high. Moreover, there is evidence that banks' returns on equity (ROE) are higher in Africa than in other developing regions.[9] Cultivating channels for firms to issue various debt instruments and raise equity, while simultaneously providing more long-term options for saving and asset management for investors, will benefit enlarging economies by increasing market efficiency.

- It could increase remittances and facilitate their use. Establishing mechanisms for facilitating cost-effective transfers and savings of funds received through remittances—a rapidly emerging source of private capital in developing countries—can also contribute to economic growth. In 2002, sub-Saharan Africa's share of the aggregate remittance flows to developing countries was 5 percent of $80 billion, or $4 billion. This amount may actually be understated, but is still quite significant in the context of sub-Saharan Africa's current

7. The ratio of banking deposits to gross domestic product (GDP) provides an illustration of the extent to which local savings are being mobilized effectively. Sub-Saharan Africa has the lowest ratio of banking deposits to GDP among developing nations: sub-Saharan Africa—22 percent; South Asia—40 percent; Latin America/the Caribbean—40 percent.

8. Nicol Degli Innocenti, "Half of South Africa's Population Do Not Have Bank Accounts," *Financial Times*, November 11, 2003. The low level of banking was attributed to the low employment levels and the lack of appropriate banking products.

9. According to a U.S. private equity firm that invests in African banks, ROEs in the banking sector vary considerably by region: sub-Saharan Africa—25.7 percent; South Asia—9.5 percent; Latin America—8.3 percent; and countries of the Organization for Economic Cooperation and Development (OECD)—5.7 percent. One observer has noted that the high banking spreads may be due to high tax rates and the need to compensate for the risk of lower credit borrowers. However, these factors do not explain the high bank ROEs.

foreign direct investment (FDI) level of $6 billion and international portfolio capital flows of $893 million.[10] Some sub-Saharan African countries are even beginning to see levels of remittances overtake levels of ODA. For example, Nigeria's ratio of remittances to ODA is 7:1 and Lesotho's ratio is 4:1.[11] Remittances offer a promising and stable potential for increasing domestic savings and fostering domestic investment.

- IT LEADS TO IMPROVED CORPORATE GOVERNANCE. Capital market development necessitates the creation of a legal and regulatory framework incorporating increased transparency and information dissemination. These monitoring systems heighten corporate governance, improve transparency, and boost investor confidence. Industry-level data from various studies have shown a positive relationship between market-based governance and improvements in industry efficiency. Industry efficiency is important because it promotes economic growth.
- IT REWARDS SOUND ECONOMIC POLICIES AND CREATES TOOLS FOR AFRICAN COUNTRIES TO CONDUCT MONETARY POLICY. The cost of sovereign borrowing is directly related to the economic conditions and policies in a country. A government that implements good economic policies is rewarded by lower borrowing costs on its sovereign bond issues, thus creating a market-based versus donor-driven incentive to strengthen financial sectors. Furthermore, debt markets provide a tool for central banks to manage the money supply and control inflation.

CAPITAL MARKET AND FINANCIAL SECTOR DEVELOPMENT SUPPORTS U.S. STRATEGIC INTERESTS. Creating regulated and transparent financial sectors is not only good for development; it is a key U.S. strategic interest.

- IT HELPS TO SUPPRESS TERRORISM. Nontransparent and inefficient financial systems provide an avenue for money laundering and financial assistance for terrorists. In the United States and internationally, significant government initiatives are under way to counter money laundering and terrorist financing throughout the world. Improving financial sector regulation and performance can contribute to this effort.
- IT REINFORCES U.S. LEADERSHIP IN A KEY SECTOR. Financial sector development is an area where U.S. institutions predominate globally. Such an initiative would build leadership in an area of proven U.S. achievement.
- IT PROVIDES AN OPPORTUNITY TO ENGAGE IN AFRICAN-LED INITIATIVES. Focusing on financial sector development offers a potential entry point for building cooperative relations with the New Partnership for African Development (NEPAD) and African Union (AU) leadership and its newly reconfigured secretariats.

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10. World Bank, *Global Economic Prospects 2003*, Washington, D.C., 2002.
11. "Migrant Remittances to Developing Countries," prepared for DFID by Bannock Consulting, June 2003.

Capital market and financial sector development is a prerequisite for the success of U.S. bilateral and multilateral initiatives to promote trade, private sector development, and good governance. In the words of one informed observer, "Without financial sector development, these other initiatives will fail."

- It enhances opportunities created by the Africa Growth and Opportunity Act. The African Growth and Opportunity Act (AGOA) has achieved significant results by opening up U.S. markets to goods produced in Africa. Strengthening capital markets would complement AGOA's benefits by ensuring that firms benefiting from AGOA trade can better access domestic financing to expand their businesses.
- It builds on the opportunity presented by the Millennium Challenge Corporation. Focusing on financial sector development would complement the launch of the Millennium Challenge Corporation (MCC); indeed these efforts could be used systematically to demonstrate impact and focus early in the MCC's life. The role of the MCC is discussed further below.
- It reinforces G-8 transparency initiatives. Financial sector development can support international efforts to increase transparency in oil and other export revenues. Financial sector development programs could be oriented in part to the oil wealthy countries in Central and West Africa that are likely to experience a surge of oil earnings in the coming decade and that currently have little capacity to manage this dramatic increase in wealth in a transparent manner.
- It supports the efforts of the Financial Systems Assessment Team. The U.S. government has established an interagency working group, the Financial Systems Assessment Team (FSAT), to coordinate all technical assistance with respect to money laundering and counterterrorism financing. The FSAT conducts country assessments of the regulatory framework, financial system, and law enforcement capabilities in order to determine whether technical assistance may be needed to bolster antiterrorist financing in key partner nations.
- It complements the new joint International Development Association/International Finance Corporation Small and Medium-Sized Enterprises Initiative. With the strong support of the U.S. Department of the Treasury, the International Development Association (IDA) and the International Finance Corporation (IFC) recently announced a joint pilot initiative to provide support to micro, small, and medium-sized enterprises (MSME) in the following seven countries—Ghana, Kenya, Madagascar, Mali, Nigeria, Tanzania, and Uganda. The program will focus on three areas: Providing access to financial services by strengthening of local financial institutions; increasing access to business development services for MSMEs; and improving the business/regulatory climate by identifying and resolving regulatory hurdles. Funds can be used to provide technical assistance or financing for MSMEs. Pilot countries will allocate a portion of their existing IDA country funds to finance this

effort. These IDA funds will be supplemented by contributions from the IFC and/or other sources.

Recommendations for U.S. Action

In light of the importance of sub-Saharan capital market and financial sector development in generating growth, promoting U.S. strategic interests, and supporting other initiatives, the U.S. government can take a number of actions to assist this development. These actions are summarized in three recommendations as follows: Establish capital market and financial sector development as an explicit objective of U.S. development assistance efforts in sub-Saharan Africa; institutionalize assistance to capital market and financial sector development within the government; and provide comprehensive U.S. support for the essential components of capital markets through increased funding, technical assistance, and coordination with other donors.

ESTABLISH CAPITAL MARKET AND FINANCIAL SECTOR DEVELOPMENT AS AN EXPLICIT OBJECTIVE OF U.S. DEVELOPMENT ASSISTANCE EFFORTS IN SUB-SAHARAN AFRICA. As discussed above, there is empirical evidence of a link between the development of a country's capital markets and its developmental progress. Yet, until recently, the U.S. government placed very little attention on building sub-Saharan African capital markets. According to data provided by USAID officials, USAID had run several projects in the past, but all of them were started before 1993. Most were completed by that year, and all were finished by 1997. A similar lack of focus on sub-Saharan Africa was evident in USAID's financial sector development work. Between 1988 and 2001, USAID spent about $118 million on financial sector development activities in Africa. That figure represents less than 10 percent of the total USAID expenditures on financial sector development worldwide. Moreover, as table 1 illustrates, the majority of these expenditures focused on "other" nonbanking financial institutions (NBFIs) and micro, rural, and small and medium enterprise finance programs, with very little focus on banking, securities and commodities, pensions and insurance reform, and housing finance.

Making financial sector development a higher developmental priority within U.S. government agencies and institutions and making corresponding changes in their operations, organizational structures, and staffing would be positive first steps toward achieving that development.

Establishing capital market and financial sector development as an objective should not be given top priority to the exclusion of other tasks and objectives. However, it should not be deliberately excluded either, as it appears that it may have been at times in the past. Promoting capital market development in a country should complement other efforts to promote that country's development. It should be recognized as an important and legitimate component of a country's development programs, and receive allocations of U.S. government departments and agencies' staff and financial resources to support it.

Table 1. USAID Spending on Financial Sector Development in Africa (in percent)

Sector of Assistance	Breakdown of Spending by Sector in Africa	Percentage of Worldwide USAID Spending by Sector in Africa
Commercial banking	9	1
Securities and commodities	5	0
Pensions and insurance	0	0
Housing finance	4	0
Micro, rural, and SME finance	31	3
Other NBFIs	42	4
Multisector	10	1
Total	**100**	**9**

Source: Deloitte Touche Tohmatsu Emerging Markets, Ltd., "Financial Sector Review and Strategy: Data Base of Financial Activities, 1988–2001," March 31, 2002.

Fortunately, an attractive aspect of including capital market development in a country's development program is that financial sector improvements should be less expensive than, for example, infrastructure or traditional poverty alleviation efforts. It is beyond the scope of this analysis to provide informed estimates of the budgetary costs to U.S. agencies of individual initiatives. However, much of the effort will likely take the form of technical assistance and training. The development benefit relative to dollar of expenditure should be high.

It should be emphasized that it is important to develop mechanisms to measure this benefit. A commitment to strengthen financial sectors in Africa should be accompanied by a commitment to build appropriate performance measurements and to provide the necessary resources to do so.

Institutionalize assistance to capital market and financial sector development within the government. As a complement to making financial sector development an objective, the government must take steps to increase its capacity to reach this objective. These steps include:

- Bring more people with capital market skills and experience into the government. Currently, individuals with the relevant training and backgrounds are in scarce supply within the government, particularly in areas with mandates to promote development. Some professionals with these skills are at the Treasury Department and at government agencies and similar institutions such as the Federal National Mortgage Association (FNMA), the Office of the Comptroller of the Currency, the Federal Reserve, the Securities and Exchange Commission, the Accounting Oversight Board, and the Federal Deposit Insurance Corporation. However, generally, these staff are focused on areas other than development, and their skills and experience are not available to the developing world.

There are several historical and current reasons for this, including the low priority given capital market development in the past, the lack of recognition that the relevant skill sets were needed, and the low compensation relative to that obtainable in the market. Establishing financial market development as a developmental objective should help address the first issue. In addition, the Advisory Panel recommends the following:

- Develop a separate salary scale for financial market experts within the U.S. government: The market provides high remuneration for skilled financial market experts. While the U.S. government can never fully meet these compensation levels, establishing a separate salary scale as it has for some other disciplines should help it attract and retain professionals with the necessary skills.
- Adjust the current USAID candidate evaluation process to award more points for subject-matter expertise: Presently, when selecting potential candidates, USAID often awards extra points in the contract evaluation process for prior experience with USAID. This biases the process against candidates with skills in areas where USAID has not operated previously. Changing the scoring system to give higher points for skills in short supply should help facilitate the hiring of capital market experts.
- Make greater use of executive exchange programs: Executive exchange programs bring professionals with needed and relevant skills into the government.

■ ENCOURAGE THE MILLENNIUM CHALLENGE CORPORATION TO TAKE A LEADERSHIP ROLE BY INCLUDING FINANCIAL SECTOR AND CAPITAL MARKET DEVELOPMENT PROGRAMS WITHIN ITS ACTIVITIES. The new Millennium Challenge Account (MCA) and the Millennium Challenge Corporation that will implement it are in their conception designed to focus on promoting economic growth and investment. The creation of these entities presents a major opportunity to establish a foundation on which capital market development programs can be built and to mobilize significant amounts of new resources. Working with its partner countries in supporting their national initiatives and plans, the MCC will be in an excellent position to assist countries receiving MCC funding to build such programs into their country contracts and to become a pioneer in undertaking comprehensive capital market development efforts. Given the central role of local institutional bodies in the functioning of financial markets, political will within recipient nations and a sense of partnership in implementation are necessities. The partnership model on which the MCC is conceived can stimulate creation of the necessary domestic political will and should facilitate tailoring the program for each recipient country to fit that country's own needs.

■ ESTABLISH AN INTERAGENCY WORKING GROUP DEVOTED TO CAPITAL MARKET AND FINANCIAL SECTOR DEVELOPMENT ISSUES. This group would ideally be headed by the MCC and Treasury Department, with membership from the

State Department, USAID, OPIC, and other agencies with interest and expertise in the area.

- FOCUS EFFORTS ON A LIMITED NUMBER OF COUNTRIES INITIALLY. Because it cannot work with all countries at once, the U.S. government should consider focusing its initial efforts on countries that will be receiving large increases in external funds over the next few years and that would thus benefit immediately from having a sound financial sector to handle these increased inflows. Three categories of countries to consider are MCA partner countries, new oil and gas producing nations, and participants of President Bush's Emergency Plan for AIDS Relief (PEPFAR). Successful initiatives in a few countries can demonstrate the effectiveness of financial sector development and can be rolled out by the MCC with other partner countries and by other U.S. agencies into non-MCA countries.

- USE U.S. INFLUENCE WITH INTERNATIONAL FINANCIAL INSTITUTIONS SUCH AS THE WORLD BANK AND THE IMF TO INCREASE THEIR EFFORTS IN SUPPORT OF CAPITAL MARKET AND FINANCIAL SECTOR DEVELOPMENT. International financial institutions (IFIs) have the resources, the expertise, and, in the case of the development banks, the mission to assist development. Yet their efforts to date in the sub-Saharan African financial sector appear to be limited. With U.S. encouragement and action, these institutions could do more to assist financial sector development. Specifically, the United States could

  - Support an increased allocation of Bretton Woods institutions' resources to financial sector development in sub-Saharan Africa. The IFIs could provide an additional source of financing for capital market development efforts.

  - Support a significant increase in the number of IMF/IBRD Financial Sector Assessment Program efforts in sub-Saharan Africa (the program is discussed further below).

  - Encourage the IMF to include a focus on developing local markets in its sub-Saharan activities.

- COMMISSION ADDITIONAL ECONOMIC WORK ON THE ROLE OF THE FINANCIAL SECTOR AND CAPITAL MARKETS IN CONTRIBUTING TO DEVELOPMENT IN SUB-SAHARAN AFRICA. In order to design programs that work, it is important to understand how capital markets and financial sector development have contributed to growth in the past. For example, the 1996 study by Ross Levine and Sara Zervos, "Stock Markets, Banks, and Economic Growth," demonstrated that stock market liquidity and banking sector development are followed by economic growth, capital accumulation, and productivity improvements.[12] Although research on how capital market and financial sector development have contributed to growth has been undertaken in emerging markets, more analysis specific to Africa is needed.

12. Ross Levine and Sara Zervos, *Stock Markets, Banks, and Economic Growth,* Policy Research Working Paper 1690 (Washington, D.C.: World Bank, 1996); http://econ.worldbank.org/files/490_wps1690.pdf.

Economic impact studies of U.S. financial sector development assistance are also not conducted widely. For instance, as previously mentioned, USAID has spent approximately $1.2 billion on financial sector programs globally since 1988. However, no information is available to measure the economic impact of that investment.

- BETTER COORDINATE WITH, AND INCREASE U.S. GOVERNMENT SUPPORT FOR, INITIATIVES OF OTHER DONORS AND AFRICAN INSTITUTIONS MAKING EFFORTS IN THE SECTOR. As noted above, European bilateral donors have already undertaken a number of ongoing capital market strengthening initiatives. These efforts are often more ambitious and more sophisticated than those undertaken by the United States, yet the U.S. government has either not contributed to them at all or has made only minimal allocations.[13] The United States should increase its coordination with, and consider greater involvement with, these efforts, as well as those being undertaken by UNDP, the African Development-Bank, NEPAD, the Southern African Development Community (SADC), and the Common Market for East and Southern Africa (COMESA).
- USE G-8 INITIATIVES TO STRENGTHEN THE FINANCIAL SECTOR IN AFRICA. The G-8's declaration on fighting corruption and improving transparency, issued at the 2003 Evian Summit in France contains commitments to several initiatives that can help strengthen the financial sector in developing countries: increasing public financial management and accountability; strengthening enforcement of anti-bribery laws; implementing the UN Convention against Corruption; fighting financial abuses; promoting transparency in government procurement and the awarding of concessions; and ensuring transparency in extractive industries.

One of the specific recommendations supports the Financial Action Task Forces' (FATF) enhanced "Know Your Customer" (banking customer due diligence) initiatives.[14] Implementing Know Your Customer procedures can help strengthen the overall transparency of the banking sector.

The United States should urge the active implementation of these procedures in sub-Saharan Africa to maximize their effect in strengthening the financial sector.

PROVIDE COMPREHENSIVE U.S. GOVERNMENT SUPPORT FOR THE ESSENTIAL COMPONENTS OF CAPITAL MARKETS. A well-developed capital market has at least four key components: a legal and regulatory framework, buyers and sellers, information, and a transaction infrastructure. Attention to each of these components is important in structuring capital market development assistance. For example, a comprehensive program could include the following:

- DEVELOPING STABLE LEGAL AND REGULATORY FRAMEWORKS. Securities regulation and oversight; corporate governance; accounting requirements; and banking/financial institution regulation;

13. One such partnership is the FIRST Initiative, discussed further below.

14. The Financial Action Task Force (FATF) on Money Laundering was established in 1989 by the G-7 Summit in Paris to develop and promote "policies, both at national and international levels, to combat money laundering and terrorist financing."

- Building market participants. Buyers (investors) and sellers (borrowers and companies needing funding);
- Increasing access to information. Availability of information concerning general country and macroeconomic conditions; relevant laws and regulations; borrowers; and stocks; and
- Improving the ability to trade and transact. Secure trading mechanisms, clearinghouses, custodians, transfer agents, and intermediaries (brokers, traders, and market-makers)

The following sections discuss specific actions that the U.S. government can take to strengthen each component after an initial diagnostic review is completed. Because these components are interdependent, U.S. efforts to strengthen capital markets will have the greatest impact if programs are conducted comprehensively.

Finally, it must be noted that the following recommendations presume that macroeconomic policies have been put in place to facilitate financial sector development. Although macroeconomic policy concerns are beyond the scope of this chapter, it is important to acknowledge that sound macroeconomic policies are a prerequisite for capital market development. Poor government behavior—for example, the funding of fiscal deficits with short-term high-yield Treasury bonds that crowd out productive local investment—macroeconomic instability, and exchange rate volatility will inhibit the productive use of capital and retard capital market development.

- Improving Understanding of the Sector/Diagnostic Support. As countries are at varying stages of economic and financial development, undertaking a diagnostic analysis to understand the situation in each country is a prerequisite for other activities within it.
  - Support expansion of the IMF/IBRD Financial Sector Assessment Program. These Financial Sector Assessment Program (FSAP) reviews are generally well done, with a detailed assessment of the current situation in each country. There is an increasing development focus in the FSAP reports, including recommendations for next steps to further strengthen and develop the sectors. However, the number of such reviews is small relative to the number of countries.[15] Increasing the staff and resources within the Bretton Woods institutions devoted to these assessments could materially boost sub-Saharan capital market development.
  - Encourage similar assessment efforts by U.S. entities if needed. To the extent that the IMF/IBRD program discussed above does not meet full needs, the creation of the MCC, USAID's proposed new financial sector strategy, and some current Treasury Department efforts present an opportunity to expand work in this area.

15. The IMF has also had two special missions looking comprehensively at issues related to accessing private foreign capital in Ghana and Tanzania. The focus of these reports was on foreign capital, but they included FDI, banks, and local capital markets.

- DEVELOPING STABLE LEGAL AND REGULATORY FRAMEWORKS. To strengthen the enabling environment by establishing more transparent and effective regulatory and legal frameworks and by building the capacity of local financial sector regulators, the U.S. government should take several specific steps:
  - Increase support to Treasury's Office of Technical Assistance and place increased emphasis on insurance and pension reforms to boost the development of institutional savings options. The U.S. Department of the Treasury's Office of Technical Assistance (OTA) provides advisory services to government officials, typically senior finance ministry or central bank counterparts, in several key regulatory areas necessary for a sound financial sector: tax policy and administration; government debt issuance and management; financial institutions policy and regulation; budget policy and management; and the prevention, detection and prosecution of financial crimes. The program originated in the early 1990s to assist former communist countries in moving from a command to market economy. OTA has expanded its mission to other regions. In Africa, OTA is providing assistance to a number of governments including Uganda, Nigeria, South Africa, Chad, Ghana, Botswana, Ethiopia, Tanzania, Zambia, and the West African Economic and Monetary Union (WAEMU). The feedback on the results of this program has been quite positive. However, OTA has a modest budget to manage its programs and conduct program development missions and relies on funding from other government agencies, such as the State Department and USAID, to fund specific programs. Expanding the program could benefit sub-Saharan capital market development.
  - Consider becoming a more substantial donor to the FIRST Initiative and other relevant bilateral and multilateral partnership initiatives as they arise. The FIRST Initiative is a multilateral and bilateral grant fund supporting technical assistance to governments on the development of financial sector regulations, supervision, and structure. For the first four years of this initiative, the United Kingdom has committed up to $29 million; Canada, up to $7.5 million; the Netherlands, up to $8 million; and Sweden, up to $2 million. FIRST utilizes a multi-donor board to select and oversee initiatives. These projects are primarily public sector–oriented and target regulatory agencies and government bodies within recipient nations. Although this initiative covers all developing country regions, there are currently 10 projects under way in sub-Saharan Africa, and all build on the findings and recommendations of the IMF and World Bank Financial Sector Assessment Program Reports and the Reports on the Observances of Standards and Codes.[16] Examples of projects include assistance to strengthen insurance regulation and supervision in Lesotho and capacity building of the Cameroon Financial Markets Commission.

16. Financial Sector Assessment Program Reports are available at http://www.imf.org/external/np/fsap/fsap.asp#cp; Reports on the Observances of Standards and Codes are available at http://www.imf.org/external/np/rosc/rosc.asp.

- Provide technical assistance to African governments to strengthen accounting and disclosure requirements. Reliable and transparent financial statements are necessary to build confidence in African capital markets. African governments can help improve corporate governance by establishing globally accepted accounting and disclosure regulations.
- Encourage increased use of the State Department's Economic Support Funds to provide technical assistance to African governments on legal and regulatory reform. Although there are many competing demands for Economic Support Funds (ESF), a commitment from the State Department to finance technical assistance will help ensure that the U.S. government has the resources to help create sound financial sectors in Africa.
- Consider introducing a corporate governance initiative in cooperation with the New Partnership for African Development. The New Partnership for African Development (NEPAD) has identified economic and corporate governance as one of its seven priority areas. Initiatives identified by NEPAD focus on strengthening macroeconomic management, public financial management, banking supervision and financial services regulation, and corporate governance. A Committee of Finance Ministers and Governors of Central Banks has been tasked with developing an action plan to address these focus areas. The U.S. government should consider developing corporate governance initiatives in cooperation with NEPAD.
- Explore further avenues for U.S. government agencies to provide legal and regulatory assistance. The Department of Justice, the American Bar Association, and the American Law Institute are U.S. agencies that could offer valuable technical assistance to African governments on strengthening the rule of law and enhancing their regulatory environments. Other specialized agencies, including the National Association of Insurance Commissioners (NAIC), could also transfer their particular expertise. The possibilities for such additional collaborations should be examined.

■ BUILDING MARKET PARTICIPANTS: BUYERS, SELLERS, AND FINANCIAL INTERMEDIARIES. As discussed above, buyers, sellers, and financial intermediaries are essential to a market and to market liquidity. Strengthening deposit-taking institutions can be particularly helpful in countries where there are too few vehicles to mobilize domestic savings. The U.S. government can increase the number and quality of participants in sub-Saharan capital markets with the following measures:

- Increase technical assistance to African financial institutions: Strengthening local insurance, pension, and social security institutions can increase domestic savings and improve the quality of investment decisionmaking. There are several ways to accomplish this:

Strengthen existing banking institutions. A sound banking system, including institutions such as credit unions, savings and loans, and savings co-ops, is a key component of financial sector development. In an effort to promote efficiency within the banking sector, the U.S. government could provide technical assistance to state-owned banks interested in privatizing or commercializing their operations. In countries where banks are privately owned or community-based, technical assistance could be provided to help improve operations, efficiency, and credit risk management. In countries where foreign investment in the banking sector is currently prohibited, the U.S. can encourage a change in this policy. By strengthening the banking sector, local companies should have increased access to working capital and short-term debt.

Expand the Financial Services Volunteer Corps' activities to include sub-Saharan Africa. Established at the request of former President George H.W. Bush, the Financial Services Volunteer Corps (FSVC) engages technical specialists to work on short-term, volunteer assignments, one to two weeks at a time, to help upgrade financial institutions and systems. FSVC programs focus on strengthening commercial banking systems, developing central bank capabilities, and building capital markets. Other focus areas include financial system legal reforms, payments system development, pension reform, and support to address financial corruption and terrorist finance. The not-for-profit organization has to date leveraged $45 million in USAID support as well as additional funds from the Departments of State, Commerce, and Treasury and the World Bank. To date, operations have primarily focused on developing market economies in Eastern Europe and the former Soviet Union, with recent growth in assistance to Asia and the Middle East. FSVC does not operate in sub-Saharan Africa.

Utilize resources available through Volunteers for Prosperity. The USA Freedom Corps was created in 2002 as a mechanism to facilitate volunteer opportunities for Americans responding to President Bush's call for every citizen to volunteer time in service to communities in the United States or internationally. In September 2003, President Bush signed an executive order creating the Volunteers for Prosperity (VFP) program as an international component of the USA Freedom Corps. VFP volunteers will participate in U.S. programs designed to promote health and prosperity in developing countries. Financial sector programs should proactively explore opportunities to make maximum use of volunteer resources available through the VFP.

- Encourage the establishment of private pension funds. Private pension funds could increase efficiency and competition in this sub-sector and the financial sector in general. Government-run funds tend to predominate in Africa. Some of these funds have been known to treat pension system assets as political assets and often favor lending to government-sponsored projects. The competition that would arise in a well-regulated system allowing private pension funds to operate alongside the state pension fund could not only help develop capital markets, but would also reward good management and keener analysis of investment alternatives. A complementary effort could include easing restrictions that require government pensions to invest only in government bonds and permitting government funds to diversify their portfolio to include corporate securities.

- Strengthen African educational and training institutions. A skilled workforce to build and support world-class financial institutions is a basic requirement for a sound financial sector. Several important initiatives to improve the educational opportunities on the continent are already under way.

Support efforts of U.S. universities and institutions to increase the availability of finance training and skills throughout the continent. Leveraging the ability of U.S. universities and other entities to share their knowledge and expertise will help provide needed skills in Africa and expand awareness of African business issues in the United States. For example, Harvard Business School conducts a training program for private and public sector leaders in sub-Saharan Africa entitled "Making Markets Work." Georgetown Business School is exploring options to help African business schools earn their internationally accepted accreditation, and the Smith School of Business at the University of Maryland has expressed interest in developing a finance education module. Additionally, Goldman Sachs is beginning to examine ways it can provide training for sub-Saharan African financial professionals.

Consider supporting creation of a financial institution module within the IFC/World Bank Global Business School Network. This World Bank Group initiative serves to build "training partnerships" between developed and developing country business schools and is a valuable tool for cultivating indigenous management skills. Current programs with 7 African business schools have included locally based curriculum development and faculty training. Enhancing the extent of these knowledge-sharing partnerships would help increase the capacities of African universities to train their future financial sector leaders.

- Encourage the OPIC Board to create a fund to invest in publicly traded African securities. Historically, OPIC has only created funds that make private investments, leaving it to the market to create funds for public securities. There appears to be no statutory reason why OPIC has not created such funds in the past, merely precedent. This policy may well be appropriate in most emerging markets, which have a number of institutional investors and players. However, very few funds invest in African securities, and the risk that OPIC might preempt private sector activity seems remote. Indeed, the creation of OPIC funds that trade securities is likely to increase market liquidity and thereby encourage the creation of other funds.
- Establish local training programs for brokers, accountants, and other financial market participants. Skilled intermediaries are in short supply in sub-Saharan Africa. Professional training programs can be developed to share U.S. expertise in this area.
- Support the current U.S. Treasury–led initiative to create sub-Saharan housing/mortgage markets. In a speech at the end of his July 2003 trip to Africa, President Bush tasked the secretary of the treasury to lead an interagency process to strengthen African capital markets by increasing the availability of mortgage financing in Africa. The Department of Treasury–

led group is considering a series of programs to create mortgage bonds, provide mortgage guarantees, and/or establish loan programs for micro lenders to finance home construction and rehabilitation. These housing finance initiatives also create a multiplier effect by increasing the usage of local labor and materials, which thereby enhances economic growth.

- Encourage the use of capital markets in sub-Saharan African privatization efforts. Privatization programs have a symbiotic relationship with capital market development. An increased number of privatizations can further the development of capital markets by increasing trading volumes, market capitalization, and liquidity. The existence of a well-functioning capital market increases the incentive for privatizations by providing a market-based, price-efficient framework. That can provide the highest proceeds to the government selling the company. The United States should provide increased technical assistance toward privatization programs that aim to utilize capital markets.
- Create a private equity fund through OPIC and/or the MCC to invest in African financial institutions and intermediaries. Building world-class financial institutions and intermediaries in Africa, such as merchant banks, mutual funds, and trade credit providers, will help provide the necessary financial infrastructure for strong capital markets. Although financial institutions have been the beneficiaries of recent private equity investments, a significant share of international investments in Africa to date have targeted infrastructure development, energy and natural resource development, and communications firms. However, interest is growing in financial sector investment opportunities. Just recently, a fund was established to invest in privatized African banks. Building on this momentum, the U.S. government should consider establishing a private equity fund that focuses on African financial institutions and intermediaries, particularly those that invest longer term.
- Explore opportunities to encourage U.S. firms to raise debt or equity in the local markets in which they operate. Increasing the pool of attractive investment opportunities for local investors in Africa can help create interest, participation, and thus liquidity in African capital markets. For instance, recipients of OPIC or donor-supported financing could be encouraged to consider issuing debt or equity in the local capital markets. While providing increased access to capital in the local currency, these efforts could also help build local support for and shared interest in the success of U.S. investments. Most corporate social responsibility programs to date have focused on providing health, education, or infrastructure benefits to local communities. However, as an innovative addition to such programs, Chevron/Texaco raised financing in Angola. Other firms could be encouraged to create mechanisms to facilitate local investment opportunities.
- Explore ways to use the guarantee authority of U.S. agencies to develop sub-Saharan capital markets. The U.S. Export-Import Bank recently provided a

guarantee for a bond issue on the Bond Exchange of South Africa to provide financing for the purchase of U.S. manufactured aircraft. The bond is supported by the full faith and credit of the U.S. government, thus providing an opportunity for local investors to benefit in an investment grade instrument while providing financing to increase U.S. exports to Africa. Additionally, project finance bonds have been issued successfully in other developing regions. Further research could be conducted to determine whether some of the African capital markets could support project finance bonds.

- Encourage the Treasury Department to evaluate the potential use of African bond markets to raise development finance. The Asian Development Bank recently announced that it is seeking permission to issue a Chinese yuan denominated bond to finance development projects in Asia. In addition to providing financing, this effort can also help establish a benchmark for other long-term bond issuances. The Treasury Department supervises the U.S. government's relationship with the IFIs and should explore opportunities to work with the African Development Bank to utilize African capital markets.

- USAID should evaluate and consider encouraging the increased use of USAID's Development Credit Authority to strengthen the banking sector and to increase capital availability. In 1998, USAID was given authority by Congress to use credit to achieve its development goals in addition to its traditional grant programs. This authority, known as Development Credit Authority (DCA), provides mission directors with a new mechanism to leverage local capital for development. Typically, DCA projects provide a 50 percent loan or bond guarantee to private lenders in recipient countries. Approximately $630 million in credit has been facilitated in 27 countries since the program's inception.

■ Strengthening Information Flows. Good information is essential to an efficient market. Companies at different stages of development depend on different types of information providers. For example, earlier stage companies need credit bureaus to provide banks the information they need. More advanced countries needing institutional equity require sophisticated debt and equity research. Large-scale international borrowers benefit from sovereign ratings that allow institutional investors to assess overall political risk.

The private sector, through firms such as LiquidAfrica, is beginning to supply research and information on public equities. However, additional efforts are needed to address the needs of companies at varying stages of development. Accordingly, the U.S. government should

- Provide training in accounting and disclosure requirements to assist both private firms and public sector oversight capacities, thereby boosting corporate governance. Transparent and trusted financial statements are a fundamental element of information about public and private firms. As mentioned above, the U.S. government should consider providing technical assistance and funding to expand existing training efforts in Africa. For instance, funding could be provided to local universities and colleges to expand their accounting curriculum.

- Assist with the development of local credit bureaus and their governing regulations. According to the World Bank, only 23.5 percent of African countries surveyed for the "Doing Business" database have laws regulating the activities of credit bureaus.[17] This figure is in stark contrast to the results for other regions: East and Southern Asia—62.5 percent; Europe and Central Asia—70 percent; Latin America and the Caribbean—71.4 percent; the Middle East and North Africa—85.7 percent; and the OECD—100 percent.
- Continue current initiatives by the State Department and UNDP to promote sovereign credit ratings. Through assistance from the State Department and the UNDP, 13 African countries now have a sovereign rating. This is a significant increase from 2001, when only 4 African countries had a rating. The U.S. government should continue to expand its sovereign ratings program.
- Expand current Department of State and Treasury Programs to establish benchmark yield curves and to harmonize securities regulations. One of the barriers to African firms using capital markets to raise debt finance is the lack of sovereign benchmark yield curves to use in pricing corporate debt. Many African nations do not issue long-term debt. The State Department is providing financing for a Treasury Department adviser to work with the governments of Uganda, Nigeria, and members of the West African Economic and Monetary Union (WAEMU) to establish benchmark yield curves. The work in the WAEMU countries is designed to harmonize government debt issuance regulations and practices, as well as standardize as much as possible the structure of securities among these countries, with the goal of increasing liquidity by facilitating cross-border trading and holdings. This technical assistance should be made available to other African nations and regions.
- Facilitate the availability of rating services to local markets. Several local ratings agencies exist in sub-Saharan Africa. Their effort to provide ratings coverage of sub-Saharan firms is important. Through vehicles such as the private equity fund discussed above, the U.S. government can help ensure that these firms have access to financing to expand their services. In addition, the participation of international ratings agencies in local markets could also be encouraged.
- Provide technical assistance to firms on meeting listing requirements. Earlier this year, the State Department initiated a small technical assistance program in Uganda focused on helping firms meet the accounting and disclosure requirements requisite for listing on exchanges. The IFC provides similar assistance through its APDF capacity-building facility. This type of

17. World Bank, *Doing Business in 2004: Understanding Regulation* (New York: Oxford University Press, October 2003), pp. 55–69.

assistance could be expanded to countries where lack of knowledge of listing requirements is a barrier to using capital markets.

- Examine whether there are appropriate ways for the U.S. government to facilitate coverage of frontier African exchanges by Wall Street. South Africa receives a great deal of coverage by Wall Street research departments. However, the same cannot be said for other African exchanges. The U.S. government should explore whether there may be an appropriate role for the government to play in facilitating the research coverage of companies on other African exchanges and the development of a frontier Africa index.
- Improve systems to collect information on cross-border capital flows. Work by the United Kingdom's Department for International Development (DFID) in Tanzania revealed that cross-border capital flows were four times larger than previously thought. DFID expects that a similar pattern may exist elsewhere. Understanding the magnitude and uses of cross-border flows could promote their more effective use.

■ Strengthening the Ability to Trade and Transact. Modernizing and upgrading market infrastructure and trading procedures can help improve efficiency and transparency.

- Encourage stock market consolidation and support the market regionalization efforts of the UNDP, World Bank, NEPAD, SADC, and other regional organizations. Secure trading platforms with trustworthy security agents are important to a functioning market. Qualified custodians, transfer agents, and clearinghouses are needed throughout sub-Saharan Africa. However, there may be too many stock exchanges. During the last decade, the number of African stock exchanges has risen significantly. There are now stock markets in Algeria, Botswana, Côte d'Ivoire, Egypt, Ghana, Kenya, Malawi, Mauritius, Morocco, Mozambique, Namibia, Nigeria, South Africa, Sudan, Swaziland, Tanzania, Tunisia, Uganda, Zambia, and Zimbabwe.[18] Many of the exchanges have only a few listed stocks and are characterized by limited capitalization and low liquidity. The ratio of stock market capitalization to GDP is less than 20 percent in sub-Saharan Africa compared with more than 100 percent in developed countries.[19] Further, this already low capitalization is concentrated in the South African market, which accounted for 88 percent of market capitalization in the region in 2002.

The problem is further aggravated by the trend toward decapitalization of local exchanges with the movement of larger companies to international exchanges, such as the London or New York Stock Exchanges, and the acquisition by some of the remaining listed companies by global companies. For example, there have been few listings and a trend towards de-listings on South Africa's JSE. According to S&P's Emerging Markets Review, as of January 2003, there were 468

18. United Nations Development Program, *African Stock Markets Handbook,* 2001.
19. World Bank, *World Development Indicators,* 2001.

companies listed on the JSE, down from 472 a year earlier. In 2002, more than 50 companies de-listed from the JSE. In 2001, 85 companies de-listed. A large proportion of the JSE's top share listings, including Anglo American, Billiton, Old Mutual, and South African Breweries, have moved their primary listings from the JSE to the London Stock Exchange (LSE), citing a need for access to the LSE's much larger capital market, in line with their aim to become truly global companies.

Rather than spending more development resources on the "bricks and mortar" of additional exchanges, some consolidation is needed. Harmonizing listing requirements/regulations, exchanging data, information and technology sharing, and cross listings are some of the steps that could build volume and liquidity.

A number of stock market consolidation and regulatory harmonization programs are already under way throughout Africa. For instance, NEPAD has programs to harmonize regulatory frameworks and a single African trading platform. In addition, the SADC Committee of Stock Exchanges has articulated a vision of "an integrated real-time network of national securities markets within SADC" by 2006. The JSE is leading a two-phased initiative to achieve the SADC objective. Phase one would provide participating exchanges access to the JSE's trading platform. The exchanges would retain their autonomy and would operate as a segment of the JSE. Phase two would involve the harmonization of listing requirements among participating exchanges, trading access among member exchanges, and the creation of a Pan African Board. The board would consist of the companies most likely to enlist interest from international investors. The U.S. government should explore avenues to provide support to these existing African and multilateral efforts.

- Provide assistance with the development of payment systems. Many African countries do not have well-functioning payment systems and significant amounts of capital can be tied up in a process as simple as check clearing. Transparent and well-functioning payment systems provide the mechanism for money to move throughout the market. Inefficient payment systems can increase risks, transaction costs, and the amount of time that funds are locked up in the clearing and settlement process and thus unavailable for productive use. The Bank for International Settlements (BIS) has developed a series of Core Principles that are intended for use as universal guidelines to encourage the design and operation of safer and more efficient systemically important payment systems worldwide, and the SADC, for example, is already working to improve payment systems within its region. The U.S. government could provide technical assistance to governments interested in implementing the BIS Core Principles.
- Provide technical assistance to clearinghouses, custodians, and transfer agents. Confidence in the trading mechanism is necessary to increase the number of local and international investors participating in African capital markets. The U.S. government should consider offering technical assistance

to existing clearinghouses, custodians, and transfer agents to strengthen their capacity to provide a secure trading environment and to build confidence in local markets as viable savings mechanisms.

Conclusion

Capital market and financial sector development can be an important facilitator of economic growth in sub-Saharan Africa. It also supports U.S. strategic interests and complements other U.S. bilateral and multilateral initiatives. The U.S. government should recognize this by adopting the following measures: (1) establishing capital market and financial sector development as an explicit objective of U.S. development assistance efforts in sub-Saharan Africa; (2) institutionalizing assistance to capital market and financial sector development within the government; and (3) providing comprehensive U.S. government support for the essential components of capital markets through, inter alia, increased funding, technical assistance, and coordination with other donors.

Appendix: Individuals and Institutions That Contributed Comments and Reviews for This Chapter

Government Agencies

U.S. Agency for International Development	Constance Berry Newman John Crihfield Jay Smith John Wasielewski
U.S. Department of State	Alan Larson Anne Pence
U.S. Department of Treasury	John Taylor Michael Grifferty Clay Lowery Ged Smith Office of African Nations Office of Technical Assistance
Overseas Private Investment Corporation	Peter Watson Marysue Shore
U.K. Department for International Development-Financial Sector Team	Gavin McGillivray Richard Boulter Robert Cook Suzanne Parkin David JN Stanton

Multilateral Institutions

International Monetary Fund Capital Markets Team	Jacqueline Irving Charles Blitzer
United Nations Development Program	Zephirin Diabre

World Bank Group

International Finance Corporation (IFC) Global Business Network	Guy Pfeffermann Laura Bures Krishnan Srinivasan
IFC Private Equity and Investment Funds & Global Financial Markets	Teresa Barger Ayaan Adam Anne Chacour Hawkins Jean-Phillipe Prosper

IFC Private Sector Development Group	Michael Klein
Multilateral Investment Guarantee Agency	David Bridgman Thomas Vis
World Bank Financial Sector Team, Africa Region	Gerard Byam Ann Christine Rennie Tony Thompson

Private Sector and Trusts

American International Group	Frank Wisner
Citibank	Stanley Fisher
Emerging Markets Partnership	Thomas Gibian
FinMark Trust	David Porteus
First Africa Group	Kofi Adjepong-Boateng
Liquid Africa	Cyrille Nkontchou
Modern Africa Fund Managers	Steve Cashin
The Scowcroft Group	Walter Kansteiner James Dunlap
WPA	Wendy Abt

Think Tanks

Center for Strategic and International Studies	J. Stephen Morrison
Council on Foreign Relations	Princeton Lyman

Universities

Georgetown University	Chester A. Crocker
Harvard Business School	Debora Spar
University of Maryland	Lemma Senbet