Do Stock Markets Complement Banks in Promoting Economic Growth? Evidence from West African Countries

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Abstract:

This paper examines the impact of stock markets on economic growth in Cote D'Ivoire, Ghana, and Nigeria using three proxies to determine whether the impact of stock markets on economic growth is sensitive to the proxy used to measure stock market development. It also seeks to determine whether the impact of stock markets on economic growth is sensitive to the inclusion of banking development indicator in the regression. After accounting for structural breaks and cross-sectional dependency, the study reveals that stock markets have positive impact on economic growth in all the countries, albeit the impact is not very robust in Ghana. The results are neither sensitive to the proxy used to measure stock market development nor the inclusion of banking development indicator in the regression. This implies that stock market is a complement rather than a substitute for banking development in the process of economic development in West African countries. Thus, the countries should strengthen policies that promote all aspects of stock market development in order to accelerate sustainable economic development.

Keywords: stock markets; banking development; economic growth; West Africa

JEL Classification: G12; 011; G21

Introduction

The growth and proliferation of stock markets globally in the last three decades underscore the belief that stock markets could be deployed as ingredients for accelerating economic growth and development. For instance, the number of stock markets in Sub-Sahara Africa has been increasing astronomically since 1980. Similar trends were witnessed in many developing economies in Eastern Europe, Asia and Latin America. However, the West African sub-region witnessed a proliferation of stock markets in recent years, but prior to mid-2000s, there were only three functional stock markets in West Africa located in Nigeria, Cote D'Ivoire and Ghana. The period of the development and proliferation of stock markets in West Africa coincided with the period that the sub-region experienced a remarkable economic growth relative to Europe, Asia and Latin America. Can the development of stock market help to explain variations in economic growth in West Africa region?

Thus, a well-developed and functional stock market is seen as a veritable ingredient of economic growth because it reduces the costs of savings mobilization, facilitates productive investments and allocates resources to investments with higher returns. Though many profitable investments require long-term capital, but most savers are unwilling to relinquish their capital for a long time. Hence, a very liquid stock market provides the opportunity for savers to trade their equity and also for investors to have permanent access to capital through equity issue. A liquid stock market is also capable of increasing the incentives for investors to have access to information about firms and their profitability. Finally, internationally integrated stock markets allow international risk sharing, improve allocation of resources and promote economic growth and development.