Factors Influencing the Sound Capital Market Development in Small Economies: A Cross-Country Comparison

Soutsaka_Bounmanit（九州大学大学院）

It is well understood that a sounder and well-functioning capital market is essential to the economic development. It provides alternative financial channels to sustain growth momentum, complimenting the banking sector and plays key role in state-owned enterprise reforms in transition economies. Indeed, there are many small economies including certain transition economies have established formal capital markets since 1992. Yet many of these markets have not been very active as expected, volatile and small in term of capitalization compared to the markets in larger economies. Understanding of factors determining a sound capital market development is crucial and will have policy implication for the government agencies in these economies.

This paper examines empirically the macroeconomic factors influencing a sound development of the capital market using a panel data of 14 economies in Asia and Eastern Europe for the period 1994 to 2006. We find that the factors such as income level, gross domestic investment, banking sector development, private capital flows, and capital market liquidity are important factors of capital market development in the small countries. Also, the relationship between banking sector development and capital market development in these economies appears to be changing. This finding suggests that at early stages of its development, the banking sector is a compliment to the capital market in financing investment. However, as they both develop, banks and the capital market begin to compete with each other as vehicles for financing investment.

Also, the findings have essential policy implications for capital markets in small countries. Economic growth plays an important role in capital market development. It is important to initiate policies to foster growth and development as countries liberalize their financial systems. Also, the development of well-developed banking sector is important for capital market development in small economies. At the early stages of its establishment the capital market is a complement rather than substitute for the banking sector. Developing the banking sector can promote capital market development as demonstrated by the experiences of many East Asian countries. Support services from the banking system contribute significantly to the development of the capital market.

In addition, domestic investment is an important factor for the capital market development in these countries. To promote its development, governments in these countries can encourage investment by appropriate policies. Besides, the market liquidity has a positive effect on the capital market development. Improving the market liquidity can be another approach of promoting the capital market development.