Peterson Institute for International Economics

The role of capital markets in emerging-market growth

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[00:05:24.07] - Monica de Bolle

Good morning, everyone, and welcome back to the Peterson Institute for International Economics. I'm Monica de Bolle. I'm a senior fellow here at the Institute. And it's my pleasure to introduce our speakers and panelists. We will start with the presentation of the study of the book that many of you have in front of you, and that will be followed by a panel discussion. We will have 10 to 15 minutes for the presentation and about 40 minutes for the panel discussion. So let me introduce our speakers. Susan Lund is IFC's Vice President for Economics and Private Sector Development. And she leads a global team that provides economic and analytical support to IFC investments and private capital mobilization. Cesaire Meh is a manager, macro and market risk at the IFC, and he leads a macrofinancial team that provides economic research and analysis to support IFC's investments advisory efforts and private capital mobilization. Sergio Schmuckler is a research manager of macroeconomics and growth in the World Bank's Development Research Group. His research area is international finance and international financial markets and institutions. Matt Robinson manages Moody's Ratings Middle East and African sovereigns and supranational ratings, as well as Global Lead for Development Finance.

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He is responsible for managing staff located in London, Frankfurt, Dubai, and New York. And finally, Arvind Subramanian, who's a Senior Fellow here at the Peterson Institute for International Economics. He's been associated with the Institute since 2007, and he was the Dennis Weatherstone Senior Fellow at the Institute during 2013 to 2014 and was on leave for public service From 2014 to August 2023. With that, I'd like to welcome our author, the authors of the book, to the stage to start our discussion. Thank you very much.

[00:07:47.23] - Cesaire Meh

Thank you, Monica, and thank you to the Peterson Institute for hosting this event for the launch of our book. And so really a pleasure for me and for all of us to be here. Um, this is a really team

effort. Uh, the team is in a group, it's in the rooms. Sergio and I will be making the presentation. And to finish, what I would like to say is that I would like to also thank the Minister of Finance of Luxembourg for the generous financial support through the World Bank Group capital market, a joint capital market program called J-CAP. Now, financing firm growth. Why are we writing this book? One idea here is that with global uncertainty, Also, with a high level of public debt, private capital is more important than ever for the growth in emerging market countries and developing economies. So this brings us to the question I want to address in this, in this book. What is the role of capital markets in the growth of firms, jobs, and aggregate productivity in low and middle income countries. So the book will address this question in 3 parts. First, we will document the large expansion of capital market financing by firms around the world since 1990.

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And then we will document how the capital market expansion is driving investment, driving firm growth, as well as employment. And you will finish by documenting the key role that policy reform play in this expansion of capital markets. So the book, to address this, will have— will use a novel database of insurance since 1990. In particular, we have 80,000 firms in 147 countries, and we will focus on with 20,000 firms located in 106 low and middle income countries. And here we exclude China. China is in the book, but we, because of the size, we present it separately. So the data we use come from LSEG. LSEG is London Stock Exchange Group. With debt and equity issuance, we come from Securities Data Company Platinum. And for the firm balance sheet, We will also have a rule scope that will give the size of the firms. Of a country income group, you will use the 1990 World Bank income group classification, and we start in 1990 because of our, our time period started in 1990. Now, the measure of expansion that we have, it is for the market activity, is going to be cumulative net capital issuance. which is basically the sum of equity issuance and bond issuance since the beginning of the period here, since 1990, minus the bond that's mature.

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So what do you find? What we find is that capital market financing for firms in low and middle income countries has grown significantly. In fact, by 2022, it has grown by $4 trillion, and the majority of this growth come after 2000. If you look at in middle income countries, the increase is about 4 times, and in low income countries is 8 times since 2000. Another interesting thing that also we have is that financing equity has been more prominent in low and middle income countries than using bond compared to high income countries. The size of the capital markets in low income countries is just smaller, but it's growing faster. So that's one element to get from this slide. One thing here is that this expansion of capital market we just discussed has been associated with an increasing number of new issuers in low and middle income countries. In

fact, between 2000 and 2002, 14,000 firms became new participants in capital markets between two— in low and middle income countries. Now, as more firms But also we're going to show here that more firms in more countries are having access to capital markets. For that, we look at two subperiods.

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Let's look at 2000 and 2009. We see here 25 countries now come to capital markets, and we can see that from more or less all the regions here. Those countries do not have access to capital markets in the '90s. In fact, from 2000 to 2009, firms in those countries can have access to capital markets. One period for 2010, you see 20 more. And again, that's the orange, you see more firms come, coming in. So the conclusion here is that more firms in more countries having access to capital markets. Now, one interesting result that we found in this book is that most of this expansion is really coming from domestic capital markets rather than foreign capital markets. Domestic capital market, basically local currency. So we see here is that over time, the share of domestic issuance has been increasing. In fact, between 2010 to '22, is accounting for more than 70% of the total issuance. The new issuers are also accounting for an increasing share of capital market financing in low and middle income countries. About more than 60% of the total issuance is accounted by 2022 by these new issuers. When you compare that to high-income countries, it's only about 40%.

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These— what, what are the characteristics of these issuers? They are younger, they are smaller, and they also issue smaller amounts. Another thing that we show in the book, but it's not in the slide here, is that these new issuers are also more productive. So with that, I will leave the floor to Sergio to finish the presentation.

[00:14:55.27] - Sergio Schmukler

Well, thank you very much, César, and thank you everybody for coming here. It's a pleasure to present the book here at the Peterson, and thank you for hosting us. So César has mentioned the expansion of capital markets in low and middle-income countries. Now let me look at, tell you the link that we find between this expansion of capital markets and growth in those countries. So the answer to this question is not obvious because capital markets can be used, first using capital markets can be linked to growth in the sense that firms using those proceeds, they can invest and expand. but also firms can use capital markets to repay expensive loans that they have from, let's say, banks, change the leverage ratios, increase the cash holdings, et cetera. So firms can use capital market financing for what we call nonproductive uses. And ex

ante, we don't know how firms are using them. So what we do in the book, we link these capital market issuance activity with the performance of firms over time. So we look at each time firms are issuing, how they are reacting. So these are estimations that we do with local projections and new econometric technique, and we project how firms' growth, the expansion in physical capital, reacts when firms are issuing.

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And what we observe is that firms in low and middle income countries relative to a control group of firms that are not issuing in capital markets, firms are expanding. So we see an expansion in capital markets of 16%, for example, in low-income countries at the time of issuance. So that suggests, I mean, it's not full evidence, but we have other type of evidence as well, but this suggests that firms are relaxing some type of financial constraints, firms have growth opportunities, and those growth opportunities are realized as they raise capital in capital markets. We also observe that new participants, the firms that are coming to the market for the first time, are expanding more relative to firms that are more established. So that suggests that capital markets are relaxing some type of financial constraints for these new participants. So these type of evidence, and these are just examples that are in the book, show that there is a link between this capital market additions activity and the real side of the firms. And this is at the micro level, firm by firm. So what we do is we then try to aggregate this for all firms in a country, in a given industry, across industries, then for all across industries, and then across countries for a region.

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Then we have the aggregate effect of this capital market activity for different regions of the world. And what we do, we try to disentangle how much of the growth in physical capital, in employment, sales, et cetera, and in productivity are coming from this capital market activity and how relative to the growth that would happen without the capital market activity. And for productivity, what we look, we divide firms that are very productive versus firms that are not productive. And we see that the ones that are issuing are the firms that are very productive relative to the same firms in the same country, in the same industries.

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And therefore, we see that firms that are issuing are the more productive ones and that have an effect on productivity, because otherwise would be unproductive firms that are investing. When we look at the aggregate effects, we see that there is an expansion in productivity, employment, and physical capital. And for example, for low-income countries, we estimate that 12% of the

increase in productivity can be associated with the issuance in capital markets. It's 2%— 12% of employment and 21% of physical capital. So on the aggregate, even though there are relatively few firms that are issuing, those firms have an aggregate significant effect. And of course, this is for firms that are publicly listed for which we can obtain Underworld Scope data. So in terms of the policies that might be driving this growth, we observe that, for example, we do it, we look at different policies that, for example, when countries introduce pension reforms, mandatory, for example, programs that are fully funded, we see an expansion of domestic issuance activity. As countries generate pension funds that then go to the markets, then firms react by issuing more in those domestic markets relative to the firms in the same countries that are issuing in international markets.

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So these pension reforms have a domestic effect. On the contrary, when countries liberalize the capital account and allow investors to come into the country, we see an expansion of the international issuance activity by firms in the country relative to firms issuing in domestic markets. So different type of policy will have different effect on different capital markets for firms in those countries. So we argue that policymakers can do different type of reforms. We don't find one single reform that will just create an expansion in capital markets. And so they have to do this series of reforms like regulations or market infrastructure. Corporate governance and reporting requirements, the development of institutional investors and the participation of retail investors, the regulation of financial markets. So these different policies can all help towards generating capital market activity and then ultimately growth in those economies. So this book, as César mentioned, is a joint effort. We are just editing book. But main authors are here like Manuel García-Santana, Pablo Hernando Kaminsky, Álvaro Perazo, Intiaz Ullahak, and then also a lot of a team, a big team that is working with us. Nico is here that has put together this nice capital markets portal.

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This capital markets portal is a tool that goes with the book. It's an interactive tool. Where users can look at all the charts in the report plus different trends for different countries. So users can compare different regions of the world and different countries during the sample period for all the graphs generated in the report. So this is available online now. So with that, thank you very much, and we are looking forward to the discussions and comments.

[00:22:05.29] - Monica de Bolle

Well, thank you very much, Sergio and César, for a great presentation and a very, very interesting study. Before I pass it on to the panelists— and we have quite a large panel, which is unusual and which led to an oversight on my part because I did not mention one of our distinguished panelists, Stijn Claessens, who's going to be joining us remotely, and he's the executive fellow at the Yale School of Management. Until 2023, he was the deputy head of the monetary and economic department of the BIS, where he led policy-based analyses of financial sector issues, oversaw central bank committee secretariats, and represented the BIS externally in senior groups. So I apologize for that oversight. But it is indeed an unusually large panel. So with that, may I please invite the panelists who are here to join the stage. So welcome. Um, I will begin— I will begin our discussion by just starting with a few questions which I'm going to direct to all of you, so I'm not going to specifically single out anyone, but naturally the place to start is the study, and so I guess most of this is to you, Susan. The study covers the development of private corporate and equity markets, corporate bond and equity markets in great depth in a lot of detail, and I think, you know, it might be useful to sort of summarize What are the main lessons regarding the factors responsible for the expansion that we've seen in these private capital markets in emerging markets and low-income economies?

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What are the key barriers that one can potentially identify for capital market development in these economies? And can you talk a little bit about country cases, just, you know, here and there for us to have an idea of the successful country cases versus the ones that are not as successful? Successful. Thank you.

[00:24:15.22] - Susan Lund

Great, thank you. That is a lot. So first I want to thank the authors. I want to thank the Peterson Institute for hosting us today, and I want to thank the government of Luxembourg for supporting this research. So this project was begun 2 years ago, and in the time since, I think it's become ever more important. So as we know today, in developing countries there are massive investment needs, whether you're talking about development goals through the Sustainable Development Initiatives or climate change or simply creating enough jobs for the hundreds of millions of young people entering the workforce. And public resources are strapped. So increasingly we're looking to the private sector, whether that's foreign investment or more importantly domestic investment. And this is where bond markets and equity markets come in. It offers a way of local currency financing, which is really important. Now you saw in the charts that we also cover international issuances, so that gets to a way to attract international foreign money as well. So I'm thrilled that we're coming out with this report today. I think that there are— one of the key takeaways for me was there is no silver bullet.

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And also capital market growth is not linear. So this issue of how do we develop capital markets has been talked about and studied by the IMF and the World Bank since at least the 1990s. And there was great work done. So we've known forever that this is important. How do you shift from a bank-based system to a more diversified set of financing? One of the interesting things to me today is that we see it's not linear. It's not like, well, first you develop a bond market and that's a simpler product and then you go to an equity market. We see it all happening. So when you look at the West African Monetary Union, WAMU, this is an area that the World Bank Group has done a lot of work to help them put in place the regulatory framework. And you see securitizations. So, in Côte d'Ivoire, the electricity company has securitized receivables to get the money up front to extend connections to more households. You see different types of derivative contracts. You see mortgage financing coming up in some countries. So, rather than being linear, it seems like there are spikes of activity. We work on issuances of green bonds, blue bonds, sustainability-linked bonds.

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So all of this is happening in small amounts. And the question is, how do we now scale it? And it's complex. You need transparent corporate reporting and auditing. You need a legal system that protects creditors and minority shareholder rights. You need a government that is willing to allow more domestic savings to go into the private sector as opposed to government paper, which is an issue. So there are a lot of different things that need to be done, but I think that the progress that you see in this report, that it's not only China and India developing capital markets, but it's more countries, smaller firms, younger firms, although I'll note the younger firms are still 20 years old, but this is an indication that we're moving into the private sector away from some of the large either multinational subsidiaries or just state-owned companies. So with that, I think I'll pass it on to the others in the panel, but encourage everyone to download the book and look at the data in the new online tool.

[00:28:06.29] - Monica de Bolle

Thank you, Susan. Anybody else want to come in?

[00:28:11.03] - Arvind Subramanian

Go ahead. I mean, after the others.

[00:28:12.19] - Monica de Bolle

No, you can go ahead.

[00:28:13.19] - Arvind Subramanian

Go ahead.

[00:28:14.11] - Monica de Bolle

Yeah.

[00:28:14.24] - Arvind Subramanian

So can I react?

[00:28:15.19] - Monica de Bolle

Yeah. This is a discussion series.

[00:28:17.15] - Arvind Subramanian

Yeah, OK, good. So first of all, I want to thank the authors for really a terrific analysis and book. And it's a great public service that you've put out the data, put out a portal. I think this shows how important studies like this are, right? So a hearty congratulations and thanks as well to, on behalf of everyone who's going to use this. I want to push back on two things, which I think I'd like to— or maybe three. One is, first, I want to connect this to the macro, right? If you see broadly the period that you covered, 1990 to 2022, there's a period from, say, 1990 to the global financial crisis. When, and this is, I've done some work on this, is that you saw convergence across the world, whereas after the global financial crisis, all those forces of convergence slowed down considerably in low and middle income countries. So just the correlation that, you know, you see all these fantastic productivity increases at the firm level, which I think are true across both periods, But certainly in the macro, certainly in the second period, there's been a massive slowdown in growth, in productivity all over the world.

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So how do we then reconcile the micro with the macro is one question. The second, maybe even more important question is that, you know, in a study like this, I think it's almost imperative for you to, cover what the downsides of this are. You know, having come from India, we've had so many stock market scandals, you know, so much volatility, the sense that, you know, even

on the bond market there have been defaults and so on. So, you know, to present this as kind of unambiguously good without, you know, a serious discussion of what the downsides are, I think that would be a little bit, you know, it would have balanced it and maybe made the report even better because there are huge downside risks, especially with relation to opening up to foreign capital. You know, the late great John Williamson, Olivier Jean, and I have a Peterson book, in fact, you know, and Danny and I have written that foreign financing is not always unambiguously good. So a sense of what the downsides, defaults, volatility, et cetera. And then which of course leads to the last question, which used to be a big concern related to that, is that we've always kind of understood with respect to finance and foreign finance that whether regulation should come first or market opening should come first or how they should move together, that important sequencing thing, it would be great to know what you found from your study.

[00:31:33.20]

And I'll talk about the Indian experience later, but this I thought were just general reactions to what is a really excellent study otherwise.

[00:31:41.26] - Monica de Bolle

Thank you, Arvind. Stein, please go ahead.

[00:31:46.09] - Stijn Claessens

Yeah, I want to join both Susan and Arvind in giving praise for the report. It's very good, and there's lots of data here and lots of facts in some sense that confirm what we would hope or improved productivity, more capital, particularly for those firms that have opportunities to grow. And at the same time, there's always this question, what are the success cases, and could there be more success cases out there if we had had in place the right policies? And the report goes towards that by looking at some factors that are associated with better productivity or more raising of capital. So, I mentioned funds dimension, the corporate governance rules, the disclosure. The list can be very long, so I don't want to expand on what they already did, but I would have liked to have seen a little bit more on the macro side. It goes back a little bit to what Arvind said. We've had a good period of moderation on inflation globally before the recent bout. And that, for example, has helped a lot on the capital markets, I suspect. So will we continue to have that favorable, both domestic but also favorable global environment going forward is a little bit of a worry.

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And that if you were more generally try to extend that kind of benchmarking, we will be able to also tailor our policies better, not only in sequencing, which is difficult. I mean, I've worked on these issues myself too in many countries, and it takes a long time. It takes a dedicated set of people. It takes a lot of assistance. And even then, success isn't guaranteed. But nevertheless, there are these, these cases, and we should capitalize a little bit more on those, and the report can help a lot in that sense.

[00:33:32.13] - Monica de Bolle

Thank you, Stijin. Matt?

[00:33:34.06] - Matt Robinson

Maybe if I can come in here as well. From Moody's perspective, we're a market observer and a risk assessor, but certainly what's in the report, uh, it confirms our view in terms of what certain countries have done, what those that have been success stories. There's no denying the, the financing gap for developing frontier and emerging markets is very, very large. Sovereign issuance and the corporate markets that have followed that have been a way to unlock some of that private capital to support that. But it hasn't been plain sailing, as Arvin said. There has been successive shocks over the past few decades, certainly in the past few years that we've seen where there has been sovereign default has led to a degree of macroeconomic and financial challenges for the corporates in a lot of these frontier and emerging markets. But nevertheless, there have been success stories. You think about some of the reforms that César mentioned, and certainly we see that the economic reforms, the business reforms, the infrastructure development, the trade, the social healthcare, education reforms, and those that have been very, very influential from a creditworthiness perspective. You think about fiscal reforms, monetary reforms, exchange rate reforms, banking system reforms, or pension reforms to unlock those, that funding.

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Some of the names that we see, like in terms of ratings, Indonesia, Philippines in the Asia-Pacific space over that not too dissimilar period of time. I think our study was 2006 to 2022, but those two ratings are 5 notches higher than they were. You've got Paraguay, 6 notches higher, and Dominican Republic, two Latin American examples, 5 notches higher over that decade and a half period. Some of the more recent market issuers like Côte d'Ivoire and Benin have also been ascending. And, and, and there's something about the way that sovereigns getting their house in order, facilitating a market, a yield curve that corporates can come under, that, that, that supports confidence. It engenders the desire to invest. It helps increase the long-term

growth prospects. And ultimately, that's what drives the issuance and what this study is looking at.

[00:36:02.24] - Monica de Bolle

Thank you. So staying on the macro themes, I want to move to something else. So in many emerging markets and low-income countries, we know that these are characteristically countries with high levels of government debt. And to a large extent, Governments do use financial markets to finance themselves. That does get in the way of financial market development, especially when it comes to private market development in bonds, equities, and everything else that you've been studying. In the past, when we saw this capture by governments with respect to their financial systems, there were several tools that were used in the process of this capture, and we sort of thought about these instruments as instruments of financial repression, so to speak. We don't use that expression as much anymore, but that's how we talked about it. So my question to you is, how widespread is financial repression today compared to the past, and how might it affect further capital market development in the economies that you were particularly focused on? And this is to all of you.

[00:37:20.08] - Stijn Claessens

I'm happy to start because I think the issue of financial repression is not just in emerging markets. And unfortunately, we also have high debt in advanced countries these days, and we may be facing some issues going forward in those countries as well. And I think that part of the growth in the capital markets we've seen is the reduction in repression. In many of these emerging and developing countries for the better. So in that sense, the reforms have worked and delivered the good things. Is there a balance to be struck? Yes. I don't think one would want to go and say, well, have completely liberalized systems always and everywhere. And you do need the domestic investor in any case to be there in some sense to nurture along. Information doesn't cross borders perfectly. So If you have a domestic investor base, it's useful for the capital markets to develop. So there's, there's a balance to be struck. And in that context, I think the ingredient to striking that balance is having an active foreign participation in both equity and bond markets. I think in equity markets we have it fairly well, um, in the sense that, uh, the global investor is considering emerging markets to some extent.

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Unfortunately, the returns haven't been Perfect. But nevertheless, the diversification of risks is there. But on the bond markets, it's been a little more of a mixed picture. So the report stresses that this is largely about local bond markets, which I understand because of original sin. We've

had some disasters, or whatever you want to call them, with borrowing in foreign currencies, both by sovereigns and a lot by corporates too. So I wouldn't want to overemphasize the foreign currency. At the same time, you want some foreign borrowings, right? You want the currency, the capital to flow from north to south, and that inevitably will have to be in a foreign currency. And the other piece of the foreign investment in local bond markets has tapered off or stabilized. I think that's actually, to me, a little bit more of a worry in terms of repression, because then you don't have the competition from the foreigners to stimulate the market in the right way and avoid this kind of capture locally. So I think the liberalization, we have to think carefully about what is for a sustainable capital flow coming in from abroad, what works, that doesn't give us the original sin problem, but also doesn't give us the foreign capital coming in and out at a very high volatile rate.

[00:39:58.13] - Monica de Bolle

Thank you.

[00:39:59.11] - Matt Robinson

Often it's a, it's, it's a balance. Like, I agree with what Stein's saying here, but it's a, it, it, it's a balance. So too much government debt in the market does absorb a significant portion of the funding pool, but not enough government debt in the market and you don't have a well-functioning, efficient market. So in some respects you need a, a vibrant, sizable government market in order for there to be that necessary amount of capital market development for there to be able to attract, whether it's the local financing options or whether it's the, the foreign money coming in. There have been a number of examples where we have seen in the very recent past where the likes of Ghana or even Nigeria to a certain extent really went to the point where government debt essentially consumed all of the, the available funding. And that, that was a real stifling impact on, on, on private investment. Repression still exists in some of the, the countries that we relate. I'm thinking of the example of Ethiopia that actually repealed in 2018 one of the most obvious examples of repression where 27% of deposits were required to be invested in government bonds.

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But as that country started to go into some of the challenging period in the post-COVID period, it reintroduced in 2021 and 2022 certain rules, not quite as egregious, but certain, uh, what we would deem likely to be financial repression in terms of how much the institutions were required to invest in Development Bank of Ethiopia. So, so, and I guess also in— saw in the West African region, uh, Sam mentioned that, uh, the refinancing operation in 2023, which could have been

argued as a, as a way in which, um, uh, that you were able to repress the, uh, the domestic system to be able so that governments were able to issue at a more or below market rate. But, but a lot of these were necessary policies at a time of a fair degree of financial market dislocation. And so I guess it comes back to that point about balance. The policymakers need to know and understand the consequences of potentially crowding out or of using financial repression. But failure to do so could lead to more systemic destabilization.

[00:42:42.05] - Monica de Bolle

Thank you. Susan, you're going to speak.

[00:42:45.03] - Susan Lund

I think I would make 3 points. One is, so when we talk about financial repression, really we're talking about the flow of capital to the government versus the private sector. And this can come through many different channels, largely through banks. When you look at bank balance sheets in many, if not most low-income countries, it's stocked full of government bonds. Sometimes, as in the case of Ethiopia, there may be requirements. But more often, if you're a banker and you can get a 15% return on government paper that's virtually risk-free to you, why would you lend to corporates, let alone smaller businesses? So is it repression? I don't know. I mean, this is what bankers would do. Same with— now on the regulatory front, I think some of the hesitation that we've seen to open up, particularly to foreign investors or offshore issuing is the fear of volatility and some of the downsides that Arvind was pointing to. So since 1997, we saw very clearly what happens when you have so-called hot money and foreign investment that can come in but then leave. And so countries are rightly concerned about how to regulate that and not letting both their exchange rate and their capital flows get out of control.

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And then the third factor though, and maybe the solution to the second problem, is developing the domestic investor base. So one of the reasons you may want a corporate bond market and an equity market is to give households a way to save in something beyond bank deposits. Which often have regulated low deposit rates. And so by creating vehicles to channel domestic savings into capital markets, it's a way maybe of mitigating against some of the volatility of foreign capital. And you saw one of the findings from the book is that when you have a funded pension system, it creates a pool of local currency you see money that wants to be invested and you indeed see more domestic issuance. So, I think this brings out you need to look holistically at not only the issuance side and the regulatory side, but who's investing in your market.

[00:45:12.00] - Monica de Bolle

Absolutely. Arvind.

[00:45:14.12] - Arvind Subramanian

Just to share a few thoughts based on the Indian experience, which kind of speak to maybe some of the larger issues. I mean, the reason that India started developing its capital markets was very simple, that it had a dominant public sector banking system. And so India tried to open up first to private banks because it could never privatize the existing public sector banks for political reasons. Even today, not one public sector bank has been privatized. And because that encourage— experience of opening up to private banks wasn't that successful, they had no choice but to say, you know, if you want to direct resources to the private sector, the banks ain't gonna do it, so that's why we developed capital markets. And India very much emphasized equities above the bond market. Even today, while financial repression has eased over time, it is still the case that there are significant restrictions on foreign entry into domestic— into the government bond market. But the equity market has been allowed to develop very strongly. But I mean, having seen the Indian experience, I mean, I cannot emphasize enough how important the regulatory institutions are to create a sense of legitimacy for any of this.

[00:46:50.03]

There have been 3 or 4 major stock market scandals in India, and every time that happens, people say, well, what's going on? We need— so I think that— by the way, Susan made a very good point about Is it repression or is it them? There's an Indian former deputy governor who's at the Fund. He has a term for it. It's called lazy banking. That's the term when banks voluntarily invest in paper. But I think the regulatory side, I think, has to be really, really— because even today, for example, I don't know how many of you have followed what's been happening. You know, there have been major scandals surrounding some big businessmen in India, and people have been worried about the independence of the regulatory agency. And, you know, because if that doesn't happen, it leads to what I call stigmatized capitalism, that, you know, the whole push to the private sector starts— people start getting, you know, anxious about that. And then again, then there's a backlash which says, let's, you know, let's rely on public institutions, public banks, you know, and so on. So it's really, really important to get the regulatory side, I think.

[00:48:12.19] - Monica de Bolle

Well, I think we have a few minutes for the audience and at least a couple of questions. So I will now turn to you, and please do state your name and affiliation. And make a question, a quick one. Not— we have a big panel, as you see. We have a mic in the back. And do we have a

roving mic as well? And we have a roving mic as well. So please raise your hand or just walk to the mic. Yes, please.

[00:48:52.22] - Audience

Hi, I'm Tristan Reed. I'm a colleague of Sergio, but this isn't a planted question. I've been thinking a lot lately about industrial policy. And that's often looked at in terms of government subsidies for specific industries or countries. But a bigger argument that has been made about China, for example, is that there are policies in the capital markets, like caps on deposit rates, soft budget constraints for state-owned banks that actually subsidize the whole economy. And I'm wondering if you can talk about which countries may have more of those. Does the low interest rate on US government debt mean that that's a kind of subsidy relative to emerging markets? How should we think about these interventions and interest rates overall? Thanks.

[00:49:38.27] - Monica de Bolle

Thank you for that question. That is actually an excellent question because it comes back to one issue that I didn't ask you on public institutions and the role of public institutions in these markets, because oftentimes what we will see is that this kind of distortion is precisely being generated by those institutions. So anyone who wants to address those questions, please, the floor is open to you.

[00:50:04.11] - Arvind Subramanian

I mean, the Chinese experience is a classic counterexample to saying capital markets are very important. But China is, I guess, sui generis. But in terms of industrial policy, I will let others— I mean, maybe the authors should speak to this, actually.

[00:50:28.20] - Susan Lund

Well, I'll offer an example. I mean, there's nothing inevitable about a financial system developing capital markets. And I think we only need to look at Germany to see that experience. Germany has relatively shallow equity and corporate bond issuance. The banks have been very strong. It's for a number of reasons, not least of which German companies, they've really preserved their smaller end of large companies. And one thing we know about capital market issuances is that even though the issuance size has come down, it's still relatively large. This is not something— a small firm is not going to go issue a bond in any country in the world or list equity because that means giving up ownership. So there is nothing inevitable. And it may be due to— I know you want to talk about Brazil's public development bank, which it makes it hard for the private sector to compete when you have subsidized interest rates.

[00:51:33.05] - Monica de Bolle

And in the case, it is as well an instrument of industrial policy, so it goes precisely to your question. Please.

[00:51:42.08] - Audience

Thanks very much. Good morning. My name is Chris Richards. I work on something called the World Bank Group's Joint Capital Market Program, which was referenced. Thanks very much to the panel, very interesting discussion, and for the book. As was touched on, this book is very important in terms of referencing the value and the benefit from the work that's possible in terms of capital market reform and development. And the World Bank Group is doing that through JCAP and through other mechanisms. And a lot of that are the things that were touched on in terms of the rules, the laws, the regulations, the policies, building the capacity of local institutions, the regulatory authorities. And making investments through the IFC through demonstration transactions. We find the research really helps that work. It helps to target it, it helps to inform it, and so this report will be useful from that perspective, particularly to help inform those partners who may focus on a range of particular interventions. So it's nice to be able to draw them into this work and to help explain why it's valuable. My question relates to the research and where to next. So what is it you think that would be the most valuable next step in terms of follow-on research opportunities that JCAP or others might support?

[00:52:56.15]

Thank you.

[00:53:01.29] - Monica de Bolle

Go ahead.

[00:53:02.24] - Susan Lund

Well, I'll let— I think the authors should answer, but certainly one area that could be next is this whole policy angle. Like, this report covers some reforms. But the fact is we lack a very clear roadmap even after 30 years of talking about this for what are— given all the disasters and the successes, what is the clear roadmap of sequencing and reforms and what do you watch out for? And in the exhaustive research that went into this report, there is no clear roadmap. And that's definitely an area that we could all do more on. But I see Sergio is ready to talk a little bit more about the next phase of this research.

[00:53:47.19] - Sergio Schmukler

Thank you very much for all these great comments and questions. Let me address some of the points that were raised here, and these are excellent suggestions. So one on the macro side and the downside risk that Arvin started mentioning and others as well. We have, I mean, we are right now at 30 years since the tequila crisis, and we have seen in the 1990s several crises in Asia, Latin America, etc. And what we have seen afterwards is kind of robust development of these markets that we didn't anticipate. Even during the global financial crisis, we see that the emerging economies performed really well compared to the 1990s. And these capital markets, in fact, what happened during the global financial crisis when there was a retrenchment on the banking side, the bond market boomed, both in developed and in developing countries. So we perceive that this development of capital markets might have helped what banks were not covering. So the alternative would be to rely, would have been to rely on bank financing. That would have been tough. So I think the capital markets fill some void and allow firms, not all, but several firms to grow, invest, and raise new funds.

[00:55:07.14]

So that's kind of some message that we find in the report. On the downside, yes, there could be possible downsides, and it's true that the report doesn't focus on them, but one thing that we document very clearly is that this large expansion of capital markets by newer firms raising funds in domestic currency, and that's something that was not obvious ex ante, and that's a good development, and that to some extent is linked to some of the domestic policies as I highlighted. It's true that there could be risks and we are not focusing on them, but there are also good stories that the book is highlighting. There is some issue that also Stein and Arvid mentioned about the success cases. It's true we don't cover them here in detail. We just wanted to provide broad base across countries, regions, et cetera, so having more panoramic view, but it could be more focused views in other reports, in other studies. In those cases, what we have seen, large development of capital markets, cases like, for example, in Asia, we see a range of reforms that they have had. It's not a particular sequence. When you see what happens is every year they have one reform, another reform, another reform.

[00:56:33.04]

It's very hard to know which one should come first or the other. You see a barrage of things like when they want to develop these markets, regulators, policymakers do them almost altogether. It's very difficult to pinpoint one. Let me, couple of more points very fast. On the link between government and corporate markets, it's true that it's a link that is very interesting to study, which

we don't study. It could have positive or negative effects, the development of government bond markets, but that's something that could be done more thoroughly. On Tristan's points on China, we haven't looked at the industrial policy linked to capital markets, but we have seen it in China What they have done is they tried to liberalize the financial market. And there we have a companion study. We look at how the Chinese reforms affected some firms and not other firms. And those— that liberalization of capital markets in China, we see a response of the firms that were targeted by those reforms relative to the other firms. So we have a nice control group, and we do a different study. And we see that this liberalization led to a lot of issuance activity and a lot of investments by the firms that were targeted by those reforms.

[00:57:53.06]

And that was prompted, even though it was a foreign liberalization, domestic investors were the ones that were investing in those companies. Finally, on CRIS, one of the next steps, I let César mention that, the study we are right now undertaking. Thank you very much.

[00:58:10.02] - Monica de Bolle

Thank you. Time?

[00:58:13.01] - Arvind Subramanian

César.

[00:58:13.21] - Monica de Bolle

Oh, I'm sorry, César.

[00:58:16.27] - Cesaire Meh

Thank you, Sergio. So actually, in terms of next step, what we are planning to do, I think the work that Susan mentioned regarding the sequencing, look at what type of policy. There might be some background research that we'll be doing in that area to see whether altogether we make a difference. Going to be not a report but mostly a research paper. But in terms of big step is, as we discussed here today, you saw that it was more on quantities. So we haven't talked anything about prices. So in the next report, we'll be talking about the cost of capital in emerging market countries. So that's something that we already started, we started, and we have something. Maybe again you'll be inviting us to present this one here. And another element is also the investor base. We talk more about the insurance side, but you don't— we haven't discussed a lot about the investors. That would be one thing. Just quickly, regarding the

question on macro and micro, it is true that the macro is a very important part for the increase in capital insurance. In fact, in the book, we show that 50% of increase is accounted by economic growth in that.

[00:59:29.25]

So that's really— The macro plays an important role in that. I stop here.

[00:59:34.17] - Monica de Bolle

Thank you, César. Now, Stein.

[00:59:38.08] - Stijn Claessens

Just two comments. Both Susan and Sergio and César highlight all the points. The roadmap will be very useful. It's very hard. I just want to stress that you need to look at both success in terms of volumes, quantities, but also in terms of impact, of course. It's really with the growth contribution that you want to look at. One list of things maybe to look at as well, and goes back to Cesare's comment on sustainable investor base. IFC has been very successful with the equity indexes from Antoine van Aertmael 40 years ago or so to get emerging markets on the map on the equity side. On the bond side, I know there's private sector, Matt is in the business too, his company, but I still feel it's not sufficiently addressing smaller markets. And there is a public good aspect of it. How can you have the passive investors that have been increasing invest in emerging market bond markets in a good way? And an index that is sensible there would be very useful. It cannot be an index that looks at actual investment because that's really leading the horse the wrong way. It should be leading where the investment should be going towards.

[01:00:49.11]

And if we can do the similar thing what the IFC did 40 years ago on the bond market, that would be very useful for more sustainable capital flows.

[01:01:00.01] - Monica de Bolle

Thank you. Unfortunately, we are out of time. I would like to thank—

[01:01:07.02] - Audience

There was one question I think you wanted to ask.

[01:01:10.13] - Monica de Bolle

Yeah, if it can be very brief because we are practically on time. Sure.

[01:01:16.28] - Audience

Brian Head.

[01:01:17.13]

I do have a question. You kept saying policy, policy, policy. And I'm more interested in the company sort of before that and the capital markets a little bit before where you're at. So the US has an IPO sort of issue.

[01:01:26.20]

We have a balance.

[01:01:27.09]

And when we were talking about industrial policy, which to me doesn't get talked about enough, is bankruptcy policy, the balance between creditors and all the agents involved. And that's something that hasn't come up today. But I feel like that is phenomenally important. So if somebody— Matt went away, but I feel like that was sort of Matt's center.

[01:01:52.04] - Matt Robinson

I'm still on in terms of the credit rating agency view. Certainly in emerging markets, more generally, the rule of contract, whether it's bankruptcy, whether it's rights of creditors, adherence to law is less well-developed or more rudimentary than a lot of the advanced economies. And I think the depth of the capital markets show that. And that when you're talking about where is the next area for this study to go, maybe looking at the, well, what has inhibited or where the shallow capital markets are, what has prevented that from being able to develop in a way. And it might be some of those rules like the intercreditor equity issues that come up in bankruptcy or solvency issues. Final point, that point of cost of capital is obviously a very big talking point this year. It's a key point for the G20 under South Africa's presidency, and what are the potential solutions there? And maybe that is another area where domestic capital markets offer an opportunity, whether or not we rate some of the local currency guarantors and the, those funds that are investing in local currency assets on the basis that, that blending of the concessional elements, whether it's bilateral, multilateral, or philanthropic concessional money with some of

the private sector money to ultimately unlock greater amounts for emerging market developments.

[01:03:39.23]

That's, that's an area of focus. For us.

[01:03:42.27] - Monica de Bolle

Thank you. Well, now we really are out of time, so thank you everyone for coming. Let me thank and acknowledge our distinguished panelists for a very, very rich discussion this morning. Thank you very much. Let me also congratulate the authors and the teams from the IFC and the World Bank who are here today. Thank you very much for this incredible study, which will be of of great use, and I'm sure we're all looking forward to the report, the follow-up report on prices, the next step to this study, as César was saying. Thank you so much, and thank you for coming to the Peterson Institute. Thank you.