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On the presence and market-structure of exchanges around the world ☆

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Abstract

We investigate the cross-section of 256 financial exchanges throughout the world. First, we empirically analyze the country characteristics that are related to having a financial exchange. Second, we investigate the determinants of an exchange's choice of trading mechanism, and third, we examine whether the presence of an exchange in a country impacts the domestic country's economy. We find that the main determinants for an exchange to exist in a country are the size of the economy, trade policy, foreign investment, development of the banking sector and the legal system. Our results show that the choice of trading mechanism depends on the number of assets traded and the legal system. Lastly, we find that the presence of an exchange is associated with a reduction in the growth of the monetary aggregates but is not associated with other measures of domestic growth and productivity.

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0. Introduction

Understanding the inner workings and overall impact of a financial exchange cannot be underestimated, particularly given the increasing globalization of capital markets. Consistent with its importance, a large literature studies exchange trading and its macroeconomic impact on the economy. Interestingly, this literature focuses almost exclusively on a handful of exchanges in the most developed countries. While crucial to our understanding of exchanges, this literature is incomplete given that at least 60 new equity exchanges have been created globally since 1990, and a significant proportion of global trading is executed on financial exchanges not covered by existing research. For example, equity trading outside the Frankfurt, London, New York, NASDAQ, Paris and Tokyo Stock Exchanges is approximately 27% of global dollar volume and 58% of the global number of transactions.[1]

We broaden the scope of research on international financial exchanges by analyzing the cross section of 256 financial exchanges within 101 countries out of the total 191 countries around the world. Our analysis has three goals. The first goal is to enhance the understanding of the characteristics of the economic environment that are associated with the presence of a financial exchange in a country. We do this by examining the factors that predict the existence of a financial exchange in a country. In addition, we examine the factors that predict multiple exchanges; this is crucial if competition among exchanges has important economic effects. Our second goal is to analyze factors that determine the choice of trading mechanisms by financial exchanges. This is salient given that the market-microstructure literature has been relatively silent about whether particular trading mechanisms are used within different economic environments and with different types of financial securities. The third goal is to investigate the long-run relation, if any, between the presence of a financial exchange and the domestic economy. Previous research investigating the impact of equity markets on the macro economy has focused on well-developed equity markets in the industrial countries of the world. The contribution of this work is that we investigate the *initial* exchange formation within a country since 1950 and include countries that *do not* currently (in 1998) have a financial exchange. Thus, our analysis benefits from knowing the exact formation dates as well as using a more comprehensive sample.

From a policy perspective, understanding why some, but not all, countries choose to have one or more exchanges remains a crucial issue. Our findings provide guidance to policy makers trying to determine the viability of an exchange in their country. Moreover, our results help officials of existing exchanges that are facing competitive pressures better evaluate their optimal choice of trading mechanism.

Our results show that the presence of at least one financial exchange within a country is associated with larger economies and civil law legal systems. In addition, countries with greater economic freedom are more likely to have an exchange, with trade policy, foreign investment, and banking being the most critical factors. Specifically, countries with open trade policies, that are open to foreign investment,

[1]Based on the Federation of International Stock Exchange (FIBV) statistics.