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Stock market development and economic growth in Belgium ☆

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Abstract

This paper investigates the long-term relationship between financial market development and economic development in Belgium. We use a new data set of stock market development indicators to argue that financial market development substantially affected economic growth. We find strong evidence that stock market development caused economic growth in Belgium, especially in the period between 1873 and 1935. Institutional changes affecting the stock exchange explain the time-varying nature of the link between stock market development and economic growth.

Keywords: Financial development; Economic growth; Stock market

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1. Introduction

The deepening and level of sophistication of modern financial markets is arguably a recent phenomenon. However, stock markets have long played an important role in economic life. DeClercq (1992) describes the early history of the financial system in Belgium, starting in the 14th century. This paper studies the importance of the Brussels stock market for fostering economic growth in the 19th and 20th centuries.

Hicks (1969) argues that in the 19th century, for the first time in history, many private investment projects were so large that they could no longer be financed by individuals or from retained profits. The technological inventions of the industrial revolution, such as steam engine, had been made before, but their implementation had to wait for well-developed financial markets. The industrial society required an adapted financial system where publicly traded companies could get long-term financing.[1]

Against this background, the Brussels stock exchange opened in 1801 under the Napoleonic occupation (1795–1815). It was the beginning of a period of rapid industrialization.[2] The spinning jenny was smuggled from England in 1799 and Cockerill imported the new techniques for the iron and steel industry in 1807. The Dutch government of William I (1815–1830) further revived the entrepreneurial spirit in Belgium. Our analysis starts at the beginning of the independence of Belgium in 1830. It focusses on the development and deepening of the Brussels stock exchange and on its growth-promoting role in the next 170 years.

Linking historical evidence to the role of the stock exchange for economic growth requires a theoretical framework. We draw on the functional approach of Levine (1997). Financial markets allow for more efficient financing of private and public investment projects. By representing ownership of large-value, indivisible physical assets by easily tradeable and divisible financial assets, and making trade in them more liquid, they promote the efficient allocation of capital. They give lenders the opportunity to diversify their investments. In these roles, financial markets increase the quality and quantity of intermediated funds. Using descriptive historical evidence, we describe how the Brussels' stock exchange fulfilled these roles.

Our main contribution is to quantitatively assess the role of finance for growth in Belgium post 1830. Using a new data set on indicators of stock market development of the Brussels' stock exchange, we find evidence that financial development significantly contributed to economic growth. Using cointegration analysis, we argue that the rapid expansion of industrial production was not only substantially facilitated, but even *driven*, by the financial development. Our econometric analysis finds

[1] There has been a lengthy debate on why the Industrial Revolution first started in England and why in the second half of the 18th century (Crafts, 1995). One often heard argument is that Both the Bank of England and the dominant stock market of London gave England a competitive edge.

[2] Belgium was the first country on the European continent to industrialize. France was immersed in its revolution until 1848; and Germany had to wait for its reunification in 1870 before industrial development took hold.