

Financial Liberalization: Integration of European & Arab Institutions

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AGENDA



- FINANCIAL DEVELOPMENT IN MENA: SUCCESSES & FAILURES OF FINANCIAL LIBERALIZATION
- NEXT STEPS: INFRASTRUCTURE, INSTITUTION BUILDING & GOVERNANCE
- BASIS FOR ECONOMIC & FINANCIAL INTEGRATION
- REMOVING BARRIERS TO INTEGRATION & PROSPERITY

MENA FINANCIAL DEVELOPMENT: 1990s FACTORS



- **REFORMS & DEREGULATION**
- **TECHNOLOGY: ICT, PAYMENT SYSTEMS**
- **NEW FINANCIAL TECHNOLOGIES & INSTRUMENTS**
- **GLOBALIZATION OF FINANCIAL MARKETS**

What Happened in MENA? Financial Sector Development



IMF Index of Financial Development composite of 35 indicators including:

1. Development of the Monetary sector and Monetary policy
2. Banking sector size, structure, and efficiency (including the role of the government in the sector)
3. Development of the Non-Bank financial sector
4. Quality of banking regulations and supervision
5. Financial openness
6. Quality of the institutional environment



Table 2. Middle East and North Africa Countries: Financial Development Index, 2002/03 1/
(Based on Qualitative and Quantitative Data) Scale: 0-10 2/

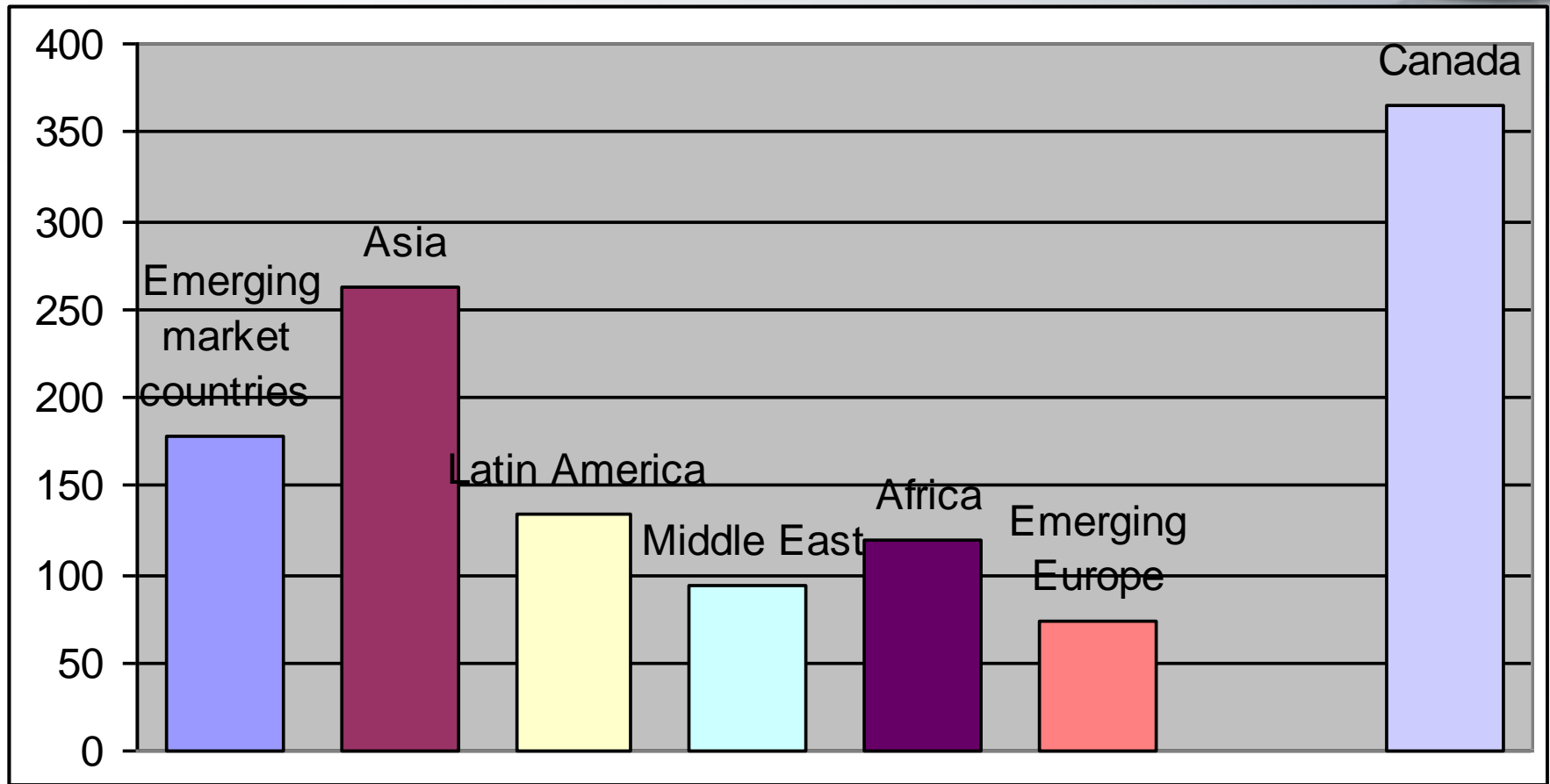
	Financial Development Index	Banking Sector	Non-Bank Financial Sector	Regulation - Supervision	Monetary Sector & Policy	Financial Openness	Institutional Environment
Bahrain	7.66	7.28	5.00	9.33	7.77	8.00	8.89
Lebanon	6.97	8.74	3.33	7.67	8.25	7.00	5.22
Jordan	6.93	7.06	6.33	8.67	6.50	8.00	5.44
Kuwait	6.80	7.36	5.00	8.00	6.62	8.00	5.89
United Arab Emirates	6.60	7.89	5.00	6.67	5.98	8.00	5.89
Saudi Arabia	6.37	7.83	3.33	8.00	6.42	8.00	4.22
Oman	6.13	7.10	5.00	8.33	4.19	8.00	4.78
Qatar	5.68	6.81	0.67	6.67	5.66	8.00	6.33
Pakistan	5.60	4.19	6.33	7.67	7.37	4.00	3.89
Tunisia	5.57	7.70	4.67	5.33	4.46	5.00	5.00
Morocco	5.54	5.62	4.67	7.33	6.84	4.00	3.78
Egypt, Arab Rep.	5.45	5.99	6.33	5.33	5.57	6.00	3.22
Sudan	4.84	6.29	0.67	3.67	6.19	7.00	4.54
Yemen, Rep.	3.87	4.15	0.67	3.33	5.00	9.00	2.22
Djibouti	3.79	3.85	1.33	5.00	4.40	7.00	2.00
Mauritania	3.45	3.76	0.67	3.00	3.94	5.00	4.50
Algeria	3.23	2.55	3.00	3.46	4.36	4.00	2.33
Iran, Islamic Rep.	2.33	1.87	3.33	3.33	0.51	4.00	2.42
Syrian Arab Republic	1.13	1.92	0.67	0.00	0.90	0.00	2.42
Libya	0.99	1.35	0.67	2.00	0.50	0.00	1.00
Average	4.95	5.46	3.33	5.64	5.07	5.90	4.20

Source: IMF staff calculation

1/ Original "subjective" weighted index.

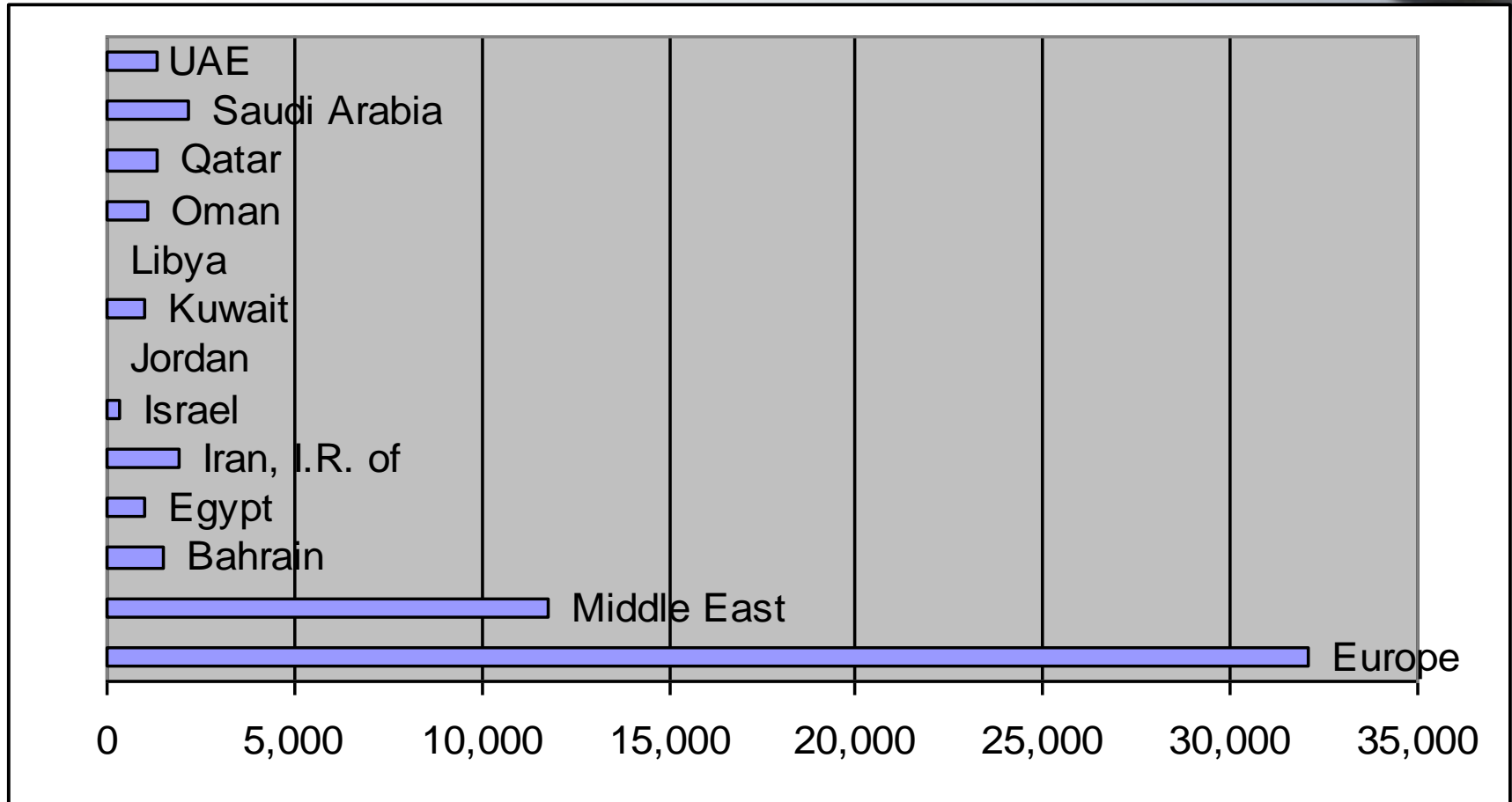
2/ Scale: Very Low=below 2.5, Low=2.51-5.0, Medium=5.1-6.0, High=6.0-7.5, Very High=above 7.5.

Bonds, Equities & Bank Assets (2003, as % of GDP; Source: GDF 2005)



Emerging Market Syndications 2004

(US\$ millions; Source: GDF, 2005)



Main Observations, Trends & Results: I

‘Roaring 1990s’ lost decade for MENA



- MENA FS less developed than other regions at similar level of economic development
- No surprises in country rankings
- MENA FS are bank dominated systems
- Colonial past and its economic history are major institutional factors explaining bank dominance of FS as well as the choice of exchange rate regime in the MENA countries
- FS liberalization & Reform, Privatization process yielded limited change: no ‘popular capitalism’
- MENA FS not integrated with international capital markets

Main Observations, Trends & Results: II



- Financial reforms of the 1990s focused on freeing interest rates and credit allocations, and other distortions
- Failure of reform & liberalization due to State dominance of financial sector
- Less effort to improve the institutional basis of banking & finance— more difficult task
- MENA countries missed out on ICT and financial sector revolution of the 1990s and on economic & financial integration

Main Observations, Trends & Results:

III



- Government ownership and intervention in the banking and financial sector resulted in:
 - Financial repression and distortion of credit system
 - Under-developed payment systems
 - Major contributor to lack of development of FS and by implication lack of contribution to economic growth
- Region's relatively good performance in bank regulation and supervision largely attributable:
 - Implementation of international standards, in particular the Basel Core Principles
 - Banking supervision appointments have tended to be non-political, technical and professional

Infrastructure, Institutions & Governance: bridging the gaps



- Financial Liberalization & Reform must be an integral part of a comprehensive policy reform package
- Financial liberalization should precede Euro-Arab integration and international integration
- Financial liberalization should focus on:
 - Governance
 - Investing in Financial Sector Infrastructure
 - Institution building

International Standards for Financial Soundness & Stability



Macroeconomic Policy and Data Transparency

- **Data Compilation & dissemination: GDDS & SDDS**
- **Transparency in Monetary and Financial Policies**
- **Fiscal policy transparency**

Institutional and Market Infrastructure

- **Insolvency**
- **Accounting**
- **Corporate governance: OECD CG Principles**
- **Auditing**
- **Market Integrity: Anti-Money laundering**
- **Payments and Settlements Systems**

Financial regulation and supervision

- **Banking supervision**
- **Securities regulation**
- **Insurance supervision**

Arab Countries Compliance with Standards (Source: eStandardsforum.com)



Country Rank	Country Name	Country Score	Positive Developments
52	Egypt	42.31	Yes
58	United Arab Emirates	31.54	Yes
62	Saudi Arabia	24.62	Yes
64	Jordan	23.08	Yes
66	Lebanon	21.54	Yes
81	Iran	4.62	Yes
83	Syria	1.54	No

Dimensions of Public Good Governance (Source: World Bank)



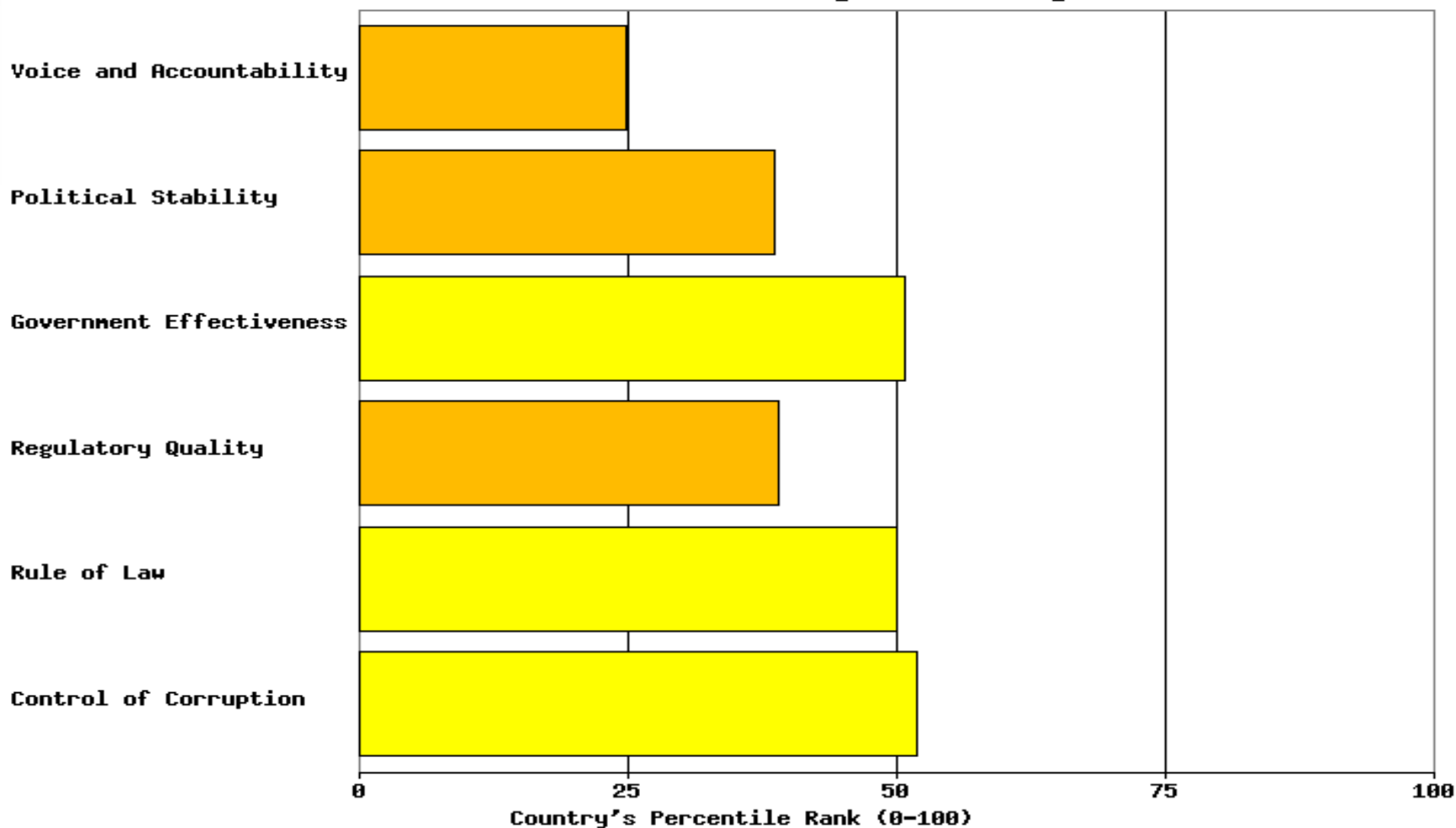
- Voice and accountability
- Political stability; No violence or conflict
- Government effectiveness
- Control of corruption
- Regulatory quality
- Rule of law



GOVERNANCE INDICATORS MENA 2004



Middle East & North Africa – Regional Average (2004)



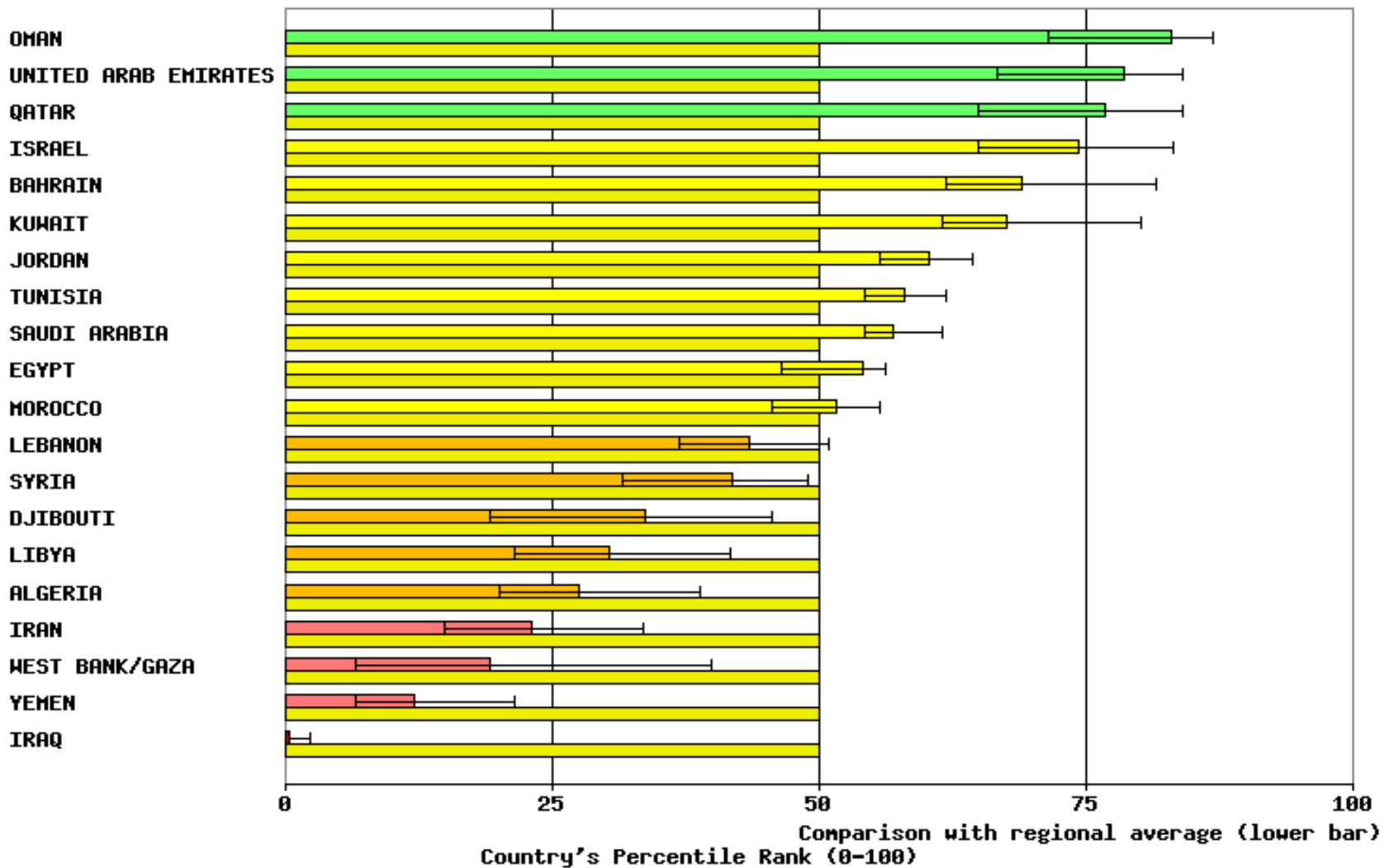
Source: D. Kaufmann, A. Kraay, and M. Mastruzzi 2005: Governance Matters IV: Governance Indicators for 1996–2004 (<http://www.worldbank.org/wbi/governance/pubs/govmatters4.html>)

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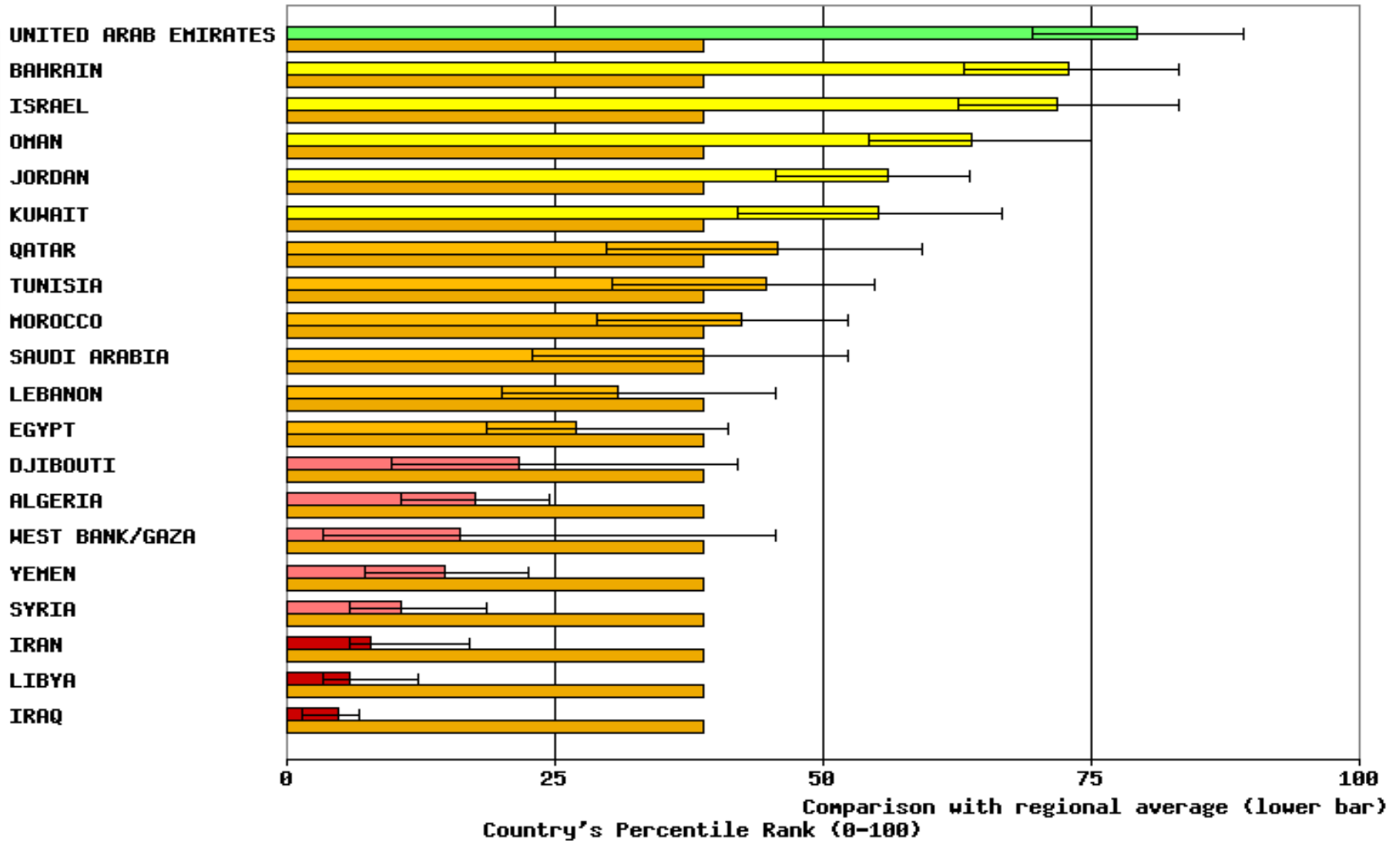
Rule of Law (Middle East & North Africa region, 2004)



Source: D. Kaufmann, A. Kraay, and M. Mastruzzi 2005: Governance Matters IV: Governance Indicators for 1996-2004
 (<http://www.worldbank.org/ubi/governance/pubs/goumatters4.html>)



Regulatory Quality (Middle East & North Africa region, 2004)



Source: D. Kaufmann, A. Kraay, and M. Mastruzzi 2005: Governance Matters IV: Governance Indicators for 1996-2004 (<http://www.worldbank.org/ubi/governance/pubs/govmatters4.html>)

Barriers to Euro-Arab Integration



- Lack of Regional Arab economic & financial integration: negative impact on market size, absence of economies of scale. Needs political will & vision.
- No framework for private sector participation
- Policy & Regulatory Barriers:
 - Basel Accords I & II: major impediments to capital flows & financial sector integration
 - Domestic regulatory barriers to market access
 - Absence of legal & regulatory and governance framework for M&A and Cross-Border investment

Non-Integration of the Arab Countries



Globalization



Trade



Labour



Capital Flows & FDI



Integrated Infrastructure basis for Economic & Financial Integration



- Geography & proximity, density & intensity of traffic suggest high returns to integrated infrastructure investments: standards, policies, pricing; integrated network
- Transport: rail, road, air
- Energy: oil & gas, electricity
- Telecommunications & Infostructure (broadband+)
- Payment Networks: increased use of Euro; facilitate payments & settlements in capital markets
- Financial Market Infrastructure: integrated capital markets

Deep Integration with Europe?



EuroMed Free Trade agreement insufficient:

- Harmonization of standards, rules and regulations, laws
- Institutional cooperation; what institutional set-up?
- Relation of EuroMed and Neighborhood policy: complements or substitutes?

Integration & Financing: a symbiotic tandem



- **Economic integration requires creation of major financing mechanisms and institutions: not successful otherwise**
- **Set-up a Euro-Arab Reconstruction and Development Bank or Facility (co-partnered with EIB) with co-financing from the region**
- **Financing for Infrastructure, Structural reforms, transition**
- **Central lesson from the EIB experience is the importance of a large and dynamic public bank to support integration and convergence processes.**

Bases for Euro-Arab Integration



- “Demographic dividend”
- Private Participation in Integrated Euro-Arab Infrastructure
- Integration and investment in ‘Networks’
- Economic Reforms and State Divestment & Privatisation
- Arab economic integration: GCC Monetary Union in 2010, Greater Arab FTA

PROPOSED BERLIN TO BAGDAD RAILWAY



FIG. 5

Private Sector Participation in Infrastructure Projects MENA 1990-2001



Annual Investment in Infrastructure Projects with Private Participation by Sector, MENA Region, 1990-2001

(2001 US\$ billions)

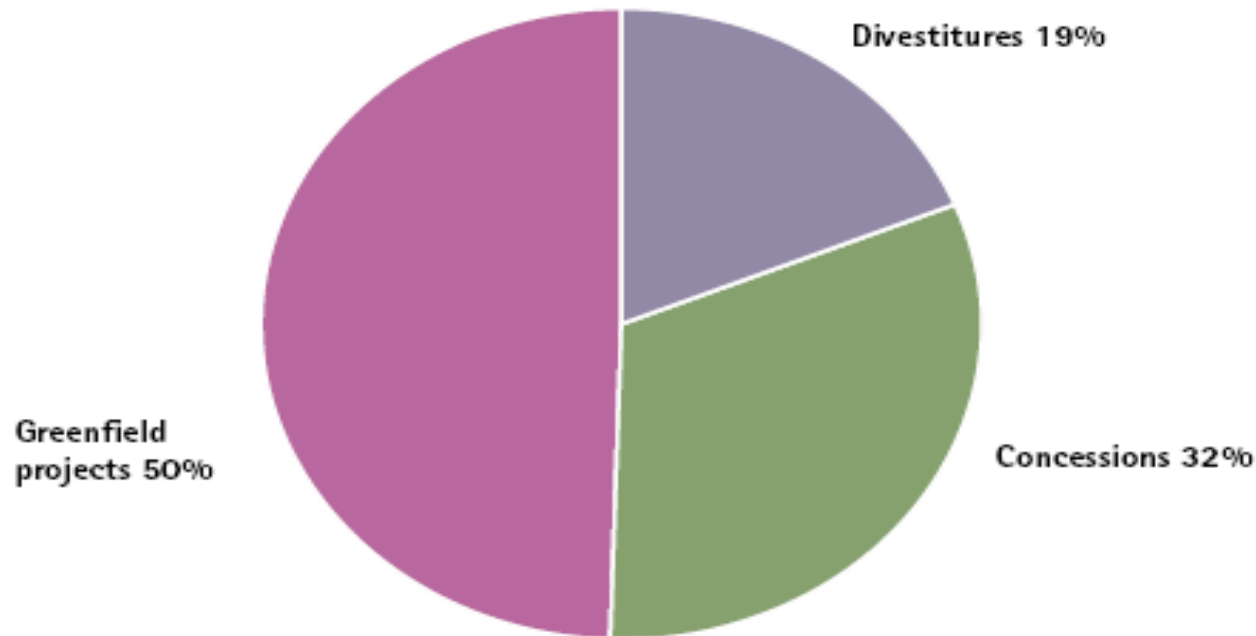
Year	Electricity	Natural Gas transmission and distribution	Telecom	Transport	Water and sewerage	Electricity and water and sewerage	Total
1990	--	--	0	--	--	--	0
1991	--	--	--	--	--	--	0
1992	--	3.6	0	--	--	--	0
1993	--	--	0	--	--	--	3.6
1994	0.2	--	0.1	--	--	--	0.4
1995	--	--	0.1	--	--	--	0.1
1996	0.2	--	0.1	--	--	--	0.4
1997	1.7	--	0.2	0.3	--	3.4	5.6
1998	--	0.3	1.8	0.1	--	1.1	3.2
1999	1	--	1.7	0.2	0.1	--	2.9
2000	0.2	--	3	0.6	--	--	3.8
2001	0.8	--	1	0.6	--	0.4	2.8
Total	4.1	3.9	8.1	1.8	0.1	4.9	22.8

Source: World Bank, PPI Project Database

Cumulative PPI by type



Cumulative Investment in Infrastructure Projects with Private Participation by Type, Middle East and North Africa, 1990–2001



Source: World Bank, PPI Project Database.

Total \$23 billion

Euro-Med Gas projects



Euro-Med Electricity Network



Remove Barriers to Prosperity



- Act to reduce Conflicts & Violence:
 - **Resolve Israeli-Palestinian & Israeli Arab conflicts**
 - **Bring peace and stability to Iraq**
- Focus on Public and Private Corporate Governance
- New Development Model:
 - **‘Bank the demographic dividend’**: education, infrastructure, housing, ICT, water
 - **Invest in Knowledge & Technology**
 - **From oil dominated and volatile to more stable and diversified**
 - **From public sector dominated to private sector dominated**
 - **From closed to more open, by facilitating the Regional & International Integration** into global goods, services, and factor markets

FS: Agenda for Action & Policy



1. FS Reform should be priority on policy agendas
2. Adopt 12 Financial Standards for Financial Stability as basis for FS development
3. Focus on Governance of Banking and Financial Services
4. Focus on Financing Regional Infrastructure
5. Develop the Capital Markets and their international integration
6. Regional economic & financial integration to develop markets and create the potential for increased specialization and potential benefits from economies of scale and scope
7. Liberalization of trade in services
8. Build-up Institutional investment
9. Reform Social Security Systems

Financial Liberalization & Euro-Arab Integration



- FS Development & Reform can be a major tool for achieving economic reform and increased private sector participation in economic development
- GCC Monetary Union historic occasion for both liberalization and Euro-Arab economic & financial integration
- Banking sector should act as '*fer de lance*' of Euro-Arab Integration

Financial Liberalization: Integration of European & Arab Institutions



Thank you for listening

***It is in our hands to make good on
the tremendous opportunities
available!***