

# Financial Sector Development in MENA: Comments & Policy Agenda

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@ MENA: The Challenges of Growth &  
Globalization  
International Monetary Fund  
April 7-8 2004

# Financial Sector Development in MENA

- What does the paper do?
- Main observations, trends & results
- Sins of Omission & Commission
- Some Issues for Policy
- Proposals for Research and Reform

# What is Paper About?

Develops 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

Develops Alternative Quantitative Index

Examines Growth-FS Development Relation

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

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

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.

**Table 1. Middle East and North Africa Countries:  
Financial Development Indices 1/  
(Based on Qualitative and Quantitative Data) Scale: 0–10 2/**

	Financial Development Index	
	2000/01	2002/03
Bahrain	7.55	7.66
Lebanon	7.00	6.97
Jordan	6.79	6.93
Kuwait	6.75	6.80
United Arab Emirates	6.55	6.60
Saudi Arabia	6.18	6.37
Oman	6.09	6.13
Qatar	5.60	5.68
Egypt, Arab Rep.	5.54	5.60
Tunisia	4.81	5.57
Pakistan	4.78	5.54
Morocco	4.76	5.45
Yemen, Rep.	3.76	4.84
Algeria	3.46	3.87
Djibouti	3.30	3.79
Sudan	3.26	3.45
Mauritania	3.16	3.23
Iran, Islamic Rep.	1.56	2.33
Libya	1.23	1.13
Syrian Arab Republic	1.17	0.99
<b>Average</b>	<b>4.66</b>	<b>4.95</b>

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.

**Table 5. Financial Development (Alternative Index), 1960-90s**  
 (Based on Quantitative Data)      Scale: 0-10

<b>Countries</b>	<b>1960s</b>	<b>1970s</b>	<b>1980s</b>	<b>1990s</b>
<b>MENA average</b>	<b>2.9</b>	<b>3.3</b>	<b>3.9</b>	<b>3.5</b>
<b>MENA average (without Lebanon)</b>	<b>2.6</b>	<b>2.9</b>	<b>3.3</b>	<b>3.1</b>
Afghanistan	...	...	...	...
Algeria	2.4	4.2	5.0	2.7
Egypt, Arab Rep.	1.7	1.9	3.5	3.8
Iran, Islamic Rep.	3.8	3.3	2.4	2.4
Jordan	3.1	3.7	5.3	5.4
Kuwait	...	...	5.7	5.0
Lebanon	5.1	6.7	9.6	6.4
Mauritania	2.4	2.7	3.0	2.6
Morocco	2.6	2.8	3.0	4.0
Oman	...	2.6	2.8	3.3
Pakistan	2.7	2.9	3.0	3.1
Qatar	...	...	...	4.2
Sudan	2.5	2.1	1.5	0.9
Syrian Arab Republic	2.2	1.9	1.8	2.3
Tunisia	3.3	3.8	4.5	4.8
United Arab Emirates	...	2.9	3.8	4.3
Yemen, Rep.	...	...	...	1.3
<b>Industrial average</b>	<b>3.9</b>	<b>4.6</b>	<b>5.1</b>	<b>5.9</b>
<b>"Asian Tigers" Average</b>	<b>1.8</b>	<b>2.9</b>	<b>4.1</b>	<b>5.7</b>
<b>Latin America - Caribbean average</b>	<b>2.4</b>	<b>2.9</b>	<b>3.0</b>	<b>3.4</b>
<b>South Asia average</b>	<b>1.6</b>	<b>1.7</b>	<b>2.4</b>	<b>2.7</b>
<b>Sub-Saharan Africa average</b>	<b>2.3</b>	<b>2.5</b>	<b>2.3</b>	<b>2.1</b>

Source: IFS.

# Main Observations, Trends & Results: I

- MENA FS less developed than other regions at similar level of economic development
- No surprises in country rankings
- 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'
- 'Roaring 1990s' lost decade for MENA
- Conflicts have retarded FS and economic development
- MENA FS not integrated with international capital markets

# Main Observations, Trends & Results: II

- Government ownership and intervention in the banking and financial sector have been a major contributor to its lack of development 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



# Institutional Investor Credit Ratings & Market Capitalization, 2002

<b>World</b>	33.5	m	27,561,743
<b>Low income</b>	18.0		158,646
<b>Middle income</b>	39.0		1,712,619
Lower middle income	33.8		883,032
Upper middle income	52.0		829,587
<b>Low &amp; middle income</b>	26.8		1,871,265
East Asia & Pacific	27.1		723,605
Europe & Central Asia	33.8		181,064
Latin America & Carib.	35.5		609,072
Middle East & N. Africa	36.4		131,528
South Asia	25.9		117,817
Sub-Saharan Africa	19.0		108,179
<b>High income</b>	87.0		25,690,523
Europe EMU	89.5		4,164,198

# Sins of Omission & Commission I

- What is the relevant benchmark for analysis? Compare with international best practice, to international codes and standards
- Measures of Breadth, Depth and Liquidity
- Under-focus on the (lack) of development of debt and equity markets
- Use indicators available from Credit Reporting Systems (public and private), relating to credit use, volume and value of credit, and the number of beneficiaries
- Indicators may *overstate* the level and rate of growth of financial sector development, since it omits:
  - The extent of un-banked households
  - The non-participation of the informal sector in financial services
  - The limited participation in equity markets
- Neglect of payment system and payment media indicators: intrinsic component of the operation of financial markets: financial infrastructure 'plumbing'

# Sins of Omission & Commission II

- Importance of distinguishing between *de jure* and *de facto régimes for exchange rate systems and financial sectors* : 'rules of the game', competition & entry, asset price & interest rate flexibility
- Develop measures of 'Coasian' transactions costs that are barriers to FS development and amenable to reduction and change through the implementation of policy reforms
- Indicators of the state of legal & regulatory reform & development

# Implications for Banking & Financial Sector Development

Our countries should leapfrog: not easy, but changes call for

- Revise view of financial sector development
- Role of government & central banks to change: selected leapfrogging to be considered more proactively, and monitoring of increased risk to participants
- Public policy needs to develop preconditions:
  - infrastructure (telecommunications) & **infostructure**
  - law and regulations to enable eBanking and eFinance
  - Security
  - Competition policies
  - From institutional to more functional approach to regulation and supervision

# Changes in Public Policies

- Enabling environment
  - Communications Infrastructure
  - Electronic Security Arrangements
  - Information Infrastructure
  - Legal framework and enforcement Risk related regulations
- Competition policy
- Managing risks
  - Institutions/prudential
  - Consumer/investor protection

# Regulatory Environment

- Credible and transparent regulatory environment
- Regulatory environment must not be perceived to be under control or influence of any particular interest group
- Regulators should be independent from industry and from political parties

# Financial services: Institutional Reforms & Governance

## Major Reform Areas:

1. Social Security Reform
2. Develop the Capital Markets and their international integration
3. Focus on Governance of Banking and Financial Services
4. Regional economic & financial integration to develop markets and create the potential for increased specialization and potential benefits from economies of scale and scope
5. Liberalization of trade in services

# Financial services: Institutional Reforms & Governance II

- Public policy needs to develop preconditions:
  - infrastructure (telecommunications) & **infostructure**
  - Law and regulations to enable eBanking and eFinance
  - Security of transactions
  - Competition policies
  - Move from institutional to more functional approach to regulation and supervision



# Financial Stability & Soundness Standards

- **Macroeconomic Policy and Data Transparency**
- **Institutional and Market Infrastructure**
- **Financial Regulation and Supervision**

# Macroeconomic Policy and Data Transparency

- Monetary and Financial Policy Transparency
  - Code of Good Practices on Transparency in Monetary and Financial Policies IMF
- Fiscal Transparency
  - Code of Good Practices in Fiscal Transparency IMF
- Data Dissemination
  - General Data Dissemination System IMF
- Data Compilation

# Institutional and Market Infrastructure

- Insolvency & bankruptcy World Bank
- Corporate Governance
  - Principles of Corporate Governance OECD
- Accounting
  - International Accounting Standards (IAS)
- Auditing
  - International Standards on Auditing (ISA)
- Payment and Settlement
  - Core Principles for Systemically Important Payment Systems BIS
  - Recommendations for Securities Settlement Systems CPSS/IOSCO
- Market Integrity
  - Forty Recommendations + 8 Special Recommendations Against Terrorist Financing of the FATF
- Market Functioning

# Financial Regulation and Supervision

## Banking Supervision

- Core Principles for Effective Banking Supervision BCBS
- Securities Regulation
  - Objectives and Principles of Securities Regulation IOSCO
- Insurance Regulation
  - Insurance Core Principles IAIS
- Financial Conglomerate Supervision

# Agenda for Action & Policy: I

- Publish Financial Development Index, ***Financial Sector Arrangements and Barriers***, on a regular basis: quarterly, interactive, online
- Include: Indicators on
  - Payment System Development
  - Debt & Equity Markets
  - Credit Market
  - Legal & Regulatory Infrastructure

# Agenda for Action & Policy: II

- FS Reform should be priority on policy agendas
- Adopt 12 Financial Standards for Financial Stability as basis for FS development
- Provide assistance for establishment of FS Infrastructure: Independent CMA, Laws & Regulations, SSS, Trade logistics
- MENA should aim to leap-frog: focus on e-Banking and e-Finance as benchmarks
- Build-up institutional investment
- Reform Social Security Systems

# Financial Sector Development in MENA

- FS Development & Reform can be a major tool for achieving economic reform and increased private sector participation