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GCC Governmental Development & Privatisation: The Great Transformation

Arabian Business Conference
Kuwait, 26 March 2008

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Agenda

- Some stylized facts and figures
- Infrastructure driving GCC growth
- De-linking capital infrastructure financing from oil revenues spending: PPI & Financial Markets
- Pre-conditions for successful privatization process
- Improving corporate governance
  - Core principles for State Owned enterprises
  - Accountability
- Regulatory challenges to ensure a level playing field
  - Anti-trust legislation
  - Regulatory authorities
- The role of financial markets and diversification
  - Secondary market for collateralized securities
  - Enhancing human capacities
- Achieving the “Great Transformation”

A ME/GCC Economic & Financial Renaissance

- **MENA has achieved above trend economic growth rates:**
  - **Average real GDP growth 6.2% over 2004-2007 vs. 3.7% in 1998-2002**
  - **Sustained by strong Global growth led by Emerging Markets**
  - **Strong fundamentals and macroeconomic conditions characterized by large twin current account & fiscal surpluses and declining levels of public debt.**
  - **Positive demographics & migration sustaining low labour costs & output growth**
  - **Oil export receipts reached $381bn in 2007, up 8% from 2006**
  - **Growth resurgence has been investment led with increased infrastructure investment leading to ↑ in absorptive capacity**

A ME/GCC Economic & Financial Renaissance

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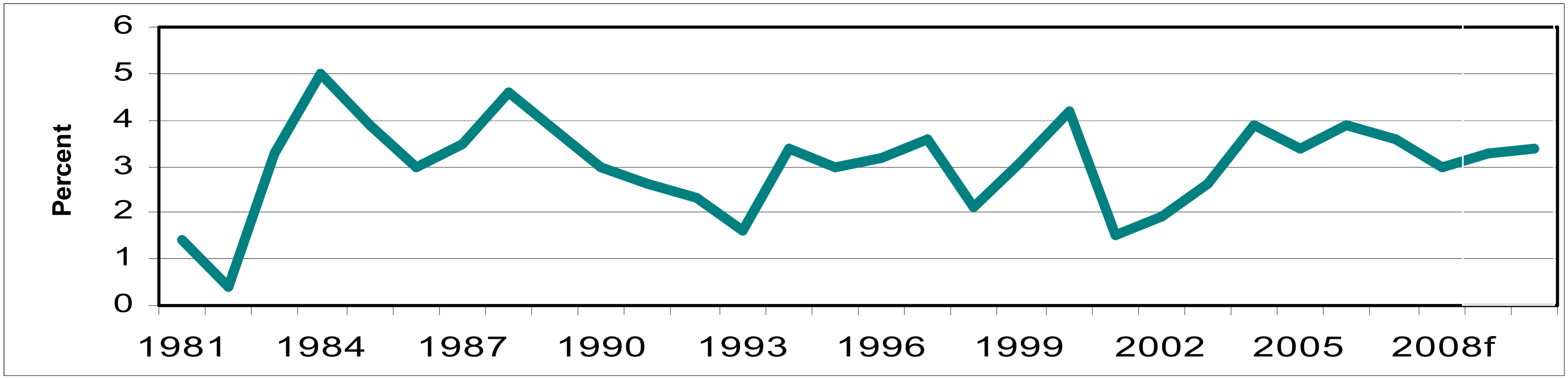
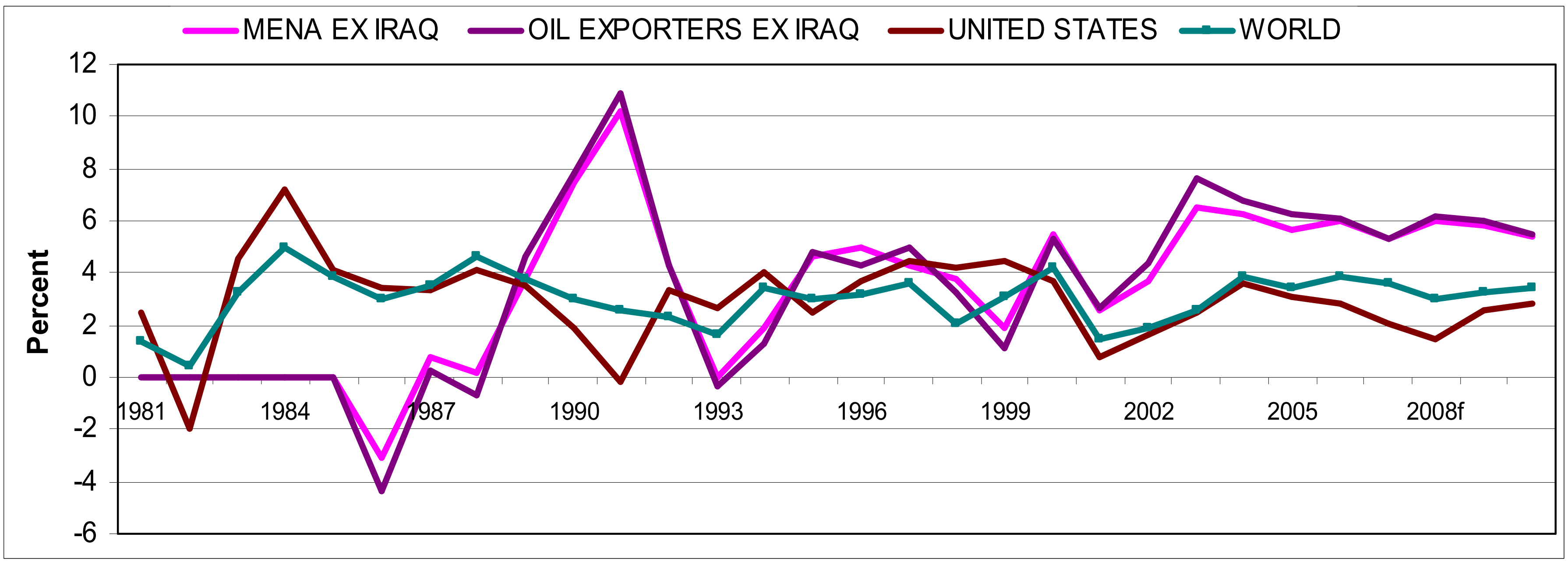
- **Shift in the pattern of public spending and investment: more inward and intra-regional approach to investment**
- **Private sector is leading and driving regional economic integration of markets, FDI, Tourism, labor flows**
- **Emergence of multinationals: DP, Etisalat, Emaar, Mittal, Orascom, MTC…**
- **Economic reforms, diversification and state divestment & privatisation: non-oil growing faster than oil sector**
- **Growth of Shari'a compliant finance**

World Real GDP Growth @ 30 Year High & Less Volatile

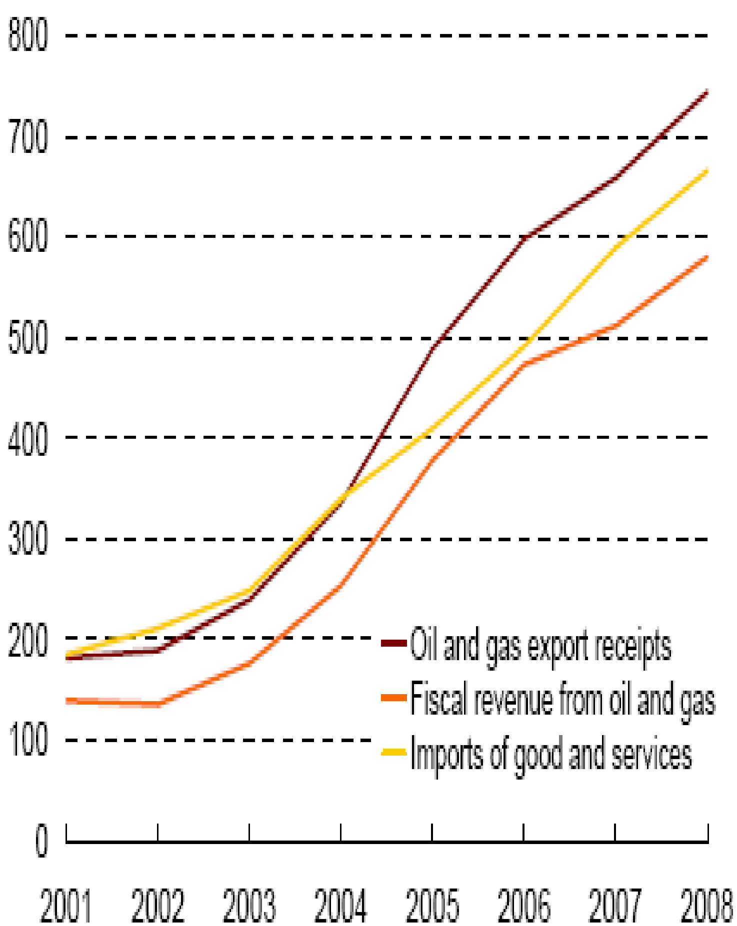


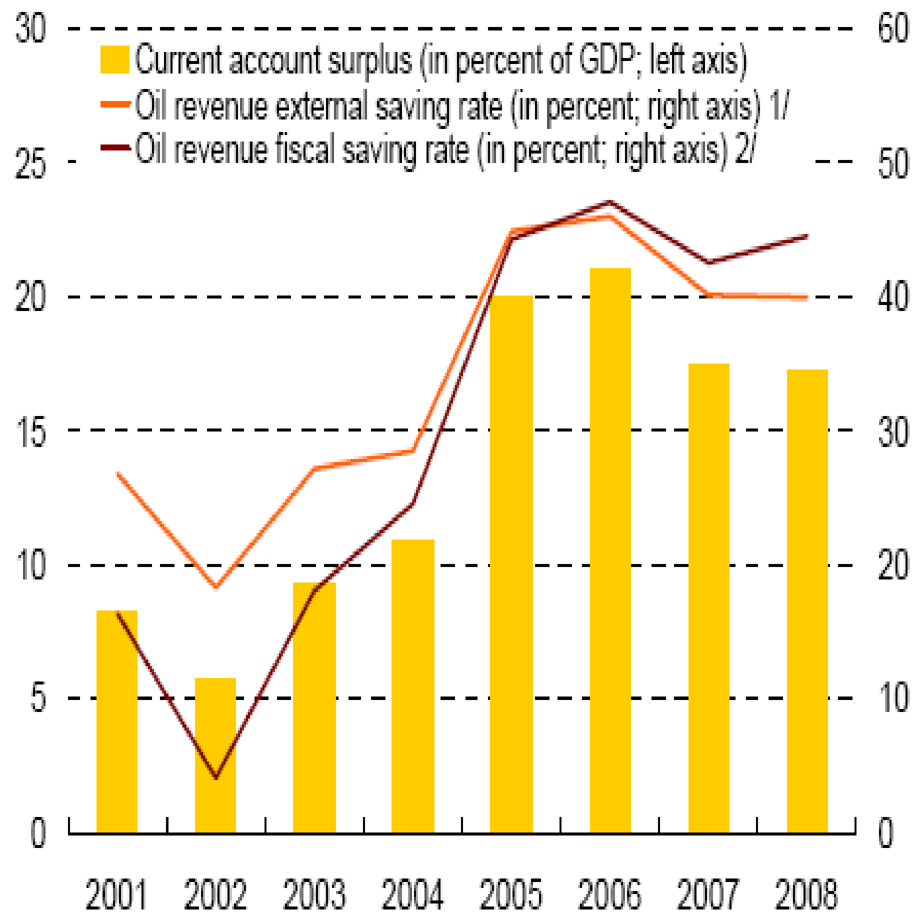


Source: IMF, IIF, EIU, February 2008

Oil and Gas Exports

Region's oil and gas exports receipts look set to rise to near $800 billion in 2008 with current account surpluses running at 20-25% of GDP.

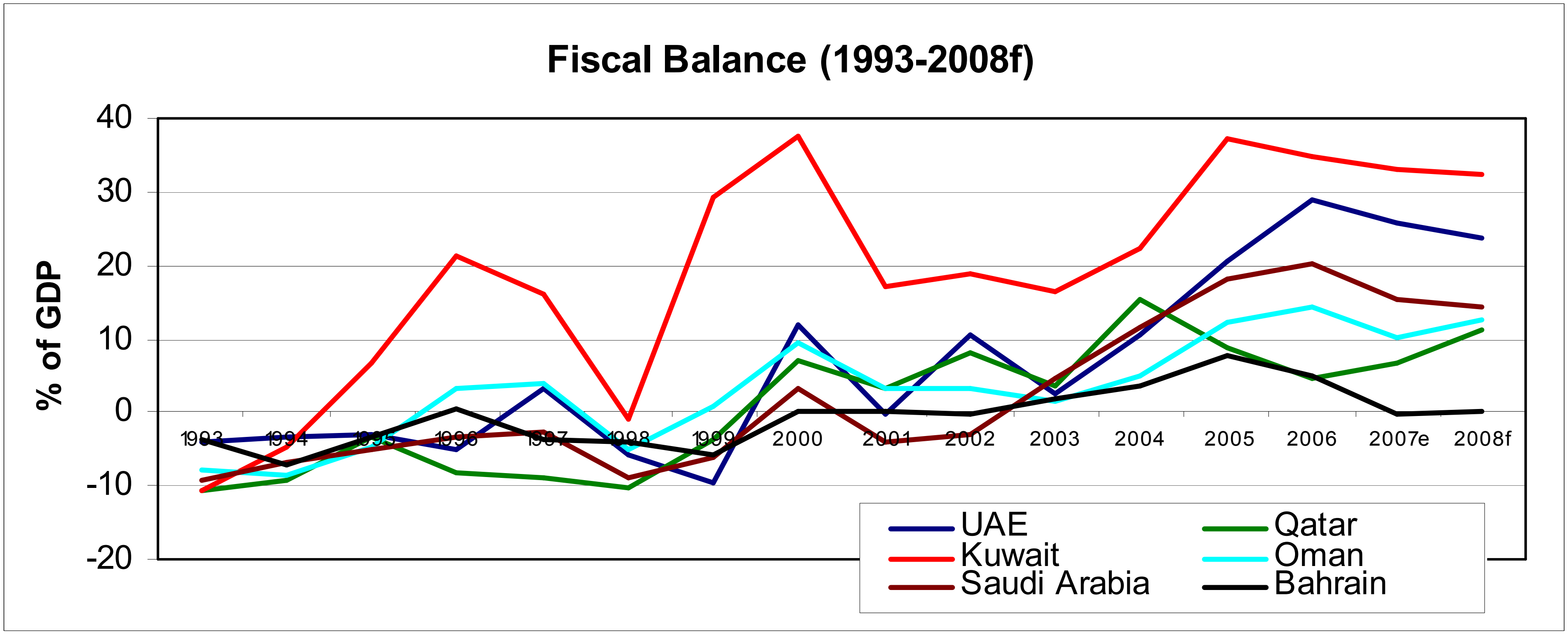




Source: IMF, REO October 2007

Large Fiscal Surpluses

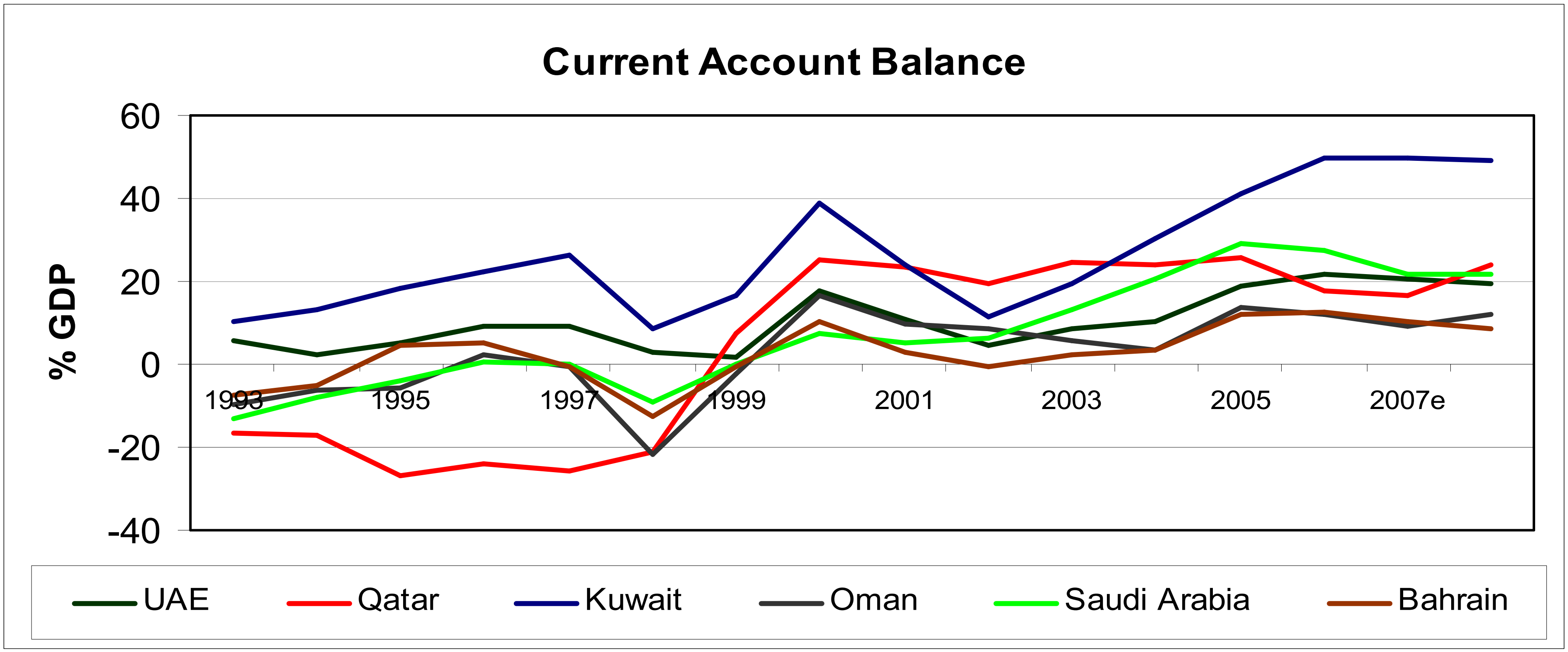
- Oil producers policy reaction has been fiscally conservative: 60% of higher oil revenues have been saved.
- Substantial fiscal surpluses (19% of GDP in 2007) even as spending has picked up
- Fiscal position of GCC remains in surplus for an oil price in the range of $35-$38
- Investment policies less dependent on oil revenues



Source: IIF

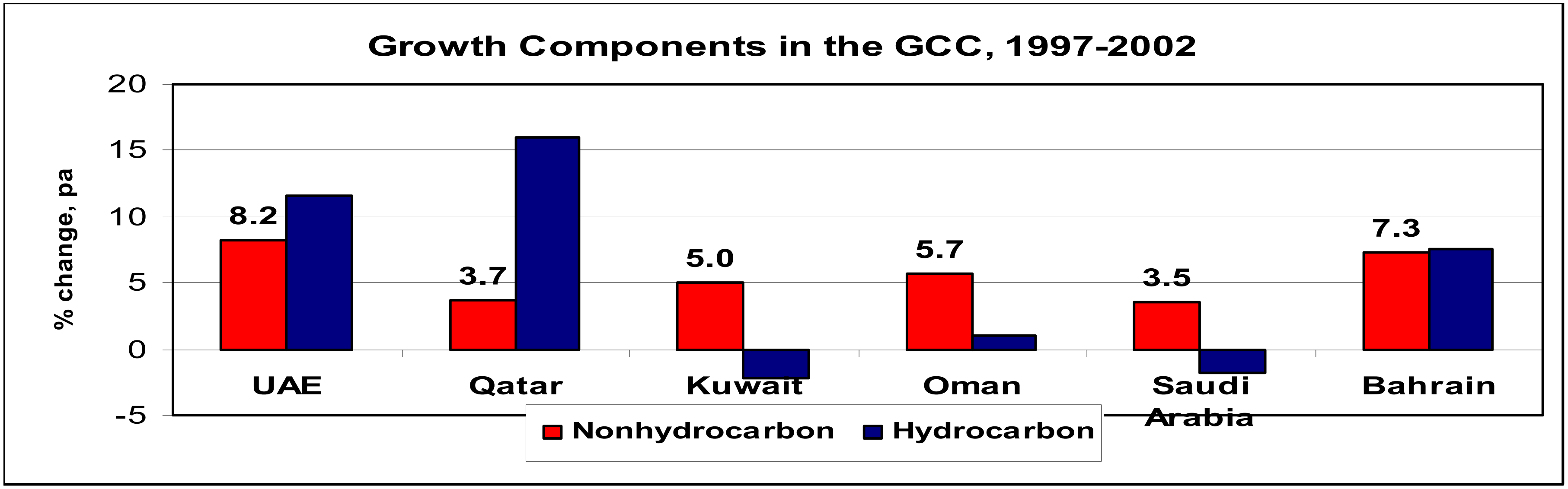
Current Account Surpluses and Build Up of Foreign Assets

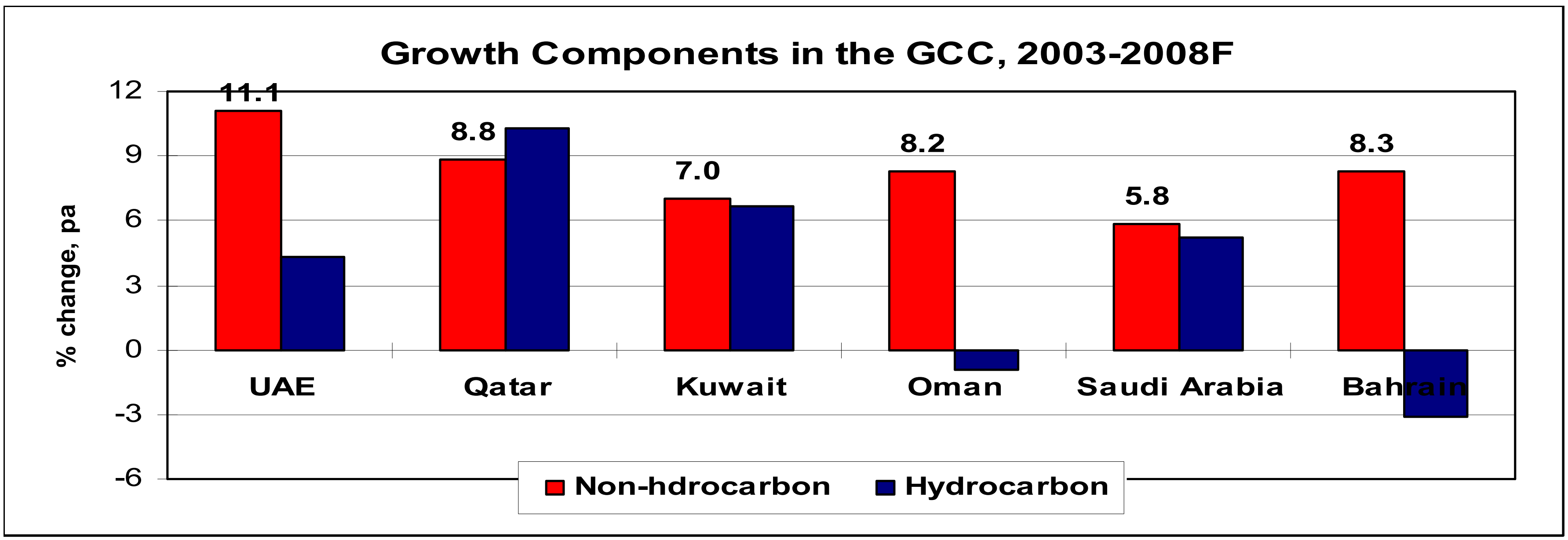
- **Current account surpluses running at 25-30% of GDP; increased recycling back into regional economies**
- **MENA international reserves have tripled between 2003 and 2007: $242.9bn (2003) to $776.6bn (2007) and forecast at $967.5 billion for 2008.**
- **GCC international reserves have quadrupled from $90.5 (2003) to $365 (2007) and forecast at $ $455 billion by 2008.**



Source: IIF

GCC Increasingly Diversified





Source: IIF

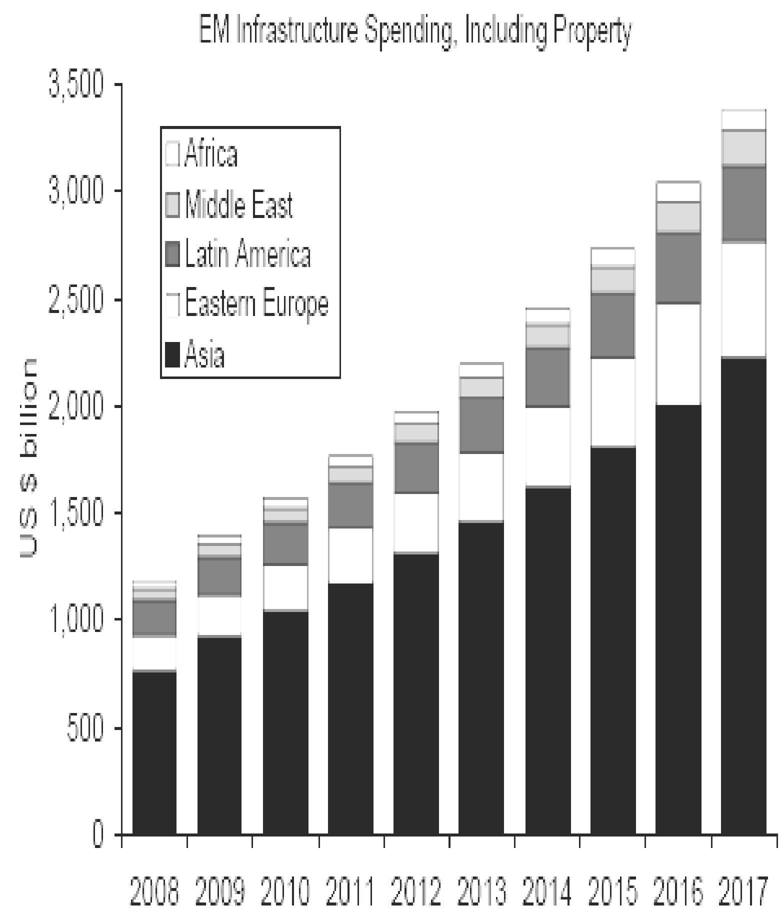
Investment, Infrastructure & New Linkages

Infrastructure drivers:
- Demographics
- Urbanisation
- Policy reforms, Increased openness and move to market-based economies

Infrastructure investment will:
- Increase productive capacity and export capacity through improved logistics
- Enable economic diversification
- Underlie economic development and higher growth
- Lead to higher total factor productivity (TFP) and labour productivity growth
- Underpin growth of financial markets

Forecast EM infrastructure investment:
Asia 67% of total, with China and India 43% and 13% of total; Russia 10%; Brazil 5%, Middle East 5%

US$21.7 trillion in EM Infrastructure Spending: 2008-17e



Source: World Bank, Global Insight, Morgan Stanley Research estimates

Gulf Infrastructure: main driver of growth

(Millions USD) (Source: MEED)

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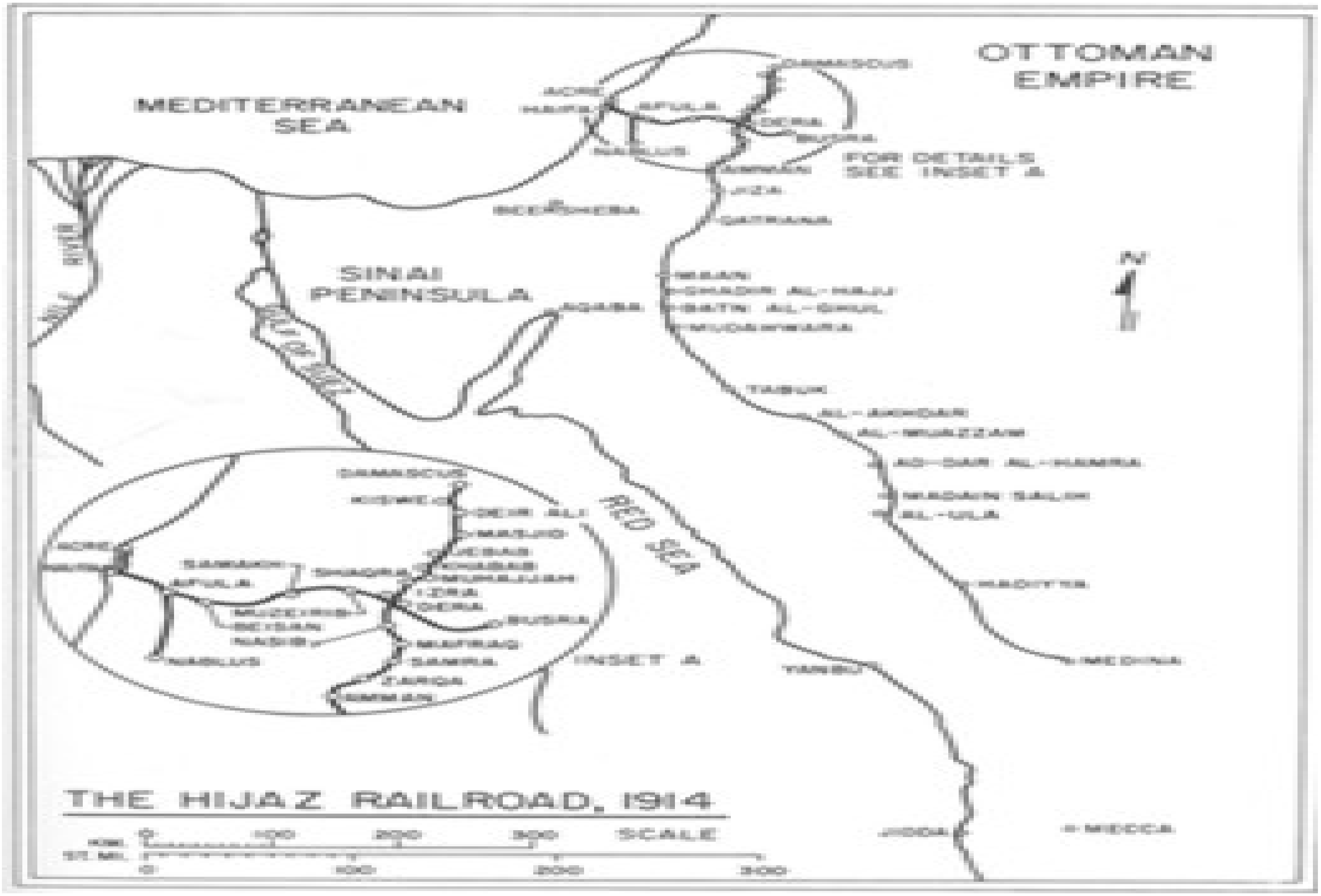
	28-Jan-08	28-Jan-07	% change, pa
Bahrain	27,821	33,155	-16.1
Kuwait	274,597	213,225	28.8
Oman	51,023	41,106	24.1
Qatar	156,192	132,325	18
Saudi Arabia	400,882	312,451	28.3
UAE	717,223	486,422	47.4
GCC total	**1,627,738**	**1,218,684**	**33.6**
Iran	151,685	103,213	47
Iraq	33,465	28,460	17.6
Regional total	**1,812,888**	**1,350,357**	**34.3**

Revisiting History: Berlin-Baghdad Railway, 1913

FIG. 5.

Revisiting History: Hejaz Railroad, 1914



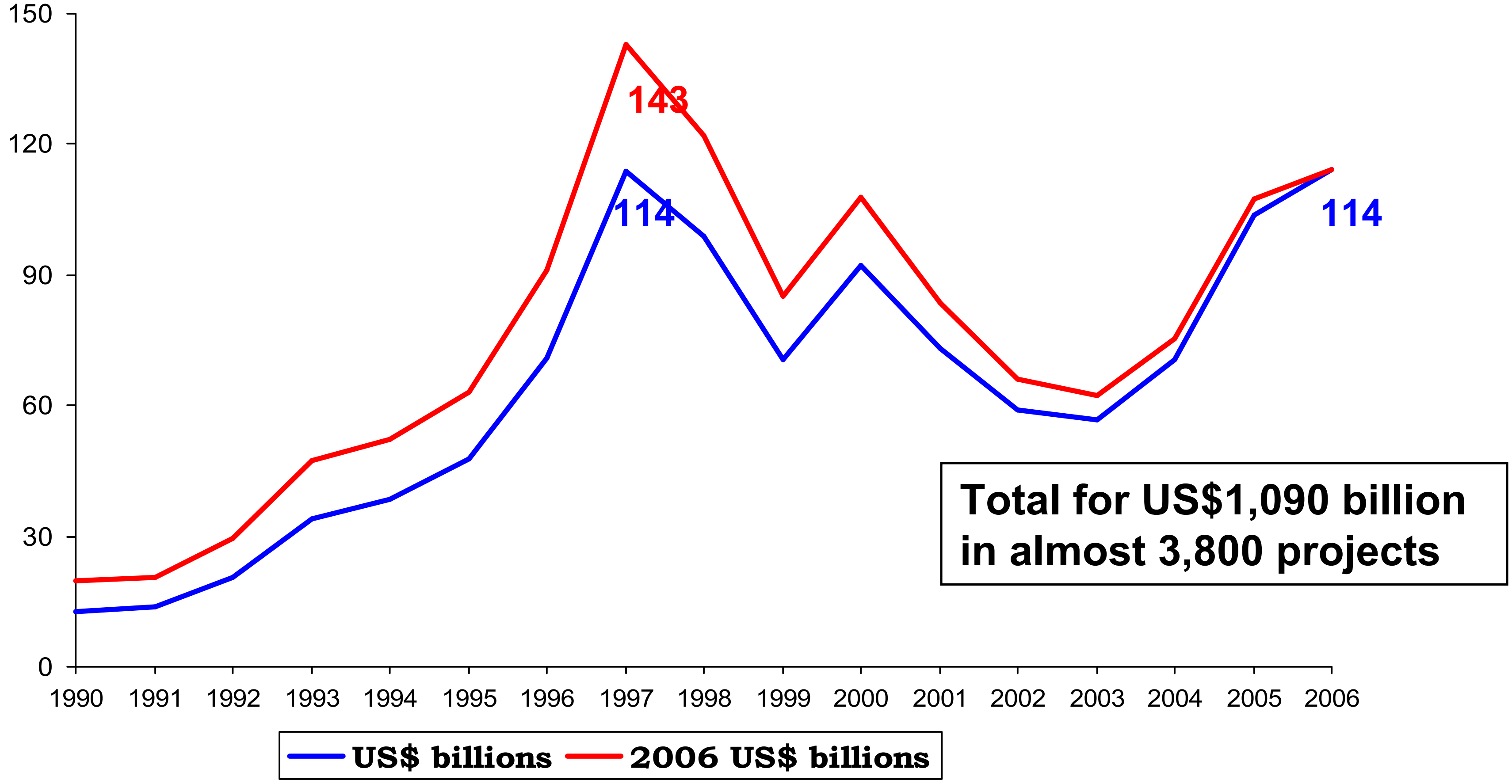
Hejaz Railway Damascus –Medina

PPI in Developing Economies

- The size and number of projects in non OECD countries had been steadily growing from 1990 to 1997
- The South East Asia crisis of 1997 had a negative impact, bur since then the sector has recovered vigorously matching in 2006 the peak in 1997
- The MENA region lags behind other areas such as South East Asia and even sub Saharan Africa
- In the GCC countries with the exception of Oman PPI are virtually unknown
- Scope for improvement is huge

Investment commitments to PPI projects in developing countries in real and nominal terms, 1990-2006

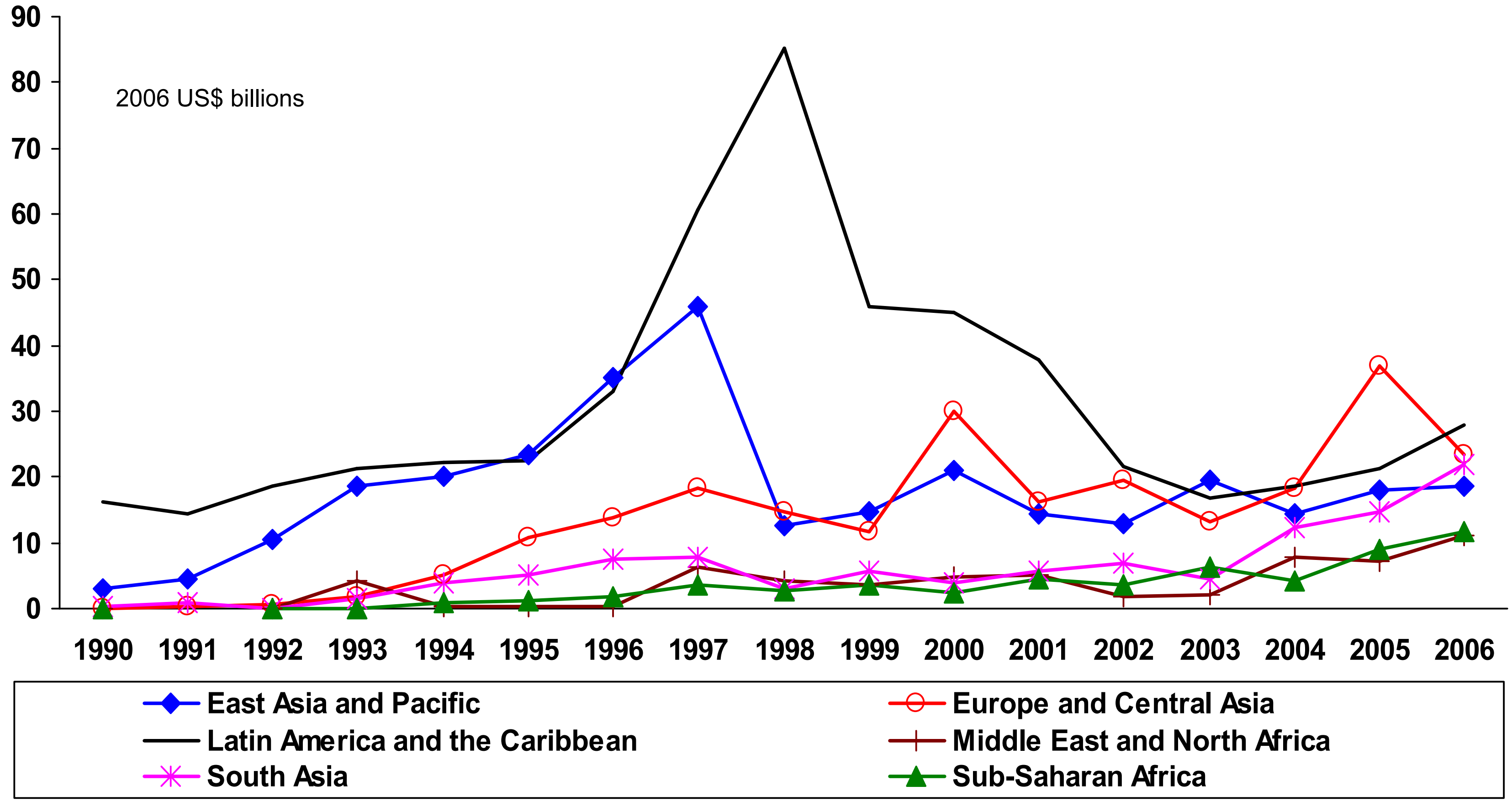
Investment commitments to infrastructure projects with private participation grew by 10% in 2006, to a level just 20% lower in real terms than the peak in 1997.



Source: World Bank and PPIAF, PPI Project Database.

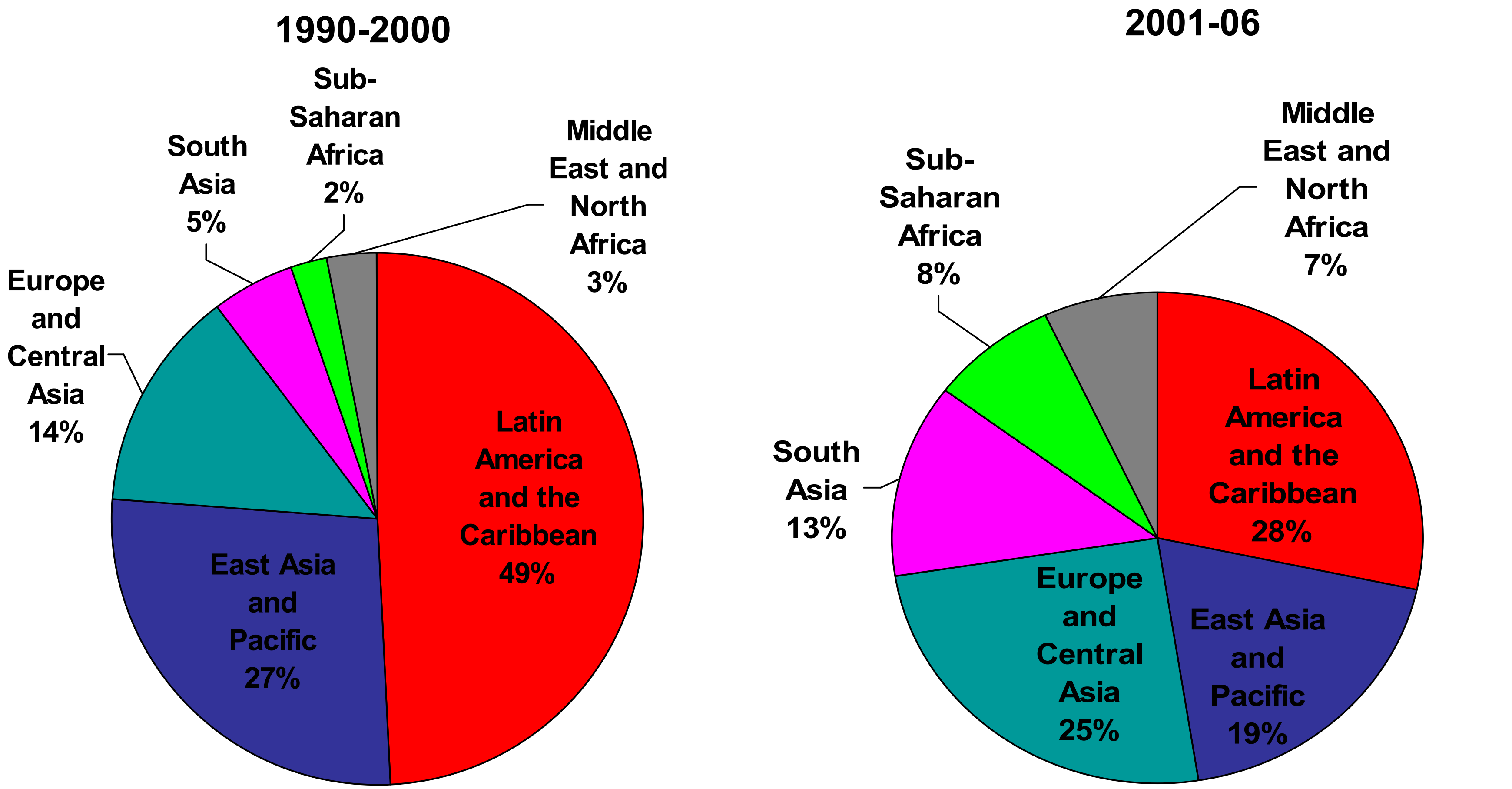
Investment commitments to PPI projects by region, 1990-2006

All developing regions saw growth in investment in 2006 except Europe and Central Asia, where investment declined from its peak in 2005, and East Asia, where investment remained stable. Investment has been more evenly distributed among developing regions since 2002.



Source: World Bank and PPIAF, PPI Project Database.

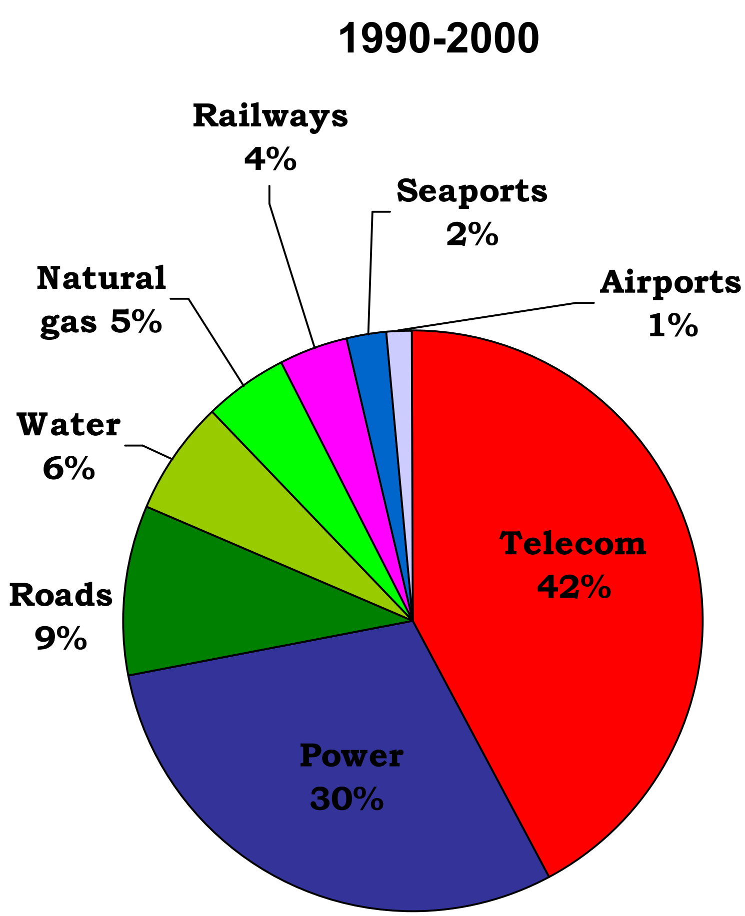
Investment commitments to PPI projects by region, 1990-2000 and 2001-06



Total: US$782 billion (2006 US$) **Total: US$509 billion (2006 US$)**

Source: World Bank and PPIAF, PPI Project Database,

Investment commitments to PPI projects in developing countries by sub-sector, 1990-2000 and 2001-06



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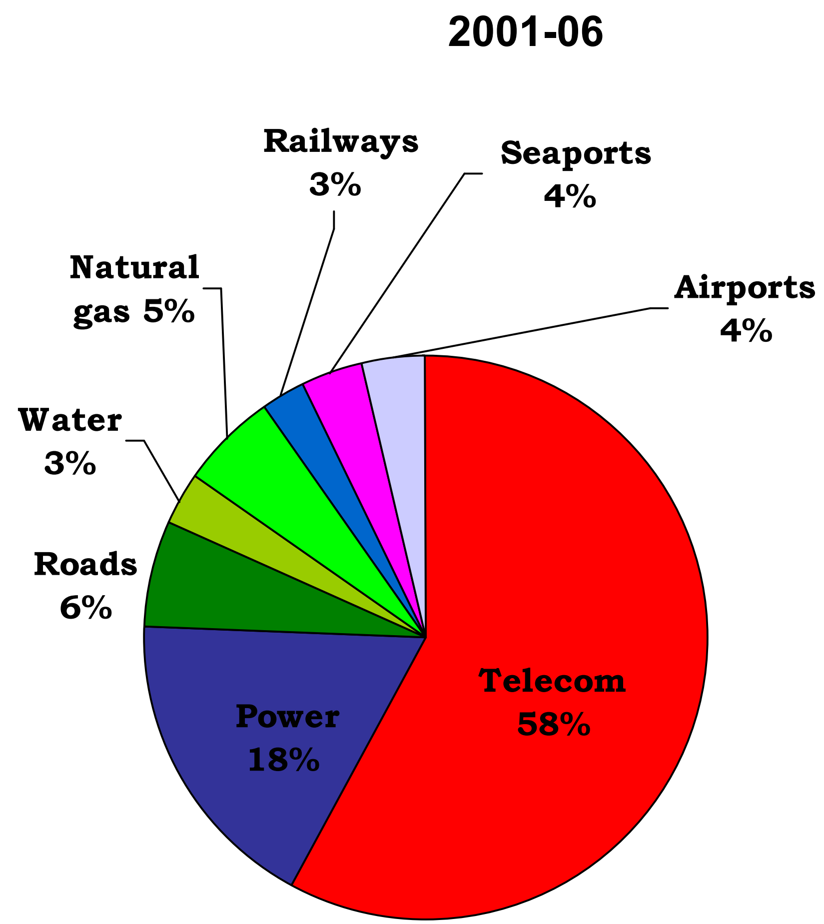


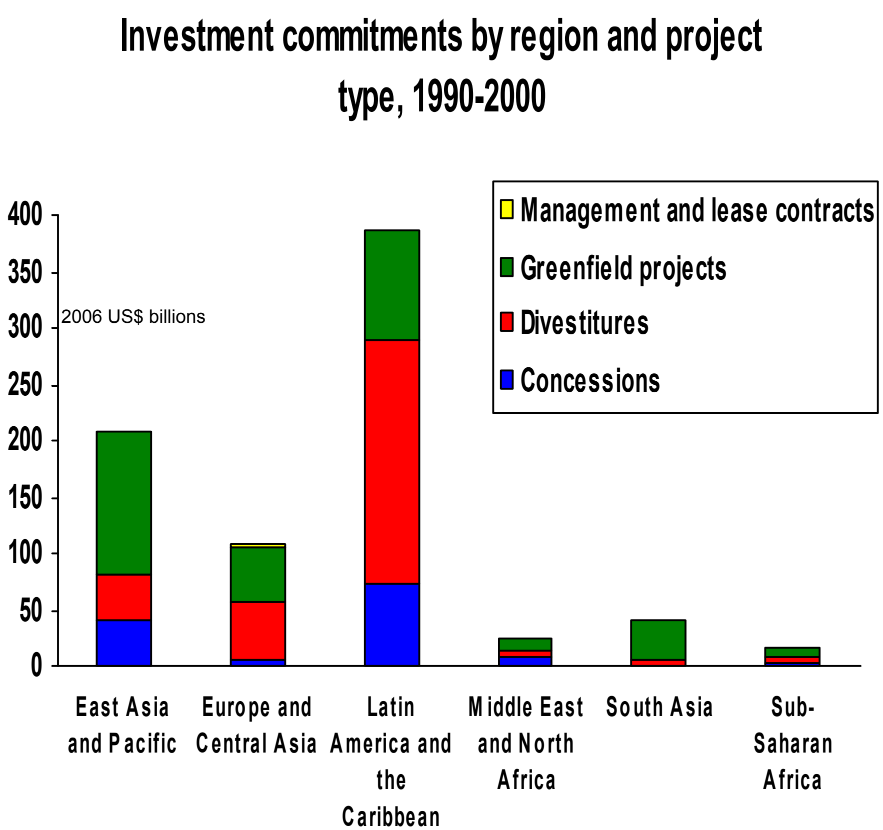
Total: US$509 billion (2006 US$)

Source: World Bank and PPIAF, PPI Project Database.

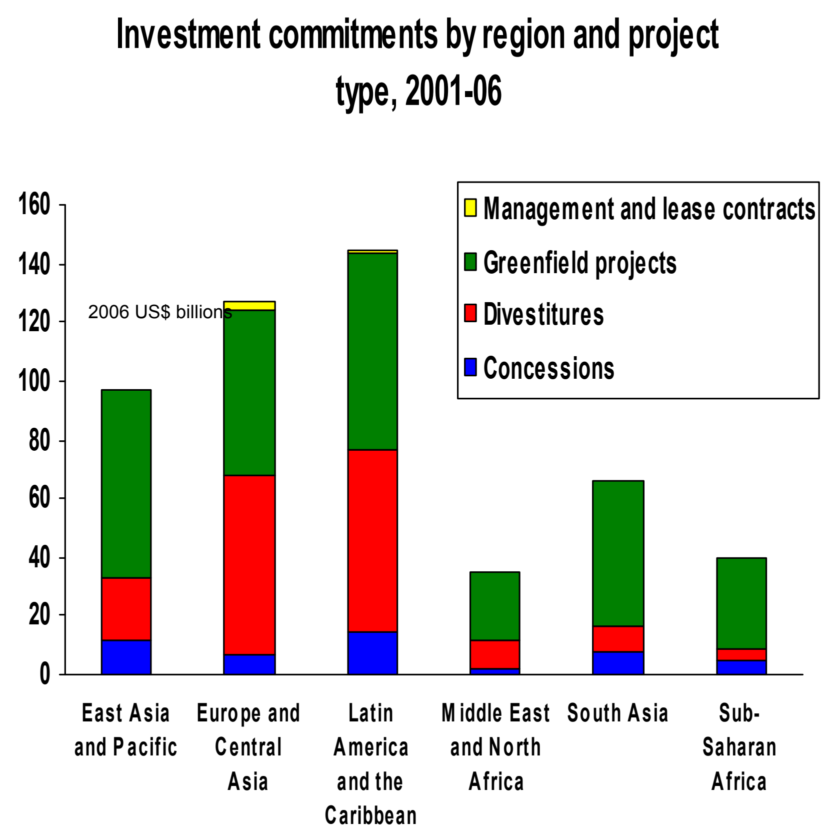
Investment commitments to PPI projects in developing countries by region and project type, 1990-2000 and 2001-06

Across regions, greenfield projects accounted for the largest share of investment commitments in 2001-06. The only exception was Europe and Central Asia, where divestitures still dominate.

In most regions greenfield projects just increased their share of investment commitments. But in Latin America their predominance in 2001-06 represented a major shift from the 1990s, when divestitures accounted for most of the activity.



Source: World Bank and PPIAF, PPI Project Database.



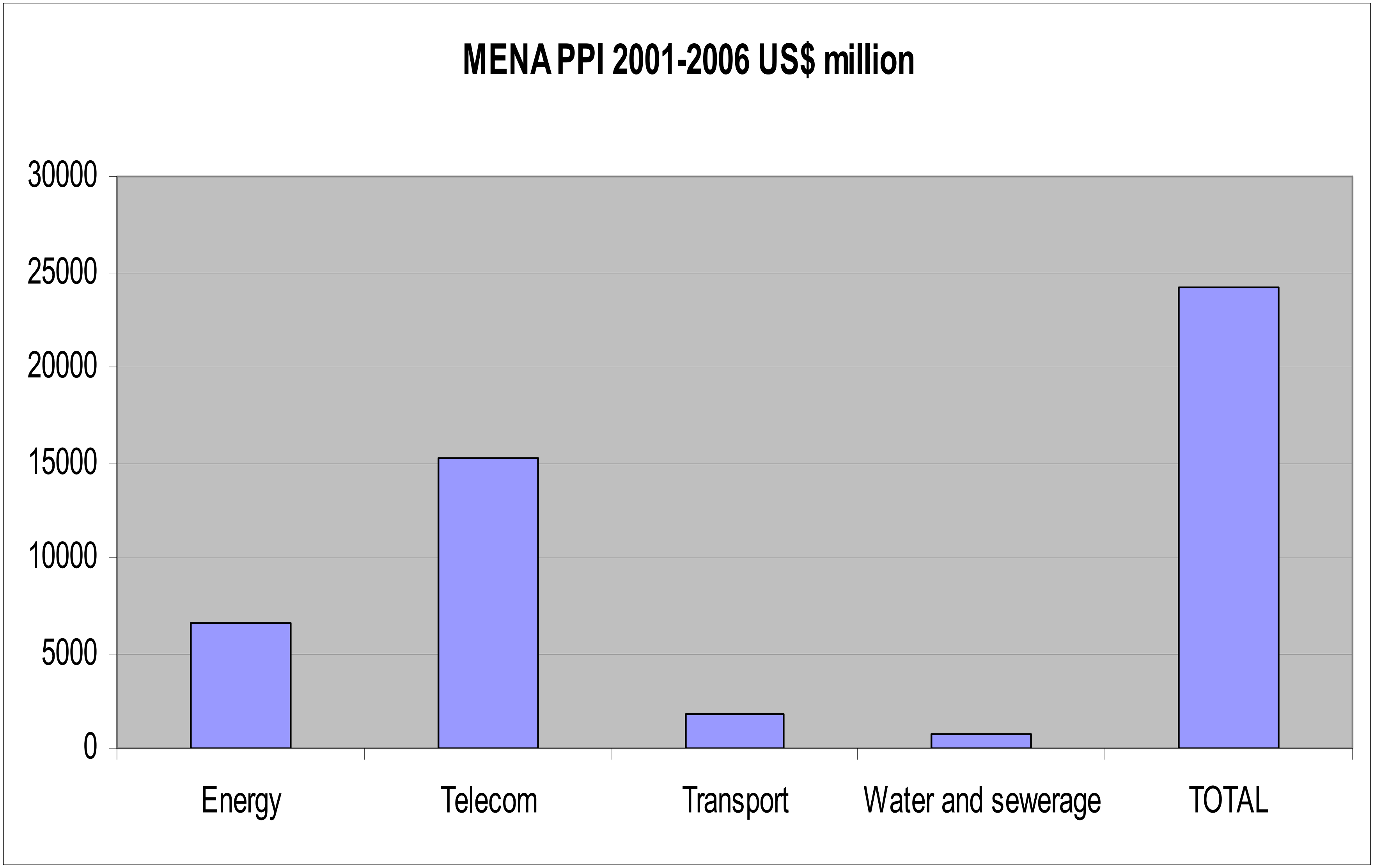
Source: World Bank and PPIAF, PPI Project Database.
Note: Includes projects reaching financial closure in 1990-2006.

PPI Projects in the MENA region

- **PPI projects by sector (in USD ml.) since 1990**

Primary Sector	Sub sector	Project Count	Total Investment
Energy	Electricity	25	12,528
	Natural Gas	5	4,347
Total Energy		30	16,875
Telecom	Telecom	41	31,710
Total Telecom		41	31,710
Transport	Airports	9	588
	Railroads	1	182
	Roads	1	104
	Seaports	17	2,125
Total Transport		28	3,000
Water and sewerage	Treatment plant	4	679
	Utility	7	0
Total Water and sewerage		11	679
Grand Total	**..**	**110**	**52,263**

MENA PPI Small but with enormous potential



Historical opportunity to transform GCC economies

- Massive infrastructure plans are already straining public sector management capabilities
- Private sector should be called upon to participate, finance and complete a large portion of these projects
- Projects selected based on their contribution to growth, productivity, environmental benefits or social improvements, not necessarily to the availability of public funds
- This would lead to a Market Test of projects:
  - More accurate Cost Benefits analysis
  - More Efficient Management,
  - More Rigorous Cost Controls
  - Better Accountability
  - Greater Transparency

De-linking capital infrastructure financing from oil revenues spending

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- Desirable to sever the link between energy revenues and capital spending
- Channel energy revenues into Future Generation Wealth Funds (FWFs)
- Crucial role of financial markets of channeling resources to the most productive use would be greatly enhanced
- **Positive repercussions: strengthen Growth Sustainability**
  - Break Oil-induced Boom-Bust Cycle
  - Absorb high liquidity growth resulting from energy revenues
  - Improved Fiscal policy discipline, management & control
  - Achieve increased economic diversification
  - Sophistication and efficiency of the economic and business environment
  - Greater fluidity of financial flows and deepening of organized financial markets

Role of Future Wealth Funds (FWFs)

- **Total value of FWFs estimated by IMF at between \$1.9 trillion and \$2.9 trillion, growing to about \$12 trillion by 2012**
- **GCC countries need to diversify against commodity price volatility and revenue risks; earn higher returns than on central bank portfolios**
- **FWFs allow countries to separate the management of their revenues from natural resources from their fiscal and monetary policies**
- **"Automatic Sterilization": avoid capital inflows leading to high money growth and inflation**

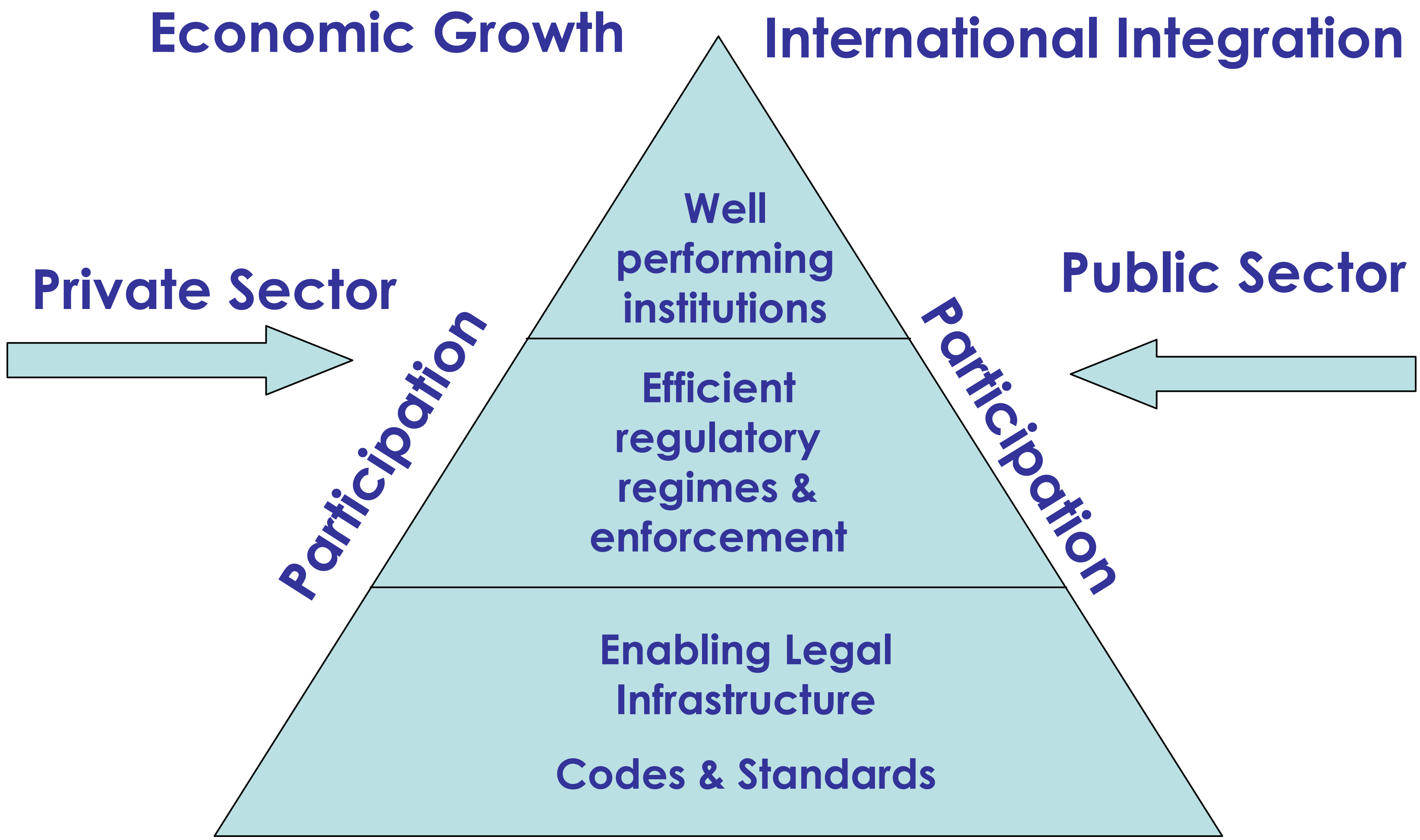
Pre-conditions for a successful privatization process

- Privatizing government owned enterprises and monopolies involves more than a successful sale of state assets
- It is necessary to establish and nurture a **competitive environment** to reap the full benefits of market discipline
- Natural monopolies such as utilities need to be supervised by **independent regulatory agencies**, with powers to investigate anti-competitive practices and impose hefty fines or sanctions
- Special courts need to be established to rule over business malpractices and consumer protection
- Corporate Governance of SOEs need to be strengthened through accountability and transparency rules
- Periodic reviews to verify whether performance and pricing schemes are in line with international standards

OECD CG Guidelines for SOEs

- Ensure a level-playing field with the private sector.
- Reinforce the ownership function within the state administration.
- Improve transparency of SOEs' objectives and performance.
- Strengthen and empower SOE boards.
- Provide equitable treatment of minority shareholders

Governance is integral element of sustainable economic growth & development:



The role of financial markets and diversification

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- The development of project financing in the MENA region could boost the function of financial markets as an engine of sustainable economic growth
- For this purpose it is critical to develop the legal framework and infrastructure for asset-backed securities and structured products both for public projects, infrastructure, residential real estate and commercial space
- Project finance and Asset Backed financing ideal for Shari'a compliant finance

New Breed of Securitization in GCC

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- Market poised for strong growth with 200-250 billion USD in expectations for total transactions volume in 3 years.
- Key Factors to Drive Growth in Structured Products:
  - Better Implementation of Basel II:
    - Restructure balance sheet through securitization; reduce gearing in line with capital adequacy requirements; help banks handle mismatch in their tenor; allow for freeing of capital, possibly leading to new lending at better margins.
  - Housing Finance:
    - Tap into housing-finance market growing at 25% per year; increase potential pool of owners; encourage mortgage borrowings, etc.
  - Infrastructure Projects and Privatization:
    - Increase private sector involvement in provision of public goods given sizeable development porojects (planned or under development) in excess of USD 1.6 trillion; reverse past under-investment in infrastructure projects; allow for easing of bottlenecks that could delay progress, etc.

Project Financing in the GCC

Potential market is enormous: however three issues need to be addressed

- **Legal framework:** infrastructure fees (e.g. electricity, water, highways, railroads) are set by public authorities, therefore it could be tempting to keep them low (in real terms) to the detriment of investors
- **Risk sharing:** if construction runs behind schedule or incurs in over costs how will the terms of the deal be redefined?
- **Institutional stability:** a project approved by a government might be repudiated by the next one.

The beneficial side effects of PF

- **Project financing would introduce market-based practices into public works and improve public sector governance**
  - Cost-benefit analysis in selecting projects
  - Sound project evaluation
  - Institutional accountability
  - Less corruption in procurement process
  - Better administrative practice
  - More entrenched rule of law
  - Financial market deepening
  - Introduction of best practices

Benefits to Securities' Issuance in the Region

- **Benefits to securitization stem from the need to diversify the region's investor base, bringing benefits to:**
  - **Large-Enough Corporations**: Useful financing tool at lower cost of funds; Off-balance sheet funding technique allowing for deleveraging;
  - **Unrated Companies/SMEs**: Ideal tool to tap into capital markets on anonymous basis;
  - **Sponsoring Banks**: Means to generate fee income w/o increasing size of balance sheet;
  - **Originators:** Method to enhance exposure to particular sectors or business lines;
  - **Governments:** Debt-reduction tool through conversion of assets that may count as part of overall public debt;
  - **Regulators:** Introduction of transparency and market discipline to asset origination & servicing processes;
  - **Investors:** Diversification into new asset classes & along credit spectrum; reduction of exposure to corporate entities; etc.

Legal/Regulatory Challenges

- Dearth of legal basis except in Egypt, Lebanon, etc.
- Tepid involvement of regional central banks in securitization process with little done to institute reforms $\Rightarrow$ current legal environment still uncertain & largely untested.
- Urgent need for more resources allocated to building regulatory framework surrounding structuring, issuance, ratings, sales, and valuation (which would move in line with governments' commitment to a heavier private sector role in the development process).
- Call for transparency to these new product areas to foster stability while maintaining liquidity, supporting further meaningful financial innovation, and capital deepening.

Creation of Secondary Market for Structured Products

- **Only after the secondary markets become mature will securitization win favor with foreign investors.**
- **Introduction of government-sponsored bodies can facilitate market integration process.**
- **Institutions of this type have proven to be profitable & efficient & can be privatized as in the US model:**
  - Fannie Mae (Federal National Mortgage Association): buy mortgages, pool them, and then issue MBSs.
  - Ginnie Mae (Government National Mortgage Association): provide insurance facilities and packaging of mortgage pools to lending institutions.

Human Capital and Professional Competences

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- **Analysts to assess credit risks and value of collateral**
- **Accountants to provide accurate information to investors**
- **Legal professionals to specify clear contractual obligations**
- **Market makers for secondary market to ensure liquidity**
- **Structurers to design securities tailored to investors needs**
- **Regulators to oversee the build up of aggregate risk and its repercussions**

DIFC's Role in Promoting Securitization

- Sound & efficient listing/trading platform (DIFX, currently the largest Sukuk market);
- International legal & regulatory infrastructure standards with independent risk-based regulator (DFSA);
- Transparency, disclosure, and corporate governance as building block for financial sector development (Hawkamah);
- International best practices;
- Modern and secure payments infrastructure;
- Cluster for lawyers, accountants, and bankers alike;
- Provision of liquidity/ease of access to local/foreign investors, and
- Assistance in establishing required legal and regulatory framework for securitization, spanning all aspects of company law/SPV setup, insolvency law, security law, trust law, etc.

New Draft Regulation on SPVs for Securitization

- The DIFC has produced a draft regulations -- currently in the consultation phase -- allowing the establishment of SPVs, thereby filling a gap in the legal framework.

- Although the DIFC does not aim to become an SPV jurisdiction this provision will broaden the spectrum of structured transactions, by providing a much needed legal underpinning and clarity.

- The use of SPVs in the DIFC under the new regulations will greatly facilitate sophisticated financing activity.

- An Exempt Company (as the SPV is dubbed in the DIFC regulation) will be allowed to undertake only a limited set of activities, namely acquisition, holding, and disposal of assets, whether according to conventional or Islamic rules.

- Set up costs and regulatory burden are extremely light.

Islamic Finance & Sukuks

- Islamic finance is securitization’s new frontier, as stimulated by the upsurge in regional liquidity for Islamic securities.
- Real estate, in particular, lends itself well to providing Islamic & ethically minded investors with projects that can yield returns equivalent and even greater than other markets.
- The Collective Investment and Investment Trust legislation already supports the development of Sharia-compliant finance.
- DIFCA, DFSA and DIFX have all streamlined the listing of Sharia-compliant financial instruments, and DIFX is already the largest global sukuk market.
- DIFC will support the build-up of a government sukuk market to finance infrastructure & to mainstream sukuk as a public finance instrument. It will also help set-up a Sharia-based mortgage market to support housing finance in UAE & the region. Its objective is to become the main regional platform for a secondary market in sukuk and Sharia-compliant funds.

DIFC: MENA Financial Sector Development

- GCC have become 'asset-based economies' with income on assets more important than oil & gas revenue
- GCC Common Currency can emerge as a global currency alongside US$, Euro and Remimbi; need to develop payment System Infrastructure
- Invest, Manage and Control region's financial wealth of $2+ trillion and growing as a result of high energy prices:
  - Financial sector to be an engine of growth
  - Strategic issue: security and safety of assets
- Develop new markets and instruments
  - Shari'a compliant financial sector & market
  - Bond market
  - Securitisation and structured finance
  - Housing Finance & Mortgage markets

GCC: "The Great Transformation"

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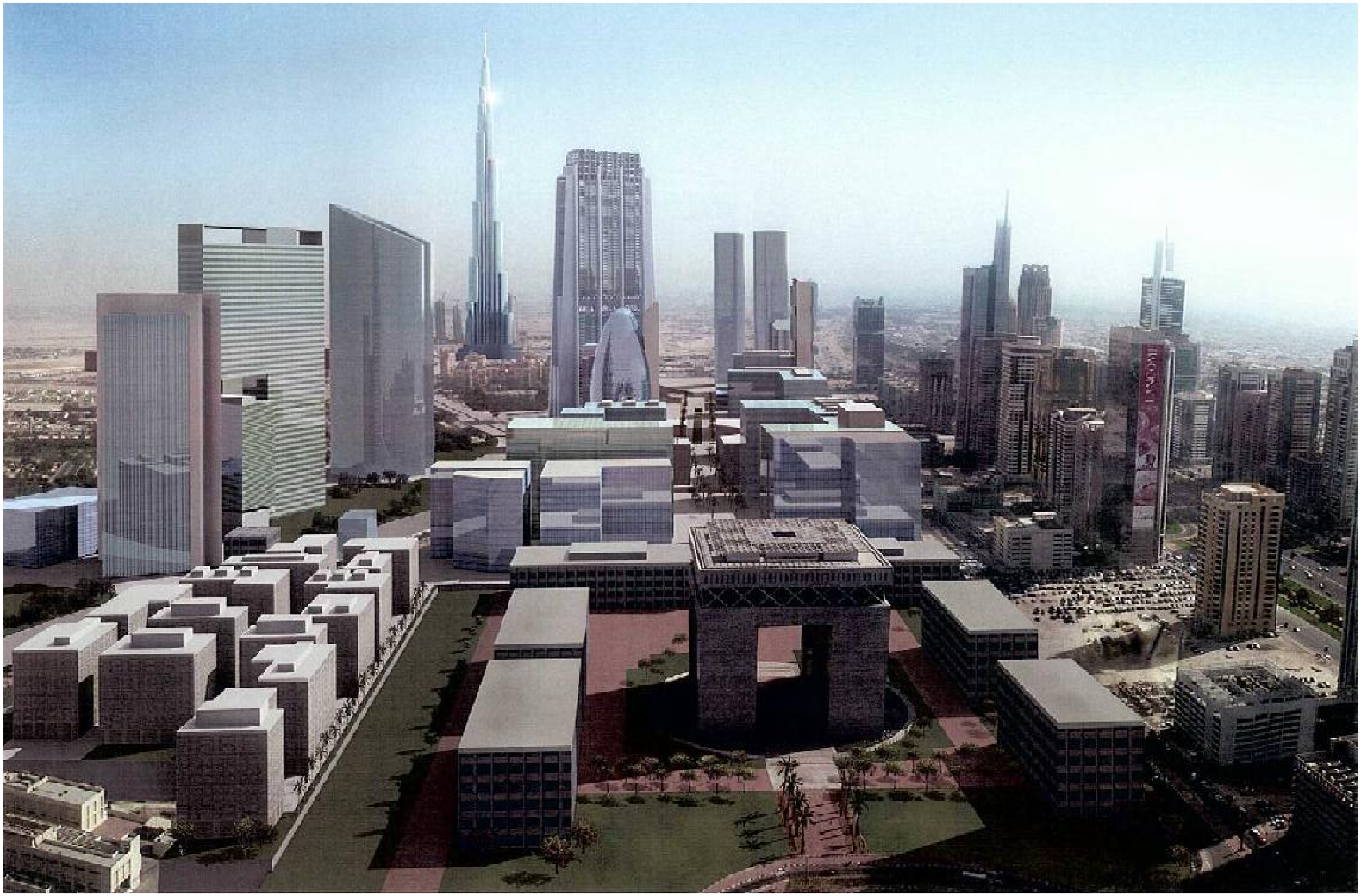
- Break Oil-Investment link: use financial markets to finance infrastructure & projects
- GCC are "Asset Based Economies": Financial markets can become engines of growth and structural transformation
- PPI and Privatisation are key to growth sustainability and diversification
- Pace and scope of market development are limited only by the institutions & existing regulatory frameworks.

Sheikh Zayed Road, Circa 1990

Sheikh Zayed Road, Circa 2002

DIFC Circa 2010



GCC Governmental Development & Privatisation: The Great Transformation

A Time for Vision
A Time for Action
A Time for Architects and Designers
A Time for Builders & Investors

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March 7th 2008