البحوث

The Role of the Financial Institutions In Promoting Capital Flows and Investment

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Introduction

The aim of this paper is to examine the flow of foreign capital into Arab countries, and to investigate the nature and pattern of these flows in the last two decades and the role of the financial institutions in promoting capital flows. It is also to highlight the significance of foreign investment in the economic development of the Arab region and the crucial role of the developed financial markets in mobilizing long-term foreign capital for economic growth. The analysis considers two main sources of long-term foreign capital: foreign direct investment (FDI) and portfolio investment. These two sources of private capital are rapidly replacing the more traditional sources of financing to developing countries, such as official grants and loans as well as commercial bank borrowing.

However, FDI (excluding oil) and portfolio investment flows to the Arab region are among the lowest in the world as both sources of financing still remain constrained by restrictive investment regimes and the absence of well developed institutional arrangements-the intermediaries, instruments and markets-that channel these funds for investment. The study emphasizes that recent efforts to liberalize the financial system must be accompanied by policy reforms and institution-building efforts to introduce proper financial intermediation and new financial instruments.

The structure of financial flows to developing countries has changed several times. After World War II official flows (mainly concessional) were the main source of capital. The largest portion was bilateral aid, but some of it was channeled through the new multilateral agencies such as the World Bank and International Development Association. Along with private direct investment and

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(My thanks go to the referees for their valuable comments on this research)

supplier credits, official finance provided the bulk of capital to developing countries until the late 1960's, when commercial banks started to play a prominent role.

Following the first oil shocks of 1973-74, international commercial bank lending rose dramatically as large OPEC surpluses placed in bank deposits were deployed to finance the growing current account deficits of developing countries. Many well established Arab banks became involved in internatioal lending, some linking up with foreign partners to form consortium banks. Further impetus came from wholly owned Arab banks set up in Bahrain, Dubai, Kuwait and abroad.

Arab countries were the main recipients of Arab bank lending until 1979-80, but others then took an increasing share. FDI declined as considerable commercial bank credit was available. However, the debt crisis caused an abrupt slow-down in commercial bank lending (including lending by Arab banks). To avoid the threat of default, official creditors and commercial banks maintained their flow of lending and borrowers changed their policies (i.e. reduced their budget and current account deficits) to improve their debt servicing capacity. Although big defaults were avoided temporarily, debts grew far larger and the threat of default still persisted. A series of debt reschedulings followed but did not resolve earlier problems of debt servicing. Eventually it was decided to reduce the debt burden of borrowing countries in the context of strong, effective adjustment programs.

Developing countries, which had earlier borrowed to postpone adjustment, now began to receive official assistance to undertake, maintain and extend their adjustment programs. As official financing became increasingly tied to balance of payments financing, and commercial banks began to reduce their exposure in developing countries, many countries had to look to alternative forms of external capital to finance investment in the absence of higher domestic savings that were systematically eroded to finance growing debt service payments in the 1980's. Foreign direct investment and portfolio investment have sine been growing in importance, particularly as they are risk-sharing non-debt creating flows of capital.

Section I reviews the developments of foreign direct inflows to developing countries as a first major source of long-term capital, while the second source is discussed in section 2, that is portfolio investment flows including country funds investing in equity, investments via Global or American Depository Receipts and direct investment by external persons and entities in developing country stocks and bonds. Section 4 gives some explanations on the promoting of capital flows in the future as an agenda for reforms. The paper ends with some concluding remarks and policy implications in section 5.

Section I
Foreign Direct Investment

Available data show that FDI is the biggest single component of the renewed flow of capital to developing countries. According to recent World Bank Statistics, FDI to developing countries has more than tripled from $ 42 billion in 1991 to nearly $ 129 billion in 1996, with the share of FDI in total world flows having risen from26% in 1991 to 37% in 1996, (Table 1).

Economic reform programs have encouraged private sector growth in developing countries and made a significant contribution to industrial development and export diversification via transfer of technology and management. These factors have led FDI to developing countries to grow rapidly in the recent years.

Table (1)
FDI Inflows by Selected Region ($ Mn)

Year	Africa	West Asia	Developing Countries (1)	World (2)	(1) / (2) %
1991	2752	1900	41696	158936	26.2
1992	3151	1823	49625	173761	28.6
1993	3691	3452	73045	218094	33.5
1994	5496	1396	90462	238737	37.9
1995	4699	- 763	96330	316524	30.4
1996	4949	1893	128741	349227	36.9

Source: Word International Report, 1997, UNCTAD

Moreover, during 1991-96, Africa accounted on average for almost 5.5% of the world FDI flows to developing countries, although its share decreased from 6.6% in 1991 to 3.8% in 1996.

Investment flows to West Asia have been decreasing over time. West Asia's share of developing country inflow fell from 30% during the period 1981 - 85, to 2% during the period 1991-96. This mainly reflected decreases in flows to eight oil exporting countries, (Bahrain. Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, and the Emirates), Whose share of total developing country inflows declined significantly from 29 to 0.3% over the same periods.

It is also to say that investment in oil exploration and other natural resources in some of the economies tends to be "lumpy" because large FDI inflows may occur in one year but not in following years. It is also said that while the oil industry in the exporting countries receives most FDI inflows, in the non-oil exporting economies, FDI flows go mainly to the secondary and tertiary sectors.

There was also a disparity in inflows to individual countries, reflectimg the differences in the investment climate of those countries. As indicated in Table 2, Egypt, Nigeria, and Morocco topped the Africa league with 58% of the total. Saudi Arabia had FDI inflows of $ 450 million annually during the early part of the nineties, but this share declined to a net disinvestment of $ 1.9 billion in 1995, before gradually climbing back to $ million in 1996.

In addition, a major role has been played by appropriate macroeconomic policies in attracting FDI-that is the existence of a favorable, stable and predictable investment climate (El-Rifai, 1993)/ The same economic reforms that have attracted renewed FDI flows in other developing countries - Privatization, macroeconomic stability, liberal trade regimes and private sector growth-have not always been present in Arab countries. Morocco and Tunisia successfully adopted a cautious and comprehensive approach of structural adjustment to stabilize their economies and liberalize their trade and investment regimes, which has resulted in increased investor confidence in their economies. The oil sector drew large FDI flows to Algeria in the seventies, but increasing political instability and growing macroecomomic imbalances in the eighties and nineties as well as the

Table (2)

Foreign Direct Inflows to selected countries ($ Mn)

Country	1991	1992	1993	1994	1995	1996
Africa	2,752	3,151	3,691	5,496	4,699	4,949
Algeria	12	10	13	15	8	13
Egypt	253	459	493	1,256	598	740
Libya	180	165	120	110	105	110
Morocco	317	422	491	551	290	400
Tunisia	125	256	562	432	264	370
Nigeria	712	897	1,345	1,959	1,830	1,720
West Asia	1,900	1,823	3,452	1,396	-763	1,893
Bahrain	-7	-9	-5	-31	-27	47
Cyprus	82	107	83	75	119	100
Iran	23	-170	-50	2	17	10
Iraq	-3	-1	1	-	-	-
Jordan	-12	41	-34	3	43	5
Kuwait	1	35	13	16	15	20
Lebanon	2	4	6	7	35	30
Oman	132	101	147	62	35	80
Qatar	43	40	29	37	35	35
Saudi Arabia	160	-79	1,369	350	-1,877	100
Syria	62	67	176	143	65	120
Turkey	810	844	636	608	885	1,116
UAE	26	130	183	113	110	130
Yemen	583	714	897	11	-218	100
(a) Developing Countries	41,696	49,625	73,045	90.462	96,330	128,741
(b) World	158,936	173,761	218,094	238,738	316,524	349,227
(a) / (b)%	26,2	28.6	33.5	37.9	30.4	36.9

Source: Excerpted from a larger table in World International Report 1997, UNCTAD.

oil price collapse led to virtual stagnation in FDI flows. Egypt, another example, started receiving large FDI flows from 1975, the beginning of Open - Door Policy, until the first half of the 1980's. However difficult balance of payments and foreign debt problems created froeign exchange shortages and restricted transfer of dividends abroad, resulting in declining FDI flows in the second half of the 1980's.

However In 1994, FDI flows to Egypt have jumped by almost twice their level in 1993, while they dropped sharply by almost twofolds in 1995. The same trend can be seen in most counties shown in Table (2).

The oil exporting counties (Saudi Arabia, Kuwait and Bahrain) have supported foreign investment and export growth in the oil sector and have attracted large FDI inflows. However, the three countries have progressively increased FDI abroad, resulting in negative net FDI inflows in some years. The Gulf War (1991) has affected recent FDI flows to the region, but countries that have pursued favorable and open economic policies have nevertheless encouraged larger FDI inflows.

Section II
Portfolio Investment

2.1 - Gross Portfolio Flows to Developing Countries.

Portfolio investment flows (including country funds investing in equity, investments via Global or American Depository Receipts (GDRs and ADRs) and direct investment by external persons and entities in developing country stocks and bonds) to developing countries remained weak throughout most of the eighties owing to the restrictive investment climate and inadequate development of securities markets in these countries.

But in the 1990s, the surge in portfolio investment flows was the most significant change in capital flows to developing countries. Available data show that portfolio flows jumped sharply in 1993 and have since contributed vitally to growth in private capital flows, despite a slight dip in 1994-95.

Portfolio flows, more susceptible to developments in international capital markets than FDI- the other major source of private capital flows-these flows were hit by higher U.D. interest rates in early 1994 due to the tightening of U.S. monetary policy.

It is also to say that portfolio flows, more in equity than debt, dropped sharply at the beginning of 1995. Total portfolio investments in 1995 are estimated at $ 82 billion, down $ billion on 1994.

As far as regional trends of portfolio flows are concerned, available data show that most portfolio flows continued to go to East Asia (40%) and Latin America (37%) in1994, Latin America - most affected by the turmoil of the Mexican crisis - saw a sharp drop in early 1995, but recovered well in the second half of the year.

The Middle East and North African developing countries have experienced some investors return in 1994 after the absence of a couple of years. Investments are estimated to show a modest increase in 1995, due to bond issues from Lebanon and Tunisia.

According to World Bank estimates, gross portfolio investment flow increased from $ 7.4 billion in 1989 to $ 81.6 billion at the end of 1995. Latin America, followed by Asia, accounted for the largest increase in resources raised in international capital markets, (Table 3). As for the Arab countries, their share in the gross portfolio investment to developing countries during 1989-1995 remained negligible.

Table (3)

Gross Portfolio flows to Developing countries ($ Mn)

Region	1989	1990	1991	1992	1993	1994	1995
Sub-Saharan Africa	0	0	0	868	144	2277	1805
East Asia and the Pacific	2883	3140	4042	10851	31465	35037	35921
South Asia	689	379	223	380	2581	7301	2230
Europe and Central Asia	2187	1881	800	7548	13796	9452	9950
Latin America and the Caribbean	1394	3772	14958	20816	51685	32624	30609
Middle East and North Africa	164	90	0	0	0	784	1085
All Developing countries	7402	9298	20275	40600	99669	87475	81600

Source: World Bank, World Debt tables, 1996.

2.2 - Equity Investment:

Portfolio equity flows form an important part (almost half of the portfolio investment) of non-debt-creating flows and private capital flows to developing countries. Equity flows, however, were limited in volume until 1989 and rose substantially thereafter.According to World Bank estimates gross portfolio equity flows to developing countries quadrupled from $ 3.4 billion in 1989 to $ 22 billion in 1995. Latin America attracted over two-thirds of the cumulative amount of portfolio equity investment in emerging markets, while almost all the remaining investment was absorbed by Asia, (Table 4). Arab countries with their undercapitalized markets that are virtually closed to foreign investors, failed to secure a share of the growing market for portfolio equity.

Table (4)

Foreign Portfolio Investment In Developing Countrie ($ Mn)

Region	1989	1990	1991	1992	1993	1994	1995
Sub-Saharan Africa	0	0	0	144	144	860	465
East Asia and the Pacific	2623	2268	1049	5102	18107	12613	12230
South Asia	168	105	23	380	2025	6223	1430
Europe and Central Asia	71	235	0	65	191	1934	1590
Latin America and the Caribbean	434	1099	6228	8229	25149	13159	6200
Middle East and North Africa	0	0	0	0	0	106	85
All Developing countries	3372	3743	7552	14057	45615	34895	22000

Source: World Bank, World Debt Tables, 1997.

Rapid growth of emerging economies, continuous efforts by host countries to attract private capital to state-owned enterprises, and positive prospects for an increasing share for developing countries in world stock market capitalization suggest healthy growth in portfolio equity flows to developing countries in the long term.

International equity issues have played a majer role in channeling portfolio flows to developing countries. Since the beginning of the 1990s, there has been steady growth of such issues. In 1994 about 57 percent of portfolio equity flows were financed by equity issues, mostly through American Depository Receipts and Global Depository Receipts that offer the potential for enhancing investor base and liquidity. In 1994, despite the turbulence in markets, equity issues by developing countries increased from $ 11.3 billion to $ 19.8 billion. But with the disturbances in the early part of 1995, the volume fell to an estimated $ 10.3 billion. Nevertheless, they still accounted for 47 percent of total portfolio equity flows.

In the early part of 1995 issues from Latin America disappeared, and the remaining issues of less than $ 500 million were accounted for by East Asia, South Asia, and Europe and Central Asia. Although equity placements picked up after the dust settled, there were signs of stalling again in mid-year.

Foreign investments by institutional investors and emerging market equity funds have become an important source of portfolio investment for developing countries in the past couple of years. They are also the most volatile component of portfolio equity flows because they allow investors to rearrange portfolio allocations at a short notice. Adequate statistics on direct investment in local equity securities market are lacking, but emerging market funds provide a good proxy. After peaking in 1993 at 75 percent of portfolio equity flows, these direct investments declined in 1994 to 43 percent. Because of spillover effects of 1994, these investments remained depressed well through the first half of 1995.

The pace of investment in emerging markets set in 1993 provided enough momentum to launch new closed-end and open - ended funds in 1994, and their number increased significantly despite the rocky investment climate in emerging markets. To hedge against market correlations and maximize overall returns, more regional and emerging- market funds have been launched. In 1995 new closed-end funds declined drastically, but activity in open-ended funds continued, though at a slow pace.

Although direct investments in local securities markets slowed in 1995, the exposure of institututional investors to emerging markets (as a share of portfolios) remained at the peak levels of 1993. The share of emerging markets in the international investments of institutional investors grew from about 2 percent in 1989 to roughly 13 percent in 1994-95. Equity investments are expected to increase modestly in the near future, with some U.S. investors taking advantage of low equity prices in developing-country markets in early 1995 and with continuing development of local corporate markets.

It is shown that Equity investments in developing countries since 1989 were channeled largely through country funds. As of June 30, 1992, there were 234 close-end investment funds with net assets of $ 22 billion, a three-fold increase over its level three years earlier (Gooptu, 1993). country funds are managed by professional fund managers and provide investors with an opportunity to invest in a diversified portfolio of securities across several industries, thereby avoiding the risk associated with direct investment in specific corporations. They provide institutional investors with an opportunity to enter newly emerging markets where poor corporate disclosure practices and domestic laws make it difficult or costly to invest in alternatives. A number of East Asian (Korea, Malaysia and Thailand) and Latin American countries (Chile, Mexico and Brazil) have raised resources via country funds en route to opening their markets to direct equity investment. Their success in mobilizing equity resources, coupled with the knowledge that portfolio equity investment is tied to economic return rather than ownership objectives, has encouraged many Arab countries to open their markets to portfolio equity investment through country and regional funds. The role of country funds in promoting capital inflows to Arab countries is discussed later in the study.

In addition to country funds, developing countries are raising capital through derivative instruments such as American Depository Receipts (ADRs) and Global Depository Receipts, (GDRs), and through direct portfolio investment. So far, ADRs/GDRs have been used mostly by private entities in Latin American and Asian countries in an attempt to raise capital in international financial markets and these instruments have not yet penetrated the nascent capital markets of the Arab countries. Direct portfolio investment in the equity of companies is still small and confined to a few developing countries (not including the Arab countries) that have opened up their capital account.

2.3 - Investment in Bonds:

Following the debt crisis, developing countries were unable to raise financing through the international bond market. Bonds that were issued in the eighties were primarily the result of debt conversions negotiated between borrowing countries and their commercial bank creditors to restructure existing debt. It was not until 1989 that developing countries were able to reaccess the international bond market.

According to the estimates of the World Bank, developing countries nearly doubled the amount of external resources raised in the international bond markets since 1990, (from $ 7 billion to $ 12 billion) mainly through issues of Floating Rate Notes, Convertible Bonds, Non-US dollar foreign currency denominated bonds, Certificates of Deposit and Commercial Paper. This trend is reflective of the preference by private entities in developing countries to issue overseas bonds other than organize non-resident purchases of domestically issued bonds, as the former offer greater liquidity, more variety and greater hedging opportunities, (Abisorour, 1993).

Many Latin American countries, followed by Asian and Eastern European countries, have been active in the internatioal bond market. Corporate entities in Arab countries have not yet explored the internatioal bond market to raise capital due to legal restrictions on issue of overseas bonds by domestic enterprises. The surplus economies of Saudi Arabia and Kuwait have been investors in foreign bond markets. Saudi Arabia recorded the highest investment in foreign government bonds of $ 13.4 billion in 1984. followed by $ 12 billion investment in the next three years, before becoming a net seller in 1989. In contrast, intra-Arab bond investment flows have been insignificant primarily due to the dearth of proper financial intermediation and financial instruments which has constrained capital-Surplus Arab countries from playing a bigger portfolio role within the region.

Section III
Financial Institutions

3.1 - Introduction:

The institutional arrangements relevant to developing countries can be divided into two parts. Firstly, the official sector which contains direct channels for capital flow, e.g. bilateral aid and a number of intermediaries, such as the World Bank and the multilateral development banks. Secondly, the private sector also has direct mechanisms - direct foreign investment - as well as intermediaries, such as commercial banks, specialized credit institutions and money and capital markets. Because intermediaries have become increasingly important in channeling finance to developing countries, the range of financial instruments has also grown. The economies of scale achieved by a range of financial intermediaries yield efficiencies that reduce costs and risks for borrowers and savers. The resulting improvement in financial efficiency implies increased flows to developing countries at lower costs.

Next,we will describe the institutional arrangements for channeling private capital flows and the growing importance of capital markets as a channel for international equity investment and a source of long-term finance to maintain the solvency of the financial system in developing countries.

3.2 - Commercial Banks:

They traditionally provide short-term and working capital finance against short-term deposit. When developing countries sought the interventionist approach to promote financial development, they created new state-owned financial institutions or directed commercial banks to provide subsidized long-term credit to state enterprises and priority sectors in the economy. However, this led to unsatisfactory lending practices, excessive risk concentration and mismatching assets and liabilities in terms of interest rates and maturities, resulting in a growing porfolio of bad debts and bank insolvency.

Bank failures have important macroeconomic consequences, disrupt the payment system and lead to disintermediation (Which decreases the mobilization of resources and the availability of finance for investment).

To prevent such failure, many countries have implemented reforms to strengthen the banking system through improved prudential regulation and supervision. These include:

(i) licensing to ensure adequate capitalization and sound management.

(ii) capital adequacy stipulations to ensure that banks have enough capital to cover both assets and items not listed on the balance sheet.

(iii) asset classification and provisioning for potential losses or problem assets.

(iv) exposure limits on lending to prevent the concentration of risk in a single borrower, a group of related borrowers or a particular industry.

(v) minimum audit standards to enable proper financial disclosures.

(vi) bank restructuring which allows supervisors to plan effectively for recapitalization and transfer of ownership or to dispose of insolvent banks quickly.

To be effective, prudential regulations must be backed by political commitment to supervision and enforcement. To promote a safer, more stable banking system, several Arab countries are strengthening prudential regulations and supervision (Egypt, Morocco, Jordan, Oman, Qatar and Tunisia). Strict guidelines for portfolio concentration, loan classification, provisioning for potential loan losses and requirements for capital adequacy are expected to rationalize the activities of the banking sector (Tunisia, Morocco, Egypt, Jordan, Oman, Saudi Arabia and Kuwait).

Financial sector reforms also include measures to make banks more competitive and efficient since they hold a major portion of the assets of all financial intermediaries in most developing countries of the assets of all financial intermediaries in most developing countries and will continue to remain an integral part of their financial markets in the near future. In many Arab countries, financial markets are dominated by large commercial banks which face growing financial difficulties. Therefore banks are increasingly being allowed greater freedom to respond to market signals, to choose their own customers and to set interest rates. Competition will also permit failed banks to go out of business, be privatized or be merged with sounder institutions and open the way for foreign banks to establish branches or start joint ventures with local banks.

3.3 - Non-bank Financial Institutions:

(i) **Development Finance Institutions (DFIs)** - It is the most common type of nonbank intermediary in developing countries. Most are public or quasi-public institutions that primarily derive their funding from the government or from official foreign assistance. Originally they were intended to address the scarcity of risk capital, for small and medium-sized enterprises in developing countries, that was not supplied by commercial banks. During the seventies, that mandate was broadened to include the promotion of priority sectors (World Development Report, 1989, p. 106) DFI s extended subsidized credit to activities considered too risky or unprofitable by other lenders. They constituted an important intermediary for development financing, and were actively encouraged and supported by bilateral and mutilateral creditors. Consequently, almost all developing countries, Arab as well as others, had at least one DFI and many had a special DFI for each priority sector.

In practice, many DFIs found it difficult to finance projects with high economic but low financial rates of return and remain financially viable at the same time (World Development Report, 1989, p. 106). The use of inappropriate lending criteria resulted in a marked deterioration in portfolio quality and the financial performance of DFIs; many of them are insolvent and need to be restructured. Many DFIs have continued to depend on governments and foreign official for funding because weak performance left them unable to pay market rates of interest for long-term resources, because term structure of interest rates often did not permit the higher rates necessary to mobilize longer term resources, and because markets for longer-term domestic instruments were pooly developed. Also in many instances, the foreign exchange risk associated with foreign resources was passed on the clients catering to the domestic market and with no ability to bear the risk or hedge it; sharp currency devaluations thus badly affected both the clients of DFIs and, in turn, the institutions themselves (World development Report, 1989).

The difficulties experienced by DFIs in other developing countries were also present in Arab countries. The ability to borrow cheaply encouraged less productive investment. Many directed credits financed high-risk investments that could not be repaid. Consequently, the distorted allocation of resources and the erosion of financial discipline have left intermediaries, especially DFIs, unprofitable or insolvent. The growing insolvency of DFIs is being addressed through financial sector reforms. Morocco and Tunisia have removed interest subsidies to DFIs and have almost phased out credit allocation to increase the efficiency of finacial intermediation through competition. Several countries have chosen to srengthen or restructure existing DFIs in the same ways outlined for commercial banks. DFIs have also been encouraged to diversify their risks by expanding their range of services. However, in the absence of adequately developed financial markets, DFIs continue to depent on foreign sources of term financing.

(ii) Leasing Companies - Leasing is closely associated with productive sectors, and with small and medium- sized enterprises, in particular. By providing such entities with an alternative source of equipment finance, the leasing industry facilitates growth in investment and capital formation. Moreover, since leasing companies have to compete for resources and clients with other institutions usually without benefiting from access to subsidized credit, they are generally more efficient in mobilizing and allocating capital as compared, for instance, to DFIs.

Financial markets of the segmented nature in most developing countries generally ensure that there is a market for leasing. This is often overlooked by operators accustomed to highly developed financial markets, where often fiscal factors are crucial to the success of leasing. In emerging countries, banks tend to be inefficient and the resulting high intermediation spreads provide opportunities for leasing companies, particularly if they can source funds outside the banking sector. However, in the absence of liquid financial markets, obtaining term funding can be a problem for many leasing companies. In such cases, joint venture leasing companies, with strong foreign shareholders, are able to mobilize resources from abroad, although they usually hedge this currency linked leases. Given that lessees - unless they are exporters - are often reluctant to take foreign exchange risk, this type of funding can at best supplement, but not substitute, local resources. Their need for local sources of term funding ofter makes leasing compaines the catalysts for accelerating stock market activity.

In many Arab countries, leasing is beginning to develop as new institutional source of long-term finace for small and medium-sized companies that cannot compete with larger firms. Currently, leasing finances only a small portion of total investment in Arab countries, and thus has considerable potential for further growth. Arab countries are encouraging the formation of joint venture leasing companies between domestic financial institutions (commercial banks and/or DFIs) and overseas leasing companies or banks with leasing affiliates. Tunisia has two leasing companies that were created as joint ventures with French institutions. Tunisie Leasing, Tunisia's first leasing company, is now listed on the Tunis Stock Exchange. Morocco has 6 leasing companies that were established jointly with local commercial banks and French leasing groups and commercial banks. Oman National Leasing Company was established as Oman's first joint-venture leasing company with Orix Leasing of Pakistan Corporation, (IFC), the sponsors have committed to arrange additional term funding through a privately-placed bond issue. IFC has played an important institution building role in establishing new leasing companies in Arab countries. IFC has identified strong technical partners and been responsible for structuring the first leasing companies in Jordan, Oman and Tunisia. IFC and other multilateral institutions can also assist the growing leasing industry by extending lines of credit to finance leasing of productive equipment to private sector enterprises, to encourage syndicated leasing for large equipment items and support the expansion of market-based leasing companies.

(iii) Ventrue Capital Companies - Venture capital is typically high risk financing aimed at "converting enterprises out of enterpreneurs" and often takes the shape of start-up financing in the form of equity capital and loans, with returns linked to profits and some degree of managerial control. Venture capitalists expect losses on some ventures to be greater than traditional financing, but they invest with the notion that greater than normal returns on others will compensate for those losses. Venture capital is ideally suited to high-risk projects and is therefore an alternative to DFIs. It requires and entrepreneurial class and an environment conductive to private sector growth. A source of long-term investible resources is also necessary. And an active stock market is essential to divest portfolio investments of venture capital companies, although investments may be sold through private placements until secondary markets become more dynamic. Several Arab countries have potential for this type of finance (Morocco, Tunisia, Egypt), which has been limited so far due to small stock markets and fiscal incentives that have supported debt-financing over equity.

(iv) Contractual Savings Institutions - Life insurance compaines, pension funds and funded social security systems are sources of long-term finance for investment in corporate bonds and equities. They provide investors with the opportunity to diversify risk with the benefits of investing in a portfolio selected by professional investors. Pension funds have contributed significantly to the supply of long-term funds in singapore and Chile. However, many governments have impeded the contribution of contractual savings as a source of long-term finance by requiring them to invest a part of their resources in government securities or programs with low returns in social sectors (Malaysia, Kenya, India, Morocco, Tunisia), This system is being phased out in most countries implementing financial sector reform. The lack of alternative investment opportunities has also confined the role of these institutions to investing in government securities. As capital markets grow in developing countries, the removal of investment controls will encourage the growth of these institutions as investors in corporate equities.

3.4 - Securities Markets:

Securities markets basically consist of money markets and capital markets.

(i) Money Markets - The develooment of securities markets usually starts with trading in a short-term money màrket instrument, often a government security. Other money market instruments are inter-bank deposits, bankers' acceptances, certificaltes of deposit and commercial paper issued by nonfinancial corporations. Money markets provide a non- inflationary way to finance government deficits. They are a source of funds for commercial banks and other institutions, including DFIs and leasing companies. By enabling large corporations to issuers short-term securities in the form of commercial paper, money markets make the corporate loan market more competitive and reduce the control of large commercial banks. Investment banks are usually issuers and dealers in money market instruments; licensed dealers are often proxies for in investment banks in developing countries with a dearth of such institutions.

Measures to promote money market growth include issuing government securities at market rates. The reluctancė of finance ministries to pay market rates on their debt is usually the biggest obstacle to the development of money markets. In Morocco, financial sector liberalization has attempted to remove barriers to the growth of money markets. The system of mandatory placements on banks and institutional investors, such as Caisse de Depot et Gestion and insurance companies, to place a percentage of their funds in Treasury bonds, is being phased out. Under the world bank's financial sector development loan, mandatory placements will be replaced by funding through the auction market, banks will be allowed to underwrite Treasury bond issues and place long-term bonds through public offerings. Deregulation of interest rates will allow government securitites to become more competitive with other bond instruments. In Tunisia, mandatory placements have been abolished for banks and are being addressed in the case of insurance companies and social security funds. The Tunisian money market came in to begin in 1987 when certificates of deposits and commercial paper were introduced with maturities of up to 5 years and in 1989, Treasury bills were introduced with attractive yields and are issued through an auction process on the money market. These developments are creating competition in the financial sector and making alternative forms of short-term finance available to private and public entities.

(ii) Capital Markets - Capital markets provide equity finance as well as long-term debt (through the issue of bonds) for both the government and corporate sector. By offering an array of financial instruments available to investors, capital markets increase competition and ensure the most effective mobilization and allocation of investible resources. This lowers financial intermediation costs and contributes to productive investment and growth. Capital markets also facilitate the dispersion of business ownership and the reallocation of financial resources among corporations and industries.

Many developing countries, including India, Korea, Malaysia, Turkey, Mexico and Chile have active equity markets. Only few countries have active bond markets; they include India and Korea. Of the Arab conutries, only 8 have established formal capital markets: Saudi Arabia, Bahrain, Egypt, Jordan, Kuwait Morocco, Oman and Tunisia, The United Arab Emirates, Qatar and Algeria are planning to establish more formal capital markets. Currently only Egypt, Morocco, Tunisia and Jordan have capital markets which are open to foreign investors. In absolute terms, Egypt has the largest market with 650 listed companies and a market capitalization of $ 21 billion, (Table 5). Currently, the capital-surplus countries represent about 85% of the total capitalization of Arab securities markets. This ratio is expected to become better balanced when the proposed privatization programs of the capital-deficit countries (Egypt, Morocco and Tunisia) are implemented, (Abisorour, 1993).

The supply of equities in many counties has been limited by the reluctance of owners of private companies to dilute their ownership and control by issuing stock to the public and to comply with requirements to disclose information about their operations. The availability of less expensive debt finance has also discouraged equity issues. The absence of an appropriate legal, regulatory and tax framework has further inhibited the development of capital markets. Double taxation on dividends and capital gains, and the tax free status of government securities have lessened the appeal of private equity and bonds. The lack of timely and accurate financial information has often resulted in speculative trading which has further hurt investor demand for securities in developing countries. The efficient functioning of financial markets also depends on institutions that lend and borrow little on their own account, investment banks, securities brokers and credit rating agencies.

Table (5)

Emerging Stock Markets in the Arab Region: 1997

Country	Market capitalization $ billions	No. of listed Companies
Egypt	20.9	650
Oman	5.5	139
Kuwait	25.6	74
Bahrain	7.8	40
Morocco	12.2	49
Tunisia	2.3	34

Source: Bulletin of Arab Stock Markets, 22,1998.

(iii) Investment Banks - Investment banks are important constituents of securities markets; they are intermediaries for locationg and collecting funds for their clients so they can finace new investment products. They are major players in the development of securities offerings. They perform the service surrounding public offering of securities known as underwriting. In addition, they arrange private placements, provide funds management and perform corporate advisory and portfolio management services. Investment banks have yet to play a major role in Arab countries, which are still in the process of developing their nascent capital markets.

In addition, investment bankers bring new securities to the market by purchasing whole issues of securities from corporate issuers or from public bodies and distributing them to institutional and individual investors. By making firm commitment to purchase the securities from the company, the investment banker issues any risk associated with a new issue. This service, known as underwriting permits government and corporate entities to broaden their sources of long-term financing beyond the banking system. Underwriting is critical to the development of emerging markets where corporate or public entities are reluctant to raise equity capital without the guarantee provided by this service. Investment banks are also market makers in secondary markets.

Moreover corporate advisory services comstitute a growing business for investment banks in emerging markets. The private sector in many developing countries has been accustomed to functioning in heavily controlled and protected market environments, which has provided inadequate preparation for businesses to respond to market signals. Investment banks can play an important part in advising businesses on how to compete in a more open and international economy. However, they also have a key advisory role in relation to project financing, i.e. identifying project risks, attracting technical partners, identifying and selecting sources of finance and structuring the financial package. While banks, long-term financing institutions and institutionl investors provide financing, investment banks, long-term financing institutions and institutional investors provide financing, investment banks arrange financing and can play a useful role in organizing loan syndications for large amounts of financing.

It can also be argued that investment banks provide portfolio management services by investing funds on behalf of institutional and individual investors. Their investment decisions are based on specialized research and analysis of securities. Consequently, they help to curb speculative tendencies, especially in emerging markets that are affected by poor corporate disclosure practices, by serving as conduits for dissemination of timely and accurate financial information.

Section IV
Encouraging the Capital Flows in the Future

Successful economic planning in developing countries depends on the ability to achieve rapid and balanced growth of investment in both the government sector and the corporate sector. This in turn hinges on an adequate transfer of household savings and foreign capital inflows to these sectors. This transfer requires the availability of diversified financial instruments and proper financial intermediation. Foreign capital flows to Arab countries have been limited by governmental policies restraining foreign private investment and favoring debt instruments over equities and financial intermediation in banking over the securities market. The policy challenge involves: increasing capital flows by relaxing regulations and reducing restrictions on international capital mobility and establishing an appropriate institutional framework to ensure that an adequate proportion of financial savings flows into the equity market, (Abisorour. 1993).

An increasing number of Arab countries are beginning to take steps to create the necessary infrastructure for securities market development. On the policy side, financial liberalization has to some extent already removed distortions that encourage financial flows into debt instruments through the banking system, and especially deposit type short-term instruments which have often led to finanial instability. Fiscal incentives in the form of differential tax treatment of equities on the one hand, and bank deposits and other debt instruments on the other, are also being removed. Taxation on dividends and capital gains on sale of shares has been removed to put equity investment on par with other types of debt instruments (Morocco and Tunisia).

One can also argue that the governments of Arab countries can play a key role in developing capital markets. In addition to policy reforms removing barriers to equit financing, the process of privatization must be expedited to create incentives for foreign investment. Privatization through private placement or sale of shares on the still emerging capital markets will encourage wider participation by domestic and foreign institutional investors and increase market capitalization substantially. Privatization has been one of the forces revitalizing equity markets in many developing countries, inculding Mexico and Chile. Several Arab countries are implementing large-scale privatization programs (Morocco, Tunisia, Egyp) to stimulate direct and portfolio investment.

Encouraging forign portfolio investemnt can raise demand for securities. Regulations and restrictions that impede the entry of intrenational investors into domestic equity markets are being lifted. Several countries remain concerned over foreign ownership of assets. But, foreign portfolio investment is usually passive, and a developing country concerns over volatile flows of money and increasing foreign country concerns over volatile flows of money and increasing foreign control can be met by such means as the closed - end country fund, whose shares can be traded but not redeemed (Morocco. Egypt and Tunisia).

Governments can help to put in place an appropriate regulatory frameworlk to increase investor confidence in securities markets. Regulations are needed to provide for accurate and adequate disclosure of corporate information to curb speculation and allow investors to make informed decisions. There is a need to license securities intermediaries, establish minimum listing requirements and to curtail improper activities such as insider trading.

Governments also have a crucial role to play in setting minimum capital requirements for securities firms. High minimum capital requirements relative to the size of the market will impede the formation of new securities firms (investment banks), but if they have insufficient capital they will not be able to take on the risks of underwriting new issues nor will they be able to work as market makers and thus provide liquidity for the secondary market. Another important aspect of regulation concerns concentration of ownership. Governments can take a variety of regulatory measures to encourage widespread ownership of equity through regulation of companies and securities markets.

Moreover, the development and deepening of capital markets in Arab countries will also require institution building efforts as well as technical assistance from external sources and multilateral agencies. International Financial Corporation (IFC) can play a role in supporting the creation of the institutional and regulatory framework for capital markets as well as help in the establishment of stock exchanges and stock market institutions in Arab countries which do not have formal securities markets.

In particular, IFC can assist in developing appropriate regulations to provide accurate and timely disclosure of financial information, ensure fair trading practices and listing requirements of companies and prevent insider training, IFC and also help set up investment banks and securities houses to provide adequate financial intermediation services for equity markets in Arab countries. So far, brokerage services have been rendered by commercial banks as a courtesy to their clients with no incentive to accelerate stock market activity. Underwriting services are also absent in most Arab countries, which is a disincentive for companies to raise equity through public issues.

The development of both brokerage and underwriting services is critical for the development of equity markets in Arab countries and should be addressed as a priority in institutional building efforts and in technical assistance programs.

Supporting the development of local markets via IFC can be also made by helping to establish investment funds for individual countries or a group of countries to encourage foreign portfolio investment in the Arab countries. These funds can best be established under a two-tier structure wherein the equity fund will be managed by a professional fund management company, to be up with the participation of domestic financial institutions and suitable foreign technical partners. This structure may create a new financial instrument to channel resources into equity investments and establish financial institutions with strong technical skills to successfully engage in such investments. If properly structured, IFC may also invest in these funds and in their management companies. IFCs presence is expected to enhance investor confidence among institutional investors and encourage them to invest in these funds.

Conclusion;

The nature and pattern of private capital inflows to developing countries have been clearly influenced by the presence (or lack thereof) of well established securities markets, proper financial intermediation and a variety of financial instruments to channel financial savings into direct or portfolio investment. Nowhere has the importance of open and diversified financial markets been more visible than in several Latin American (Mexico, Chile and Brazil) and East Asian economies (Korea, Malaysia and Singapore). They have attracted the lion's share of private capital inflows by complementing their economic liberalization efforts with the removal of stringent foreign investment countrols and the deepening of their financial markets. Korea is a striking example of the successful transition from a heavily regulated financial structure to a more open, robust and diversified financial system. Korea initiated stabilization, structural adjustment and financial reform in the 1980's. The govenment encouraged competition in the financial sector by relaxing barriers to entry, deregulating nonbank financial institutions and allowing different institutions to offer a wide array of services. Foreign financial institutions, including banks and insurance companies were permitted to open branches. Many government-owned commercial banks were privatized. Preferential credit lending rates were eliminated and no new directed credit programs were introduced. Controls on interest rates and capital flows were maintained until inflation was brought under control and exchange rates stabilized. By the mid-1980's Korea had established macroeconomic stability and laid the foundation for a rapidly expanding financial sector, which included primarily nonbank institutions and securities markets. Between 1983 and 1992, Korea's stock market capitalization increased from $4.4 billion to $108 billion, the number of listed companies went up from 328 to 688 and value traded soared from $2.2 billion to $116 billion, (IFC Emerging Markets Factbook, 1993).

Many Arab countries (Morocco, Tunisia, Egypt) are beginning to redress their closed-door policies by dismantling rigid investment regimes; others had already opened their doors, at least partially, to foreign investment (Jordan and Oman); another group is planning for foreign investment (Kuwait), but investment flows are still constrained by the absence of diversified financial instruments and policies that have supported banks and DFLs over other forms of financial intermediation. The interventionist financial policies of strict control over interest rates and channeling of subsidized credit to certain sectors have resulted in investments in financially questionable projects and agrowing portfolio of non-performing bank assets in developing countries. In several Arab countries, the banking system has been seriously undermined and the need for financial liberalization has become imperative. Financial sector liberalization in Arab countries should not be limited to the removal of credit allocation and interest rate controls and reform of the banking system, but seek to develop a more broadly based financial system that includes money and capital markets and nonbank intermediaries. Active securities markets would increase the supply of equity capital and long-term credit, which is vital to maintain the solvency of the financial system and effectively mobilize domestic savings and foreign capital for investment. Competitive and a balanced financial system will also reinforce macroeconomic stability by making the system more sturdy in the face of external and internal shocks. Multilateral institutions such as IFC should play an increasing role in assisting Arab countries to build stable and competitive financial systems.

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الإداري

دورية متخصصة في مجال العلوم الادارية

تصدر عن معهد الادارة العامة ـ مسقط ـ سلطنة عمان

ص.ب: ١٩٩٤ روي ـ الرمز البريدي ١١٢ ـ برقيا معهدارة ـ

تلكس: ٥١٠٥ معهد اوان ـ فاكس: ٦٩٨٧٦٣

تليفون: ٦٠٢٢٥٢/٦٠٢٠٦٦/٦٠٢٣٨٦

الأهـــداف

- نشر الثقافة والوعي الإداريين بين العاملين في مجالات الخدمة المدنية ودعم سبل الاتصال والتفاهم الإداري.
- عرض المشاكل الادارية المعاصرة وتحليلها وبيان أنجح الحلول لها واستظبار تجارب الدول الأخرى واجراء ما يلزم في ذلك من دراسات مقارنة.
- تعميق الاتصال والتبادل الثقافي في مجال الادارة بين المعهد ومعاهد الإدارة الأخرى والمؤسسات المماثلة في الدول العربية والأجنبية.

شروط النشر

- أن يكون العمل العلمي ذو علاقة وثيقة بمجالات التنمية الادارية مع الالتزام بالموضوعية والمنهج العلمي.
- أن تكون مادة البحث أصلية ولم يسبق نشرها من قبل أو تقديمها الى أية جهة أخرى.
- أن تكون المادة العلمية مطبوعة على الآلة الكاتبة، وأن تكون من نسختين.
- أن تراعى الأصول العلمية المتبعة في اثبات مصادر المعلومات وتوثيقها.
- تخضع جميع الأعمال العلمية المقدمة للنشر للتقييم العلمي حسب الأصول المتعارف عليها.
- يحق لهيئة التحرير ادخال التعديلات المناسبة على الأعمال العلمية التي تم تقييمها وقبولها في ضوء شروط النشر المعلنة.
- تصرف مكافاة رمزية لكل عمل علمي يتم نشره في الدورية

عزيزي القارىء ...

* تعرف على قضايا التنمية الإدارية من خلال الإشتراك في دورية «الإداري»

قسيمة الاشتراك

الاشتراك السنوي :

للأفراد: ٨ ريالات عُمانية .

للمؤسسات والجهات الحكومية: ٢٠ ريالا عُمانيا .

الاســـم : ________________

العنوان : ________________

الإشتراكات : تعنون باسم مديرة التحرير