Overcoming Barriers to Private Investment in the Middle East and North Africa Region

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The development of the financial markets and the private sector in the Middle East and North Africa (MENA) region has made marked progress over the last several decades. However, this progress and subsequent economic growth severely lags overall global growth, as well as comparable regions. Over the last three decades, economic growth in MENA has underperformed due to several political and economic factors. These conditions include restrictive regulatory regimes, foreign investment regulations, import quotas, lack of WTO access, low levels of foreign direct investment (FDI), and lastly, relatively underdeveloped financial markets[1]. Furthermore, the region has been subject to several conflicts, which act to disrupt reform efforts and focus attention on defense spending as well as lessen the political will to enact reform.

Financial market development varies greatly by country in the MENA region, however many characteristics are common among most countries including; low market capitalization, low foreign ownership, low private vs. public investment and insufficient economic diversification. Sovereign debt markets are often small and consist mainly of short-term government maturities and similarly corporate bond markets are for the most part limited and lack liquidity. Lastly, low public savings, inadequately funded pension funds, and low levels of liquidity in the domestic and regional banking systems, contribute to lower levels of economic growth for the MENA region.

In this paper, I will examine the economic and financial sector growth in the MEAN region and the implications of the last twenty years of relatively anemic growth when compared to the rest of the world. I will then address several factors that act as barriers to private investment in the region. This paper is being prepared for the Arab Financial Forum in Bahrain, November 2004. The four barriers to investment will subsequently be the focus of separate AFF working groups that will act to draw upon regional experience and best practice to learn lessons that can then be applied to countries actively trying to reduce these barriers.

Economic Growth

The MENA region enjoyed relatively strong growth and increases in standards of living in from the period of the 1960s through the 1980s. [2] The increase in oil prices and oil-exporting revenues not only aided the oil-rich countries but also provided funds through remittances, trade, and capital flows to the non-oil generating Arab countries. This growth led to increases in standards of living, education and capital formation, both human and physical.

This reform and strong growth rates were sustained in the following twenty years, from 1980s through the year 2000. The MENA region, in this period, dramatically underperformed the rest of the world in terms of increases in economic growth, GDP per capita as well as increases in private and foreign investment flows. Many countries, recognizing this stagnation, acted to initiate fiscal and monetary reforms in the 1980s. Several sectors were liberalized and reforms were taken to promote both private and public investment. Many countries in the region have had varying degrees of success, with Jordan, Tunisia, Morocco and Egypt, and Lebanon having a more developed financial sector, increases in trade, and investment and often times better economic growth than the rest of the region.[3]

Additionally, there are different patterns of growth in the oil vs. non-oil producing countries. Oil countries are more prone to swings in economic growth given oil prices

[1] Marcus Noland, Howard Pack. International Economics Policy Briefs. June 2004
[2] Abed, George and Davoodi, Hamid. *Challenges of Growth and Globalization in Middle East and North Africa*. IMF, 2003.
[3] Abed, George and Davoodi, Hamid. *Challenges of Growth and Globalization in Middle East and North Africa*. IMF, 2003.

fluctuations. The growth rates do indeed show varying levels of growth for oil vs. the non-oil countries, despite their relationships and regional proximity. However, according to World Bank studies, the strong economic growth in the medium term for both the oil and non-oil countries lessened greatly after the high rates of the 1960s and 1970s.[4]

This muted economic growth coupled with the alarming demographic trends in the region present an urgent need for reform in the financial sector. The Arab population of the Arab region will increase 25 percent between 2000 and 2010 and by perhaps 150 million people by 2010.[5] Furthermore, the age distribution is such that only four countries in the region will have a median age over 30 years old in 2020, with the remaining countries' median age falling between of 15-30 years old. Without sufficient investment, estimated by the UNDP to be 30% of GDP, this high labor growth will create massive unemployment. Currently, 40% of the population under 24 years old is unemployed.

The regional economic growth of 2 to 3 percent over last twenty years is not sufficient to meet the challenges of the next twenty years. Economic reform, increased private domestic investment and trade, and continued expansion of the capital markets are greatly needed to meet the regions growing demand for employment. Furthermore, non-oil exports have remained stable over the last twenty years at around 10 percent of GDP. This percentage is relatively low compared with other regions, and efforts should be directed to increasing this percentage. A more diverse earnings base in the economy will also act to create more opportunities for domestic investment and employment.

It is duly noted that economic growth in the last two years has been formidable, both due to escalating oil prices but also to increased investment and underlying global trends. However, this growth, while impressive, should not mask the need for continuing reform and progress, especially as it relates to diversifying the economies so that growth can be sustained in periods of varying oil prices.

The development of the financial sector can play a critical role in achieving this economic growth. The relationship between financial markets and economic growth is widely analyzed, however it is commonly accepted that underdeveloped financial markets, government control and improper pricing all act to inhibit economic growth[6]. However the type of investment is also very important. While investment can be a factor in economic growth, the most significant factor is the quality and efficiency of the investment. [7] Studies by Doppelhoffer et al. (2002) show that the correlation between public investment and economic growth is in fact negative – concluding that the larger share of investment from the public sector, the lower the growth rate of the economy. This is not to conclude that all public investment is unproductive, for in many cases it is not, however when the investment is unproductive the impact of the investment is magnified by the need to fund it through taxes or government funds.[8]

Moreover, the high levels of investment have not translated into increased productivity in the region. In fact, overall total factor productivity has been negative in the region between 1975 and 2000. While some countries have increased, the majority has not.

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[4] Sala-I-Martin, Xavier and Artadi, Elsa. *Economic Growth and Investment in the Arab World.* World Bank. 2004.

[5] UNDP Arab Human Development Report. 2003.

[6] IMF Staff Report. IMF Country Report, Staff Report for the 2003 Article IV Consultation. July 9, 2003.

[7] Sala-I-Martin, Xavier and Artadi, Elsa. *Economic Growth and Investment in the Arab World.* World Bank. 2004.

[8] Sala-I-Martin, Xavier and Artadi, Elsa. *Economic Growth and Investment in the Arab World.* World Bank. 2004.

World Bank sites three reasons for the lack of productivity growth: political and social instability, high levels of government regulation and the low quality of human capital.

The ability to rely on oil revenues to fund public sector needs in many countries has only acted to limit the urgency of developing a strong and independent financial and private sector. The trend is slowly reversing but the demographic and economic demands of the next twenty years warrant a more immediate pace. The MENA region has been unable to attract large amounts of foreign direct investment over the last three decades. The Arab world attracted less than 1 percent of global FDI between 1975 and 1998. The figure further declined to 0.4 percent in 2000.[9] Deepening the financial markets is critical to attracting global FDI as well as attracting domestic capital that has fled overseas back to the region. Privatization is another key factor in increasing FDI to the region. Private investment in the region as a share of total investment is around 40-45 percent, this is lower than Africa, and compared to Latin America with levels of 75-80 percent, is quite low. [10] The underdevelopment of the financial markets in the MENA region also acts to lessen the movement of capital into the most productive uses – often due to state ownership, monopolies and limits of foreign investment ownership.

Barriers to Investment

In this light, this paper reviews private sector investment in MENA region and identifies four significant barriers to private investment in the region:

1. Lack of ownership diversity
2. Insufficient diversification of the economy
3. Inadequate transparency and regulation
4. Underdeveloped capital markets

This paper will briefly address each issue. The second phase of this project will result in each obstacle will be highlighted by a case study illustrating how the barriers are addressed in different countries and circumstances. For each case study, a description and strategy comment by the company or country will be provided, followed by an analysis and critique of each study. The analyses will comment on the scope for applying best practice in other Arab markets, as well as on necessary reforms that are required. By highlighting these barriers to investment and proposing concrete solutions and examples of countries and companies that have made gains in tackling such obstacles, the study aims to present best practices that can then be applied in other countries and markets.

Ownership Structure

This section will address the negative factors that arise from an economy with both a high percentage of government-owned enterprises, and a limited number of shareholders of privately owned companies. A diversified shareholder base and the privatization of state assets, act to strengthen not only the economy and individual companies, but also create demand for a diversified set of financial products, innovative financing schemes and increases private investment from both domestic and foreign investors.

The MENA region is vast, encompassing eighteen countries with over 300 million citizens with varying forms of government, thus when studying the region, one cannot generalize without hesitation. However, to some extent in most countries, there is a large degree of state ownership of assets. This structure has several negative implications on an

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[9] UNDP Arab Human Development Report. 2003

[10] Ogutcu, Mehmet. OECD Report. *Investing in the Midde East and North Africa Region to Promote Development and Modernization.* OECD. 2004.

economy. Direct consequences include a slow innovative process of government-owned enterprises, the inability for industry to adapt to new trends, slow expansion and low technological expertise. Furthermore, state-owned companies are subject to government funding, direction and discretion that can hamper growth and transparency. As mentioned earlier, studies indicated that while investment is necessary for growth, the quality and efficiency of such investment is the critical factor. The MENA region has comparable levels of investment and high savings growth rates versus other regions, including East Asia, however the quality of investment and returns to productivity has lagged.

It is difficult to draw comparisons between regions given the vast differences in resources, area, population and political climates. Furthermore, many economies such as South Korea and other Asian countries have experienced tremendous growth with the strong industrial and state-heavy policy initiatives. However, these policies can limit the diversification of the economy and often stifle growth of nascent but potentially successful industries. Many of these economies though have taken the next step, which is to move towards increased private sector investment and create a competitive domestic climate. The MENA region has been slow to do this, reflected in the non-oil exports of the region remaining low at about 7% of GDP[11].

Furthermore, an economy based on natural resource exploitation, which can often translate to lower levels of employment, is not similar to state sponsored industries such as technology or industrial sectors. Estimates from the World Bank conclude that given the investment potential and comparable markets, the MENA income per capita could increase by 4% a year if only half the potential FDI and trade were accomplished. Moreover, the study suggest that if half the trade were realized over the next ten years, the GDP per year would grow from 1% to about 4% a year for the region.

The ratio of private investment to public investment[12] is only at 2 in MENA, versus 6 in OECD countries, and 5 for most of SE Asia. The FDI invested currently in MENA focuses only a few countries, namely Saudi Arabia, Egypt, UAE, Tunisia, Morocco and Jordan. The high percentage of family and public ownership is one prohibiting factor. Additionally, the close relationship between banks and the government is often cited as a constraint on credit availability and lacks sufficient transparency. There has been progress towards increased autonomy of public sector companies, such as clarifying the role of the board and auditors, but further progress is needed.

Banking sector regulations are restrictive in most MENA countries. Levels of foreign investment are tightly controlled as well as domestic investment and competition tightly monitored. While foreign banks do have an influence in many countries, usually the percentage shareholding is quite low and highly controlled. This can limit a banks' ability to establish a strong regional presence and network. Despite this regulation, the profitability of many local banks, notably the Saudi banks, are still quite high. However, the sustainability of the profits and the banks' ability to expand is a key issue. The Saudi government is well aware that opening up the markets to foreign competition and issuing licenses to other banks is a positive step to enabling competition and increasing innovation.

Privatization can be a key source of revenue in many MENA countries, especially given the high dependency of many countries on oil revenues. Even with high oil revenues, in countries such as Saudi Arabia, privatization and private investment is required to ease high unemployment and employ the increasing labor force. Furthermore, the liberalization and the

[11] IFC Report. February 2004.

[12] Private to Public Investment: Ratio of the value amount of private investment to the value amount of public investment. At 2, the ration of private investment in MENA is only twice that of public where as a ratio of 6 in other areas indicate private investment of 6 times that of public investment.

privatization of services and of production inputs, such as communications, electricity, finance and transport, acts to reduce the costs of production and further strengthen the ability of the country to connect with global production supply chains. This link into global production systems feeds back through increasing domestic production and exports.

Lastly, as noted by the World Bank, studies find that the heavy public sector in the MENA region often provide inefficient and costly services, raising the cost of exports and limiting the returns, and thus diminishes its attractiveness to international and domestic private investment[13]. Privatization in these sectors will also help to facilitate trade and investment in related sectors, such as tourism and technology sectors.

Please see Annex I: Case Study Saudi Telecommunications Company.

Economic Diversification and Market Size

This section will focus on the importance of economic diversification in the MENA region. Diversification refers to both movements into industries other than oil for oil-generating countries and a continued move to manufacturing, higher-valued added services and export-oriented policies for non-oil countries. The manufacturing sectors of most MENA countries are almost half the typical size of other comparable lower-middle income countries. [14] This focus will encourage industry that promotes employment for a burgeoning younger population. As highlighted in the previous section on privatization, the diversification of the economy into industry, services and other goods will both allow further investment by both domestic and international investors but also act to strengthen the sustainability of the economy. The state-led employment system that sustained growth throughout the 1970s and 1980s began to fade as oil prices have declined in real terms as income per capita derived from oil has decreased. Coupled with a large population increase, the necessity transition to non-state led economies is clear.

The small size of many of the financial markets is partly due to a lack of privatization, but also to the lack of both small and large diversified and regional companies. Only 8% of Arab trade is conducted within the MENA region, highlighting the region's dependence on Europe, Asia and North America for many of its goods. Moreover, as highlighted in the introduction there is an urgent need to create employment, most of which cannot be provided from the oil sector and must come from other industries, such as tourism, manufacturing and services. The size of the combined MENA market region is 370 million, but the inter trade is quite low, mainly due to a lack of products, as well as lack of conducive regional trade agreements.

In the GCC states, Saudi Arabia, UAE, Bahrain, Qatar, Kuwait and Oman, over two-thirds of the population are under 25 years, and 21 percent are between 11 and 15 years old. Jobs are desperately needed for the young nationals as the oil sector provides relatively few jobs. Growth is historically not sufficient to create new jobs to absorb the rapid expansion of the labor force. IMF studies indicate that in economies that derive a significant share of their income from oil, the large size of the government sector has been the overriding problem, stifling private sector growth and making it hard to diversify production.

Increasing the diversification of the economies as well inter-regional and international trade is a must not only due to employment issues but also for the MENA region to keep pace with an increasingly competitive world market. Declining labor remittances, aid flows and

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[13] World Bank Report. Trade, Investment and Development in the Middle East and North Africa. January 2004.
[14] Trade, Investment and Development. Middle East and North Africa. World Bank. 2003

labor migration are factors underlying the need for increased investment diversity and trade. [15] Furthermore, studies conclude that given the MENA countries assets and size, exports other than oil are only a third of what they could potentially be and manufacturing imports are only one-half. The region is 2% of world income but 5% of population. If only half of the trade and investment potential was realized over the next ten years, GDP / capita growth would rise from 1 percent a year to 4 percent. [16] (See Figure 1.)

It is important to note that the nature and the pace of reforms should be country and region specific. Each region has its own boundaries, capabilities and national identities that require specific reform, sequencing and attention. Concerns include the potential increase in unemployment from movement away from state-sponsored employment as well as the impacts on pricing and costs from the liberalization of services

Please see Annex II: Case study Tunisia

Transparency and Governance

Good governance in the public sector entails the respect of human rights, freedom and requires transparency and accountability on all levels. Governance is an increasingly visible theme globally as increased transparency, good corporate and public governance are necessary in a globalized world to meet the demands of the population and that of investment. On the public front, citizens require and are demanding, increased knowledge and accountability of government policies and affairs. Likewise, investors, who have various options when choosing investments, require consistency and reliability when reviewing investments and those countries with the most transparency and credibility will attract the most investment. Governance and transparency extends not only to corporate accounting, legal and regulatory frameworks, but also to transparency and consistency in government regulatory guidelines, investment guidelines and macroeconomic policies. According to McKinsey and Company Report, 2004[17], "…investors in emerging markets, including the Middle East, are willing to pay as much as 30 percent more for shares in companies with good corporate governance".

The UNDP Human Development Report 2002 stated that the MENA region's "freedom deficit undermines human development and is one of the most painful manifestations of lagging political development". The freedom deficit relates directly to public governance and is a crucial element in creating a transparent and inclusive society that then is reflected in governance in all spheres of the society, social and economic.

Governance and transparency in the region is varied and it is difficult to generalize specific reforms and policies. However, there are several common qualities that most countries share including; a general lack of freedoms as referred to by the UNDP report, low transparency in business and government polices transactions, and a lack of full accountability. This includes proper recourse for transactions by both domestic and international parties in a court of law, as well as the formation of parliaments and representative governments. The accountability of the government to its people is the anchor to good governance.

Economic growth and good governance are interconnected. In most regions, as incomes grow so then does public governance. However, in the MENA region, the quality of public accountability does not follow this pattern. There is not a single country in the MENA

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[15] Trade, Investment and Development. Middle East and North Africa. World Bank. 2003.
[16] Trade, Investment and Development. Middle East and North Africa. World Bank. 2003.
[17] AMEinfo.com. United Arab Emirates: Tuesday, February 17 – 2004.

region that is above the world median in terms of public accountability[18]. Productivity, economic growth and good governance are related and given the lack of improvements in governance, the economies have suffered.[19] Productivity in the MENA region has been on decline for thirty years and average annual per capita growth has grown at only 0.9% over the last 20 years. Furthermore, excessive bureaucratic systems and lengthy regulatory environments inhibit growth. Lighter; more efficient regulation is associated with higher productivity growth and lower unemployment.[20] Again, there is an optimal regulatory environment that differs for each country and region and different issues will be more important given the cultural, political and economic conditions.

A recent study on Doing Business in 2005 by the World Bank found the following data for the MENA region versus other regions (see table 1):

	# Procedures to Start Business	Getting Credit % cost	Legal Rights Index
MENA	10	18.6	2
East Asia/Pacific	8	2.0	5
Latin America	11	19.4	3
Eastern Europe/C. Asia	9	7.6	5

Getting credit: cost to create collateral as % income per capital
Legal Rights Index: higher values indicate more disclosure

While there are some areas where the MENA region does well, on whole, the region lags in capital needed to start a business, access to credit and protection of legal rights, private bureau coverage – which indicates the amount of credit available to the private sector.

Please see Annex III: Case study Bahrain.

Financial Market Development

Developed financial markets are critical to the growth and success of the MENA region. Theory suggests that that financial sector development can facilitate more efficient and productive credit financing, decrease financial costs of growth and credit, increase information-sharing, reduce transaction costs and facilitate the exchange of goods and services. Studies indicate that in order to have a well-developed financial structure, countries should enact strong and consistent macroeconomic policies, encourage competition, and institute transparent legal and regulatory frameworks. [21]

The financial markets in the MENA region are growing and are increasingly playing a larger role in the development of the economies. While different countries have distinctly different levels of financial sector development, some generalizations about the region are acceptable. According to a recent IMF study, in general regulation and supervision in the region is reasonably sufficient. The study indicated six areas of financial market development; monetary policy, banking sector, non-bank financial sector, regulation and supervision, financial openness, and institutional environment. The study indicated a need for the markets to focus on non-bank financial sector development and institutional development.[22] The study also concluded that, while the MENA region ranks above other developing countries in

[18] World Bank Study 2004. *Better Governance for Development in the Middle East and North Africa.*
[19] World Bank Study 2004. *Better Governance for Development in the Middle East and North Africa.*
[20] *Doing Business in 2005*. World Bank. 2004.
[21] IMF Working Paper. *Financial Sector Development in Middle East and North Africa.* Creane, Mobarak, Goyal and Sob. 2004
[22] Ibid.

financial sector development, it has fallen substantially behind the industrialized countries, as well as the East Asia, which it had previously led. [23] (See Figure 2).

In most MENA markets, banks are still overwhelmingly local and lack a pan-Arab presence. There tends to be little competition locally, and many banks are still state-owned. Despite the existence of private banks, competition is not actively encouraged. Product innovation is low, although this is changing in many countries, such as Saudi Arabia, as consumer and housing finance is starting to surge. Loan duration is also an issue, with many banks currently offering predominantly short-term loans versus the longer-dated loans needed for large projects. This forces many investors to seek capital from abroad.

The corporate bond market is in its infancy in most MENA countries, further hampering the financing of corporate expansion. This also forces would be creditors into the hands of the banking system, which further enhances the power of the banking system and the control of credit by strong state or private banks. Furthermore, the capitalization of the equity markets is low, consisting of a limited number of companies, and offer very poor liquidity. High liquidity is needed to attract both large domestic and international investors. Efforts to increase the size, liquidity and product offering of the local markets are in progress but are often hampered by cumbersome regulations and requirements.

ESCWA commissioned a report in 2003 reviewing the regional equity markets of the Arab region. Realizing the importance of financial markets, ESCWA cited the importance of having developed equity markets as FDI into the Middle East is limited, and thus the importance of the local markets is heightened. Furthermore, large financial and real estate companies, monopolies and state-owned enterprises, dominate the Arab region stock markets[24]. The report also notes that the markets lack liquidity, transparency, reliability, sufficient legal framework and accurate financial information.

Regional stock markets and functioning capital markets are not only important for mobilizing investment and growth from foreigners, but for attracting the vast amount of wealth that is sent overseas, leading to a net outflow of domestic capital in the region. An estimated $500bn worth of capital has fled overseas out of the Arab region. Creating domestic investment opportunities will act to attract these funds back to MENA region. Moreover, the MENA regions' stock market capitalization accounts for only 6.5% of the total market capitalization of the emerging markets and only 0.6% of the world's stock market capitalization[25].

Reform in the financial sector should also address the inefficient regulation in the banking sector and equity markets, opening up to foreign investment and domestic competition, local privatization as well as increasing sound governance and institutional capabilities.

Please see Annex IV: Arab Bank Case Study.

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[23] Ibid. See Table 1.
[24] ESCWA. *Responding to Globalization: Stock Market Networking for Regional Integration in the ESCWA region*. October 2003.
[25] Ibid. Page 1.

Annex I. Case Study for Ownership Diversity - SAUDI TELECOM COMPANY

In order to illustrate the progress made in the region on privatization, Saudi Telecom will be the case study. Saudi Arabia and SAGIA, the Saudi Arabian General Investment Authority, have made large gains in removing bans on foreign investment in many areas including education, transmission and distribution of electrical power with the public network, pipeline transmission services and partial opening of publishing, communications and insurance services. SAGIA was created in 2000, in line with royal decree, with the intent of attracting more foreign investment as part of a larger set of economic and structural reforms. In June 2002, twenty companies were listed as candidates for privatization and others removed from the prohibited foreign investment list. The Capital Markets Law was approved in June 2003, further enhancing regulation and open capital markets and setting up guidelines for further foreign investment.

In 2002, the Saudi government privatized 30% of the Saudi Telecom. A summary of the transaction and the strategy of the government and company will be then followed by an analysis of the privatization by several telecom analysts. In conducting this outside analysis the hope is to glean insight into both positive experiences and lessons that can therefore be applicable to other companies and countries. In addition, this analysis will also indicate areas where improvements could be made when considering future projects in privatization and ownership structure.

In 1997, the Saudi government passed a resolution calling for the telephone services, mobile telephones and other public areas to be privatized. This was part of an overall strategy to privatize telecommunications services. A critical part of the preparation was the creation of the Saudi Telecommunications Company (STC) into a corporation that could be used as the vehicle for listing. In creating STC, the law stipulated that privatization must be approved by the company and by the government and the council of ministers.

STC is a large-scale provider of telecommunications services with a diverse customer base of home users, business and commercial. STC offers GSM, wireless, fixed-line, paging, satellite, internet services as well as other services. The IPO of STC in October 2002 saw 30% of its company sold to Saudi investors and state-affiliated funds.

Annex II: Case Study for Economic Diversification: TUNISIA

Tunisia will be the case study for the country that has had successes in diversifying its economic base. Tunisia has pursued a policy of economic liberalization since the late 1980s. Throughout the 1990's, this reform process has allowed Tunisia to benefit from increased globalization and integration with the world economy[26]. Faced with high unemployment, and overburdened public sector and a pressing need for economic growth, Tunisia in the early 1990's pursued a dedicated reform process aimed at increasing exports, diversifying its economic base, including a focus on tourism and integrating itself with the world economy.

Tunisia focused on sound macroeconomic policies, prudent monetary and fiscal policies, social programs as well as a focus on maintaining prices and controlling inflation. Over the 10-year period, levels of poverty declined significantly as did the illiteracy rate. In addition, the real effective exchange rate was held relatively constant to ensure competitiveness[27]. The success of maintaining constant and credible policy framework is clear. From 1997 to 2001 the economy grew by 5.3% annually with stable inflation and manageable fiscal deficits.

Led by President Zine El-Abidine Ben Ali, Tunisia is a republic that is dominated by a single political party. Ben Ali and his Constitutional Democratic Rally (RCD) party have controlled the Government and the legislature, since 1987. The President appoints the Prime Minister, the Cabinet, and the 24 governors. Over this period, Ben Ali has focused on expanding the domestic economy, diversifying the GDP base, and instituting economic and institutional reform. This economic reform, did not however, go hand in hand with political reform, a point that will be discussed in the final case study.

The study will include an economic background of the country and a review of the policies by Tunisia Government. It will then survey several economists and experts to both highlight the successes of this transition, and also policies that can be further improved or implemented to ensure continued diversification and sustainability.

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[26] IMF Staff Report. *IMF Country Report, Staff Report for the 2003 Article IV Consultation.* July 9, 2003.

[27] Ibid. Since the 1980s the pace in MENA developed has lagged that of Asia's.

Annex III: Case Study for Transparency and Governance: BAHRAIN

To illustrate an example of improved transparency and governance, I will use Bahrain as a case study. The report will survey initiatives by the Bahraini government to increase investment by creating a legal and regulatory framework that is hospitable to investors, both domestic and foreign. The report will then call upon several analysts to discuss the policies and further regulatory and governance policies that could be enacted as well as potential applicability to other MENA countries.

As early back as mid-1970s the Bahrain government and the Bahrain Monetary Authority devised a plan to attract international financial institutions to Bahrain. Included in this plan was an administrative and legal framework that is transparent and clear, stable macroeconomic policy, liberal economic policies as well as offering a stable and convertible exchange rate. Coupled with an educated workforce and good location, Bahrain was well suited to become the financial center of the region. It now has over 180 financial institutions and over 100 insurance companies.

The Heritage Foundation, a conservative Washington think-tank, rates Bahrain's banking system a 1 - "very low level of restrictions" - on a measure of economic openness ranging from 1 (open to international capital) to 5. Among the investment incentives are: tax free status of corporations, 100% foreign ownership, 100% repatriation of capital, easy access to visas, fast-track registration, duty-free imports and 100% ownership of land. Bahrain was a founding member of the World Trade Organization (WTO) and has been consistently ranked amongst the top most economically free countries in the world over the past eight years.[28] Furthermore, Bahrain has been rated as the freest economy in the Middle East and the Arab world.[29]

In addition, the Amiri Decree established the Economic Development Board, another example of Bahrain's' commitment to a liberalized economy that can achieve long-term sustainable growth. Perhaps the most important new law is the Commercial Companies Law that came into effect in January 2002 as well as the various Intellectual Property laws.

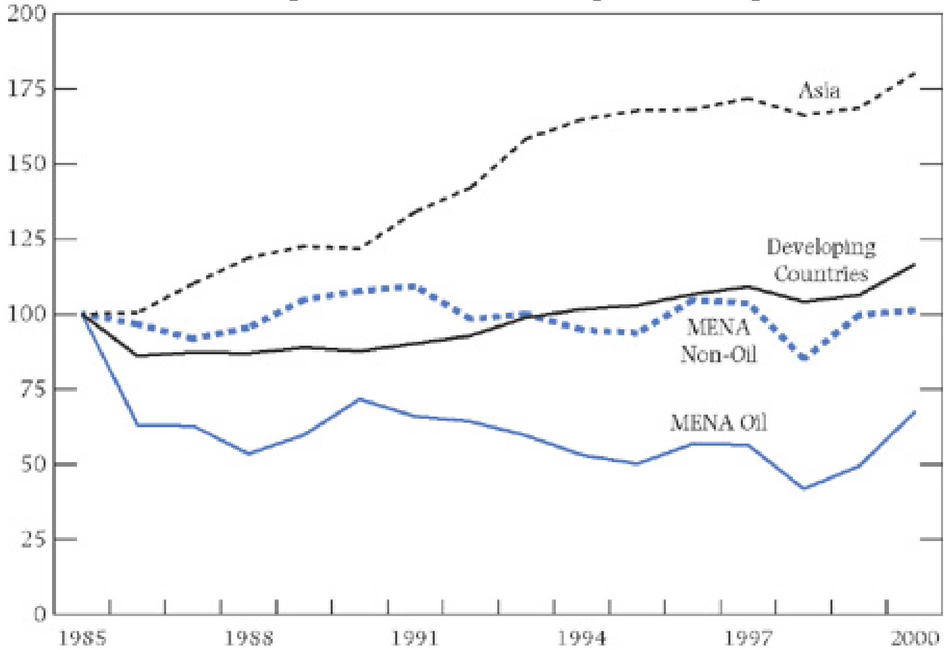
[28] Heritage Foundation and the Wall Street Journal
[29] Bahrain Chamber of Commerce. July 2004.

Annex IV: Case Study for Financial Market Development: Arab Bank

To study the impact of increasing regional exposure and accessing new innovative financing this report will use Arab Bank as a case study. Jordan's Arab Bank has successfully implemented a regional approach and has exhibited above average growth by doing so. The case study will review their initiative to expand regionally and their corporate structure and will analyze their strategy by inviting banking analysts to review the company, highlighting the applicability of its strategy to other MENA companies and further steps that can be taken to improve the banking sector, financial markets and regional diversification of MENA companies.

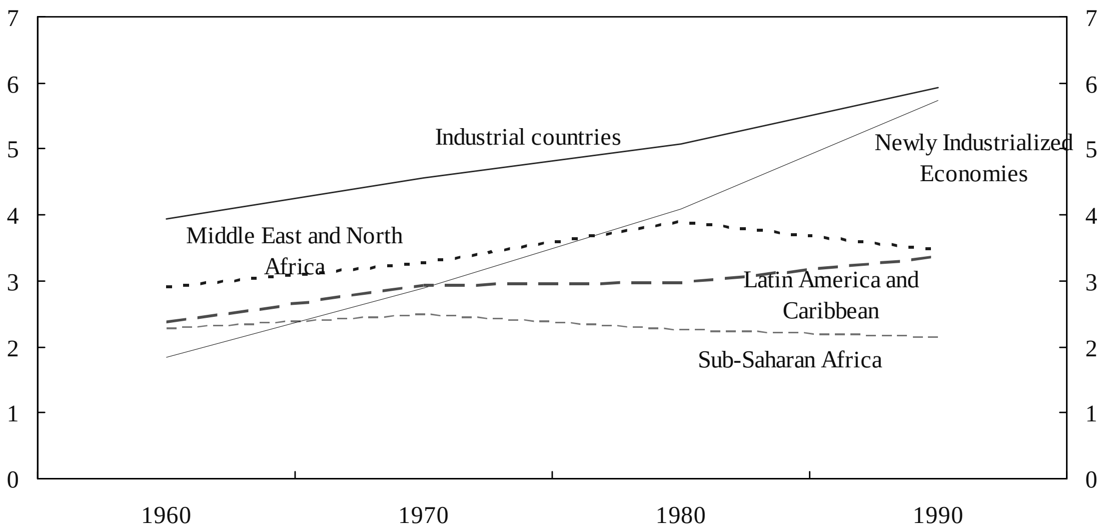
Tables and Figures

Figure 1. MENA and Comparators: Exports Shares



Source: World Bank 2003

Figure 2. MENA and Global Comparators: Quantitative Index of Financial Development, 1960s - 1990s



Source: IMF 2003

Table 1. Doing Business in 2005.

Region (2004)	Starting a Business: Number of procedures	Time (days)	Cost (% of income per capita)	Min. capital (% of income per capita)	Getting Credit : Cost to create Collateral (% of income per capita)	Legal Rights Index	Credit Information Index	Public registry coverage (borrowers per 1000 capita)	Private bureau coverage (borrowers per 1000 capita)	Protection Disclosure Index
MENA	10	39	51.2	856.4	18.6	3	2	20	12	2
East Asia and Pacific	8	52	47.1	100.5	2	5	1	33	67	2
Latin America	11	70	60.4	28.9	19.4	3	4	85	325	2
Eastern Europe and Central Asia	9	42	15.5	51.8	7.6	5	2	6	46	3

Data: World Bank database. 2004.

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